

Meeting of the Federal Open Market Committee
November 17, 1998

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, November 17, 1998, at 9:00 a.m.

PRESENT: **Mr. Greenspan, Chairman**
 Mr. McDonough, Vice Chairman
 Mr. Ferguson
 Mr. Gramlich
 Mr. Hoenig
 Mr. Jordan
 Mr. Kelley
 Mr. Meyer
 Ms. Minehan
 Mr. Poole
 Ms. Rivlin

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

**Messrs. Broaddus, Guynn, and Parry, Presidents of the Federal
Reserve Banks of Richmond, Atlanta, and San Francisco
respectively**

Mr. Bernard, Deputy Secretary
Ms. Fox, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist

**Messrs. Cecchetti, Dewald, Lindsey, Simpson, Sniderman, and
Stockton, Associate Economists**

Mr. Fisher, Manager, System Open Market Account

**Mr. Winn, Assistant to the Board, Office of Board Members,
Board of Governors**

**Mr. Ettin, Deputy Director, Division of Research and Statistics,
Board of Governors**

**Ms. Johnson, Director, Division of International Finance, Board of
Governors**

Messrs. Alexander and Hooper, Deputy Directors, Division of International Finance, Board of Governors

Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Mr. Reinhart, Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Whitesell, Assistant Director, Division of Monetary Affairs, Board of Governors

Ms. Garrett, Economist, Division of Monetary Affairs, Board of Governors

Mr. Kumasaka, Assistant Economist, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Moore, First Vice President, Federal Reserve Bank of San Francisco

Messrs. Beebe, Eisenbeis, Ms. Krieger, Messrs. Lang, and Rosenblum, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, New York, Philadelphia, and Dallas respectively

Messrs. Evans, Fuhrer, Hetzel, Miller, and Sellon, Vice Presidents, Federal Reserve Banks of Chicago, Boston, Richmond, Minneapolis, and Kansas City respectively

Transcript of Federal Open Market Committee Meeting of
November 17, 1998

CHAIRMAN GREENSPAN. Before we get started I would just like to reflect on the fact that it is Bill Dewald's last meeting. He is sitting over there seeing that we do the right thing, a struggle requiring infinite patience among other things. He has been the Director of Research at the St. Louis Bank for six years. We will miss you, Bill, and hopefully your replacement will do as good a job as you have done.

MS. RIVLIN. Is applause appropriate?

CHAIRMAN GREENSPAN. Yes. [Applause] Who would like to move to approve the minutes of the September 29 meeting?

VICE CHAIRMAN McDONOUGH. So move.

CHAIRMAN GREENSPAN. Without objection. As you know, in two or three of our recent meetings, we have been contemplating ways to improve a number of the procedures that we use to communicate to the public. We seem to have reached a consensus around this table that the wording in the operational paragraph of the directive requires some revision. We have considered a number of different versions, and at this point I will call on David Lindsey to introduce today's discussion by describing the state of play at the moment.

MR. LINDSEY. Mr. Chairman, beginning on page 15 in the Bluebook for today's meeting, we list three options for Committee consideration. Option 1 is the traditional language. Option 2, which was included in a memorandum that I wrote to the Committee in early November, reflects the revisions that President Hoenig suggested at the September meeting. There are optional inclusions of some "furthers" in options 2 and 3 that the Committee may

wish to consider. The purpose of the latter is to pick up the possibility that after the Committee has moved at a meeting, it may wish to reflect that fact in the wording of the tilt sentence. I have indicated in the note on page 16 of the Bluebook how some presidents and one Board member have reacted to the proposed addition of a sentence in Option 2 concerning potential adjustments to policy during an intermeeting period. I think I should turn the discussion of Option 3 over to President Minehan, since it is her proposal.

MS. MINEHAN. I would like to apologize to everyone because I really didn't mean to complicate needlessly or in any event to extend the discussion to yet another alternative. What I thought I was doing in responding to the request for possible rewording was to include a reference to the balance of risks in the paragraph. On the basis of my notes at the September meeting, that was an idea that Tom Hoenig brought up and that most of the members appeared to endorse. At least that is what my notes say. In any event, the inclusion of a reference to the Committee's view of the balance of risks is the major difference in my alternative.

I differentiate between the "tilt" and the "no tilt" language. In the "no tilt" language, there is an explicit reference to the Committee's perception of risks as being balanced at least for the intermeeting period and a related belief that no change or a slight upward or downward move might be equally likely. In the "tilt" language, the perceived balance of risks is not explicitly mentioned but is implicit in the Committee's adoption of an upside or a downside tilt. Also, I would agree with Presidents Boehne and Parry and with Governor Kelley with regard to the desirability of dropping the next to last sentence in Option 2 that starts with "Any potential changes...." I don't think it is needed. I don't have any pride of authorship, but I do have some warm and fuzzy feeling for the idea of mentioning the balance of risks in the directive.

CHAIRMAN GREENSPAN. I never heard anybody talk about risks as "warm and fuzzy." [Laughter] President Jordan.

MR. JORDAN. Cathy, your alternative wording for a tilt in the directive refers to economic, financial, and monetary developments; that is fine. Option 2 talks about prospective developments, tilt or no tilt; that is fine as well. I am agreeable to talking about risks, but your "no tilt" sentence refers to "risks to the economic outlook." That stopped me because it could be interpreted to mean real growth rather than "economic, financial, and monetary developments." As we saw very recently, a variety of near-term risks may cause the Committee to do something that may not translate in the view of every outsider as pertaining to the economic outlook.

MS. MINEHAN. My intention was that the reference to the economic outlook would be modified by the subsequent phrase about changes in "economic, financial, and monetary conditions" so that the two expressions would be considered to be equivalent in the context of that sentence. But I see the problem that you're talking about.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN McDONOUGH. Mr. Chairman, I understand the logic of Option 3, but when we talk about risks to the forecast, we are engaging in internal Fedspeak. Jerry Jordan has picked up on the concern I would have about mentioning risks in this context, namely that the average American would conclude that we thought economic growth was a risky thing. In popular use, it is a word that could get us into some trouble. So, I end up being very comfortable with the alternative language of Option 2. With some amendments from Tom Hoenig to the earlier version, that option captures what we found reasonable at the last meeting. I believe that even when we have no tilt, we need the disputed sentence, "any potential changes in the federal funds rate operating objective during the intermeeting period should be considered in

that context." That sentence makes it clearer that the Chairman has the power--in fact there is no question about that in my view--and the good will of his colleagues on the Committee so that if circumstances in the intermeeting period should indicate the desirability of a change in policy, he can implement the change. The courtesy that you have shown us, Mr. Chairman, at least in the 5½ years that I've been sitting here, has been such that I don't think there's the slightest worry that that power would not be used wisely and well. So, I think it's very important that the sentence in question be retained.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mr. Chairman, I think that either Option 2 or Option 3 would be a significant improvement over what we have now. For the reasons that Jerry Jordan mentioned, I would have a preference for Option 2. In my view, it is a little more compact and a little clearer. I would agree with those who feel that we should remove the third sentence. If we do so, I would suggest a change at the end of the preceding sentence. Where there is a reference to "the federal funds rate in coming months," I would prefer to see the words "in coming months" changed to "in the intermeeting period." That would make the period that we are talking about a little more explicit and definite. Finally, if we can get the language changed, I hope we will then move on to the next and I think equally critical question of whether or not we will release this information to the public shortly after the meeting at which the directive is set.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I prefer Option 2. In my view, it captures what we have been talking about around the table. I would drop the sentence beginning with "Any potential changes." My only reason for suggesting its deletion is that I think it is basically redundant, though it is substantively harmless. We need to have a Chairman who is fully effective. A fully effective

Chairman needs to be able to change the federal funds rate between meetings. If dropping or adding this sentence in any way affects that, I am for whichever strengthens the Chairman's hand to be fully effective.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I prefer Option 2, and I would like to remove that third sentence because I, too, believe it is redundant. It seems to me, though, that both Options 2 and 3 are a tremendous improvement over the wording we have been using in recent years.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I think Option 2 would be a distinct improvement and I favor that. I think dropping that sentence about "any potential changes" is probably a good idea because it seems redundant to me, but I don't feel very strongly about it.

CHAIRMAN GREENSPAN. Governor Meyer.

MR. MEYER. I want to join what seems to be the emerging consensus. I, too, prefer Option 2, and I would eliminate the sentence in question. I don't think it adds anything, and whatever is briefer and more to the point is better. I also would echo the view that it would be desirable for us to move at some point to the immediate release of this language after our meetings. Thank you.

CHAIRMAN GREENSPAN. Governor Rivlin.

MS. RIVLIN. I, too, after thinking Cathy Minehan was on the right track, am back to Option 2 because it is simpler. The subtleties of the sentence that is under consideration for removal had escaped me, so I was in favor of taking it out. I still favor dropping it unless there is some subtlety that can and should be conveyed. But if it is that subtle, and I have been here 2½ years, maybe it really is unnecessary.

CHAIRMAN GREENSPAN. Governor Ferguson.

MR. FERGUSON. Mr. Chairman, I think either option would be an improvement over what we currently have, but I, too, have a slight preference for Option 2 mainly because I think our discussion about risks is very internally focused. On the other hand, I hope we will decide to release the directive and, therefore, I would like something that is written in relatively plain English. In my view, Option 2 does that quite nicely. With respect to the added sentence, I will follow what I think is the emerging consensus that it be dropped, though I don't feel strongly about that.

CHAIRMAN GREENSPAN. President Poole.

MR. POOLE. I favor Option 2, and I agree that the sentence about "any potential changes" does not add to the clarity of the directive. A new issue that I would like to raise relates to the last sentence of the directive concerning M2 and M3. I would hope that we would not have a ritual expectation of slowing monetary growth if we do not in fact have such an expectation. I think, for example, that slower growth probably was not our expectation in the recent past. So, I would hope that if we are going to have this sentence in the directive, it actually will reflect the judgment of the Committee and not be just ritually inserted.

CHAIRMAN GREENSPAN. Do you mean that you would refer to it as a staff forecast as distinct from a Committee statement?

MR. POOLE. Perhaps, yes.

MR. LINDSEY. We actually were using monetary growth numbers in that sentence earlier. When the Committee downgraded the monetary aggregates further in 1993, we changed the wording of that sentence to eliminate the numbers and include a qualitative description. Our intent always has been to provide a qualitative description that exactly describes the staff forecast

over coming months--not always over the next month or two but, for example, over the 6-month horizon that is currently in the Bluebook. Unfortunately, as 1998 has progressed we have been hit with continuing upside surprises in relation to our forecast. So, we have been somewhat embarrassed by not having the slowdown that we predicted.

MR. POOLE. There is a potential problem here. I agree with Al Broaddus that the federal funds language should refer to the intermeeting period, but I think it's clear that the reference to growth in the monetary aggregates covers more than the intermeeting period. So, we should put in some language that has a longer horizon for the aggregates.

VICE CHAIRMAN McDONOUGH. Mr. Chairman, could I explain why, unlike some others, I feel as I do on the Option 2 sentence in question?

CHAIRMAN GREENSPAN. Let's first finish our discussion of the money supply issue. Does anybody else have any views about how to handle that question?

MR. MEYER. I think that President Poole is bringing up an extraordinarily good point. It is almost an embarrassment to use over and over a standard sentence that incorporates an expectation that can only sometimes be right. If we want to include this reference in the directive, we should adjust it to reflect changes in the money growth forecast.

CHAIRMAN GREENSPAN. Does anyone have any further insights? I think that raises a quite unanswerable question, but we do have to resolve it one way or another. It is a problem in the sense that if the contemplated reserve conditions are constantly changing but are always consistent with some moderation in the growth of M2, it strikes me that we are implying a good deal more about the extent of our knowledge of how the system is working than evidently is the case.

MR. LINDSEY. In recent memory, which includes the last couple of years, we have altered the wording in that sentence to say "consistent with moderate growth of M2 and M3 in coming months" when we thought such growth would continue to be moderate. While actual monetary growth has been strong this year, we have had a persistent staff forecast of moderation in the future. So, the wording of that sentence this year has continuously reflected our staff forecast of moderating growth.

CHAIRMAN GREENSPAN. It turned out that the sentence was wrong, but that wording was not locked in.

MR. LINDSEY. Exactly. It is not locked in. It just happens to describe the staff forecast over coming months.

MS. MINEHAN. The choice should be "moderate" or "some moderation."

MR. LINDSEY. When it has been appropriate in terms of our forecast, we have said "moderate."

CHAIRMAN GREENSPAN. I think President Minehan has the right answer.

MR. LINDSEY. That's a good point. At meetings in the future, the Committee could choose what the exact wording will be. The Committee may want to do that henceforth.

CHAIRMAN GREENSPAN. Is everyone in agreement that that is advisable?

SEVERAL. Yes.

CHAIRMAN GREENSPAN. Vice Chair, you have the floor on the other sentence.

VICE CHAIRMAN McDONOUGH. I just wanted to clarify my view on the "any potential changes" sentence and why it should be included in the directive. Those who say that it should not be there are saying that it is redundant, and for us around this table it is redundant. But we are not the only audience. There is a whole world out there filled with Fed watchers and

journalists. I am firmly persuaded that, however abnormal it may appear, these outside observers would read the absence of that sentence right after an intermeeting easing of the funds rate as an indication that the Federal Open Market Committee decided to take a power away from the Chairman, which he traditionally has had. I can assure you that that's how it would be interpreted. That is not our intent, but our intent is not very relevant. That would be the way it would be interpreted. It would involve us in a big brouhaha about nothing. If those who object to the sentence think it is redundant, that's a very small price to pay to avert a highly political event that would dismay all of us. I really encourage us not to do that.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. I agree with the consensus to go with Option 2. I think the sentence that President McDonough is referring to is redundant and unnecessary. I just wonder if there is some other way to deal with the problem that you raise, Bill, which is a real problem. We might put out a statement when we notify the public about our future use of different language in which we would say that the rewording does not reflect any change in Federal Reserve policies. It is just an effort to clarify the meaning of our directives. That in fact is exactly what we are trying to do.

VICE CHAIRMAN MCDONOUGH. I think such clarifications tend to get lost, and this problem would be perpetuated meeting after meeting. In the effort to eliminate redundancy, we really would be inviting a problem that we don't need to have.

CHAIRMAN GREENSPAN. Would President Broaddus's recommendation resolve this? One possibility is to combine the sentences to read in part "more likely to warrant [a further] increase/decrease than [a further] decrease/increase in the federal funds rate in the

intermeeting period" instead of "in coming months." It might be an interesting way of combining the sentences.

MR. FERGUSON. May I speak to that point, Mr. Chairman? I may be a minority of one in thinking that your suggested revision doesn't do what we need to do. Okay, I may be speaking for others! As I read our use of the tilt, it covers a longer period than the specific intermeeting period. If we collapse the two, we will leave a false impression that we are focusing only on the intermeeting period as opposed to indicating that we may end up adjusting policy in a given direction over a longer period of time.

CHAIRMAN GREENSPAN. Why don't we say "in the intermeeting period and in coming months?" Would that do it?

MR. FERGUSON. That answers my particular problem.

MR. KELLEY. The problem that I have with a longer time frame is that we review the tilt sentence routinely at every meeting. We may not come to the same conclusion from meeting to meeting, though we tend to do so more often than not. In any event, the tilt adopted at a given meeting is operative only in the intermeeting period because we always review it at the next meeting.

VICE CHAIRMAN MCDONOUGH. That, I think, is the magic of the original drafting. It picked up the "in coming months," which is longer than the intermeeting period, but it gave the Chairman the power to adjust policy in the intermeeting period. It explained with the greatest clarity how we, in fact, behave.

CHAIRMAN GREENSPAN. It is not power; it is authority. Power is irrelevant.

VICE CHAIRMAN MCDONOUGH. Agreed. Correctly stated.

CHAIRMAN GREENSPAN. President Guynn.

MR. GUYNN. Mr. Chairman, I found working through this issue much like eating the first raw oyster I ever ate. The more I chewed on it, the bigger it got and the harder it got to swallow. [Laughter] Our discussion this morning has not made this issue any easier to swallow. I certainly agree with others who say that Option 2 is an improvement over the language that we have today. I came to this meeting with a preference, and I think I still have it, for the language in Cathy Minehan's option. I say that because I think that adding a reference to the risks to the outlook, although that creates some ambiguity, avoids what Option 2 seems to imply, namely in the minds of at least some people a forecast of the next policy move. That may be providing more information than we really intend. So, I would be more comfortable with Option 3, but Option 2 would be an improvement over what we have today. Thank you.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I am on record as in favor of taking out the sentence that has been under discussion, and that is still my preference. I do agree that the sentence is redundant, but I also think that it would be confusing to the public. Its subtleties are rather deep. I have no problem with the sense that the sentence is attempting to convey. I certainly agree with the Vice Chairman that this Committee, under your leadership, does not have a problem in this area at all. But I find the sentence confusing, and for that reason I don't think it serves us well. I also would like to repeat that I support the notion of changing the timing reference in the previous sentence from "in coming months" to "in the intermeeting period" as suggested by President Broaddus.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, after listening to this discussion, I would mention first that I think the solution that you and Al Broaddus proposed of placing "intermeeting period" at

the end of that sentence strikes me as a good suggestion. I would then take out the sentence we have been talking about. I agree with Governor Kelley that it is confusing. It confused me and I think it will confuse others. The authority is clear in the previous statement without that additional sentence, especially if we put in a reference to "intermeeting period."

VICE CHAIRMAN McDONOUGH. It becomes clear only if you put in "intermeeting period."

MR. HOENIG. I agree with that.

CHAIRMAN GREENSPAN. This becomes a language question. I do concur, however, with the point that Governor Kelley made that the previous positions taken by this Committee are void as of the next meeting. In that sense, we may continue with a given tilt indefinitely, but it does require renewal every time we meet. We give the Desk authority to move only during an intermeeting period and without any presumption about further moves thereafter nor with authority to anyone thereafter. I don't know whether the sentence solves the problem, but Governor Gramlich is going to tell us whether it does.

MR. GRAMLICH. That is just what I was going to do! [Laughter] First, I am for Option 2. I was all set to support Bill McDonough on keeping the sentence in question just to point out to the world that there could be changes in the funds rate in the intermeeting period. But I think your proposed insertion of "in the intermeeting period and the coming months" in the previous sentence does that. It makes it clear, in Roger Ferguson's sense, that we are talking about symmetry or asymmetry into the future, but it also calls attention to the fact that there could be changes in the intermeeting period. If that modifier is in the tilt sentence, then we can in my view take out the other sentence, as Mike Kelley and Ed Boehne suggested. So, I am for Option 2, adding "in the intermeeting period" to the sentence on the tilt and deleting the next

sentence. I also hope that we will get a chance to discuss the issue of immediate release because I would favor the immediate release of this paragraph.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. Mr. Chairman, I just wanted to weigh in on the time period question. I am fully in agreement with you and Governor Kelley that we should confine the tilt sentence to the intermeeting period. I changed the language in my alternative to be very explicit about that. So, I think the change that you and President Broaddus have suggested--to insert a reference to the intermeeting period in the tilt or no tilt sentence--is the right way to go. I also favor taking out the next sentence and then qualifying the reference to the aggregates in the last sentence by providing alternatives such as "moderate/some moderation" to get the potential range of growth into the discussion of M2 and M3. So, I could go with Option 2 the way it has been revised today.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. On the sentence relating to the tilt, I would like to substitute "the intermeeting period" for "in coming months" and to delete "in coming months." I do, though, want to ask that the staff think about that last sentence on money and the aggregates. The only thing I like about this sentence is that the constant repetition of some expected moderation is a subtle acknowledgement that growth has been immoderate, [laughter] that we are embarrassed, and that we would like to do something about that. However, I never look at M3. I look at the monetary base and to some extent at MZM. Once upon a time, we used the expression "monetary aggregates." I would like the staff to think about that and maybe come back to it when it refers to money. What is it about money that we really care about?

CHAIRMAN GREENSPAN. That is a problem. I feel very uncomfortable about our inability to understand fully what the monetary aggregates are telling us. I fear that we are missing something subtle, something we have not yet grasped. President Parry.

MR. PARRY. Mr. Chairman, I forgot to note that if we do eliminate that sentence, there is in my view an advantage to referring to "the federal funds rate operating objective" instead of just to the "federal funds rate." The former is really what we deal with.

CHAIRMAN GREENSPAN. Mike Kelley has given me a note that I think is to the point, namely that we have made considerable progress today. We are not quite there, but I think we are now down to Option 2. We are down to a couple of variations of the tilt sentence. We are down to options on how we should handle the M2-M3 sentence. Since we are only five weeks away from another meeting and we have been dithering on this for so long, delaying a decision for one more meeting is not going to be all that significant. I believe that at this stage we should be able to refine the wording. We are quite close. We could, if we wanted to, spend more time on this right now, but it is not worth it. Let's get another draft and have another round of discussions. We may at this point have the equivalent of a notation vote in favor of a change.

MR. GRAMLICH. I am happy to wait another month, but when we reconsider the language can we also have on the agenda the issue of the immediate release of the operational paragraph?

CHAIRMAN GREENSPAN. I see that as a separate issue. I do think that we can and should put it on the agenda, but we don't have to decide both questions the same way.

MR. GRAMLICH. We cannot immediately release something we have not agreed on.
[Laughter]

CHAIRMAN GREENSPAN. I acknowledge that! Let us put that issue on the table again. Hopefully, we will get this wording issue resolved at the next meeting and perhaps make considerable progress, even come to a conclusion, on the release issue. President Poole.

MR. POOLE. I just wanted to emphasize the release issue, too. I do not want to miss the discussion of immediate release.

CHAIRMAN GREENSPAN. We finally got through! Peter Fisher.

MR. FISHER. Thank you, Mr. Chairman. I am going to be referring to a package of colored charts that you should find in front of you.^{1/} My report today will be in two parts. First, I will discuss market conditions and review domestic open market operations, answer your questions, and seek your ratification of our open market operations. After that vote, I will seek your approval on the two special matters identified in the revised agenda.

Turning to the first page of colored charts, the top panel shows forward rate agreements in red for the United States. While the forward rates have backed up from the lows they reached in late October, both the 3-month forward and the 9-month forward 3-month rates are still trading below 5 percent. The 9-month forward rate is still trading slightly below the 3-month forward rate. This certainly continues to suggest a decidedly downward slope to interest rate expectations here in the United States.

Turning to Germany and its forward rate panel in blue, I would make four points. First, it is interesting to note that German forward rates broke below the current 3-month rate following this Committee's September 29 decision to lower rates by 25 basis points. Secondly, it is worth at least observing that rate cuts in the periphery of Euroland had no impact on German interest rate expectations. Indeed, the German rates have backed up gently and consistently throughout a period of rate cuts by other European countries.

Third, much ado has been made of the political pressure on the Bundesbank to lower rates following the German election, but we do not see that in the forward rates. At least we don't see any downward or upward movement after the initial break downward in the forward rates following this Committee's action. I think there unfortunately is also a certain sense

^{1/} Copies of the charts used by Mr. Fisher are appended to the transcript.

of irony in that political outbursts may be preventing both the Bundesbank and perhaps the European Central Bank from making a rate cut that they might be inclined to make absent the political outbursts.

Finally, it is worth noting that the German 9-month forward rate is also trading below the 3-month forward rate. So, there still is a decidedly downward tilt to interest rate expectations in Germany.

In the bottom panel relating to Japan, we can see the rather steady trading in a clump of forward rates around and just below the current 3-month rate, reflecting the Bank of Japan's policy of providing ample liquidity. But these narrow ranges, I think, mask a number of other developments in Japanese money markets.

If you turn to the second page, in the top panel, you can see one measure of the Japan premium, which is expressed here as the spread between the 3-month Bank of Tokyo/Mitsubishi \$LIBOR rate, and the \$LIBOR rate fixing in London. You can see that the spread is rising much earlier this year than it did last year. The real shock that occurred to the Japan premium last November and into the year-end followed the bank closings in Japan. This year, we see more of a persistent updrift from the summer through the fall, reflecting I think the broadening and now generalized negative sentiment toward the Japanese financial sector and, more recently this autumn, the effects of risk aversion and credit line cutbacks to Japanese banks by non-Japanese banks.

In their search for alternative sources of dollar funding, the Japanese banks have turned away from the Eurodollar market and toward the foreign exchange swap market where they buy dollars and sell yen spot, and simultaneously enter forward contracts to sell dollars and buy yen. As the Japanese banks have swarmed into the swap market eager to swap out of yen and into dollars, implicit costs of yen funding have fallen toward and through zero for non-Japanese banks, as you can see in the bottom panel. Here, the red line depicts the 3-month yen interbank borrowing rate in Tokyo--the average borrowing rate for Japanese banks--and the green line is the implied yen borrowing rate for non-Japanese banks taken from the prevailing spot-forward swap and \$LIBOR rates, assuming covered interest rate parity.

The extraordinary movement into negative territory reflects at least two factors. There is reduced demand for yen funding in general in global financial markets, with the general delevering and the unwinding of the carriage rate that has been abruptly occurring throughout the fall. There also is the increased supply of yen coming into the swap market from Japanese banks looking for dollar funding. These two, the demand/supply nexus,

together caused the non-Japanese banks to express their reluctance to take more yen by posting zero or slightly negative yen/LIBOR rates at the fixing in London.

Not depicted here but occurring simultaneously is another effect you may have seen reported in the papers, namely the glut of yen in the hands of non-Japanese banks that they now seek to invest to avoid credit risk. This is driving Japanese Treasury bill rates toward and through zero, not at the auctions but in secondary market trading.

Turning to the top panel of the next page, you can see selected credit spreads in the U.S. markets depicted in various time slices: first, at the time of your last meeting; second, just before the intermeeting rate cut; and third on November 13 which was last Friday. The table also shows the highs and the lows for this year. The simple observation one can make is that spreads are down from their highs and from where they were in mid-October, but they are not down a great deal.

The more interesting problem in my view is that it is very hard to judge where spreads should be. I don't want to pretend that I have any idea. I think that uncertainty is a real problem for the market. Most people know and understand that the highs were somewhat uncomfortable. Most people understand that the lows of last spring were probably unsustainable. But what that means in these rather risk averse year-end funding markets is that the market as a whole has yet another challenge of just trying to find a new equilibrium for these various credit products. That in itself is quite a challenge.

In the bottom panel, we have depicted the spreads between the top tier and second tier for 90-day and for 30-day commercial paper, with the former spread shown in the blue line and the latter in the red line. I should be careful to point out that these spreads are based on indices. This panel, in brief, shows the more pronounced than normal year-end effect we are experiencing this year. There usually is some year-end aversion to A2/P2 paper. This year it is a bit more pronounced than it has been in the past, reflecting the general reluctance to hold the lower grade paper over the statement period at year-end.

Turning to domestic operations, we did not do quite as well as I would have liked since your last meeting in containing the fed funds rate around the Committee's target. So, I thought this might be a useful time to show you a little about how we assess our own performance. On page 4 we have depicted the distribution of daily observations of one standard deviation of the fed funds trading range and of the deviation of the fed funds effective rates from the target. On the vertical axis, we have a measure of volatility

expressed in terms of the number of basis points of the trading range contained in one standard deviation. On the horizontal axis, we have similarly measured the negative or positive divergence of the daily effective rate from the Committee's target, expressed as zero. Each dot represents one day. The red dots represent days when we know there is going to be some difficulty because of high payment flows, such as a quarter-end, a month-end, a maintenance or a coupon settlement date. The blue days are all other days. The period here is for the year through the end of July of this year.

In the upper right-hand corner, you can see the little red dot for last June 30 when the effective rate was almost 160 basis points above the target and one standard deviation of the trading range was almost 350 basis points. As you may recall, that day was a rather volatile day. Luckily for us, most of the other observations are clustered much more tightly around zero, which indicates the Committee's target. This cluster is depicted on the next page, where we take the same sample of data for the same 12-month period within the constrained range of approximately 50 basis points.

The two small boxes drawn on the chart depict the two smallest areas in which we can contain 25 percent and 50 percent of the observations, respectively. Luckily for us and gratifyingly, the 25 percent box falls exactly plus or minus 1/16 percentage point around the Committee's target, the 50 percent box being of course somewhat larger. This gives us some notion of the norm for the calendar year through the end of last July as a comparison for how we have done in the last few months.

On the next page, we show in the same constrained range the data from August 1 through last Friday, distinguishing two subperiods within this more recent period. The hollow dots are for the August 1 to September 28 subperiod and the filled-in dots for the September 29 through November 13 subperiod. The contents of the two boxes are summarized in the lower left-hand corner of this chart. You can see there that from August 1 to September 28, we got about 30 percent of the observations inside the 25 percent box and 58 percent inside the 50 percent box. Now, this included the period of late August and September when there was considerable volatility and convulsion in global financial markets, but that disturbance did not flow through to the funds market. However, in the next period from September 29 through last Friday, we had a much tougher time. Only 19 percent of the observations fell within the 25 percent box and only 25 percent within the 50 percent box. It is rather hard to avoid the conclusion that the market conditions that have prevailed since your last meeting indicate at the very least that we have not lived up to our own standard that we set during the prior year.

On the next page, there is a chart that I normally show you to illustrate conditions in the federal funds market. In the top panel, the green dashed line is the Committee's target, the blue vertical lines represent the federal funds trading range on each day, the red horizontal tick is the daily effective rate, and the red vertical line shows one standard deviation of the fed funds trading range. In the bottom panel, the blue bars depict on the left-hand scale the daily excess reserves we in fact provided to the banking system, and the red dots indicate on the right-hand scale the deviation of the daily effective federal funds rate from the target.

Looking at both of these panels at the same time but focusing on the top panel, two background factors came into play that I think are useful for you to note. First, there was a rather significant shift of volume into the fed funds brokered market in late September and October. This shift reflected a cutting back of credit lines and a general aversion to risk in the term funding markets by both buyers and sellers. On the lending side, there was an aversion to lending money at longer term and over year-end, and that created a reluctance to post offers. On the buying side, there was an aversion to be seen placing bids high enough to attract the limited amount of money the other side was willing to sell--a reluctance to post bids. So, we saw a literal thinning out of the market, with a paucity of offers and bids and a consequent shift of both demand and supply to the overnight market. But the rush of this volume into the overnight market induced the kinds of behavior patterns that contributed to volatility.

The second consistent background factor during this period was that the major banks that normally would be willing to act as two-way traders tended to hold on to funds through most of the day in this period. They were willing to sell those funds late in the day at very low rates, which they viewed as the expected cost of minimizing the risk that they might have to come to the discount window. This was true not only of banks that were subject to rumors. Discount window aversion affected the full range of depository institutions.

The first challenge we faced after the rate cut at the September 29 meeting was the month- and quarter-end on September 30 when markets usually are quite tight. You can see that we had a wide trading range and a firm market on that day. We supplied reserves in an effort to lean against the market's firmness on that day and on subsequent days when the firmness seemed to carry over. The resulting excess reserves led to the soft rates that were hard to counter toward the close of that period.

During the second maintenance period, it was widely assumed that the intermeeting announcement of lower rates at 3:15 p.m. on October 15 reflected an abrupt action to deal with one or two troubled institutions. This

then caused an extreme level of discount window aversion over the subsequent days, particularly as you can see in the chart on October 16, 19, 20, and 21. We faced a trading range that was consistently above the target, the blue line, during the morning on those days as banks held on to as many reserves as they could to avoid late day surprises and the risk that they might have an overdraft on their reserve account. Once they reached a comfort level where they felt they were not likely to see an overdraft at the end of the day, they were all willing to sell their funds in the market at quite low rates. The surplus reserves we had been providing to lean against the heightened rates then began to show through.

I should acknowledge that during this period we were reluctant to be stingy late in the period for fear that a negative miss on our part might spike the funds rate upward or force a reluctant bank to the discount window. That would make it even harder for us to lower the rate to the intended level on subsequent days. We faced similar difficulties around the October month-end, which was in the next maintenance period, but as you can see on the chart market conditions may now be stabilizing. It is my hope that we can do better, but I think, to be candid, that we may continue to face an extreme form of discount window aversion and some volatility through year-end and into January.

Finally, I would like to discuss a few matters relating to our outright operations. We have reduced the size of our normal purchases of Treasury coupon securities that we do at one time to about \$600 or \$700 million. In the relatively illiquid conditions we have seen, going into the market for smaller and smaller bites at any given time means that we cause less and less disruption in the market. I am quite pleased that despite the volatile conditions we have experienced, our operations have become something of a non-event. That is precisely the objective toward which I have been aspiring.

A second item I want to mention--and give you an opportunity to express an opinion, if you wish--is my intention to purchase inflation-indexed securities in our outright operations. We have not been purchasing such securities in the secondary market. We have been acquiring them at auction. I know that when we began doing so, a couple of members of the Committee expressed a degree of reluctance, wondering why the Federal Reserve needed inflation protection. [Laughter] I would like to be clear. We do not buy them because we need inflation protection. We buy them because the Treasury issues them. The general asset class involved in all our purchases is U.S. government credit. As the Treasury has shrunk the size of its bill issues, we have not been able to purchase bills in the same proportion to coupon securities as we did in the past. We do not purchase agency securities outright. We accept them in repo, and I have no particular

desire to acquire them on an outright basis. But if we should have the good fortune to confront federal government surpluses going forward, we are going to face the challenging question of finding new asset classes to add to SOMA over time. So, as long as the Treasury is issuing indexed securities, I think it is useful for us to buy them at least in rough proportion to their issuance by the Treasury.

I mention this because as an operational matter, it doesn't make any sense for us to purchase the indexed issues at the same time we're buying the regular coupon securities. We cannot judge the relative value of regular coupons and indexed securities. So, to make this operationally practical, I propose to go into the market and do a mini pass of the entire index yield curve. I suppose we would start out by purchasing around \$300 to \$500 million. I'm not entirely sure how much we might purchase in a mini pass of the index yield curve. For every \$5 to \$7 billion that we purchased of regular coupon securities, we would periodically conduct one or two passes to buy a small tranche of the indexed securities benchmarked against each other to allow us to make some relative value choices about the prices the dealers were showing us. But I did not want to do this without informing you in advance and giving you an opportunity to express your views on the subject.

Mr. Chairman, we had no foreign exchange intervention operations during the period. I will need the Committee's ratification of our domestic operations. I would be happy to answer any questions on any aspect of my report, but I think our plan is to seek a vote on the ratification and then go on to the two special items.

CHAIRMAN GREENSPAN. I have observed that we are continuously getting a glut of yen and a disinclination to hold them, but the oversupply does not seem to be spilling over into the foreign exchange markets in any significant way. It is a fact that the total size of the Bank of Japan's balance sheet is greatly expanded, and there are very large amounts of yen out there that somebody has to hold. Why doesn't that have an impact on the exchange rate?

MR. FISHER. That is a very good question, and I wish I had a precise answer to it. I think that it is important to look at the last two months. I didn't talk a lot about the big move in the dollar/yen that we had. That was an extraordinary event, obviously, in terms of the standard deviation of the move. It was also an extraordinary event in terms of the factors that came into

play. One major fund began to move rapidly out of a series of positions as has been reported in the markets. Other funds then had positions that triggered--

CHAIRMAN GREENSPAN. This was a yen-carry reversal?

MR. FISHER. This was the unwinding of the yen-carry reversal and a move down in the dollar/yen.

CHAIRMAN GREENSPAN. You just expressed that in terms of a double negative!

MR. FISHER. Right! I see the big move down in the dollar/yen as just a reflection of the delevering. That delevering was going on in many places, and one place where it showed up was in the dollar/yen exchange rate. The latter then triggered a series of extraordinary movements that developed into a big technical move down, forgive the term. In the general back-up of the dollar against the yen in markets dominated by considerable uncertainty and reluctance to take risks, I think we were seeing precisely the effect that I believe you are trying to explain. The glut of yen has been spilling over gradually and not in the shocking way in which the downward move occurred. But we are getting a move back up in the dollar. The market has gone from 111 back to the 120-123 range. If we were not looking at that against the standard of a move from 124 down to 111, the size of this move back up would seem impressive.

CHAIRMAN GREENSPAN. Any other questions for Peter? If not, President Jordan.

MR. JORDAN. Are we discussing the whole range of topics, including the purchase of indexed securities?

MR. FISHER. Yes.

MR. JORDAN. In a very important sense, when we buy Treasury securities we effectively cancel that part of the government's debt. The word "monetize" is used to describe that result. Wright Patman used to say that the bonds owned by the Federal Reserve might as

well be burned because the Treasury gives the Fed interest on those bonds, and for the most part, the Fed gives the interest back to the Treasury. Those bonds do not exist in an economic sense any more.

MS. RIVLIN. We didn't know that there were no bonds in our portfolio! [Laughter]

MR. JORDAN. Whatever the Treasury's reasons might be for wanting to increase the outstanding stock of index-linked securities, I would be troubled if we were, in effect, to undertake to cancel some of those securities by monetizing them. As I understand it, a problem with that market has been its illiquidity; it is not a market that has developed breadth and depth, and all those things. For us to buy up some of these securities and remove them from the market when it is still in its early stages of development would be troubling, so I think we should proceed very slowly and carefully before engaging in this activity. And then there's the notion you alluded to, regarding the public policy perception of the central bank buying inflation protection.

MR. FISHER. There is something of a "Catch-22" about the liquidity issue. I'm particularly sensitive to that issue because, while Wright Patman was free to have his views, one of the jobs the Committee has assigned to me is to worry about what I would do if I had to sell large amounts of securities within a short period of time. What if I have to make changes to the System's balance sheet along the lines that we talked about a couple of years ago? In that context, I feel I need to be as diversified as possible among the full range of assets that I am allowed to hold, so that I will have maximum flexibility in the event that I have to shrink the size of the SOMA portfolio to a major extent. We currently hold about 30 percent of the Treasury bills outstanding, about 10 percent of the coupon issues outstanding, and 5 percent of the index-linked securities outstanding. Now, the share of Treasury bills in SOMA has been

declining recently because I can not in good conscience, and the Treasury is rather uncomfortable as well, continue buying such large amounts of Treasury bills as to dry up the supply in the public market. So, I am constrained on the bill side.

On the coupon side, our operations currently are geared toward trying to smooth out our holdings so we will have roughly a 10 percent share across the coupon spectrum. Once we have reached a smooth distribution across all maturities, then we will have to step up our purchases of coupon securities. In my discussions with the dealers, I tell them that they are responsible for fostering a deep, liquid market; and, in turn, they suggest that I also have some responsibility in that regard. Now, you may feel that this is a camel's nose coming into the tent but if the System, having purchased Treasury indexed securities at auction, were never to purchase them in outright operations, the market would see that as a rather big black eye for those securities. But I'm not sure I want to be providing such a negative signal to the market about a type of security that the U.S. Treasury is offering.

Consistent with the spirit of your concern, President Jordan, I want to proceed very carefully. I certainly have no intention of holding a larger share of the outstanding indexed debt than I do of the regular coupon debt, and I would move in that direction very gradually and episodically. However, I have a problem in terms of the asset classes that I hold, and I feel some constraint on where I should go. And as you and I were discussing before the meeting, it will only get worse next year in the Y2K environment. So I'm feeling somewhat hemmed in, and if people have alternative solutions for me, I am all ears.

CHAIRMAN GREENSPAN. You also should point out that you are hemmed in by the constraint that you have to hold a certain amount of securities on your balance sheet in order

to implement the directives that the Committee gives you. Although I guess you could buy furniture!

MR. FISHER. You would have to authorize me to do that I think! It is a choice of asset class.

CHAIRMAN GREENSPAN. Governor Rivlin.

MS. RIVLIN. We could, of course, unbalance the budget to make it easier.

[Laughter] Peter, I was already persuaded that you have a very hard job and that you do it well, and this little schematic of how hard it has been recently was very persuasive. However, I didn't hear anything that could be of help to you other than the possible reduction in the aversion of depository institutions to utilizing the discount window. Is that the message, or is there something else that this Committee ought to do to make it easier for you to hold the funds rate on its target?

MR. FISHER. The discount window aversion is probably the message. Don Kohn and I have been working for several years with the discount officers in the System. We have been talking with money center banks, trying to get them away from the discount window aversion that was prominent in the late 1980s and early 1990s. We have seen all our good work evaporate in a very short period of time. The problem is that the people who were the CFOs eight years ago are now the chairmen of the big banks. So, they have been there and it didn't take much of a scratch of the old wound to have it all come back. It will be interesting to see whether this is just a year-end effect or we are really going to see a new round of discount window aversion.

CHAIRMAN GREENSPAN. Let's go back to the TIPS issue for a moment. You are operating under authority that has been given to you. The ability to choose the classes of assets in which you invest is also implicit in those regulations.

MR. FISHER. Yes.

CHAIRMAN GREENSPAN. The point that I am raising is that you have the authority to buy TIPS, unless the Committee decides to rescind it. Am I correct?

MR. FISHER. Yes, absolutely. There is going to be a headline effect: When I enter the market to do a coupon pass exclusively for TIPS, it will generate a certain amount of news. I have the authority to do this, but I didn't want to do it without informing you in advance.

CHAIRMAN GREENSPAN. The reason I raise the issue is that if there is a very strong predilection that it is a bad idea, it is better that you know it beforehand.

MR. FISHER. That's why I'm raising the issue.

CHAIRMAN GREENSPAN. Now is the time to speak up if anyone has a strong objection. Silence presupposes acquiescence.

MR. MCTEER. It would make a wonderful column by Alan Abelson.

CHAIRMAN GREENSPAN. President Poole.

MR. POOLE. I agree with Jerry Jordan that it does not matter, in buying securities at auction, whether the Treasury is issuing conventional bonds or TIPS. In either case, we are just taking them off the market. So, I don't think it's a good idea to buy them at auction either. I think TIPS are an experiment. It has not been under way all that long, but I am concerned about the message that we might be sending to the market. I think we might interfere with the information value of these bonds if we're in the market, particularly if we're in the secondary market, because then the game for the dealers becomes one of trying to figure out when we are

going to come in and at what price we are going to come in. I want to leave that market alone and let it function on its own. The larger the amount of floating supply, the more likely it is to be a liquid market. So I am opposed to dealing in these bonds at all.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I have no doubt that Peter has a real problem that needs to be worked on, and I wish I had an answer for him. However, I very much identify with Presidents Jordan and Poole in that I would prefer to stay out of this market. It seems to me, Peter, that given the very small size of these issues, if you buy indexed bonds in the same proportion that you buy regular bonds, you would be buying so few that you probably would not alleviate the problem in this market.

MR. FISHER. If I can first respond a little further to President Poole, I then will address your question, Governor Kelley. The Treasury knows in advance what we are going to be buying. They make the decision regarding the size of a floating supply they want to have. Part of their decision is based on knowing what we will tend to hold on average along with a recognition that our securities lending program gives a little elasticity to the floating supply. By the way, I'm going to be coming to the Committee in the near future to seek some changes in the lending program.

The Treasury's reaction to the question of our participation in the first TIPS auction was one of encouragement. We wanted to participate so that we would have securities to lend out, to provide elasticity to the public supply as a means of avoiding the problems of squeezes and so forth. We are not interfering with the Treasury's judgment about what the floating supply should be, and I don't think we're going to make a big difference in the liquidity of the market by buying \$300 or \$400 million periodically. That is not going to be a big issue. However, it

already is a big issue that we have not bought any. So I see the shoe as being on the other foot, at least from where I sit, Governor Kelley. Dealers are asking the Treasury, and occasionally me, why the Treasury and the Fed are not doing more to promote these securities when the Treasury requires that dealers bid on them in auctions. But I take your point. We can not make this market liquid all by ourselves. It's up to the market to create the liquidity.

MR. KELLEY. I guess it's a new notion to me that we would be promoting the market by buying some of these bonds and retiring them from circulation.

MR. FISHER. We are part of the U.S. monetary authority and the largest holder of U.S. Treasuries. The dealers view our periodic coupon passes, through which we expand our holdings of securities, as a normal part of our support for the Treasury market. And our purchases are seen by the dealers as a process that thins out their inventories of securities.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I have just two comments. The first is on the issue that is on the table right now. I understand where Peter is coming from, but I would feel more comfortable if the TIPS market were deeper; with time it may become deeper, and in that event we would have less impact on it. I recognize that Peter has had discussions with Treasury officials and that this may be worked out, but I certainly would feel more comfortable if we waited.

On the second point, I would like to come back to Governor Rivlin's inquiry about the discount window. This is not the time, but I know that some work has been done on how the discount window could be put to better use. Some papers were written and some options were explored but not followed up. I think there were some good suggestions in those papers that could make the discount window an instrument that the market might be more comfortable using

and in the process help us smooth or reduce some of that volatility in the market. I would encourage us to revisit this matter.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. I agree strongly with Jerry Jordan, Bill Poole, and Mike Kelley on the TIPS issue. It seems to me that from a policy standpoint the great advantage of this market is the possibility that it can give us a clearer read on inflation and price level expectations down the road. We should not confuse that picture in any way, so I would much prefer to stay out of it.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. I would like to applaud what Tom Hoenig just said about finding ways to make the use of the discount window a more normal step in American banking circles.

On the TIPS issue, it seems to me that by our inactivity in the TIPS market we have been saying that indexed securities somehow are different from other Treasury securities. And our failure to treat them like other government securities says either that we do not approve of them or that we are refraining from buying them in order to help them to become a more reliable predictor of inflation. However, it seems to me that by treating indexed securities differently and by not having our normal relationship with the dealers in regard to these securities we adversely affect the supply and demand for indexed securities relative to other securities. It would be better, as a marginal enhancement to the liquidity of the SOMA and to have a balanced view of U.S. Treasury securities in general, to buy indexed securities along the lines of the very modest program that Peter Fisher has suggested than not to buy them.

CHAIRMAN GREENSPAN. Let me just say that the ability of these securities to give a useful view of long-term market inflation expectations is being significantly impaired by

what is undoubtedly a very large and variable illiquidity premium in these markets. Anyone looking at the difference between nominal and TIP yields on 30-year bonds and interpreting it as a forecast of inflation expectations would find it very difficult to explain how the difference got down to 1.2 percent. Surely, no one would argue that the published BLS index is going to average 1.2 percent over the next 30 years. The difference between a realistic expectation of the yield spread, which clearly should be more than 2 percent and probably is closer to 3 percent or perhaps even more, and the current spread is indeed reflecting an illiquidity effect that unfortunately has been changing quite dramatically over the period. So, I think the presumption that the difference in yields for those two securities is very useful as an inflation indicator is dubious at this point. But I do think the issue is important, because one of the reasons for selling indexed securities is eventually to achieve a useful inflation indicator. Reaching that goal comes down to the question of how to get adequate supply and on-the-run characteristics that either will remove the illiquidity premium or stabilize it in a form that would make the yields on indexed securities useful. I don't know where that comes out with respect to the issue that Peter Fisher is raising, but I think it is important to recognize that the indexed-securities market has a long way to go before it will become very useful to us. Governor Gramlich.

MR. GRAMLICH. I think I support Peter Fisher and Bill McDonough on that. I polled the chairman on this, but I couldn't quite tell where he was coming out. [Laughter]

CHAIRMAN GREENSPAN. If you can figure out where I stand, let me know!
[Laughter]

MR. GRAMLICH. I will not pretend that I know much about New York money markets, but it is true that these securities have a liquidity problem, and that does make it hard to interpret their inflation signals. Peter and Bill are arguing that our present behavior has actually

distorted the market a little, and I agree with them. It is not that we would be taking these securities out of the market. It is that we would be trying to make the TIPS market function like normal securities markets.

Let me also say something that I have said before on other aspects of what we do. If this does not work, we can change it. This is not something that we will be doing for all time. So, at least on an experimental basis, it makes sense to go along with Peter, and so I would support it.

CHAIRMAN GREENSPAN. President Poole.

MR. POOLE. I want to go back to the issue of the volatility of the federal funds rate, which has been mixed in with the discussion of indexed bonds. First of all, I don't quite understand the concern over volatility. There are simple ways of reducing volatility if we really want to do so. For example, we could post very narrow buying and selling rates, perhaps 1/16 percentage point on either side of the target rate. It also would be perfectly feasible to eliminate volatility completely, although there may be very good reasons for not doing it. Second, the Desk used to intervene more frequently during the day, but it has ceased doing that, probably for good reason. More importantly, however, I just don't think that the volatility of the federal funds rate should be of much concern to us. Peter does a good job with the situation he has, and we should just accept that some volatility is inherent in the way we choose to operate.

CHAIRMAN GREENSPAN. I agree with that. I think the issue should really be how aggressive the Desk should be in its operations. The funds rates that fall out from those operations are what the market is telling us, and volatility in funds rates is market information that we can very readily suppress if we wish. I like the little boxes in Peter's charts. They are very interesting, but I think there is a question as to what they tell us. President Minehan.

MS. MINEHAN. I want to extend this discussion on volatility just a little further. I totally agree. I think that volatility has been used in the past as an estimate of whether the Desk is doing a good job or not. But I think it is useful to see how much volatility there is and how hard it can be on some days for the Desk to achieve the results that it wants; it does tell us something. So I don't regard that as necessarily a measure of the Desk hitting its stride operationally or not. It is useful to have this information, and I think it tells us a good deal about what has been going on in the fed funds market, and a good deal about the hesitancy to use the discount window. I agree with President Hoenig and President McDonough that we should review the use of the discount window once again, but I must say that as long as the media can learn who is using the discount window, or make guesses that turn out to be reasonably accurate, there is going to be a continuing hesitancy to use the discount window.

CHAIRMAN GREENSPAN. I think the alternative is to indicate that only those of superior moral fiber would have access to the window. [Laughter]

MS. MINEHAN. What test are we going to use for that?

CHAIRMAN GREENSPAN. Good question.

MS. MINEHAN. With regard to indexed securities, I must say that I am not enamored with them. I thought that the decision to begin issuing them just as we were getting inflation under control did not say anything very positive about economic policy in the United States. However, the fact is they exist, and if we are going to get any useful information out of them, we should treat them like other Treasury securities. So, I am in agreement with Peter Fisher's suggestion. Maybe over time they will be useful; I have my doubts but maybe.

CHAIRMAN GREENSPAN. Governor Meyer.

MR. MEYER. As I listened to the discussion on TIPS and SOMA, I was struggling with it for a while. When I heard the Chairman's remarks, they seemed to summarize my views just perfectly [laughter] because I wasn't quite sure where I would be. Then when I heard Governor Gramlich, I thought he really put it together very, very well. [Laughter] On balance, I think that it makes sense to treat them like other securities and to allow operations in TIPS as well as other securities.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Just one other comment on your comment, Mr. Chairman, on the forecasting usefulness of TIPS. I think it's important to keep in mind that we are in a period of very low inflation and very low inflation expectations. If we were to move back into a situation where there was more inflation, I think we can foresee that indexed securities would be a more useful forecasting tool. I guess, Ned, if we are doing these operations and find ourselves in a situation where we might want to pull back, I would be concerned that it might be very difficult to do so.

CHAIRMAN GREENSPAN. You are probably right in the sense that the illiquidity premium almost surely does not fluctuate with the inflation premium. As a gross measure, it must be useful to some extent. At this point, I would suggest that there has been enough discussion about the TIPS issue, and I think it might be useful for David Lindsey to make a quick survey of everyone's view on this question and provide his survey results to Peter Fisher to give him a sense of where the Committee members stand on the issue. Then, if Peter feels that he does not have Committee support, it will be up to him to get on the telephone and try to muster it. I suggest that we try to deal with this informally and hopefully more expeditiously. What is your deadline on making a decision, Peter?

MR. FISHER. We will be adding a fair amount permanently to the System portfolio over the next 30 days. It would be nice to make the purchases in the next 30 days, but we will see how it goes. It is not vital. I think you've made a very good suggestion, Chairman Greenspan.

MR. POOLE. Mr. Chairman, could we also get information from foreign central banks? After all, the U.K. has been involved in this a good bit longer than we have. And we may get some useful information from experience abroad.

MR. FISHER. There are very few foreign central banks that have the kind of permanent portfolio that we have. There is also information from the U.K. and other countries about their experience with inflation-indexed securities. I don't think it is going to be apropos central bank operations.

CHAIRMAN GREENSPAN. When I made reference to the Committee a little earlier, I was really referring to all 18 people around this table. This is a long-term issue, and on certain questions that go beyond one year, the views of all of us are important, not just the Committee members at any point in time. Peter Fisher.

MR. FISHER. I need a vote on my operations during the period.

CHAIRMAN GREENSPAN. Would somebody like to move approval?

MS. MINEHAN. So move.

VICE CHAIRMAN McDONOUGH. Second.

CHAIRMAN GREENSPAN. Without objection.

MR. FISHER. I have two other items, which I hope can go a little more quickly. First, I need a vote authorizing renewal of our swap agreements with the Bank of Canada and the Bank of Mexico. By my silence and your inaction, all our other swap arrangements would lapse

as described in Mr. Truman's memo and my memo to you of September 28. This is consistent with what we have discussed in recent years. Karen Johnson is working with other central banks to insure that the announcement of this action in the FOMC minutes that will be released shortly after the December meeting will be consistent with statements that might be issued by other central banks. That issue is still being worked on. With regard to the second item, I am seeking your approval of an amendment to the Domestic Authorization to allow repo operations of up to a 60-day maturity. This was explained in my memo to you of November 10. I would be happy to answer questions on either of those two items. I seek your vote on both.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. On the swaps, Peter, I would applaud you and all the others who have worked very hard to get to the point where we are with most of these arrangements. In the memorandum you and Ted Truman distributed at the time of the last meeting, you made reference to your intention to talk with the Bank of Mexico about their swap line. Could you update us on any progress on that?

MS. JOHNSON. I had a conversation with a fairly high-level staff person at the Bank of Mexico. They are still persuaded that it is useful for them to have this swap line. They believe that the market sees them in a different light from the other industrial central banks. The language that we are going to use, suggesting that the long period of disuse and the changed character of international financial markets makes the swap lines no longer necessary, does not apply to Mexico. They would like this swap arrangement to continue.

MR. FISHER. If I may add, our Canadian colleagues, who face the Quebec issue at this moment, feel even more acutely than the Mexicans that this is not the time to let go of those swap lines.

MR. BROADDUS. I am not concerned about the timing of not doing it now. But I just hope that on our agenda going forward we would always listen to--

MR. FISHER. We certainly have that in mind.

CHAIRMAN GREENSPAN. Yes. The presumption that these are truly balanced bilateral swap lines is clearly false. Swap lines are becoming increasingly obsolescent. I was surprised at how successful we were in unwinding the others. I thought we might have a shot at these last two, but it turned out, for the reasons that Peter Fisher mentioned, that we were mistaken. So we still have these two lines, but hopefully the two other parties will feel sufficiently comfortable at some point to agree to unwind them.

VICE CHAIRMAN McDONOUGH. Mr. Chairman, if I could make a comment. The Mexicans are not so much interested in the swap lines per se. They would like to have the world begin to think of Mexico as part of North America, not Latin America, and anything that appears to foster that view is very important to them.

CHAIRMAN GREENSPAN. Further questions for Peter? Would somebody like to move approval of the reciprocal currency arrangements with Canada and Mexico?

VICE CHAIRMAN McDONOUGH. So move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Would somebody like to move the proposed change in the authorization for System repurchase agreements?

VICE CHAIRMAN McDONOUGH. Move approval.

MR. POOLE. May I ask a question about that?

CHAIRMAN GREENSPAN. Certainly.

MR. POOLE. I do not understand to what extent the extension of the repo maturities is solving a problem for the dealers rather than solving a problem for us. I think our responsibility is to solve our own problems rather than the dealers' problems.

MR. FISHER. It is very much about solving a problem for me, though the dealers are comfortable with the notion, so in that sense there is reciprocity here. We had been discussing this long before the emergence of the credit market conditions of the last two months. We had been thinking about this particularly in terms of Year 2000 problems when we expect a rather large increase in the demand for currency, which we hope will run off rather quickly. But it is also something that Sandy Krieger and I have talked about for several years in terms of the difficulty that we sometimes have in getting collateral for shorter maturity RPs. When we have a hard time getting collateral for a large volume of two- or three-day repos, we often find that the dealers are willing to offer a lot of collateral for 10-day operations. That has led us to believe that it might be worthwhile to try to do a 20-day or 25-day repo to meet occasional longer-term peaks, and in the case of the year-end, maybe 30- or 45-day RPs. This would let us to lay a foundation by doing occasional smaller operations at longer maturities, so that we would not be put in a bind in the infrequent circumstances when we need to do a big operation for which we cannot get enough short-term collateral. I want to be clear that it doesn't happen very often that we get insufficient propositions from the dealers, but I think it should never happen and it is not a situation I want to be in. I am proposing it now because I want to practice this year-end before I come to year-end 1999.

MR. POOLE. We should not be taking any responsibility for the term structure, and that is the advantage of focusing our operations on the very short end. I would not like to see us possibly affect--or be viewed as affecting--the term structure even in just this maturity segment.

MR. FISHER. First, I think it is important that we are working in the repo market, not in the fed funds market. There are very different dynamics involved. There are different supply and demand dynamics for funds and securities. Secondly, I do not think we are going to affect the term structure; we are price takers; we do not set a price. The dealers know there is risk involved if the Desk does a 30- or 60-day operation and there's an FOMC meeting during that interval. And they are going to price accordingly. That also is relevant to our outright open market operations vis-à-vis TIPS; we hold an auction. We do not publish the price at which we operate in the repo market. The dealers attempt to discover the stopout rate, but I don't want that to be an issue and so we don't publish it. Their estimates of stopout rates reflect only rumor and gossip. You are raising a good issue, but I think we are unlikely to affect the term structure, and we certainly have no desire to do so.

CHAIRMAN GREENSPAN. Is there a second to the repo request?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Let us move on to Mike Prell and Karen Johnson.

MR. PRELL. Thank you, Mr. Chairman. Over the past couple of weeks, participants in the financial markets have become less certain that this meeting will bring another easing step. My sense is that they continue to perceive that you're strongly committed to keeping the economic expansion intact, but that they see recent developments in the markets and in the economy as raising some question about at least the urgency of further policy action.

The sources of this uncertainty about what you will decide to do have their parallels in risks that we noted in Greenbook. While our forecast hasn't changed very much from that presented at the last meeting, this doesn't mean that we have a great deal of confidence that this is what would transpire under the assumed policy. We are still confronted with an uncomfortably broad range of plausible outcomes.

For example, it's not difficult to imagine a scenario in which the credit markets continue their healing process, the stock market moves to new highs, and aggregate demand barrels along. You can get a sense of what that might look like by blowing up the differential between the baseline and the "higher stock prices" simulation in the Greenbook, which involved only maintenance of last week's market level. On the other hand, it's just as easy to imagine a scenario in which there is another significant disturbance to the world economy and financial system, perhaps precipitated by a "meltdown" in Brazil; we have offered a far from extreme version of this in the Greenbook as well.

Karen will have something to say about the international outlook but, before that, I would like to offer a few comments on the forces currently at work domestically.

First, the fact that GDP growth in the third quarter apparently outstripped our expectations invites the conclusion that we've once again underestimated the momentum of demand in the economy. However, the upside surprise appears to have been pretty much an inventory story. In that regard, I should note that this morning's report on retail inventories showed that, outside of auto dealers, stocks were little changed in September--probably implying only a marginal downward revision to our third-quarter guess. As we said in the Greenbook, we don't think that there is a major overhang of unwanted stocks in the aggregate; but inventory-sales ratios have climbed, and they are quite high in a few industries. At a minimum, I believe we should anticipate that businesses, at least outside the auto sector, will be attempting to curb the pace of accumulation. That may well be one reason why the tenor of news from the manufacturing sector has been quite negative of late.

Over the past couple of years, we've often underestimated the desire of businesses to maintain rapid rates of inventory accumulation, basically because we underestimated the strength of final demand. But, recently, domestic final demand has not been any stronger than we anticipated; it wasn't in the third quarter, and last Friday's figures showing a hefty October advance in retail sales were closely in line with our expectations. Moreover, the greater growth of output evidently has not generated any extra jobs and labor income. Instead, payroll growth has slowed more than we expected, and there seems to be some pickup in corporate downsizing announcements. This may be one reason why the early November Michigan SRC survey--while showing a considerable bounceback in the sentiment index--didn't show much improvement in employment expectations.

The flip side of the more moderate growth of labor income may have been a shade healthier corporate profit performance than we anticipated.

But the trend of profits is still weak over the past several quarters and, though hope springs eternal in the stock market, the deterioration in corporate cash flow is a negative for capital spending. The anecdotal evidence suggests that, whether for that reason or simply because they don't see current and prospective demand warranting further additions to capacity, many firms--especially manufacturers--are gearing back their investment programs.

I've not mentioned the developments in the debt and equity markets, per se, in my comments on the spending picture. The jury is still out on whether the recent turmoil is going to leave a substantial mark on the real economy. On the credit side, the bond markets have reopened for business in terms of new issuance activity, and spreads are narrowing. The commercial paper market is having some difficulty accommodating the over-the-year-end borrowing by firms that are not in the top credit rungs, but banks are filling in--sometimes reluctantly--and those tensions presumably will be behind us in a couple of months.

Nonetheless, we still think it's reasonable to anticipate that it will take a while for the sting of the recent experience to wear off fully, and that the capital markets will continue to show a greater sensitivity to liquidity and credit risk considerations. The commercial banks are not insulated from the capital markets, and they too have learned something about the risks facing them in their lending activities; consequently, we don't expect the recent tightening of loan terms and standards to be reversed immediately. And, although the decline in the level of interest rates for prime borrowers, supported by the Fed's easing, takes some of the bite out of this tightening, credit terms overall have deteriorated for some higher risk enterprises and certainly the trend toward ever easier access to credit has been halted.

Similarly, despite the rousing rally that has occurred in recent weeks in the stock market, unless that rise continues we also should see the impetus from wealth effects waning in the coming months. As we indicated in the Greenbook, this is a real wild card in the outlook. We believe that the market is skating on thin ice, at best, given the trend of profits; in that context, our prediction of a 10 percent price decline might even be said to be conservative, as it would leave the averages considerably above their recent lows. But tell that to an investor who has once again seen demonstrated the virtues of buying on dips and who hears market gurus chanting the mantra that "you don't fight the Fed." And one might ask what earnings have to do with share prices, anyway, when any company with "dot com" can generate a huge market capitalization overnight on a base of nothing but losses.

In sum, while we believe you should view financial conditions as having shifted in a less accommodative direction since August, this clearly

is a situation that will have to be monitored closely in the coming weeks. We're dealing with volatile phenomena, the implications of which can be difficult to judge.

In any event, even if we have the aggregate demand outlook right, that still leaves considerable uncertainty about the prospects for inflation. Recent news has been quite ambiguous on this score. The ECI for the third quarter, on the face of it, raised some serious questions regarding our forecast of a peaking in wage and compensation increases, but it was followed by hints of a moderation in the trend of average hourly earnings. Among the major price indexes, with an increase of two-tenths last month the year-on-year change in the core CPI dropped back to 2.3 percent--not far above its low point. However, the chain price index for GDP apparently decelerated further last quarter. Going forward, the recent softening of the dollar suggests that the prices of imports may not continue to exert so great a disinflationary effect, but anecdotally one hears that the oncoming flow of cheap Asian goods will result in significantly lower retail prices in the first half of next year. There is something for every taste in this wage-price stew. I think we've taken an honest sampling from the pot, rather than picking out the bits that most appeal to us; but you may disagree, and we'll be happy to answer any questions you may wish to put to us regarding our view.

But, first, if I may, let me turn the floor over to Karen.

MS. JOHNSON. As we stated in the Greenbook, our forecast this time for the external sector is not much changed from that in September. We have chosen not to assume that the depreciation of the dollar during the intermeeting period will be significantly reversed. As a consequence, our path for the dollar going forward is about 3 percent lower in the near term, and about 2 percent lower toward the end of the forecast period, than last time.

Such a change in our outlook for the dollar by itself would tend to stimulate exports and restrain imports. Offsetting this stimulus for exports to some extent is a somewhat weaker projection for real output growth in our trading partners.

By far the biggest downward revision in our outlook for growth abroad has been to our view on Japan. We now expect that the trough in real output will not occur until sometime in 2000. This more negative outcome is expected despite injections of fiscal stimulus of about 1½ percent of GDP next year. We are thus expecting continuing declines in private domestic demand, particularly business investment, with little or no help from the external sector. Since the Greenbook was published, we have learned some additional detail about the latest fiscal package proposed by the Japanese

government. The package contains 6 trillion yen of personal and corporate tax cuts, an estimated 6 trillion yen of "real water" expenditures, and an additional array of measures that are expected to provide little direct economic stimulus. Accordingly, the actual stimulus contained in the package is probably not more than half the 24 trillion headline value and is broadly in line with the Japanese fiscal assumptions in the November Greenbook. Given the lags in implementing these packages, we expect that the effects of these measures will be felt during the second half of 1999, as the effects from the April 1998 package, which we think are now becoming visible, begin to wane.

The other country of particular interest in this forecast round is Brazil. In putting together the forecast, our strategy has been to assume that the international rescue package for Brazil succeeds in the sense that no abrupt change in the exchange rate regime is forced upon Brazil, and no contagion in that respect spills over to Argentina or elsewhere. Real GDP in Brazil is expected to decline this quarter and through 1999, but the trough is now projected to occur in early 2000, and some recovery begins that year. This contraction results from the high interest rates already in place, which are projected to ease some, and the fiscal restraint that is part of the policy program Brazil has announced. We have built into the forecast some contraction of output elsewhere in South America as well.

There are many pitfalls in the months ahead that could put the Brazilian program off track. In the near term, Brazil and its private creditors must reach an understanding such that most, but not necessarily all, of the short-term external credits to Brazil are maintained. Domestic creditors also must refrain on net from moving capital out of Brazil. The fiscal agenda must proceed; in particular, the Brazilian Congress must enact crucial proposed measures so that an IMF review planned for February 1999 will be successful. We recognize that it is far from certain that all this will proceed smoothly. In the Greenbook, it seemed to us more useful to present in the baseline the implications for the foreign sector under the assumption of "success," as at the moment that outcome is being actively pursued by officials in Brazil and at the IMF. We did include as an alternative scenario, a model-based version of the impact of "meltdown" in Brazil and contagion elsewhere in the region. In that event, with no policy adjustments here, U.S. GDP growth would be reduced $\frac{1}{2}$ to $\frac{3}{4}$ percentage point in 1999 and in 2000.

On balance, we look for the external sector to subtract nearly 1 percentage point at an annual rate from U.S. GDP growth this quarter and about half that in 1999 and 2000. This is a bit less than we had been thinking in September, particularly for the current quarter.

We would now be happy to take questions.

CHAIRMAN GREENSPAN. Questions for either?

MR. MCTEER. For Mike Prell, in Part 2 of the Greenbook, page III-19, there is a sentence that says "Growth of retail money market mutual funds and of currency outstanding, both domestically and overseas, was strong over the most recent two months." Do we have any indication of overseas holdings of currency, whether they have increased significantly, and whether we ought to be taking that into account when we look at the growth rate of M2?

MR. PRELL. Dave Lindsey follows that more closely than I do.

MR. LINDSEY. We were actually prompted by a question from Governor Gramlich a couple of months ago to look intensively into this question. We have considerably improved our estimation procedures, including our seasonal adjustment procedures. We have come up now with a series that we find to be the best estimate we can produce. What that shows is that whereas in recent years there has been an effect of a little less than $\frac{1}{2}$ percent on the growth of M2 coming from demand abroad, that seems to have lessened some most recently. Let me give you some figures to suggest what I'm talking about. In September and October, our estimate is that foreign holdings of U.S. currency grew at 13.8 percent and 8.5 percent respectively. That implied, however, growth of domestically held U.S. currency in September and October at even faster rates, $18\frac{3}{4}$ and $12\frac{3}{4}$ percent respectively. When we contrast the growth of M2 with the inclusion and the exclusion of foreign currency holdings, it turns out not to make too much of a difference in those recent months. For example, M2 as we normally calculate it, including the foreign currency holdings, grew at a 14.8 percent rate in September. Without the foreign currency holdings, we have estimated the growth to be 14.9 percent. In October, the two numbers are 12.3 percent and 12.6 percent respectively. So, on balance in recent months and

recent quarters, it doesn't make a material difference whether we look at our overall estimate of M2 or our estimate of M2 stripping out the foreign currency holdings.

MR. MCTEER. That seems kind of intuitive to me, given what is going on overseas.

MS. JOHNSON. You might remember that the U.S. economy is growing much more strongly than many of these overseas economies, and that is supporting profits and growth of M2. One might think that shipments to these countries have risen some but that they just have not risen as much as demand for currency in the United States has risen. That is not the benchmark that would determine them.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. A question for Karen Johnson: When the Brazil agreement was announced recently, although the way it was discussed was confusing, there seemed to be at least a portion of it that was going to be handled under what might be characterized as a new philosophy that was incorporated in either the G-7 agreement or the Treasury's statements on the subject. Is some of the financing going to be distributed faster?

MS. JOHNSON. The standby encompasses different ways of financing the sum of money involved. A substantial portion of the initial tranches will be done under what is called the SRF, which is actually a facility that was created at the time of the Korean crisis. Now there is a variant of that under discussion, which would have contingent elements to it. It was referred to in the G-7 communique and has been discussed in the press and elsewhere. The contingent element was not really in play for Brazil because events overtook the debate, so to speak, but the characteristics of the SRF part are that it will be at a penalty rate and it will be disbursed in large quantity initially in an effort to discourage contagion and speculation and so forth. But that is under the umbrella of the standby arrangement. The term "standby" can refer to financing this

way or financing through some of the other devices at a different pace. In that sense, it is not absolutely new. But, yes, this option will be used for Brazil.

MS. MINEHAN. So, to get to the heart of the matter, you mentioned the IMF review in February.

MS. JOHNSON. Yes.

MS. MINEHAN. They could get money before that.

MS. JOHNSON. They will. The first tranche will be disbursed upon the vote of the executive directors of the IMF, and that money will come immediately. The conditions of that first tranche have already been met. They were set and they had to do with some of the items in the fiscal package that were already announced and actions that the Brazilians have already taken, so that is a given. The next tranche will come up for review in February of 1999.

MS. MINEHAN. Okay.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Karen, I think it was a little more than a year ago that we looked at a worse case alternative for East Asia. One of the two countries that played a role in that was Brazil, and it is obvious from our discussion why that was the case. The other one, of course, was China. It seems to me that there are interesting things going on in China about which it might be worthwhile to update the Committee either at our next meeting or even as part of one of the Monday morning briefings. China's growth rate, at 8 percent at least by the official statistics, is remarkably good. Their external position is quite strong. Yet at the same time, one does see some financial problems with the ITICs in some of the provinces. Of course, they are experiencing actual deflation, which might suggest that the renminbi is overvalued. I would find it interesting, and perhaps some of my colleagues would as well, to know what your latest

thoughts are about either why they have been so successful in dealing with the problems of East Asia or whether we, in looking at the official statistics, are being deluded by what might indeed be the pressures in China.

MS. JOHNSON. I certainly take your point. The 8 percent number was somewhat unexpected. We have not really had the opportunity to look into it, and it is hard to do so with China because we don't get a lot of detail and can not get behind the scenes. I am skeptical but I can't cite good reasons for that skepticism other than that we know Asia as an economic area is in trouble, and it is hard to believe that China is escaping as it would seem. We will certainly view this as something that we should look into and get more information through various channels and give it to the Committee.

MR. PARRY. Of course, their approach to the problems is quite different with exchange controls and so forth.

MS. JOHNSON. Yes, capital controls and the like. We expect them to be able to maintain the present exchange regime into 1999, something we had assumed previously with some trepidation, and it seems to be happening. But I think we probably do need to question the sequence of events and the policy choices they are making and ask some hard questions about that. We will try to do more about it.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. President Poole.

MR. POOLE. I want to go back to the monetary aggregates. My friend from Texas referred to the currency component of the aggregates, although I thought Texans always concentrated on bigger things than currency. Let's talk about savings deposits for a minute, which are three times the size of currency. When we look at the detail on the aggregates, the

really rapidly growing areas are savings deposits and money market funds. We know that banks are filling some of the gaps in the credit market arising from the partial seizing up of the securities markets. Large denomination time deposits, which banks often use for funding their credit growth, are shown as essentially flat in the table, but banks are meeting their funding needs from money market sources as well. Banks are funding themselves very comfortably with very rapid growth of liquid deposits, probably mostly from households. Savings deposits are mostly from households because it does not make sense for businesses to hold such deposits. The money market mutual funds also are growing very rapidly. So, it looks to me that there is extremely rapid growth in the liquidity position of households, and it is not tapering off with the recovery of the equity markets. I could understand the story that households were apparently taking funds out of the equity markets when those markets were weak and parking them temporarily in money market funds, or somewhere. But there is always the question about the people on the other side of the equity markets because for every dollar that comes out of the stock market, somebody else puts money into the market. It is just the prices that change. What insight can you offer as to what to make of this, Dave? It has been a phenomenon just since August, but my interpretation is that there clearly have been very rapid increases in liquidity in the household sector.

MR. LINDSEY. Yes, there is no question about it. Everything you have described is quite accurate. For example, look at the chart of M2 velocity versus its opportunity cost--in honor of Bill Dewald I will mention a piece he has published using opportunity cost defined as the bond rate less the own rate on M2; Board staff tend to look at the three-month Treasury bill rate less the own rate on M2. With either chart, you will see an upswing in velocity that occurred in the early 1990s extending through mid-1997. Then velocity started coming back

down, and since mid-1997 it has fallen every quarter. Depending on where the opportunity cost line is placed and if the velocity shift is deemed to have ended around 1993, then velocity is shown as returning to that opportunity cost line. One interpretation, particularly if one chooses a scale that shows the cluster of points to be fairly narrow, as Bill Dewald did, is that velocity is more or less returning to normal. Another interpretation, on which I personally tend to put more weight, is that we saw a continued increase in velocity after 1993 that was somewhat inexplicable. Now we have seen a reversion to declines in velocity, which also are not completely understandable. Indeed, for this quarter, if we take the Greenbook forecast of nominal GDP along with the money forecast, which we do our best with but as I indicated before is not always perfect, we get a velocity decline of 8.7 percent. In other words, much of the liquidity that you have been describing seems to be showing up in the ratio of M2 to GDP rather than in GDP either currently or in a predicted sense, at least if one believes the Greenbook forecast. We have some explanations. We can always come up with them after the fact. But the truth is, as I mentioned to someone yesterday, I sat in that seat in February of this year telling the Committee that it could expect M2 growth of 3½ percent this year, given the Greenbook forecast. We now have a forecast of 9 percent growth in M2, a slight error in our February projection. [Laughter] The Greenbook forecast admittedly underestimated the strength of spending this year and maybe there was a signal from the monetary aggregates to that effect. But there was a lot more to it than that. Velocity took up a great deal of that error.

MR. PRELL. President Poole, may I try to move from the big picture to the very small picture? Looking at the flows in the last few weeks--and recognizing your point about somebody is paying someone and that makes it a little difficult to track this sensibly--it does look to me in the data that I have, though I think we may have more recent estimates, that savings

deposits have leveled out in the last few weeks and money market fund growth has decelerated substantially. This coincides quite precisely with the time when we see the reflow of money into the equity mutual funds, not in quite the same proportions we saw in the first part of this year but still substantial. So, there does seem to be a correspondence here that is consistent with the story that people were hesitating and parking money in these very short-term assets. And with Treasury bill yields having come down so sharply the opportunity costs actually had narrowed for putting the money in savings accounts.

MR. POOLE. But we do have to be careful about the magnitudes. Money market funds have decelerated in October to an annual rate of 31.5 percent.

MR. PRELL. I am looking at weekly numbers where growth has been inching up by comparison.

MR. POOLE. Yes, I understand.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Just a quick question on Brazil. I found this alternative scenario in the Greenbook very helpful. I took note of the U.S. GDP projection of minus 0.4 in 1999 and 2000, but you were careful to mention that this is by no means the worst case concerning a potential meltdown in Brazil. I was wondering if you could give us some idea of the relative probabilities of this alternative scenario or even a worse case.

MS. JOHNSON. While you're at it, the timing as well! [Laughter]

MS. MINEHAN. All derived from by the model, of course.

MS. JOHNSON. I think the next three weeks are crucial for at least the initial success of the Brazilian program. The time between now and the signing of the letter of intent, which will be on one of the first days in December, is the first hurdle that has to be gotten over. People

even less cynical than I might think that chances are that what is needed to get a positive vote at that first hurdle will take place because it is in the interests of many parties to have that happen. The critical feature is whether or not the private creditors of Brazil, both those within the country and external to the country, appear to be carrying their fair share. If so, the governments that have money to be extended both through the IMF and through bilateral mechanisms will feel that it is appropriate to vote "yes" and the program will go forward. So, one might think that that will happen, although I would not characterize it as 100 percent sure by any stretch of the imagination. But it certainly is still possible that things will unravel between then and February of 1999, and one way it will become obvious that things are unraveling is if Brazil again starts to lose reserves rapidly.

I would guess the likelihood that the baseline Greenbook scenario will occur is in the neighborhood of 50 percent, maybe a little more. We thought it had a good chance or we would not have given it any credence. The meltdown scenario is a fairly contained one; it has spillovers for Argentina, it has some implications for Mexico, and it would be messy. Exactly how this would take place is not clear. It might include a combination of some unilateral actions on the part of Brazil, some forced exchange rate adjustment, and then a return to the IMF and an attempt to restart negotiations--all of which would certainly play out over some period of time. I guess I would give this scenario a big chunk of the remaining probability. So, if the probability of the Greenbook scenario is 55 or 60 percent, this alternative may be another 25 to 30 percent.

But there is at least a 5 to 10 percent probability that Brazil could fall so hard that Hong Kong, for example, would become threatened again, a possibility that is not in this scenario. Hong Kong is the other fixed exchange rate regime that has been tested repeatedly since this crisis began. If Hong Kong is forced off of its peg, then the progress that we have seen

to date in Korea and Thailand might be called into question because capital markets would again become skeptical of their viability, and the citizens of those countries would begin to feel that they should move their capital elsewhere. That could trigger a worse scenario that I would not give a lot of weight to, but one whose probability is not zero by any means.

MR. MOSKOW. Thank you.

CHAIRMAN GREENSPAN. Further questions? If not, let's break for coffee and come back in 10 minutes.

[Coffee break]

CHAIRMAN GREENSPAN. Who would like to start off the Committee's discussion? President Poole.

MR. POOLE. I didn't realize I was going to be that close to the top of the list! [Laughter] Let me talk a bit about the Eighth District first. I think our situation is largely a microcosm of the national picture. I would like to comment particularly on a new source of information that I am in the process of developing.

I have this information under a pledge of our confidentiality.

With regard to national economic conditions, I would note that although the forecast for the fourth quarter in this Greenbook is down from that in the last Greenbook, the third quarter came in higher than was expected and therefore the second half of 1998 now looks somewhat stronger than at the last meeting. It's just by a few tenths, but generally the picture is for a little more strength than we had been expecting. My sense is that output has overshot full employment and that the labor market has been pushed temporarily beyond its long-run sustainable capacity. If that view is correct, we are going to see growth in the near term below the long-term trend for a while as the economy returns to its sustainable path. That is my sense from all the information that we have about the labor market and the pressures that we've seen, particularly all the unfilled jobs and the difficulty in finding people to fill certain job positions.

So, the question for me is whether this below-trend growth, let's say over the next year or so, is going to occur with or without rising inflation.

I think the financial turmoil around the globe has passed its peak. My reading of Asia is that we're seeing some progress, with the very important exception of Japan. Prices in many of the Asian equity markets are a little higher, exchange rates are a little stronger, the bond spreads are a little narrower, and conditions generally seem to be getting a little better there.

I don't know where the appropriate place is to bring up this matter today, but included in my FOMC packet that was delivered to the hotel last night was a letter from the National Association of Manufacturers (NAM) urging this Committee, urging me in particular, to lower interest rates. I hope that in the future the staff will not include such letters that come from outside sources in my FOMC packet. If word gets around about this, my briefcase will not be big enough to carry home all the mail I might receive. I am happy to respond to the NAM folks if they write to me in St. Louis, but I don't think it is appropriate for their letters to come here. Thank you.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mr. Chairman, overall activity slowed in our District in the third quarter as it did elsewhere, but my sense is that it has strengthened on balance over the period since our last meeting. Consumer spending in October in particular was considerably stronger than anticipated. Automobile sales and outlays for other durable goods were especially robust in October, supported by well above average refinancing activity. In general, retailers seem to be considerably more optimistic in our region than they were a few weeks ago. Housing activity, both sales and construction, also appears to remain quite solid throughout our District on the basis of anecdotal information we are getting from our directors and others. One director we

have from the District of Columbia described conditions in the housing market here as booming. The main weak spot in our region, as elsewhere I guess, is manufacturing due to the disproportionate impact of negative international developments on that sector. Farming also is down, owing to weak prices and income. One of our directors from South Carolina said they did not have any agriculture in South Carolina this year.

On the financial side in our District, bank business lending has increased very sharply recently, especially at the larger banks as companies that have been shut out of the securities market have turned to the banks for credit. My sense is that credit is readily available for all but the lowest-rated borrowers in our region, albeit at higher rates than earlier in the year. To round out information on the District, I would just add that yesterday I attended the meeting of the Committee on Revenue Estimates for the Virginia Governor, with 20 Virginia CEOs in the meeting. I was struck by the number who still emphasize the tightness of labor markets and the difficulty they are having finding qualified people at all levels of the experience and knowledge spectrum.

With respect to the national economy, the Greenbook is projecting a deceleration of real growth to a below-trend rate next year, even with an assumed further easing of monetary policy. There is no question in my mind that this is a plausible forecast, but it depends heavily on a halving of growth in consumer spending next year. That could happen, but it seems to me far from a sure thing. Certainly there is not much evidence of any marked deceleration of household spending currently. Problems in capital markets do not appear to be constraining consumer credit to any significant degree. Some have argued that the low recent saving rate could crimp consumer outlays going forward. But some empirical work and research we have done at our Bank shows that on average over the last 20 or 25 years low saving rates have

preceded increased rather than diminished growth of consumer spending. A weaker stock market certainly could damp such spending, but clearly we cannot feel very comfortable in forecasting either the stock market or its impact on consumers. There also is Bill Poole's comment and observation during the question period about the strong growth in household liquidity.

In short, it seems to me that consumer spending could decelerate less than is projected in the Greenbook. If it did, overall GDP growth would be close to potential, which would be a favorable development in my view. I think that scenario is not much, if any, less plausible than the Greenbook projection. Obviously, the still unsettled conditions in capital markets pose continuing downside risk to the economy, but the aversion to risk in capital markets has clearly diminished greatly in recent days. A number of yield spreads have narrowed significantly. Risk premia, of course, are still higher than they were before August, but the overall credit intermediation process seems to be adjusting to this. Credit flows that would have bypassed the banks in the more normal circumstances that prevailed before August are now going through the banking system. Bank credit rose at a 27 percent annual rate in October on a reported basis, and the accelerated growth of M2 indicates, as you would expect, that the size of our open market operations has increased as the demands for liquidity are being met.

In sum, the economy may not be out of the woods yet, but prospects seem distinctly better now than they were at the time of the September meeting. I think that may justify a little caution on our part when we address policy later. Thank you.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Thank you, Mr. Chairman. Since our last meeting and particularly since our mid-October actions, a degree of calmness seems to have replaced at least some of the

unsettled conditions of late September. However, our contacts remain more nervous and uncertain about the future than they were in mid-summer. In many respects, conditions in the Seventh District are quite similar to what I reported in late September. Growth in our manufacturing sector has slowed further, although activity levels generally remain high. Housing activity remains strong, and consumer spending continues to be relatively healthy. Price pressures remain benign despite tight labor markets. The latest Manpower survey of hiring plans for the first quarter of 1999 suggests little change from the strong plans reported for the current quarter as well as from a year ago. These results will not be made public until next Monday, November 23, so they should be considered confidential until then. The key point from the survey is that aside from normal seasonal movements, there is no indication that the labor market is facing significant layoffs or downsizings.

We continue to see signs of slowing in our manufacturing sector, but conditions there are mixed. Foreign markets are adversely impacting producers of electronics, steel, and agricultural equipment. In the steel industry, the production decline from a year ago is now greater in our District than for the nation as a whole. Domestic producers continue to be challenged by steel imports, which doubled their U.S. market share from about 20 percent to 40 percent this past summer. The head of one steel company told me that he believes that world steel prices are bottoming and that firms are more likely to shut down capacity now than to reduce prices any further. In contrast, domestic demand continues to support fairly strong activity at our heavy and light motor vehicle producers as well as housing-related manufacturers. One contact in the heavy truck industry described business as booming, but he immediately said his firm was making extensive contingency plans for next year that would be implemented

quickly if necessary. Industry sources suggest that auto and light truck sales this month will be strong, though not as robust as the annual rate of 16½ million units in October.

Because of the recent financial market volatility, we made a special effort to contact some market participants at the Chicago futures and options exchanges. Although our contacts believe they have successfully weathered the extraordinary volatility of late summer and early fall, many were apprehensive about the market's ability to withstand future shocks. One concern is that market depth may suffer in the months ahead. Banks face pressure to get exposure off their books and consequently they have cancelled lines of credit to some clearing members. Further, year-end redemptions by hedge fund customers may stress the markets. The second key issue is that some over-the-counter swap market participants are apparently concerned about the condition of some of their large money center bank counterparties. As a result, these participants are increasingly substituting away from over-the-counter contracts into relatively more expensive futures contracts. These contracts reduce the participants' credit risk by substituting the AAA-rated exchanges as counterparties in place of many of the money center banks.

Conditions in the agricultural sector remain weak. Our latest survey of agricultural banks showed third-quarter farmland values down on average for our five District states. Bankers also reported an increase in loan extension requests and expect that loan repayment difficulties will emerge. The inflation picture generally remains quite good. The auto industry, for example, is negotiating a 3 percent reduction in steel prices in next year's supply contracts. However, two different retailers noted to me that construction costs for new stores had risen considerably in the last year.

Turning to the national economy, although somewhat more balanced than at our last meeting, I still believe that the risks remain greater on the downside. Three factors seem

especially important at this time. First, although stock market prices have rebounded sharply in recent weeks, market volatility remains high and that should restrain consumption spending somewhat in the months ahead. Second, although credit spreads have narrowed since our intermeeting rate cut, financial markets remain jittery and spreads could easily climb again. Finally, the risks of rising inflation appear to be relatively low. Although labor markets continue to be tight and wage growth is rising, productivity growth has been strong enough to largely offset those gains. Moreover, declining profit margins going forward are likely to stiffen the resolve of many firms to hold the line on wage increases. These factors combined with the continued dismal international outlook--we were talking about Japan and Brazil earlier--lead me to the view that the risks remain greater on the downside.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, the Twelfth District economy has expanded at a solid pace in recent months, although the disparity across states has increased and the pace of growth has moderated from earlier this year. Employment growth in our fastest growing states, Arizona, Nevada, and Washington, is averaging between 3 and 5 percent on a 12-month basis. It is interesting that the State of Washington is also the state that probably is among the most vulnerable to developments in East Asia in terms of trade. Five other District states, Alaska, Idaho, Hawaii, Oregon, and Utah, are expanding at or below the national pace of growth. In California, employment growth remains solid at 2.8 percent, although it is significantly slower than the 3.8 percent pace of expansion in 1997.

Construction and services as well as finance, insurance, and real estate have continued to be the strongest sectors of the District economy. Slower overall growth has yet to loosen

District labor markets significantly. District unemployment in September was just 0.1 percentage point above the average for 1997.

Returning to California, the East Asian economic slowdown has reduced employment growth throughout the state, but its impact has varied significantly across regions. Strong trade ties to East Asia, especially in the high-tech manufacturing area, have pushed employment growth in the San Francisco Bay area below that for the state as a whole for the first time in three years. In contrast, the more diversified southern California economy has remained relatively immune to global economic turmoil, with little deceleration in growth from last year. The changing pattern of growth in California is helping to equalize the levels of economic activity in the Bay Area and Southern California following the deep recession and slow recovery in the Los Angeles/Long Beach Area.

Turning to the nation, we believe the outlook for economic activity has improved since the Committee met in September largely because of the easing of monetary policy, the decline in the value of the dollar, and increases in U.S. stock prices. Under the assumptions of an unchanged federal funds rate and no further changes in the stock market or the dollar, we have raised our forecast of real GDP for 1999 by about $\frac{1}{2}$ percent to 2 percent. I see risks on both sides of this forecast. On the upside, growth in the economy has outperformed most forecasts for the past three years, and this certainly could continue. On the downside, the stock market is still overvalued according to most models, and although U.S. debt markets have stabilized somewhat in recent weeks, risk spreads are still elevated, and confidence remains vulnerable. There obviously are still many risks in the international arena as well.

Under our forecast, there is continuing upward pressure from tight labor markets on wage and price inflation next year, although the magnitude of this effect diminishes over time as

the unemployment rate rises. However, price inflation continues to benefit from low inflation expectations, ample industrial capacity, falling commodity prices, higher trend growth in productivity, and negative speed effects as the economy slows. As a consequence, we expect inflation in the core CPI to average 2¼ percent both this year and next, and that is using a consistent definition for the CPI. Overall, if we assume an unchanged monetary policy, our projections show a constructive outlook for the economy with moderate real GDP growth and moderate inflation as well. Thank you.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. The Eleventh District economy is showing increasing signs of slower growth especially in the goods-producing sectors including energy, petrochemicals, semiconductors, and now commercial construction as well; the latter had been quite robust until recently. Commercial construction is being held back by financing considerations, higher credit standards, reduced REIT activity, and so forth, but there is some feeling that that is not altogether bad. It may be a timely constraint on a new round of overbuilding. Employment growth in the goods-producing sectors has decelerated from vigorous in the first quarter to barely positive in the third. Employment has declined in oil and gas extraction and in oil service industries. Our Texas index of leading indicators has declined for the past five months. The declines have been broad-based, with seven of the eight components declining. Our forecasting model of Texas employment growth, which has been very accurate over the past three years, forecasts employment growth of 0.3 percent in 1999. Our leading index for the Mexican economy also signals more slowing there in 1999 than we have seen thus far, with negative implications for the Eleventh District. This is consistent with a reduction of spending by Mexican nationals in Texas border cities, which we have noticed, and with a reduction of U.S. currency flowing into our San

Antonio branch from border areas and from Mexico itself; this probably reflects Mexican fears of further peso depreciation more than an actual decline in activity so far.

On the national front, I have no unique insights to offer. Risk and liquidity premiums have declined since October 15 but remain high. Financial markets around the world continue to be vulnerable. There have been arguments on both sides of the policy question. I guess where I come out is that the fire department has only a limited amount of water to deliver to a fire. It is better to get there earlier rather than later. [Laughter]

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. Thank you, Mr. Chairman. The New England economy continues to perform quite well, but growth is slowing and uncertainty seems to occupy a larger proportion of anecdotal conversations. Nonetheless, at least for some areas of New England, notably Greater Boston, some slowing could be welcome if it increases commercial vacancy rates, if it stabilizes or slows the growth in home prices and apartment rents, if it puts a brake on medical cost increases, and if it adds a little more breathing room to the labor markets.

It is not quite a tale of two cities. But with international and financial uncertainty hitting some firms and others hampered only by their inability to get workers, one can get a very different picture of New England depending on where the data originate and whom one talks to. New England labor markets remain quite tight, with employment growth slower than the nation's but a bit faster than historical levels, and unemployment rates well below the national average. Employment growth varies considerably by industry. Construction, tourism, finance, insurance, and real estate employment are growing at solid rates, while manufacturing employment has declined in six of the last seven months. Gillette, Raytheon, and Pratt and Whitney have

announced layoffs as have a number of smaller firms. These layoffs appear to be very closely related to the spreading ripples of the Asian situation.

Retail contacts, as well as those in a wide range of high-tech businesses, report difficulties in attracting and retaining workers even for seasonal jobs, and firms have reported slowing growth due to a lack of new employees. This at least partially reflects a reversal in the growth of the region's labor force due to a decline in the participation rate and a decrease in net in-migration from other states. There is, however, no translation that we can see from the arguably tighter-than-average labor market in New England to generally higher wages than those paid in the nation as a whole, except in certain industries.

The Boston CPI rose by 2.6 percent, a little higher than the national rate, but this difference seems almost totally the result of medical care cost increases, which climbed almost 9 percent over the past year.

As of the second quarter, the region's merchandise exports were 3 percent below a year earlier, but almost all of this decline was concentrated in Asian markets. Consumer and business confidence, while still positive, reflects the possibility of reduced growth in spending and economic activity. Most of this involves readings of future expectations, however, with both consumers and businesses positive about the current picture but uncertain about the future. Financial market volatility clearly has played a role in heightening the levels of uncertainty. Some continue to see this period as simply a swing back from the very low spreads of the summer, while others are concerned that liquidity is not back to normal levels and that funding constraints could hamper future economic growth. But here again the story varies quite a lot depending on whom you speak to.

Money managers are worried, to say the least, but small businesses continue to report a great deal of competition among banks for their business. Some bankers believe that the supervisory message of concern about REIT and other real estate lending is really affecting their business, as no New England banker who survived the regulatory travails of the early 1990s wants to go down that road again. On the other hand, a major real estate developer told me recently "the markets have saved us from ourselves." Clearly, speculative real estate deals throughout the region are now on hold, a welcome sign given the speculative excess that preceded the early 1990s recession.

Commercial and industrial lending shows little in the way of slowing, however. Based on data from the three large banks in the region, C&I loan growth has reached nearly double the pace of the nation's in recent weeks, with some tightening of standards at one institution but none at the other two. Clearly, First District banks have helped to pick up the slack from the tightening of bond markets, particularly as it affected non-investment-grade borrowers. In sum, while conditions by industry are mixed and the various states and cities in the region have their own particular stories, the New England economy continues to grow and thrive--perhaps at a slower pace--not unlike the national picture.

Turning to the nation, we agree with the Greenbook that the economy seems poised to make a transition to a lower growth path. Job growth is slowing; consumer sentiment is off a bit but still at a rather high level; the personal saving rate may not remain negative; and business fixed investment should slow given the rise in wages and lower, if not negative, profit margins. We agree that an inventory correction probably looms ahead, but the size of the correction projected in the Greenbook and its suddenness seem to us a little large. We also believe equity

prices may flatten or fall, given the profit picture, and that this will feed back to consumer spending as families feel less wealthy.

However, when we take all these factors together, our forecast puts us about at potential for the fourth quarter and for 1999, albeit with a lower unemployment rate than the Greenbook and some uptick in core CPI even without the additional 25 basis point ease that is incorporated in the Greenbook forecast. We do not think this is a particularly bad outcome. We think it is not inconsistent with the rebound in equity prices, the reduction in risk spreads, and the current strength in motor vehicle sales, durable goods orders, and retail sales. In fact, there is some risk that growth in the near term could be stronger, particularly if the stock market increases hold, consumer spending remains healthy, inventory accumulation in the third quarter turns out to be more intended than unintended, and financial panic dissipates as it now seems to be doing. In that event, we might see a good deal stronger picture in 1999 than we project.

We do admit that there are downside risks. Equity prices could fall further than either we or the Greenbook project. Various aspects of the external environment could turn more sharply negative, particularly in Brazil and Japan. The financial panic could resume. Consumers and businesses could retrench to a greater degree than now seems likely. Moreover, it also seems that financial markets remain fragile, at least for the near term. There is some widespread expectation that we will ease either now or at our next meeting to address that fragility. However, I believe we do not want to go all the way back to the conditions in the credit market that existed earlier this year. Those were no more healthy than the current degree or the previous degree of fragility.

I think we face a delicate balance given the rebound on the equity side and given the strength in consumer spending, at least in the short run. So, in that regard I believe that vigilance, which has served us well for most of this year, may continue to be the answer now.

CHAIRMAN GREENSPAN. President Guynn.

MR. GUYNN. Thank you, Mr. Chairman. Signs of moderation or at least a leveling off in the rate of growth have begun to emerge in our District also. While some of that can be traced to international developments, perhaps more reflects a pause or a respite in a maturing expansion. People clearly are being more cautious in their spending and lending. I am hearing economic activity described as good, or very good, or pretty strong as compared with the extraordinary adjectives that we were hearing a few months ago.

Reflecting the moderation that I referred to, retail sales increases in our region have been more modest recently and inventories have risen slightly. Our most recent manufacturing survey and industry contacts indicate that factory production, new orders, and employment have increased only modestly. At the same time, strength in our tourism and hospitality industry continues to help stabilize the regional economy; and despite the short-term adverse impacts of Hurricane Georges, bookings are strong and theme parks are expected to be packed over the Christmas holidays.

To be sure, there are pockets of special difficulties in our region. For example, regional steelmakers have recently announced layoffs and are seeing inventories build. Someone remarked recently that steel has gone from just-in-time inventory management to just-put-it-over-there. [Laughter] We are also seeing some definite indications that housing may have peaked in our area, and there is evidence that the very strong commercial real estate sector has begun to soften. In South Florida, there are concerns that weakness in South America and Asia

may begin to have a significant impact on tourism, but we have not seen that in any meaningful way yet. Hardest hit in our region have been the pulp and paper, forest products, and energy sectors. Lower oil and gas prices have discouraged drilling, and the rig count is now the lowest that it has been in three years. Finally, despite continuing tight labor markets, employers still seem to be resisting wage increases, and we continue to get fragmentary reports that labor shortages have delayed the expansion plans of some firms.

We made a special effort to determine what, if anything, we could detect about prospective corporate investment spending plans and found that the evidence is mixed. Some firms are cutting back, some are being more cautious, and some are simply continuing to expand. Our manufacturing survey outlook index for capital expenditures declined nearly 3 percentage points, yet we found numerous examples of firms continuing their investment plans. In general, we learned that cutbacks are being planned exactly where one would expect, in the traded goods area that is being adversely affected by international problems, while expansion is continuing in service industries and domestically oriented production.

We also, like others, made some attempts to assess whether there has been significant change in the availability and terms of credit. Reports that we get from talking to lenders indicate that the credit adjustments seem to have been dictated by prudence rather than a pulling out of lending markets. The one area where funding seems to have dried up has been in REIT lending for development in the Southeast. Overall, I would not characterize these financial market developments in our area as a credit crunch. By contrast, our people on the ground in Latin America continue to come home with reports of severe contractions in lending, including trade loans, in that part of the world.

On the national front, I'm a bit more optimistic about the pace of growth in the period ahead than is the Greenbook. Certainly, recent data suggest that the U.S. economy has considerable resiliency and remains relatively strong, perhaps stronger than many of us anticipated. Looking beyond the near term, I agree that a slowdown, but a gradual one, seems to be in the offing. While employment has softened a little, early pessimism for holiday sales seems to be abating. While we certainly see some slowing in investment spending, especially in the goods-producing sector, it is my sense that spending on productivity-enhancing equipment will continue to be strong and that those businesses in the service area and those producing primarily for domestic markets will continue to invest.

In hindsight, our intermeeting policy move was timely, and financial markets, as everyone else has observed, appear to have calmed considerably. The adjustments that have taken place in lending standards and terms are probably a good thing. Echoing President Minehan's comment, the rationing of credit for real estate development in markets that had become a bit frothy should help damp the boom/bust cycles that we have seen so many times in that industry. In the spirit of letting markets adjust, we should also be comfortable to let equity markets adjust to underlying fundamentals.

Clearly, we remain vulnerable to further international shocks. The more I learn about Japan, the more I realize that a big turnaround there is not likely to come very soon. As the part of the country that is most closely attached to Latin America, I clearly understand how unsettled things are there. We have enjoyed a number of weeks now without a big, bad development or revelation, and it is difficult to judge just how fragile our economic psyche is at the moment.

All that said, with acknowledgement of the downside risks, it seems to me that we are in a period where we can afford to be a bit cautious and patient and let things play out. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Thank you, Mr. Chairman. As is usually the case, conditions in our District are partly like those in the Eighth District but especially like those in the Seventh District with regard to motor vehicles and so on. One big difference that I had failed to note, until a director pointed it out to me a couple of Saturdays ago, was the sudden, dramatic plunge in consumer confidence when Ohio State lost to Michigan. [Laughter] I assume that there was an offset in East Lansing.

One director at a recent meeting argued that we are suffering from a severe shortage of people. Our problem in the region is that we cannot fill up the hotels, the motels, the shopping malls--although they are pretty packed--the houses, and the office buildings that are being built because there just are not enough people. One major homebuilder in southwest Ohio and northern Kentucky said that 1999 will be the best year ever. Builders tell us that taxpayer-financed construction in 1999 will exceed that of 1988 if they can find the workers needed to build all of it. So, we need a strategy for the region to get more people to do the work and to fill up all these places. About the only things that we seem to be able to build and fill readily are the prisons. I am tempted to suggest that we go down to Texas to try to recruit some people there, but I am skeptical about how effective that effort would be. That's because the head of the construction trades union on our board told us that the scarcity of labor is so severe that construction workers are complaining that they're not getting their usual time off for deer hunting. So, I'm not sure we can recruit the workers that we need.

In conversations with directors and advisory councils since the last meeting, references to the notion of a credit crunch or credit crisis came up frequently. A common comment was that they were mystified in that what they understood was going on in global capital markets simply didn't apply to their customers. Some bankers said that they had looked hard for financial strains. They figured that would give them an opportunity to deploy some of their excess liquidity more profitably than in the past, but they were not able to find such opportunities. Business loans are still being made at fixed rates of 7 and 7½ percent for up to 15 years and no personal guarantees. One banker reported a deal with a 10-year maturity at a fixed rate of less than 7 percent. There are complaints that the competition is still bidding down the pricing on loans to medium and small businesses. It is not an issue for them of having survived a credit crunch; it simply did not happen.

There is a disparity in the outlook in that the communities and the businesses tied to steel in particular are in a very gloomy mood and say that 1999 is not going to be that great a year. If anything, we are going to see more plant closings and more layoffs in businesses related to metals. Agriculture is also suffering some strains. There are record crop volumes, but that has not fully offset the depressed prices.

In retail, there is a nervous optimism. The malls are packed now, but retailers are worried that it will not last. Bankers and others are trying to draw a connection between the stock market and consumer optimism, but they seem to want to have the causality going both ways. I really don't know what to make of that. One banker, an active member of our community bank advisory council, said that an indication of consumer optimism is that 80 percent or more of the ballot initiatives in the region passed. He said he thinks that when the voters approve anything for bond financing or tax increases, they must be feeling good. One

banker believes an indication of trouble is that a chain of 16 pawnbrokers is reporting record traffic. Maybe people are just hocking things so they can buy more Asian goods; I don't know. Labor turnover continues to be a problem in the retail industry. Frequently mentioned are rising starting wages, overall compensation, and of course the poor quality of the people who apply for jobs.

Some bankers in the area have reported that a withdrawal of the Japanese lenders has allowed them to increase margins and gain back some lost customers. One regional bank was telling us that loan demand bounced back dramatically and was surprisingly strong in the third quarter and will probably be even stronger in the fourth quarter. We had a meeting with the senior credit officers of eight of the largest banking companies in the area and asked them about their policies. They said that, having received letters from the Board and the OCC about tightening credit standards, they felt more reluctant in the course of putting the largest amount of loans on their books in a very long time. At least they had their attitudes right, because they all smiled about it! One banker contends that the jolt, as he puts it, to the capital markets was very much needed and has brought back realistic pricing for risk in his view.

Auto production, as Mike Moskow reported, is very strong. All the auto communities are very buoyant. Heavy truck production is not only operating at high levels, but the order backlog going into 1999 is reported to be at historically high levels. In contrast, makers of construction and agricultural equipment are telling us that orders recently have been falling off sharply and production will be lower next year.

On the national economy, I want to say a few words about money and monetary policy and the conjecture that what we have seen in terms of some of the monetary aggregates--notably mutual fund balances, money market balances, and various types of savings balances--is related

to the stock market. Saying that the behavior of money just reflects a decline in velocity is, of course, tautological; it doesn't help us to understand the causality. Any statement about velocity is a statement about the demand for money. If it had anything to do with increased uncertainty related to the capital markets and the stock market, then we would expect the rise in velocity to be reversed at some point in the context of a decline in the broad money measures. Earlier in the decade when we saw no growth in broad money measures like M2 and M3, I reached a comfort level with that because other measures were growing very rapidly. Usually when we have these explanations about depositors, whether it is households or others that are shifting their behavior, there are disparate movements of the various narrower and broader measures of money and credit. This time we are not seeing that. What we are seeing is that the monetary base adjusted for sweep accounts, MZM, M2, M3, total bank credit--all of these measures--have simultaneously been increasing very dramatically. I think this is an issue in search of an explanation that can let us feel comfortable with what we can see going on and that will leave us unconcerned about the implications down the road. But I'm concerned about the implications down the road. I think there's at least a risk that we're going to see that monetary growth showing up in ways, whether it's in the asset markets or in the goods markets, that we are not going to be happy about.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. As far as the Ninth District economy is concerned, there has been no appreciable change in recent months. Labor markets remain very tight. If anything, they have tightened further because we are getting the normal increase in seasonal part-time demand for workers. Consumer spending has been strong and that appears to be continuing. My unscientific survey of mall parking lots suggests that they are operating close

to capacity, or in some cases even beyond. Construction remains strong. Banks are seeing strong loan demand in part, no doubt, because other investors and lenders have disengaged to some extent. My impression is that bankers are both willing and able to accommodate the demand that they are seeing.

Less favorably, conditions in both manufacturing and mining are mixed, depending on their exposure internationally, and agriculture has problems of one degree or another throughout much of the District largely as a consequence of both crises. If you're looking for change in our District, you have to look to the governor's office in Minnesota! [Laughter]

As far as the national economy is concerned, I would use the phrase "broadly acceptable" to describe what is going on. I am referring to recent developments and conditions in the economy and the outlook, as I see it, for both economic growth and inflation. I certainly would say that recent trends in financial markets are broadly acceptable, and better than I might have guessed a month ago, or certainly six or seven weeks ago. No doubt part of this is due to the policy changes we made, and there is now a danger of overreacting to the last six or seven weeks of readings on these various things. But taking a step back, all this reminds me of something that I think we have known for a while, and that is that our economy is fundamentally very resilient. I believe that is what we are seeing.

CHAIRMAN GREENSPAN. Governor Rivlin.

MS. RIVLIN. I think the evidence is accumulating that the real U.S. economy is run by a bunch of cheerful little elves [laughter] who do not like forecasters. Every so often they get together and say, "Okay, guys, if we work real hard, maybe we can surprise them again." But don't knock the elves; they've been doing quite a good job for most of the 1990s and we have all benefited. The U.S. domestic economy has certainly shown heartening resilience in the face of

global downdrafts in the last year and particularly in the last three months, much as it showed resilience and adaptability to upward pressures and threats of overheating in the previous couple of years. Consumers are spending cheerfully, buying houses and cars and maintaining a fairly robust outlook on their situation. In their role as small investors, some of the same people are reinforcing their own optimism by continuing to buy stocks in companies whose near-term earnings prospects would not seem to justify their purchase.

Elsewhere in the economy, the effects of the world slowdown are evident. Agricultural prices and exports are suffering. Manufacturing is feeling the difficulty, laying off some people, and beginning to pull back on expansion plans. Investors are still wary of any risky venture despite some melting of the frozen capital markets of a few weeks ago.

The elves have to do their job and we have to do ours. I believe that most of the signs point, as the Greenbook indicates, to a substantial slowing of the U.S. economy as we go into 1999. We have an extraordinary responsibility to make sure that the U.S. economy, as the linchpin of the global economic system, does not slow too much. That is why I believe we should take the downside risks very seriously and reinforce our last two easing steps by taking one more today. If we did not have the world depending on us, we could afford to wait and see whether we have done enough already. But the world still looks very fragile to me, and whether we like it or not, the U.S. economy is carrying a heavy load in the world's recovery. Asia is barely turning up, if it is. Russia is a total disaster. Western European countries seem quite myopic in their preoccupation with their own affairs, but they are revising their forecasts down. Latin America, as we have discussed, seems extremely fragile; there is hope but by no means a certainty of staving off disaster in Brazil and another round of contagion. So, it does seem to me that we have to worry a lot about that.

On the other side, I see little downside domestic risk in worrying too much about our responsibilities to the world. Inflation is not a near-term threat, although we may see some wage increases. The stock market is clearly a concern; we might encourage investors too much. But I still believe, experience notwithstanding, that rationality will reassert itself in the stock market as earnings fall. So, I think we have a close question today, and it may be a comforting thought that we cannot do a lot of harm. On balance, I see the risks on the downside, especially internationally, and feel that we have a special responsibility to take them very seriously.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Business conditions in the Philadelphia region have been steady overall, but there is a continuing weakness in manufacturing. Looking ahead, business contacts expect some slight improvement in economic activity going into next year, but there is a cautious tone to this forecast. In the interest of moving the meeting along, I will skip the District details.

Clearly, the national economy is currently showing a lot of resiliency, given the turmoil in financial markets. Perhaps the economy will escape major damage and continue to move forward at a healthy clip. The most likely outlook, however, is for a slowing of growth for the reasons already given, particularly the international ones. In short, the risks are on the downside. With inflationary pressures subdued, we have the flexibility to take out some additional insurance against excessive weakness in demand.

Financial markets have improved from their earlier unstable condition, but they are not yet back to normal. We need to continue to facilitate a return to normalcy. Financial markets currently are like a sick person who feels better after taking antibiotics for a few days but still needs to stay on medication to avoid a relapse and to aid a return to good health. In short, in

both the real sector and the financial markets, we have downside risks that, in my judgment, need to be counteracted.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Thank you, Mr. Chairman. Let me say a few things about the Tenth District. The regional economy is still growing moderately. There are some signs of slowing in the data and in some of the anecdotal reports from business contacts, but the degree to which growth is slowing is not at all apparent. Employment growth continues to be steady in our District, although it is slightly behind the national economy. Manufacturing activity, as others have reported for their regions, is slowing in our District as well. Our factory survey in October was flat. On the other hand, retail sales are generally good across the District, and some of our retailers have indicated that they are anticipating a very strong holiday shopping season. The construction sector remains generally strong. Some builders are reporting an easing of activity but one of our largest construction firms, which is active in both the Midwest and the Pacific Northwest, indicates that some of this has been due to the REIT activity that others have talked about; the firm feels that reaction probably has been very healthy in terms of stanching some of the excess that they thought was building in their markets. Energy activity remains weak, obviously due to the low oil and gas prices and the uncertainty there. Our agricultural sector has tended to stabilize a little; although prices are still low, they have stabilized and crop production has been good. There has been a recent infusion of funds by the Congress, but my contacts in both ag and the ag banking sector assure me that next year certainly will be a disaster. Despite signs of slowing, the District labor markets are still very tight. More than half of our Beigebook and business contacts are talking about raising wages more than what they consider normal. Still, we have not seen the effect on prices in the District at all.

On the national front, our outlook and the Greenbook are quite different in terms of the projections for the next five to six quarters, with the Greenbook showing a much sharper deceleration in growth than we are projecting. Beginning with slower growth in the fourth quarter, the Greenbook has five quarters of below-trend growth whereas we have growth in line with trend or slightly below. As a result, we have a less favorable inflation outlook, although we do not anticipate that inflation will be a substantial problem.

We think the risks are more balanced than they were at the time of the last meeting. We believe that the financial markets are more stable and are pricing more realistically. We think domestic demand is remaining fairly stable, and it could actually be stronger depending on the stock market and other factors because, as others have reported, consumer confidence is relatively high. On the downside, manufacturing could slow more than we're expecting, especially given the international uncertainty. But on balance, we think that it would be prudent, given that there are only five weeks to the next meeting, to wait and watch in this intermeeting period.

CHAIRMAN GREENSPAN. Vice Chair.

VICE CHAIRMAN MCDONOUGH. Thank you, Mr. Chairman. The Second District economy is slowing. The manufacturing sector in northern New Jersey and western New York is participating in the general slowing of manufacturing nationally and the growth in the service sector is not sufficient to make up for it. The housing area is also somewhat weaker. Commercial construction is slowing, largely because of restricted availability of credit. Retail sales were weak in September and bounced back some in October and early November.

Nationally, I believe that the Greenbook has it about right. Like the Greenbook, we see economic growth well below trend in 1999, with recovery to something more like trend

growth in 2000. Inflation is clearly well controlled. We think that the weakness in fixed income markets, although somewhat reduced, is still a potentially serious risk to the real economy. When we look at the likely pressure on the banking sector, it is worth remembering that about 25 percent of C&I loans come from the money center banks and about another 25 percent come from foreign banks operating in the United States. Both the money center banks and the foreign banks are dependent, just as their commercial customers are, on purchased money. We believe that year-end pressure on the money center banks, which they are very concerned about and already are seeing, could well exacerbate the problem in fixed income markets. Certainly, the pressure that the money center banks will face will be more than that experienced by the foreign banks.

Consequently, I think there is a possibility, not a probability but a distinct possibility, that the month of December could be a particularly difficult one and that the problems in the financial sector could mean that Main Street, which has been holding up very resiliently as many have pointed out, will be adversely affected. Therefore, I believe that the risk coming from the domestic economy and the considerable risk coming from the foreign sector indicate that the Greenbook forecast, whose growth in 1999 I would not find adequate, is more likely than not the better of the cases that we can expect. Thus, the downside risk is still very considerable and points to the need for some additional action on our part. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Governor Ferguson.

MR. FERGUSON. Thank you, Mr. Chairman. As we have already heard, there are significant and reasonable scenarios on both sides of this discussion. On the one hand, we can believe that the most recent strength in the real economy will abate, but just slightly, and that the economy that has surprised us on the upside time and again will continue to do so. In this

reality, labor and households reign supreme. GDP growth comes in for a soft landing without further help from monetary policy. After all, one might say, in the third quarter the economy grew at an annual rate of 3.3 percent. Household spending is still growing about 4 percent. This strong growth is fueled by jobs--as some have indicated, labor markets are still tight--and wage and salary growth, and credit.

In the optimistic scenario, financial markets are described as fragile but recovering. The stock market continues to defy reasonable analysis and gives added impetus to consumer spending, and possibly to capital spending. Most importantly in this optimistic scenario, Asia already has turned the corner and Brazil avoids the worst outcomes due to timely international intervention.

For me this picture is very, very attractive, but I'm afraid that it reflects only a limited reality. I believe that growth due to labor and household consumption, which underpins the most positive scenario, is limited. Job creation does seem to have slowed considerably of late. Secondly, I note that last quarter's GDP growth was heavily fueled by inventories, which seems unlikely to repeat. Finally, in what I describe as the more pessimistic scenario, there is a great focus on capital and capital investment. Business fixed investment fell in the last quarter at about a 1 percent annual rate, which I think is the first decline of that magnitude since 1990 or 1991; BFI admittedly was retarded by nonresidential construction, but even investment in producers' durable equipment barely budged.

More disturbingly, anecdotal and survey evidence suggests that capital spending plans for many firms have been revised downward. This slowdown reflects a realization that profits may not be as robust as in the past. Internal cash flow will not be as strong. As others have indicated, financial markets are still uncertain. In any event, businesses may decide they do not

need to add to their capital budgets because inventories are adequate and export orders are lagging. It is this that I think brings the Greenbook home. So, in this pessimistic scenario, one would say financial markets have not yet returned to normal liquidity and risk spreads, and stock market evaluations will soon catch up with the much changed profit outlook.

Finally, the pessimistic scenario involves international concerns that have been alluded to by others. Japan, obviously the largest economy in Asia, continues to be mired in recession. Brazil's economic performance is likely to be weak. I am concerned that its ability to defend against devaluation, were that to be necessary, is limited given its reserve position. Finally, as others have indicated, China may not prove to be as strong as the current official numbers support or suggest.

So, we have these two scenarios. The question is which one we believe. If we believe the optimistic one, obviously monetary policy is probably properly positioned now. On the other hand, while it is not at all a certainty, for my money the more pessimistic scenario does seem all too possible. If the domestic and international components of this scenario do come to pass, the consequences for the U.S. economy are dire. The good news in some ways is that we do not have to choose between these scenarios today. Fortunately, by most measures, inflation is subdued and likely to stay so. Just as limitations in pricing limit corporate spending, they also limit the risk of inflation. Therefore, as I think at least one other person has said, we can afford to buy some insurance at this time. I think the premiums are manageable. I think the risks of not buying some insurance are just too great for my taste. Thank you.

CHAIRMAN GREENSPAN. Governor Gramlich.

MR. GRAMLICH. Thank you, Mr. Chairman. While the most extreme manifestations of the credit crunch have abated, risk spreads are still high, and the real federal

funds rate is still high also. I think the period of the credit crunch is not entirely behind us. I like Ed Boehne's metaphor on that: It's probably a little too soon to go off the medication.

On the forecast, I have no complaints with the Greenbook. The numbers show that final sales already have gone down to below trend, and the Greenbook forecast has the GDP falling below trend. I think we all recognize it, but let me repeat that that is with an assumed further cut in the federal funds rate. Even then, there is a fairly prolonged period where GDP is below trend, with unemployment rising above 5 percent.

There are not as many risks on the downside this time around, partly because of actions that we already have taken. But I think there are still two. One is the stock market. Even though the Greenbook forecast does program in some decline in the stock market, it is not that great a decline and it could be more significant if the likely effects of the earnings forecasts come to pass. The second is the foreign troubles, about which we have talked a lot. Karen Johnson gave the pessimistic Brazil forecast a significant probability; as I remember it was 30 percent or so. If we look at that forecast, we do have a fairly soft GDP situation.

On the inflation side, I am beginning to feel as if I am in the audience of the play, Waiting for Godot. We have had steady unemployment at below 5 percent for seven quarters now, and the signs of acceleration of inflation still are not much more visible now than they were then. I don't know what is going on here; it is possible that the natural rate model should be amended, and it is possible that 5½ percent is the wrong estimate of the NAIRU. I don't know what the latter is, but I think the paucity of signs of accelerating inflation this long into a period of unemployment under 5 percent is really quite striking.

We rarely discuss fiscal policy at these meetings. In fact, I don't think I have ever heard it discussed. But let me bring that up because there is increasing talk in Washington of

dealing with a recession, if it comes, either on the spending side by having some more spending or on the tax cut side. My view of what macro textbooks used to call the assignment problem in an era of flexible exchange rates is that the proper role of monetary policy should be to stabilize the economy and the proper role of fiscal policy should be to worry about the overall national saving rate, which is very low in this country and should not be lowered still further by expansionary fiscal policy. At this point, I will switch to Bob McTeer's analogy and say that the right course is for us to keep control of the firetrucks.

My last point is that one very clear advantage of monetary policy is its flexibility. It strikes me that things are still a little soft. I would still like to see a little more adjustment, through the "use of water" in Bob's analogy. This may prove not to be the right thing to do, but if it proves not to be right, we can observe that and act accordingly. So, I believe the flexibility of monetary policy gives us a degree of freedom here, and I would like to see us use it. Thank you.

CHAIRMAN GREENSPAN. Governor Meyer.

MR. MEYER. Thank you, Mr. Chairman. Let me start off by focusing on what I think has changed and what has remained the same in the outlook since the last meeting and particularly since the intermeeting move. First, the second half looks stronger, with growth at or above trend. This reflects both the surprise in third-quarter GDP and the general resilience in the spending data. Second, I think the forecast going forward has been bolstered by depreciation of the dollar and particularly since our intermeeting move by the resurgence in equity prices and some relaxation in financial stress. Third, the announcement of the Brazil package and some other developments in the international realm have added at least a bit of optimism that the worse case scenario for global turmoil might be avoided.

What has remained the same? I think the general answer is the qualitative forecast going forward. It still appears that growth will be clearly below trend next year, though some modest upward revision along the lines of the Greenbook forecast appears justified. It still appears that inflation will remain well contained. And it still appears that downside risks predominate though perhaps less so than before. I think the main difference is that there is renewed appreciation of some upside risk going forward.

Why so little change in the forecast? First, I think the upward revision to the third quarter was concentrated so heavily in inventory investment that it is more likely to be reversed than extrapolated going forward. Second, the rebound in equity prices appears to be incompatible with a forecast of slowing growth and declining profits, and therefore it also is likely to be reversed going forward. Third, while the depreciation of the dollar is certainly a positive, its effect is offset by some further slowdown in foreign growth, as in the Greenbook forecast. Finally, while the financial stress has been partially unwound, financial conditions, at least outside of equity markets, have nevertheless significantly deteriorated since July.

Here is how I would characterize the broad qualitative features of the outlook. First, private domestic demand appears to have decelerated to about a 4 percent growth rate in the second half from the 8 percent rate in the first half, returning to its average rate over the previous two years. This is very consistent with the gravity story that I told earlier. A further slowing in private domestic demand, as in the Greenbook forecast, toward roughly a trend rate over 1999 looks plausible. This partly reflects a diminished stimulus from the wealth effect, assuming equity prices do not rise further, and it reflects, in addition, the effect of the recent deterioration in financial conditions along with the projected further correction in equity prices. This spreads the effects of global turmoil from the external to the domestic sector. Given the slowdown in

private domestic demand, even the slower rate of decline in net exports over 1999 is enough to push overall growth below trend. The slowdown is reinforced over the next couple of quarters by a reduction in inventory investment from its unsustainable third-quarter pace. I think it is also reasonable to anticipate that growth will rebound to about trend in the year 2000.

I would put my best guess of growth next year just a shade higher than in the Greenbook forecast, but I would also take into account the still asymmetric downside risk that I see to that baseline in setting monetary policy. I'm a little less optimistic about the course of nominal wage change and a bit more concerned about the size and inflationary effect of the depreciation of the dollar than is the Greenbook, but I still believe inflation will be well contained.

I think what we do at this meeting is a close call. But were we to move one more time, which I would support, it would seem to me that that would bring to a conclusion the cumulative adjustment in monetary policy that seems appropriate in light of the discrete change in the outlook that has occurred. We should find some way to perhaps signal that as well. Thank you.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Thank you, Mr. Chairman. I will bat cleanup here. The fundamental worldview of hawks and doves is always evolving, but I do think that both of those birds are alive and well. To oversimplify, a hawk's view of policy today might well be that, with the U.S. economy strong and the world's financial structure shaky, our policy should be to insure that our financial system remains a rock-solid anchor to windward. That is the best thing that we can do to help both the world and ourselves, hence a bias toward firmness. A dove's focus might be on the U.S. economy as the engine whose forward drive is essential to the world's stability and

recovery, and U.S. policy should insure that that engine stays in high gear, hence a bias toward ease.

I find much that is appealing in both of these arguments and I don't want to have to choose one path over the other. Fortunately, if we stay focused on the same mission that we have pursued for so long--namely, seeking maximum sustainable growth fostered by price level stability--I think we can reasonably seek both of those objectives, and the best policy, as before, still lies there.

How do we identify that policy path? As always, that comes from assessing the risks and trying to determine how strong they are and where the balance lies. I believe the balance of risks has migrated to the downside, particularly as it relates to the likely timing of potential shocks. To be sure, upside risks remain and could readily resume their dominance of only just a few months ago. First of all, of course, our primary concern for many quarters now is still with us. Economic activity is still very strong, labor markets are still very tight, and that means that inflation is still a major potential threat. But I believe that that scenario is of diminished probability for all of the reasons with which we are familiar. The good news timing-wise is that if we should see that scenario evolving, its latent risks should materialize slowly enough for us to have time to counter them if need be.

I worry more today about the potential for very serious mischief that could arise in the stock market if it should boom to new highs. That could put us in severe jeopardy of a crash that could bring down a great deal more of the world and, indeed, our own economy with it. My hope is that, as a slowing economy results in declining corporate earnings, this market will self-correct in an orderly way. However, a real crash has too high a probability to give me much comfort, and easier policy may heighten the chances of a plunge in the market.

The downside risks seem to be growing and, perhaps of even more importance, could burgeon much more quickly, perhaps severely and without much warning. The international risks, we know, certainly have those characteristics. There could well be others yet to unfold in this dynamic environment. That the U.S. economy is slowing seems to be a growing probability. While that may be desirable within limits, once a downward trend gains momentum, it is hard to know how far and fast it may go and what it might take to arrest a decline if that becomes necessary. In today's world, I think that is a more than usually important factor.

I do think we should keep a wary eye on deflation. There are some signs that its impetus may be slowing, but in the context of an increasingly sluggish U.S. economy, if that is what should ensue, it could become a real danger.

To sum up, Mr. Chairman, I do not believe that we are behind the curve, but I do believe that the ground is shifting. Perhaps we need to shift a bit more with it. I see little reason to wait as any upside risk would likely emerge rather slowly over time, whereas the existing downside risks could appear suddenly and soon. The respective time frames are quite asymmetric. My mother used to say "a stitch in time saves nine." We have taken two so far, and three might do it.

CHAIRMAN GREENSPAN. Thank you very much. We now can move on to David Lindsey.

MR. LINDSEY. Thank you, Mr. Chairman. The Committee's choice today would seem to boil down to standing pat or easing by another 25 basis points. The Committee's last two easing actions were of a preemptive nature, taken to ward off undesirable economic weakness prospectively, as opposed to being based on softer economic data already in hand. The economic data received since the last FOMC meeting, while somewhat mixed, would not necessarily alter that perspective. That is, they continue to paint a picture of satisfactory real growth looking backward, turning into a significant slowing in the future. The inflation outlook is little changed. In

the staff forecast, credit market stresses gradually unwind further in coming quarters, but conditions do not return to their earlier lax state, while stock prices move back down, damping spending. Financial problems are not predicted to intensify in Latin America.

Because resources gradually return to a more sustainable utilization rate while the rise in inflation is limited, the Committee could well find the staff forecast to be an acceptable outcome. The Committee also could consider the forecast to be plausible as a point estimate. Ironically, the staff forecast can be read as providing support for either standing pat or for easing slightly at this meeting. The Greenbook forecast assumes one more quarter point of policy ease later this year. Easing now simply would move forward the staff's assumed action by a little more than a month, while standing pat to await further information on the impact of previous policy easings could still accord with deferring an easing until the next meeting as assumed in the staff forecast. Of course, these two courses of action would presumably have basically indistinguishable macroeconomic effects, assuming no disproportionate differential impact on financial markets. For that matter, the outlook presumably would not be altered greatly if there were no further quarter point easing at all, again absent an unusually adverse financial market reaction. Instead, the Committee's decision today would seem to hinge, as many have pointed out already, on its assessment of where the forecast could go wrong--that is, on where the most important risks to the forecast may reside.

In the present circumstances, several areas of possible downside surprises come to mind, and they could provide a rationale for the quarter point easing of alternative A. Despite the support package put together for Brazil, that country, as well as others in Latin America, could be further affected by financial contagion, as Karen has noted. Closer to home, potentially sizable further losses could be felt by key banks and other players in our financial markets. Also, the projected decline in corporate profits could foster a greater stock market correction than the staff has built into its forecasts of consumption and investment spending.

The still tender state of other securities markets means that the reversal of extreme risk aversion since the mid-October policy easing is still incomplete and somewhat tentative. This condition has raised the concern in some market circles that a decision not to ease today could be enough of a disappointment to market participants to spark a short-circuiting of the recovery in risk spreads and trading conditions. This concern has lost some force with the recent scaling back of expectations of Fed easing. The probability of easing at this meeting built into fed funds futures quotes has receded from more than two-thirds two weeks ago to somewhat better than even odds as of yesterday, in part because financial market stresses have

continued to unwind on balance. Even so, as the Bluebook discussion suggested, not easing today probably would induce some immediate widening of risk spreads, as private rates back up more than rates on Treasuries, especially those "on the run." Some increase in liquidity premiums, and shrinkage in trading volumes, also could be expected to occur right away. But on the assumption that markets still will perceive the Federal Reserve as closely monitoring financial developments and prepared to ease again if necessary to head off any reversion to extremely unsettled conditions, the adverse market reaction is likely to be essentially limited in scope and duration.

Another, perhaps related, concern that might add support to alternative A has to do with the likelihood of unusually severe year-end financing pressures, especially for borrowing institutions not viewed as being of top-notch credit quality. Already some commercial banks have reported restricting their interbank lending to certain domestic institutions and to Japanese and, to a lesser extent, European counterparties generally. As Peter noted, banks also have tended to shorten the maturity of their interbank loans to overnight. In the commercial paper market, contracts extending over the turn of the year now embody a substantial interest rate premium. Although a policy easing may not appreciably affect the extent of year-end-related increases in rates on loans and securities in the money market, at a minimum it would lower the base interest rate levels on which those pressures would operate, muting some of the adverse effects on credit costs for affected parties.

A phenomenon likely to be longer lasting is the firming of conditions on bank loans to nonfinancial borrowers. A large share of commercial bank respondents to the November Senior Loan Officer Opinion Survey reported tightening standards and terms for C&I loans to large- and middle-market businesses and for commercial real estate loans. Evidence also surfaced in that survey of some, though less pronounced, firming of standards and terms for small businesses. And large commercial banks on balance have seen an appreciable rise in their costs of funds in capital markets. The staff does not foresee much further deterioration of credit availability through banks, but the Committee may consider this possibility as a nontrivial risk to the economic outlook. Certainly, the episode of the early 1990s vividly demonstrated that a credit crunch can involve the banking sector and that aggressive easing can be a necessary monetary policy response. However, I think some important differences between that earlier episode and the present situation suggest that this credit influence could easily be overstated in today's context. Banks then were partly motivated to restrict their lending by impaired capital positions that needed rebuilding. Today, banks are generally much better capitalized. Then, actual loan growth was quite sluggish, while today it has been rapid. And, finally, then the growth of the

broad monetary aggregates was anemic. Now, although admittedly the velocity of M2 has been dropping since mid-1997, the quite rapid growth of this aggregate, especially of late, is at least worth a passing mention.

The strong growth of the monetary aggregates, including M3, may be suggestive of upside risks more broadly to the staff forecast, emphasis on which would enhance the attractiveness of alternative B. Even with an unchanged funds rate, financing conditions may normalize more promptly than in the staff forecast. Moreover, the possibility that a policy easing could spur a further run-up of equity prices--in contrast to the Greenbook forecast of a decline--that could combine with the recent rebound in consumer confidence to impart added impetus to spending, may strengthen the case for staying the Fed's hand at this meeting. Also, in light of the support package for Brazil and the recent narrowing of Brady spreads, the global financial crisis may mend more rapidly than we can reasonably assume now. For these and other reasons, the extent of the output slowdown that is predicted by the staff is not a foregone conclusion. Finally, the stronger-than-expected third-quarter employment cost index against the backdrop of still tight labor markets may be viewed as highlighting the risk of higher inflation. If the Committee places much weight on these considerations, it may wish to adopt a "wait-and-see" posture--standing pat until more actual evidence of a slowing economy shows itself.

But given the staff's prediction that such a slowdown is impending, if the Committee chooses not to act today, it may still wish to maintain an asymmetric tilt toward ease. The Committee also may want to keep the tilt toward ease if it does decide to ease. Alternatively, it may judge that a prompt further easing would bring the risks to the economic outlook into balance. If so, the Committee may decide not to go on record as suggesting that further decreases in the funds rate are an especially likely prospect.

Mr. Chairman, that concludes my briefing.

CHAIRMAN GREENSPAN. Thank you. Questions for David? If not, let me get started. This is a more difficult call than that at the last meeting. There is very little question that there has been considerable easing in a number of the areas where we are concerned. The one area where things have eased regrettably more than I would have liked is the stock market. In a certain sense that has created a major question in my judgment as to whether we should move. If the Dow Jones industrial average were 200 to 300 points lower, I think the case for

moving one additional time and then putting policy on indefinite hold would be fairly strong for a number of the reasons that have already been discussed today, as well as additional ones that I would like to raise. I do not think that inflation has become a problem; if anything, it is the reverse. I do think the concerns about an asset bubble are not without validity, and that is where I have my greatest concerns about easing.

Let me first, however, address the inflation issue. The crucial question we have to ask ourselves is how we should measure inflation. If we look at the core CPI, it has clearly accelerated in the last year or so and at the moment is running in the area of somewhat under a 2½ percent annual rate. In contrast, the core PCE has been decelerating fairly dramatically and depending on whether we are using 3-month, 6-month, or 12-month rolling averages, the increase is barely more than 1 percent. More than half of the difference in these measures of core inflation reflects the difference in the weights for housing. As you know, owners' equivalent rent is over 20 percent of the CPI and total housing is close to 30 percent, as I recall. In the PCE, they are about half that. The difference occurs to a substantial extent as a consequence of two elements. First, the weight in the CPI is based on individuals' views of the potential rental value of the houses in which they live. In the PCE, it is derived from more detailed macro data. Second, the scope of the PCE is much broader in that it covers a much wider area of consumer expenditures and obviously, other things equal that would lower the weight for housing in the PCE. So even though the actual price changes for housing and owners' equivalent rent are close in both the PCE and the CPI, the mere difference in the weights and the fact that housing costs are rising faster than average has created a very dramatic widening in the spread between CPI core inflation and PCE core inflation, which now is 1½ percentage points.

I seriously question whether housing should be a component of any measure of underlying inflation. I don't want to get too involved in this, but I think all the other measures that we are looking at--the PPI, the intermediate prices, the commodity prices, the data from the purchasing managers--are all suggesting, in my judgment, that the inflation rate is still falling. To put it another way, the real funds rate is rising.

When we look at the unit cost structure for nonfinancial corporations, which I have discussed on numerous occasions before, we get a similar story. Average hourly compensation for that sector, and that measure is more relevant than the ECI for the analysis of unit costs, has accelerated somewhat but so has output per hour for nonfinancial corporations. The consequence is that unit labor costs have been rising at a rate of less than 1½ percent in recent quarters and total unit costs, which include declining unit nonlabor costs, have been increasing at a shade above 1 percent. With corporate prices generally stable, this implies a decline in profit margins. Indeed, the profit margin for the nonfinancial corporate sector has been declining over the past year.

The importance of these data, as best I can judge, is that they suggest underlying inflationary forces are continuing to recede despite the tightness in labor markets. I would point out that there is very little evidence that those markets are tightening further at this time, but I also would not want to argue that we are seeing any significant labor market easing. The measure that I have found most useful recently in measuring the degree of labor market tightness, the sum of those who are unemployed and those who are not in the labor force but would like a job, fell quite rapidly from 1995 through 1997 but stabilized at the beginning of this year and since then has moved hardly at all. In addition, the diffusion indexes in the payroll

employment series are clearly falling very sharply, suggesting that the recent slowdown has been widespread across industries.

In any event, it is the case that the price pressures and the wage pressures are not behaving the way they have in the past under comparable circumstances. Something different is going on. It is this overall downward pressure, which I think is coming to a great extent from international forces, that clearly has undercut to a substantial extent the pricing power of manufacturing industries. As you know, these prices have been weakening quite measurably in recent months.

I think the pressure on profit margins is beginning to affect capital investment. Many of the company executives to whom I speak and much of the secondary information that I pick up from a number of different company sources clearly indicate that there is a scaling back of capital appropriations. It is not very large as yet, but obviously something is very gradually exerting downward pressure. The underlying diminished growth, which I think is fundamentally being caused by the squeeze on margins, has not yet shown up in the consumer areas, as best I can judge. Consumer markets continue to be strong, and the wealth effect has not yet had a measurable damping effect. Motor vehicle sales, which were sharply higher in October largely because of incentives, have eased some this month, as Mike Moskow indicated. Officials from the auto companies whom we talked to the other day all suggested that sales are running below expectations, but I think their expectations are probably quite high. Having said all that, I think the likelihood that consumer spending will continue to grow rapidly is somewhat questionable. We do have a continued high level of housing sales; I see no real evidence that they are deteriorating, but there also is no evidence of a pickup. There has been some backing up of inventories.

There also is the broad and very important question of the financial issues. It certainly is the case that yield spreads and risk aversion, which had been quite substantial through October and have eased quite measurably in the last several weeks, have stopped easing. In fact, there actually has been some minor upturn, especially on commercial paper, and I have run into the same issues that Bill McDonough has raised with respect to year-end effects. I think we are beginning to see some potential year-end effects emerging in the banking area. To be sure, the weakening in the availability of funds in the capital markets has spilled over into the commercial banking sector, and we have seen a very dramatic acceleration of C&I and other lending generally. A number of banks are quite unhappy about having to accommodate this additional loan demand largely because, as you know, they have backup lines on commercial paper that were issued and priced on the assumption that the lines would never be used. If you speak to banks, especially the money center banks, it is by no means clear that they are eager to accommodate the spillover in loan demand from the capital markets. As a consequence, I think the presumption that we are going to see a gradual return to full and fluid capital markets is only a hope at this stage and a hope that I don't think is about to materialize very quickly.

I must say that the risks in the Brazil situation are significant. The meeting that occurred yesterday in New York seemed to suggest that the American banks were going to be helpful in stabilizing Brazil's funding. Having spoken to a number of them fairly recently, I have the impression that each will participate only if everyone else does. At the first sign that that will not be the case, they will back off. I judge the risks here at close to 50/50, maybe a little less. I'm a shade less optimistic than Karen Johnson on this, but I grant that conditions have improved from where they were. Three weeks ago, I would have said that the Brazilian situation was really dangerous. Since then it has improved to close to 50/50 in my view, but it strikes me

that maintaining the Brazilian exchange rate is going to be very difficult. An exchange rate that is under pressure from 40 or 30 percent interest rates, capital account deficits, and programs that are presumably very good on the fiscal side suggests that something is not right. I am a little concerned that we have not yet seen the worst of this.

I agree with Mike Kelley on how one evaluates all of this. If we move rates down and we are wrong, it will be very easy to move them back up. With the inflation rates where they are and the real funds rate where it is, the question is more an issue of where the rate should be rather than whether it should be going up or down. As best I can judge, the funds rate that appears to be appropriate in current circumstances, with all the risks we have talked about, is closer to 4¾ percent than it is to 5 percent. My judgment at this stage--and I grant you that it is not a clear-cut call in all respects--is that if we hold steady at this time and things begin to deteriorate and we then move the funds rate down, we would look as though we are behind the curve and are reacting to events, and that could create a very unfavorable atmosphere in the marketplace. I see very little risk in moving down another 25 basis points today, provided we indicate that we are on hold. I think the clear thing to do at this point is to move down and go symmetric, largely because the economy is in fact doing reasonably well. The extent of deterioration is modest. I believe we are moving to a slower path of economic growth and a potentially less inflationary environment, but there could be a far more deleterious outcome ahead and I agree with many of you that a little insurance at this stage is probably wise. The cost of the insurance is very small, and I suspect it is probably not a bad thing at this stage to take out the insurance but then to stop at that point, stay on hold, and watch events as they materialize over the weeks and possibly even months ahead. At that point, we would be poised to move

rates lower if necessary, but there is no obvious need in my judgment to be assuming such a move at this time. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Thank you, Mr. Chairman. I agree fully and rather enthusiastically with your recommendation. One might wonder why those of us who have talked about year-end pressures would find symmetry appropriate. The reason I do is that if we have severe year-end pressures and have to react, the need would be so obvious that there would not be a whole lot of debate. I am hopeful that that will not be necessary. Therefore, I think symmetry is the right answer.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mr. Chairman, I agree with you that this is a tough call but let me just get the other point of view on the table. As I see it after listening to all of this, there are two principal arguments for easing policy today. One is the downside risks in the economy, the possibility that the actual outcome will be weaker than the Greenbook projection. The other is the need to act to prevent a reemergence of the extreme risk aversion of a few weeks ago. I just respectfully do not believe that either of those two arguments is very compelling today. They may be compelling a few weeks down the road but not today. It seems to me that recent developments and a lot that we have heard around the table this morning suggest that growth may decelerate to trend rather than below trend as in the Greenbook.

On the other point, it seems to me that the financial system is adjusting, as a number of people have said, and working reasonably well. In a situation like this, there is always a tremendous bias and pressure on the Fed to do something. But I would point out that we are already doing something even if we don't reduce the funds rate today. Just given the way we

operate, we are providing additional liquidity to meet the additional demand for it and at a 50 basis point lower price than that liquidity was being provided just a few weeks ago.

One other point I would make is that I see some risk in moving today because it is always difficult to tighten monetary policy. With all respect, I think it might be difficult to change our policy course and it might be hard to do it as quickly as we would like. Given all of that, I would have a strong preference for alternative B.

CHAIRMAN GREENSPAN. Governor Ferguson.

MR. FERGUSON. Mr. Chairman, I support both halves of your recommendation. I believe that we have achieved much of our goals from the two earlier policy easings. Credit market conditions have improved but are probably not normal. Just to follow up on what President Broaddus had to say, some may ask why we should not wait until December, given the possibility of further improvement. My answer to that question is that if we do not take this opportunity to complete our work, we risk losing the advantage that we have now. I am concerned that if we do not act, the markets may return to their very disturbed state of a few weeks ago. That would then require us to adjust policy, perhaps by larger amounts and perhaps again in an intermeeting move. If contrary to my expectation, the easing proves to be premature, I do think we can undo it. I believe the move to symmetry is an important internal signal that we are prepared to go either way if the facts so indicate. That is why I support symmetry as well.

Finally, as you have pointed out, given the direction of inflation, we perhaps have tightened passively. The tightening was appropriate earlier in the year, but I am now in favor of the proposed easing and moving to symmetry.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. As I noted in my earlier comments, after a difficult balancing process in thinking about this, I came to this meeting clearly in favor of waiting to see what happens for the rest of this quarter and considering a possible move in December. I have listened very carefully to all of the arguments. I do believe that we face some risks that relate to the ebullience in the stock market and the feedback from rising levels of stock market prices into consumer confidence and spending. Sooner or later, that is going to come to a halt. I think we are all in agreement on that. The prospects for profit margins just are not where they were earlier in this cycle. Sooner or later, reason is going to prevail. Governor Kelley's comments earlier on that topic were right along the line of my thinking. If the stock market does not go a whole lot higher, we are better off than if it does because eventually the rise will come to a halt and the overall impact on the economy will be worse at that time. So, I think that is one of the risks we face if we move at a time when a lot of the basic signals from the domestic economy, the real economy, are showing resilience if not strength, which almost everybody has commented on.

I also think that almost everything that has happened since our last monetary policy move--the intermeeting ease that I think was extremely well done in the sense of getting the markets to function better than they were--has been on the positive side. It seems a little strange at this point to be thinking about a further easing of policy against a lot of the positive developments, although all of them involve a significant degree of downside risk. I see a process where easing now creates a risk in the short term that things could get a little beyond us. Whereas over the longer term, if the slowdown in the expansion occurs and if financial conditions turn more negative than we expect, we might see more of a downward ratcheting of the economy than if we had not moved.

Those are my basic concerns. My thinking is more in line with that of President Broaddus, but I am not going to dissent because I think it's a close call. The people who are closer to the markets than I are worried about year-end financing and overall fragility and uncertainty, and I know that has been factored into your thinking as well, Mr. Chairman. There is something to be listened to there, so I will support your proposal to ease, but I am nervous about it.

CHAIRMAN GREENSPAN. Governor Meyer.

MR. MEYER. Thank you, Mr. Chairman. It seems to me that we have been playing catch-up to a discrete change in the outlook. The question today is whether we have caught up, and if not, whether we should complete the likely further move sooner rather than later. It is clear from the discussion around the table today that it is a close call. On balance, my judgment is that another quarter point move would complete what I think would be an appropriate adjustment to the discrete change in the outlook. Because the slowdown is projected to be around the corner, a case can be made that the additional easing should be sooner rather than later. These considerations lead me to support your recommendation, Mr. Chairman, to cut the funds rate a quarter point today and return to a symmetric directive. The move to a symmetric directive signals the pause that I believe is in order after the move and highlights the possibility that the move may have completed an appropriate response to the change in the outlook.

CHAIRMAN GREENSPAN. Governor Gramlich.

MR. GRAMLICH. Mr. Chairman, I support your recommendation of both the 25 basis point cut and the move to a symmetric directive. I don't have much to add to the discussion, but I would like to emphasize the point that it is important for us to stay ahead of the game, and I think this does it.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I support your recommendation. In the interest of time, I associate myself with the remarks of Governor Ferguson.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Mr. Chairman, as I mentioned in my comments, I think the risks clearly are on the downside. I agree with others that this is a close call. Coming into the meeting I agonized over this, but I came to the conclusion that we are either going to move now or in December. It is difficult to imagine that real growth in 1999 is going to reignite to any unsustainable rate, but it is relatively easy to imagine scenarios where growth is going to slow abruptly. So, I felt that we definitely would move at one of these two meetings, and therefore we might as well do it now. I don't see any reason to wait. Inflationary pressures appear to be modest. There is an opportunity to balance the risks now by lowering the funds rate by 25 basis points. When I add in the Brazil risk, which I am very concerned about, I agree completely with your recommendation on both counts, for a 25 basis point reduction and a symmetrical directive.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I would prefer to leave the funds rate unchanged at the present time for a couple of reasons. First, despite the forecast to the contrary, the economy continued to show some strength in the third quarter, and the few available monthly data that we have for the current quarter indicate solid growth. Second, I believe that the chance of a recession or major slowdown in the economy in the quarters ahead has been significantly reduced by recent financial developments, including the two federal funds rate cuts. I recognize that prospects for our economy could change rather suddenly given the continuing vulnerability of our financial markets and of many foreign economies. While this could require another

change in policy in the near future, I would prefer to retain the 5 percent funds rate for now along with the asymmetry toward easing.

CHAIRMAN GREENSPAN. Governor Rivlin.

MS. RIVLIN. Mr. Chairman, I support both parts of your recommendation. In the interest of lunch, I will not elaborate.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Me, too! [Laughter]

CHAIRMAN GREENSPAN. President Poole.

MR. POOLE. Mr. Chairman, I will support your recommendation, but with considerable reluctance. I think this is another example where immediate disclosure of our decision on symmetry would be very useful to us in terms of providing a signal to the markets. I fear that the markets will interpret this adjustment as another in a string of easing actions yet to come. I would hope that along the way in coming weeks, when the time seems appropriate and the market tone seems acceptable, you could indicate to the market that it looks as if our easing is finished for the time being, whatever is the right way to do that. I think this is a case where disclosure would help the Committee.

I am concerned that we are pouring gasoline rather than water onto this economy. The fact that the growth of money is unexplained is not a great comfort to me. It would help if we could explain what is going on by pointing to some statistical anomalies, to some institutional changes, to money going abroad, or to whatever, but the fact is we cannot come up with any good explanation. I fear we may be pouring a great deal of liquidity into an economy that is bound to be slowing anyway for the reasons that I talked about earlier. The economy currently is

fully employed, its growth rate needs to be a little slower, and therefore I am not at all concerned about the forecast of slower growth. If it comes true, that is going to be very good news.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Mr. Chairman, I have a mild preference for alternative B for two reasons. First, I consider the case for alternative A far from overwhelming. Secondly, I think there is something to be said at this stage for patience, not necessarily for patience's sake but because the next meeting is only five weeks away and because we want to make sure that any action we take will be consistent with our long-run objectives.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. For the reasons that several people have stated, I think it would be better to wait.

CHAIRMAN GREENSPAN. President Guynn.

MR. GUYNN. Mr. Chairman, although I understand your arguments, I too would be most comfortable with no policy change today. Respecting the clock, I will not repeat the arguments that Presidents Broaddus and Minehan made. I want to underscore the point that President Poole made, wishing that we had had our discussion about an early announcement so that we could tell the world that a symmetric directive is in place. Thank you.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, for reasons that others have cited, my preference would be to wait. I think President Poole said it best, that we could be pouring gasoline on this economy. I have concerns that a bubble economy syndrome may be building. I believe it was in place before the more recent events, and I think it may again come into being as a factor. You mentioned the stock market, and that gives me real pause.

However, like others, I am not going to dissent for several of the reasons that they gave. One, the point you made, is that I do not see inflation as an immediate threat. Secondly, I understand the international circumstances that we face; I'm not sure this easing move is going to make a whole lot of difference to those circumstances, but we will see. Thirdly, I might hold others to their statement that if this easing does prove to be more than we need, we will be firm in our resolve to move back if that is called for.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I unequivocally support your recommendation, but I must say that I have a lot of sympathy with the views of those who would prefer to maintain a steady policy.

CHAIRMAN GREENSPAN. Okay, I think we have a majority for "A" symmetric, 25 basis points.

MR. BERNARD. I have a question, Mr. Chairman, regarding the final sentence.

CHAIRMAN GREENSPAN. David Lindsey, we are still using the old directive. Do we still want to use the word "moderation"?

MR. BERNARD. "Moderate" instead of "some moderation"?

MR. LINDSEY. No, I would stick with the language we have been using, "some moderation." That is the staff forecast for coming months.

MR. JORDAN. Less immoderate? [Laughter]

MR. BERNARD. The directive language is: "In the implementation of policy for the immediate future, the Committee seeks conditions in reserve markets consistent with decreasing the federal funds rate to an average of around 4 $\frac{3}{4}$ percent. 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, a slightly higher federal funds rate or a slightly lower federal funds rate would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with some moderation in growth in M2 and M3 over coming months."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Ferguson	Yes
Governor Gramlich	Yes
President Hoenig	Yes
President Jordan	No
Governor Kelley	Yes
Governor Meyer	Yes
President Minehan	Yes
President Poole	Yes
Governor Rivlin	Yes

CHAIRMAN GREENSPAN. I put together some words just in case we needed a press release. I tried to suggest that we have gone as far as we are going to go. Let me just read it to you quickly. "Although conditions in financial markets have settled down materially since mid-October, unusual strains remain. With the 75 basis point decline in the federal funds rate since September, financial conditions can reasonably be expected to be consistent with fostering sustained economic expansion while keeping inflationary pressures subdued." That is Fed language for symmetric.

The next meeting is on December 22. The Federal Reserve Board should retire to my office and make a decision on the discount rate. Afterward, we will go directly to lunch.

END OF MEETING