

Meeting of the Federal Open Market Committee
February 2-3, 1993

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, February 2, 1993, at 2:30 p.m. and was continued on Wednesday, February 3, 1993, at 9:00 a.m.

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

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

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

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly,¹ General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

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

Mr. McDonough, Manager of the System Open Market Account
Ms. Greene,² Deputy Manager for Foreign Operations
Ms. Lovett,² Deputy Manager for Domestic Operations

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Assistant Director, Division of Monetary Affairs, Board of Governors

1. Attended Wednesday session only.
2. Attended Tuesday session only.

Mr. Brady,³ Section Chief, Division of Monetary Affairs,
Board of Governors
Mr. Rosine,³ Senior Economist, Division of Research and
Statistics, Board of Governors
Mr. Wiles,⁴ Secretary of the Board, Office of the
Secretary, Board of Governors
Mr. Winn, Assistant to the Board, Office of Board Members,
Board of Governors
Ms. Werneke,⁴ Special Assistant to the Board, Office of
Board Members, Board of Governors
Mr. Siciliano,⁴ Special Assistant to the General Counsel,
Legal Division, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of
Monetary Affairs, Board of Governors

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

Mr. McNees, Vice President, Federal Reserve Bank of Boston
Mr. Gavin, Assistant Vice President, Federal Reserve Bank of
Cleveland
Mr. Weber, Senior Research Officer, Federal Reserve Bank of
Minneapolis
Ms. Meulendyke, Manager, Open Market Operations, Federal
Reserve Bank of New York

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3. Attended portion of meeting relating to the Committee's discussion of the economic outlook and its longer-run objectives for monetary and debt aggregates.
 4. Attended portion of the meeting relating to the release of FOMC information to the public.

Transcript of Federal Open Market Committee Meeting of
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February 2, 1993--Afternoon Session

CHAIRMAN GREENSPAN. Even though I have no legal authority at the moment, I call the meeting to order. Governor Mullins has no legal authority but he'll be Chairman pro tem.

MR. MULLINS. It's my honor to nominate Chairman Greenspan as Chairman of the FOMC for the coming year.

MR. LAWARE. I second the nomination.

MR. MULLINS. Are there other nominations? Without objection. I also have the great honor of nominating President Corrigan as Vice Chairman of the FOMC for as long as he may be with us and his successor thereafter for the year ending December '93. Without objection, you're now legal.

MR. ANGELL. You mean an unnamed successor? What does that do to Jerry's confidence?

VICE CHAIRMAN CORRIGAN. I'm not worried.

MR. MULLINS. Well, you're legal.

CHAIRMAN GREENSPAN. I'm legal. We now have the issue of the staff officers, and I'll request that Norm read the list.

MR. BERNARD.

Secretary and Economist, Donald L. Kohn;
Deputy Secretary, Normand R. V. Bernard;
Assistant Secretary, Joseph R. Coyne;
Assistant Secretary, Gary P. Gillum;
General Counsel, J. Virgil Mattingly;
Deputy General Counsel, Ernest T. Patrikis;
Economist, Michael J. Prell;
Economist, Edwin M. Truman.

Associate Economists from the Board of Governors:

David E. Lindsey;
Larry J. Promisel;
Charles J. Siegman;
Thomas D. Simpson; and
Lawrence Slifman.

Associate Economists from the Federal Reserve Banks:

Richard G. Davis, proposed by President Corrigan;
Richard W. Lang, proposed by President Boehne;
Arthur J. Rolnick, proposed by President Stern;
Harvey Rosenblum, proposed by President McTeer; and
Karl A. Scheld, proposed by President Keehn.

CHAIRMAN GREENSPAN. Unless there are objections, I will assume that the Committee accepts this slate of officers. The next item on our organizational agenda is the selection of the New York Bank as the Bank to execute transactions for the System Open Market

Account. Unless there are objections from the Committee, I will assume that that also is authorized.

The next item on our agenda is the selection of the Manager of the System Open Market Account, the Deputy Manager for Domestic Operations, and the Deputy Manager for Foreign Operations. Our respective incumbents in these jobs, as you well know, are William J. McDonough, Joan E. Lovett, and Margaret L. Greene. Unless I hear objections, I will assume that the Committee authorizes another term for all of them.

The next item is a review of the Authorization for Domestic Open Market Operations, which I believe was circulated to the members of the Committee. Unless somebody has any questions relevant to it, I will assume that the authorization is reaffirmed. [Secretary's note: No objections were heard with regard to any of the above items.]

Mr. Truman will now take us to our next agenda item, which is a review of several matters relevant to the foreign [side].

MR. TRUMAN. Mr. Chairman, there are four items to consider: the Foreign Currency Authorization, the Foreign Currency Directive, the Procedural Instructions, and the related agreement to warehouse foreign currencies for the United States Treasury. There is a technical change proposed for the Foreign Currency Authorization and the Procedural Instructions concerning the change of the structure of the management of the System Open Market Account and the new positions of Manager and Deputy Managers. I will be glad to answer any questions.

CHAIRMAN GREENSPAN. Would you like to say a few words on the Gonzalez letter relating to the purchases of the Mexican peso?

MR. TRUMAN. We thought that the Committee ought to be aware of the fact that Congressman Gonzalez in one of his January 19th letters raised a number of somewhat garbled questions about the swap network, foreign currency operations, and in particular the purchases of the Mexican peso, all of which have been done in connection with swap operations completely covered by foreign operations. He asked us to provide material to him covering the history of these arrangements going back to the beginning of time or pretty close to it--1962. We are in the process of doing that. Almost all of what we're going to provide involves documents that are already in the public record in the form of the Managers' reports and excerpts from the FOMC policy records with regard to the Mexican swap arrangements and how they have evolved since 1967.

CHAIRMAN GREENSPAN. Unless there is an objection, the vote that we will now have would amend the Foreign Currency Authorization and the two additional documents indicated by Ted only with respect to the updating of the managers' titles. Would somebody like to move [their approval]?

MR. KELLEY. So moved, Mr. Chairman.

CHAIRMAN GREENSPAN. Is there a second?

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. Without objection. The next item is the [report on the] examination of the System Open Market Account, which has been circulated. Unless there is a question or an objection, I will assume that that also is accepted.

Having worked our way through the organizational items with seeming tranquility, we now get to the less interesting part of our meeting and I will ask somebody to move approval of the minutes of the December 22nd meeting.

VICE CHAIRMAN CORRIGAN. Move it.

MR. SYRON. Second.

CHAIRMAN GREENSPAN. Without objection. Gretchen, would you present the foreign currency operations [report]?

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

CHAIRMAN GREENSPAN. Questions for Gretchen?

MR. FORRESTAL. Mr. Chairman, this is perhaps a question more for you. Do we have any idea at this point what the attitude of the Administration is with respect to intervention?

CHAIRMAN GREENSPAN. No, but I've been having some preliminary discussions with Larry Summers on precisely that question, and I should think we will get some judgments reasonably quickly as to what set of principles they would like to be supportive of. I've suggested that we develop those principles jointly and, hopefully, that will be initiated sooner rather than later. In fact, I just discussed it with him this morning.

MR. JORDAN. I was monitoring the Call from the November meeting through year-end. As the news unfolded about the [domestic] economy being stronger than before versus Europe and versus the rest of the world, I had no sense on a day-to-day basis that we were positioned [correctly] for the environment we're going into. If you didn't have the inherited position, would you wish to have a larger position in foreign currencies or different currencies or a smaller position? Do you feel you're positioned with the right portfolio for this environment?

MS. GREENE. Are you talking about the portfolio of the Federal Reserve and the Treasury?

MR. JORDAN. Yes.

MR. MCDONOUGH. Gretchen has done that remarkable thing, which is to flip the ball upward. Most of our reserves are in marks and yen, and those are certainly the two currencies that I think one would want the reserves to be in. We hold for the two monetary authorities approximately \$40 billion in total reserves now, which would impress me as at about the upper end of the reserves that one would consider appropriate. What I'm less certain about is what the lower end of that is because I do subscribe to the view that on the day when we need them we surely don't want to have to pass the hat and

go get them. We have a few remnants of reserves from the past in sterling and Swiss francs. I would think, as we move forward in our discussions with the Treasury, that we might wish to concentrate on the reserves of the two most useful currencies [for intervention purposes]. If one starts with the notion that reserves are good to have, which I do, I don't think the present level of our reserves is too high. But I think it is at about the upper limit of what we would need.

MR. TRUMAN. I might comment that we don't always position our holdings as if we were maximizing the [return] in our portfolio in a short-run sense. That's not the way the Domestic Desk runs its operations. If you were a private citizen, you might choose something else.

MR. JORDAN. If I could follow-up on that comment: I suppose the analysis as to whether we had the right amount or not would be quite different on the domestic portfolio than it would be on the foreign currency portfolio--assets denominated in foreign currencies. You would not make the same after-the-fact judgment about whether we had the right amount or not.

MR. TRUMAN. I think you're right in what you're referring to, but I think the ex-post analysis would be equally difficult since we don't really know until we've liquidated [our position].

CHAIRMAN GREENSPAN. Any other questions? If not, let's move to the domestic open market operations and Mr. McDonough.

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

CHAIRMAN GREENSPAN. Do you have any sense as to how market participants are viewing the size of the proposed short-term stimulus package and its impact on intermediate- and long-term rates?

MR. MCDONOUGH. The growing feeling, prior to Secretary Bentsen's using the number \$30 billion, had been that the likely size of the package would be in the \$15 to \$20 billion range. And I think that was very thoroughly discounted and was being explained as about the minimum the new President could get away with given the campaign promises. When [the figure] gets up to about \$30 billion--and certainly anything beyond that--I'd say the market has not prepared itself for a fiscal package of that size. Therefore, when it gets beyond, say, \$25 billion, I think it could create something of a backup, especially in intermediate rates. However, this will all be done against a background of what degree of credibility there is in longer-term deficit reduction. So, the larger the number in the short term, the more convincing the package for longer-term deficit reduction is going to have to be. But it still will be looked at as a package with a desire--not necessarily on the part of the Street firms but we think, [based on] what they say, of the ultimate investors--to believe that there may be a fiscal breakthrough. There seems to be a desire to believe as [investors] start moving out the yield curve and picking up more duration that they will pick up more yield. It's a rather emotional climate that can be easily dissatisfied. But it's sitting there waiting to be satisfied. That is how I read it now.

CHAIRMAN GREENSPAN. Other questions for Bill? Tom Melzer.

MR. MELZER. Bill, do you have any sense of what the market is discounting on the mix of this refunding package? Is there an expectation of a significant reduction in the [size of the] bond [issue]?

MR. McDONOUGH. Until last Friday when the word came out of Roger Altman's comments on the McLaughlin show, which was aired Sunday, I think there was a feeling that the 30-year bond could be reduced in size to, say, as low as \$8 billion. After Altman said what he did, my guess is that the number has crept back up and that people think the reduction, if any, will be more nominal. If I had to pick a number now, I'd say they probably assume it will be \$9 billion or a fraction more.

CHAIRMAN GREENSPAN. Further questions for Bill? If not, would somebody like to move to ratify the transactions?

VICE CHAIRMAN CORRIGAN. So moved.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Thank you very much. We now move on to Messrs. Prell, Slifman, and Truman and the Chart Show.

MR. PRELL. Thank you, Mr. Chairman. I'll give you a second to locate the chart package that was put in front of you.

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

CHAIRMAN GREENSPAN. Questions for our colleagues?

MR. SYRON. Mike, you touched on this. What are you inclined to think--I guess not terribly much--about these arguments on the composition of inventories? I've seen things about work-in-process inventories having declined more than inventories at the wholesale and retail levels.

MR. PRELL. Well, there are longer-term movements one can observe. I think manufacturers have made particular progress over time in reducing materials and work-in-process. But basically our assessment is that inventories are probably at comfortable to lean levels at this point. Retailers reported stronger-than-expected sales coming out of the Christmas season, which suggests their inventories probably are in good shape. And manufacturers' inventories would seem quite likely to be rather lean in light of the volume of shipments reported in December.

MR. SYRON. The increase you have in inventories is not focused in any one sector particularly?

MR. PRELL. Not really. As I've said, we don't have a large increase. We just perceive that with sales seemingly on a clearly upward path, [business firms] are going to want to stay closer to that trend in their [inventory] stocking. Even so, as we indicated, we

still allowed for some downward tilt in the inventory/sales ratio. While the arithmetic of the current quarter is such that it looks like inventories are a significant story, looking at the broader picture we don't really see that as a key driver in the forecast.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Ted, what assumptions have you made in regard to the international trade process including GATT and the likelihood of dumping and possibly increased protectionism that might be forthcoming?

MR. TRUMAN. Well, as far as NAFTA is concerned, we are assuming that it will be passed and put into force; if it isn't, that would be a negative factor on our forecast coming through Mexico. As far as the Uruguay rounds are concerned, we have made no assumptions because we convinced ourselves that in the 1993-94 period it is irrelevant, if I can put it that way, in terms of its trade expansion impact. That's not to say, though, that the failure of the Uruguay rounds in some form, or rather the wrong kind of failure, couldn't be a disaster looking out a little further. As far as other trade measures are concerned, we have not taken explicit account of those-- maybe we should have--partly because of our feeling that developments like this steel dumping and so forth and so on, although they are politically sensitive in both the domestic and international dimensions, are not sufficiently important quantitatively to have a major macro-economic influence on the forecast. The other reason is that, while there is considerable scope for those kinds of actions, they have long time tables on them. And most other forms of action are precluded by international agreement, so there are some constraints. So, we could have further dumping cases; but if they were all filed tomorrow, we wouldn't get them implemented until late in the year, so that would have a relatively small--

MR. ANGELL. But in the steel cases do we not [impose] the necessity of posting bond so that already in the February--

MR. TRUMAN. But the total amount of trade imports that are affected by that is \$3 billion.

MR. ANGELL. I understand. But do you think any modification of pricing behavior would be likely in this kind of environment?

MR. TRUMAN. There is considerable dispute on that point. I've noticed articles in the newspapers and some commentary from President Keehn, based on his contacts in the market, that the producers are looking forward to this \$3 billion, which is a non-trivial increase in sales, and the opportunity to raise prices behind those dumping markets. On the other hand, the economists' argument is that there are a lot of other producers in this world and quite a lot of competition around the margin from other U.S. industries. That would suggest that the [prospects] of steel prices going up by the 15 or 20 percent average margins being plotted here are pretty unlikely. In any case, in thinking about all this there are enough uncertainties that we decided not to take explicit account of it.

MR. ANGELL. Thank you.

MR. KEEHN. I can comment on that, Wayne. The people I talk with say that the dumping suits ought to result in about a 4 million ton change in shipments this year. The production level in the steel industry currently is about 80 percent of capacity. Based on this one change it could go up to, say, 85 percent. And shipments this year as a result could go up to 88 to 89 million tons. In terms of price, there is a proposed price increase for cold roll, hot roll, and coated products [scheduled] for early April, and they expect that increase to stick. This affects about 50 percent of overall steel production and, therefore, the anticipated overall increase in the price of steel is 2 percent for this year.

MR. ANGELL. Thank you. That's very helpful. It's about what I would have expected.

CHAIRMAN GREENSPAN. It actually sounds much larger than I would have expected. You said 4 million tons?

MR. KEEHN. Yes, as a consequence of this change and the change that took place late last year, imports will be down by 4 million [unintelligible] 5 to 6 million tons.

CHAIRMAN GREENSPAN. When I see it, I'll believe! President Stern.

MR. STERN. One of my questions was along the lines of Wayne's on protectionism. My second question relates to this issue of the liquifying of home equity. Do we have evidence that that has an independent effect--independent of the normal wealth effect we might get as home equity rises? Is there something additional there?

MR. SLIFMAN. Well, I think the main [effect] would be on those households that might feel their liquidity is constrained. That is to say, the wealth is there but the [increased] ability of such households to liquify that wealth could boost consumption. The other point is that in the case of turnover of the [housing] stock, some would argue that when capital gains are realized we do see evidence that some of those realized capital gains are not plowed back into the housing industry. One can see that from the mortgage debt data. So we have a feeling that some of [the capital gains] are being used to support consumption. We also note from the refinancing data that a fair amount of cash is being taken out there, too. There is no direct econometric evidence, but other kinds of ancillary information seem to suggest that this is going on.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. How sensitive do you believe job growth is to GDP growth? Suppose we ended up with GDP growth closer to 4 percent than 3 percent. How do you think that would translate into job growth?

MR. PRELL. Well, at this stage we'd probably see a large share of that showing up in employment growth. One is hard pressed at this time to pin down what the productivity trends are. But I think at this stage, given the shedding of labor that has occurred, we'd expect to see a larger proportion show up in actual employment

increases. I'm not sure whether you're talking employment hours versus numbers of workers.

MR. BOEHNE. Numbers.

MR. PRELL. Again, we'd expect it to show up to a greater extent in numbers of workers rather than a lengthening of the workweek.

MR. BOEHNE. That's my question. We see these structural adjustments by the larger firms. However, in talking to people in smaller businesses one gets the impression that there really is a reluctance to add people, for obvious reasons, but that if their volume picked up they more or less would be forced into it.

MR. PRELL. That's the thrust of my remarks. I'm sure there is still some elasticity in many cases and they could [increase production] without adding more workers. But I think we are getting closer to that margin here and, on the presumption that additional growth is demand driven rather than an increase of potential supply, we'd look for additional hiring.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mike, you indicated that the difference between the Blue Chip forecast and the staff forecast of real growth and what has happened to the unemployment rate probably is not a sufficient explanation of the difference in the forecasts with regard to prices. That difference is rather large. Is there any way to know, for example, if they are making different assumptions about food and energy prices that would explain the difference or if they have a different Phillips curve?

MR. PRELL. Well, we're making some inferences here. We don't have any information about [their assumptions for] food or energy prices. But it seems unlikely, given the general tenor of [developments] in those markets, that that would be a major factor. We've been seeing this pattern for some time. At this time in 1992 I think one would have perceived a difference in outlooks. And we feel somewhat vindicated by events, which showed in fact that we could have some decent growth with the disinflation trend continuing. Some of my colleagues have suggested that this pattern is one that could be perceived in private forecasts over a number of years. That is, at this point in a cycle, during the early expansion phase of a recovery, forecasters have tended to expect an acceleration [in inflation]. Our interpretation of history, some of which is visible in the chart, is that that is not an empirical regularity; indeed, with significant slack the tendency is for inflation to slow. It is something of a mystery why we're at odds with so many of these forecasters.

MR. PARRY. Did you say that their forecasts involve a fairly significant increase in nominal interest rates at the short end, in which case they're probably assuming the same real short-term interest rates as in your forecast?

MR. PRELL. Well, to a first approximation that may work here. The Treasury bill rate in the fourth quarter of 1994 in the Blue Chip average is 4-1/2 percent, which is more than a point higher

than our forecast. And there is a similar picture in the inflation [outlook]. So, yes, I think that may come out fairly close.

MR. PARRY. [They are] much more pessimistic.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mike, on productivity growth we had a very gratifying 3 percent in 1992 but, although the expansion continues at more or less the same pace, you are projecting that productivity growth is going to come off rather badly over the forecast period to 1.8 percent and then 1.3 percent. Why?

MR. PRELL. Well, let me emphasize that in a broad historical perspective those numbers don't constitute bad productivity performance. Those numbers are stronger than the trends in recent years and would be above what we would regard as the likely underlying trend at this time. Basically, the typical pattern is that in early phases of recovery we get very large productivity increases as some stretching of the available work force occurs. This time we had a lot of labor shedding and we haven't had even the normal employment gains. And we think this process will only go so far before, harking back to President Boehne's question, [firms] begin to have to add some workers as they expand production. As I noted, there's probably some distance to go in this labor shedding process--not so much for typical cyclical reasons but because there are some large firms who probably have the capital to hang in there for a long time and not make the adjustments they should have made a long time ago in the size of their operations. I think firms like Sears or IBM are going to be shedding workers for a while. That is an ingredient in the process that gives us what we believe to be above-trend productivity increases.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mike, let me piggyback on Ed Boehne's question. If we get a significant upside miss on real GDP, say, to [a growth rate of] 4 percent, what does that do to your inflation projections? Would it make a significant difference?

MR. PRELL. Well, that becomes a difficult question. One, we would expect the unemployment rate, as a first approximation, probably to be 1/2 percentage point lower at the end of a year--

CHAIRMAN GREENSPAN. But doesn't that also depend on what the assumption is on productivity?

MR. PRELL. Indeed, as I noted before, I'm taking this [greater strength] as a surprise that comes more from the demand side. And one does need to specify that to be clear. If it were entirely from productivity performance and we were accommodating, then it would not have any inflationary consequences.

MR. BROADDUS. I'm not thinking about the miss--

MR. PRELL. A 1/2 percentage point lower unemployment rate would give us a shade more inflationary pressure, but it wouldn't show up very much in 1993 given the normal lags in the process. The other risk, though, is what I alluded to before. Growth of 4 percent begins

to be a noticeably faster pace of expansion, where perhaps one needs to worry a bit more about so-called speed effects. And that might intensify the inflationary pressures relative to what I just said. So it could quite possibly be a situation in which there is little, if any, further progress in disinflation in 1993, especially if that growth came early on and we were getting a rapid drop in unemployment.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I was just wondering in the revised green sheets why the nominal GDP for the fourth quarter went down so much?

MR. PRELL. Well, in an accounting sense the implicit deflator came in much lower than we expected. Relative to the fixed weight price index, that was largely a consequence of the behavior of service import prices. This is an artifact of the way they deflate the insurance payments. In fact, we have some information that suggests that all of those price measures may be off by a few tenths due to an error that [BEA] made in their import price measures. But that still would leave a considerably lower number than we were anticipating.

MS. PHILLIPS. So, you think we might hear more on this yet?

MR. PRELL. Well, not on this divergence necessarily, but it's hard to say. If there are vastly different inventory movements or credit movements than they've anticipated, it could alter these numbers significantly.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Al Broaddus asked my question.

CHAIRMAN GREENSPAN. Any further questions?

MR. HOENIG. Just one question on savings. Given some of the demographics you showed here, I'm curious as to why you are expecting the saving rate to stay as low or lower than we might otherwise have thought.

MR. SLIFMAN. Well, it's true, as my other chart shows, that we have this shifting of the baby boomers into peak life cycle saving years and that demographic factor [tends to raise] the saving rate. But, as I suggested, working the other way are economic factors, primarily the fact that net worth positions are a bit stronger and that household perceptions of income and job prospects seem to be improving substantially. Both of those would tend to give you a lower saving rate. Finally, though, there is the statistical question of who knows what the real level [of savings] is anyway!

MR. HOENIG. Then this could be more of a temporary--

MR. SLIFMAN. Yes. It is true that in some longer-run sense, all other things equal, we would expect the demographics to work toward a higher saving rate.

CHAIRMAN GREENSPAN. Any further questions?

MR. ANGELL. Yes, I just want to follow-up. If there's an error in [their estimate of] the deflator, would that be an error in the nominal or in the real?

MR. TRUMAN. Well, the error has to do with the pricing of capital goods imports. They put two large price increases in the fourth quarter through an error. That would feed through to give you a lower increase in the prices of imports, which contracts GDP and gives a slightly higher overall deflator everything else equal.

MR. ANGELL. So then real GDP will go down?

MR. TRUMAN. If we presume that their assumptions about the nominal value of capital goods imports are unchanged, it would increase the real value of capital goods imports and would subtract one or two billion dollars from real GDP in the fourth quarter.

CHAIRMAN GREENSPAN. Are there any reasons to believe otherwise?

MR. TRUMAN. No, but one has to understand that there's a big error band around what they assume. It could be wiped out completely by other changes. That's all I'm trying to say.

MR. PRELL. For one, we don't have the December trade data yet, so anything in this area is open to substantial change. We've received a number of pieces of data since BEA published the fourth quarter, including the durable goods figures and the construction figures. Doing a sort of full accounting, adding up all of these things, we come out very close at this point to our Greenbook estimate of 3.6 percent. So, it isn't a material difference from what BEA has at this point; we'll just have to wait and see what the additional data show.

CHAIRMAN GREENSPAN. Further questions? If not, who would like to start the tour de table? President Broaddus.

MR. BROADDUS. Mr. Chairman, with respect to our District, things are still looking pretty good both currently and prospectively. Economic activity in the region appears to be accelerating moderately. The improvement in residential construction nationally is helping our region quite a bit. Industries like lumber, textiles, furniture, and appliance manufacturers, all of which are [important] industries in the Fifth District and are driven by housing activity, are all doing better. The most striking development in the District, though, is what I would call a markedly greater optimism, pretty much across the board, about the near-term outlook. We see it in our directors' comments and we see it in our various surveys of real estate people, retailers, and manufacturers. Actually, this improvement in optimism has been going on for several months but it strikes us as more pervasive, less tentative, and--as one of our directors put it--deeper than it was before.

One specific sectoral comment may be of interest. We are seeing what we think are pretty clear signs of a turn in the market for office space in some of our local areas, specifically in Washington, Richmond, and Charlotte. Absorption rates are rising; vacancy rates are declining. In particular, large blocks of space--in

excess, say, of 30,000 square feet--are becoming increasingly harder to find, especially in the suburban office malls.

Our forecast is very similar to that in the Greenbook. In fact, it is almost identical for both real GDP and inflation. In that regard, I would point out that we do our forecast differently than does the Board staff. Specifically, we use a small VAR model as the basis for our forecast, judgmentally adjusted, which is quite different from a structural model. The fact that our forecast is close to the Board staff's, given the fact that we do it differently, gives me a little bit of comfort. I would make the point that our VAR model in recent months has done a particularly good job in forecasting the decline in the inflation rate. I think what that means is that our policy of maintaining sufficient monetary restraint has generated improvement on the inflation front. It has been in place long enough to be captured by the data we use in the model. So, our longer-run strategy is working and we are making some progress.

MR. KEEHN. With regard to the national outlook, our forecast has somewhat lower growth than the Greenbook. We don't have any major differences, but our numbers are a little lower across the spectrum of components. For example, our number for personal consumption, is lower. We also have lower business fixed investment, exports, and housing starts. There are more differences in consumer nondurables and services than in durables.

In terms of the District, I think there has been a decided improvement in attitudes about the underlying rate of expansion since the last meeting. The positive retail outlook coming out of what was a strong Christmas held up surprisingly well in January. The Christmas season seemed very strong, particularly in places like Michigan where the Retailers Association reported that over 70 percent of their members experienced sales increases and that attitudes were "generally euphoric." An appliance manufacturer located in Michigan reported a fantastic fourth quarter, the best since 1978. They expect a good sales increase this year--not as strong as last year, but still a good increase. In the auto industry, while the most recent sales data have been a little on the soft side, first-quarter production schedules have been set about 20 percent over last year. And with inventories currently at what seem like quite reasonable levels, the first-quarter production risk doesn't seem that high. I will say, though, that the industry is forecasting--or at least those we talk to--a somewhat higher sales number for the year than we are. The heavy truck business continues to be strong. The industry's incoming order rate is running at an annual level of 165,000 to 175,000 units. That's higher than current production rates, so the order backlog is beginning to lengthen to a delivery [schedule] that the industry is not comfortable with. And if this order rate is sustained, they are likely to add to their production levels.

Attitudes in the steel business understandably have improved considerably since the dumping suits were announced. I've already commented on the price impact that that is likely to have, but they do think that the announced price increases on the products that I mentioned are likely to stick this time. I would point out, however, that the price increases that will result from that are from very, very low levels. Their pricing has been awfully soft for an extended

period. With regard to inflation, the pricing environment continues to be favorable. Very heavy market pressures are holding down price increases. But I will say that this time at least one or two companies did comment about some modest increases in their expectations regarding the cost of their raw materials purchases. The steel price increase is certainly a part of this, but there are some other parts as well. These are not significant shifts in terms of the amount; nonetheless, it's the first time I've heard this in quite a while. Offsetting what I think are pretty good economic reports, almost every company executive that I talk to expects to continue to reduce their employment. Everybody says that they are simply going to produce more this year with fewer people; this has come to be the macho thing to do. And, therefore, while the immediate outlook has improved, the question of sustainability continues to be the key issue. Either employment and disposable income are going to increase to support this higher level of consumption or we're going to see consumption come down a bit. So, while the outlook seems much more balanced than it has been, I do think the risks, given this disposable income issue, continue to be a little on the down side. Thank you.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, the Twelfth District economy remains mixed, but unfortunately there are new signs of weakness in several states. California's employment fell about 1.8 percent in 1992 and the pace of decline has not slackened in recent months. Moreover, the California recession is no longer just a southern California phenomenon. Early last year we saw about 80 percent of the job losses coming from southern California, which is far in excess of that area's relative contribution to employment. More recently, about 60 percent of the job losses are coming from southern California. Other areas such as the Bay Area, the Central Valley, and other parts of California are also reporting losses that are not all that different from that of southern California in percentage terms.

Concern also is rising in Washington state where Boeing cutbacks are threatening to choke off that state's recovery. I would point out that actual employment has been rising rather robustly in recent months in the state of Washington, but Boeing as I'm sure you've all seen--it was actually commented on in the Greenbook--has announced significant cutbacks in planned production beginning in the second half of this year. The specific layoff figures are not yet available but analysts in the region clearly are concerned and are talking about the multiplier effects of any further job cuts. Hawaii's economy may be facing a recession this year. Weak tourism from the mainland, particularly California, is a concern and has been a problem. But a new and larger concern is that rising job insecurity in Japan, which is a very big source of money for Hawaii, could eventually cut into the Japanese visitor count. Lending activity remains very weak in the District, with loans outstanding at large banks in December falling 8.1 percent below the year-ago level.

There are some bright spots in the region, however; we've found one or two! The drought conditions eased dramatically in California and the Pacific northwest. At the present time, water officials are reluctant to declare an end to the drought, but estimates of available supplies have increased sharply. Christmas sales were not too bad. As a matter of fact, even in southern

California Christmas sales were stronger than had been anticipated. A very large retailer in our District indicated that sales continued to be good in January and that January may turn out to be the best month they've had for the past year. Utah and Idaho continue to report strong economic conditions, while Alaska, Arizona, and Oregon are reporting moderate growth.

Turning to the national economy, the data released since the last meeting have been encouraging; they certainly suggest that the economy is in a sustained moderate expansion. Our forecasts, if you assume no change in monetary or fiscal policy, are very similar to those in the Greenbook. We project somewhat stronger growth in investment and less consumption than the Greenbook. With real GDP growing below potential we expect the downward trend in inflation to continue; our forecast for the CPI, for example, is that it will average around 2-1/2 percent this year. Thank you.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, with respect to the District, the news continues to be quite good. In fact, I think I can now change the adjective that I've been using to describe growth in the Sixth District from modest to moderate. I think the District is going to outperform the nation; that's partly reflected in the unemployment rates that we had at the end of 1992, which were below the national average for every state except Louisiana. Christmas sales were quite good. People were very pleased with the performance in that area. And consumer spending in January appears to be holding up quite well, although not quite at the rate we had in December. Tourism continues to be a positive factor in the District and that's represented not only by domestic tourism but by foreign visitors as well. Manufacturers are reporting moderate gains in activity right through mid-January and business lending is holding up fairly well in contrast to what's happening in the rest of the country. Housing continues to be positive, and the housing-related industries like carpets, furniture, appliances, and so on are also quite good. We [see evidence of] more interest in investment on the part of business, particularly for equipment and most notably computers.

As some others have commented this afternoon, I too think that attitudes are much, much better than they have been over the past several months. And I think that's accounted for in part by more realistic expectations on the part of business. As we came out of the recession most businesses were anticipating a much stronger recovery. Now they're beginning to understand that we're not going to get growth like we did in past recoveries. There also is a sense of optimism that the deficit reduction program will [materialize]. And perhaps more importantly, there is a feeling among business people I talk to that the fiscal stimulus package will not be excessive, and I believe that's helping attitudes as well.

We do, of course, have negatives in our regional economy. Nonresidential construction continues to be one of them. We're having significant declines in employment in major companies, particularly the airline industry. The health services industry, which had been accelerating quite rapidly in terms of employment, is now beginning to decelerate a bit. The energy sector is still weak. The rig count was 92 versus 88 one year earlier, so there's not much change there. And

oil and gas production is not up to the levels that we had prior to Hurricane Andrew. On the fiscal side, about half the states in the District are likely to raise taxes or they are going to face pressures on spending. I don't hear anybody talking about price increases at all in the District, so I think inflation is not a concern. Putting together those negatives and positives, I think the positives clearly outweigh the negatives. As I said, the economic situation is good in the Atlanta District.

With respect to the national economy, our forecast is very little changed from the last time. We have GDP expanding a bit faster than the Greenbook, the CPI marginally higher, and unemployment down by a little less. We don't have as much gain in productivity, and our net export situation does not deteriorate as rapidly as in the Greenbook forecast. But these differences are very small. So, we think that '93 will wind up pretty much the way the Greenbook forecasts it. In general, Mr. Chairman, I think we have reason to be confident about the outcome this year. And I continue to be confident that this is a sustainable recovery, although I think the euphoria that some people are demonstrating is being a bit overdone as was the pessimism earlier on. I'm a little concerned about the sustainability of consumer expenditures. And the biggest concern that I have in terms of the impact on policy, obviously, is the situation with respect to employment. These layoffs are getting more attention than they perhaps deserve and people are getting increasingly "spooked," if I may use that term, by the media attention to the layoffs that are occurring. But in general I think the situation is pretty good.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, our region of the country continues to grow slowly, steadily however, with strong agriculture and construction sectors and less robust manufacturing and energy sectors. First of all, I would say that our employment picture is mixed, with fairly decent employment growth in the Kansas City area and in Colorado and New Mexico, and fairly poor employment growth in other parts of our region, particularly in Oklahoma. Although that is the case, the optimism is uniformly good even in Oklahoma where there's less job growth. A lot of efforts are going forward to encourage employment growth where [possible]. In the agricultural area, as you well know, increased livestock prices last year kept farm incomes higher than originally expected. However, I'm pleased that as far as the land prices go, there's a little speck of renewed optimism in that they have stayed fairly flat. Construction activity is very strong, obviously helped along by residential construction. And though there has been some modest slowdown since November, our construction levels are still a good 25 to 30 percent higher than they were a year ago. Manufacturing is generally sluggish. There is a stable environment in the auto industry, particularly at GM where there's a lot of uncertainty in our area. And [activity at] our Ford manufacturing plants is very good. We, too, are affected by the announcements of [cutbacks at] Boeing, which will affect our Wichita area. Generally that will be handled gradually, but it will be a drag because it's a very important part of that economy. Nevertheless, overall there should still be some good job growth in Kansas, particularly in the Kansas City area. In the energy area, natural gas drilling has fallen off since the end of the year because of tax changes. Nevertheless, the number of rigs operating is still 50

percent over what it was a year ago and that is at least a positive event in our part of the country. So, overall, we [anticipate] steady growth for the region going forward.

As far as the national economy goes, our projection, allowing perhaps for some differences in fiscal policy, is very similar to the Greenbook forecast. We have a little slower growth in the first part of the year but that picks up. For the year as a whole our projection is very similar to that of the Greenbook both for GDP and for the inflation picture.

CHAIRMAN GREENSPAN. Thank you. President Melzer.

MR. MELZER. In terms of our projection overall, we're at the high end of the central tendencies except, of course, for unemployment where we're at the low end. I'd make several observations about these projections. One point I've made before is that because of the [wide] confidence intervals I think it's a very difficult basis on which to make policy. And that's particularly true with respect to timeframes and inflation. Our inflation forecast for '93, even though it is at the high end of the central tendency, is still what I would call a very benign forecast. But in a sense it's irrelevant because of the impact of policy on prices and much longer time lags in that area. Just as an aside, Mr. Chairman, as you're thinking about the Humphrey-Hawkins testimony, given particularly what I read on the questioning at some of the [previous] hearings, that might not be a bad point to make about current price performance. I'm not making it the way you would in testimony, but I'd suggest a little education about [the fact that] future price behavior is not necessarily governed by what is happening right now with respect to prices.

I have the general sense that the pieces seem to be in place for a fairly strong cumulative upturn. So, in terms of the risk in the forecast, I would say that there's a significant upside risk. I'm not as confident that we'll see continuing declines in inflation over the next couple of years as in the Board staff's forecast.

District-wide we're seeing an acceleration of economic activity. It's pretty consistent with what Bob Forrestal was saying. I guess a change from "modest" to "moderate" is probably reasonable, Bob. In the most recent three-month period we are seeing 2 percent employment growth and before we were seeing growth in maybe tenths of a percent. Still, we have more or less the same pattern--flat--in manufacturing employment; the growth in the District is coming from the nonmanufacturing sectors. The other comment I would make is that even in that 2 percent growth number we're absorbing fairly significant head winds in a couple of areas, specifically electrical equipment and construction. In that three-month period both declined 3 or 4 times as much as they did nationally and [yet] we're still showing that kind of overall growth for the District. As far as real estate is concerned, the residential side is a strong point, as has been mentioned for some other areas. We are seeing in the most recent period some weakness in the commercial area, but on an annual basis we still have significant growth in both residential and nonresidential construction.

As for anecdotal comments, what I've experienced is very much similar to what Al Broaddus described. The tone of the comments I'm

picking up--and I guess the sample where I have the most consistent experience would be our St. Louis directors--has changed very dramatically in the last two times we've talked about monetary policy in that the comments are much more positive. What I sense is a lot of caution, though, with respect to getting too optimistic. In other words, I don't sense the ebullience that I have read into some of the comments here; there is still a good deal of caution. And I think we may be affected by [the fact that] this whole recovery and expansion process has taken so long that it's difficult to make oneself get too constructive about it. But the tone of the comments definitely has changed.

CHAIRMAN GREENSPAN. Thank you. President Boehne.

MR. BOEHNE. My sense is that the District continues to move forward, but I don't think I've graduated up to the term "moderate;" I'd keep it at "modest." I think we're still lagging the nation. Manufacturing has been a relatively bright spot. The retailers, including the auto dealers, have been pleasantly surprised by how well sales have been going. I'm increasingly impressed, however, by how deep the hole is in commercial real estate construction. The more I talk to people in that area, the more I think we may have a problem for much of the rest of the decade in terms of getting caught up there. With regard to attitudes, it's not so much that there is an improvement in attitudes but a lack of complaining about what's bad. So, underneath, I think there is--

CHAIRMAN GREENSPAN. That's called improvement.

MR. BOEHNE. That's improvement. It's not an overt statement of improvement, but I do take heart in that. In fact, as one talks to groups of people, they want to talk about things other than the economy and monetary policy. They would rather complain about unemployment compensation, medical costs, and those sort of things. I take that as a rather positive change in attitudes. I am impressed, though, by the variation in economic activity around a relatively a small District; 75 miles in several directions can make quite a difference. New Jersey, for example, continues to operate at low levels, and the expectations there are not high at all. Pennsylvania seems to mirror the nation more and Delaware continues to do better. I do sense that people have made the adjustment toward the notion that we're in for a number of years of slower growth and that the decade of the '80s is not likely to repeat itself.

I don't sense any price pressures coming. Someone made the comment that it's almost a macho thing [for firms] to say they are going to hold employment down; I think that attitude is very strong. Lending, outside the consumer area, [particularly] business lending, continues to be fairly weak. I still hear comments that there's some action in the pipeline but it's turning out to be a very long pipeline. It's not coming out the end of the pipeline to the point where we actually see the loans on the books.

Despite that somewhat less optimistic view at the District level, my sense is that we will do better in terms of growth at the national level. [My view stems] not so much from pointing at this sector or that sector. I just have a sense from talking to people with national businesses and looking at the national indicators that

this national recovery may be taking better hold. So my sense is that if we err on GDP growth, it's going to be 3 percent plus rather than 3 percent minus. I also have the feeling that if we are wrong on the inflation side, its performance may be better. I think we have some disinflation momentum going here that we may be missing. What lies beyond in '94 and '95 could be a different story, but I suspect that inflation in '93 will turn out to be better than the numbers in the Greenbook. Having said all that, if I were a professional forecaster, I probably wouldn't be all that far from the Board staff's forecast. But I'm not a professional forecaster; I can wing it a little, not that the staff wings it.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. Well, the favorable trends that have been under way in the District for quite some time are continuing and, if anything, probably strengthening a bit. But rather than run down all the sectors, the one exception that stands out is probably commercial construction, which is quite mixed depending on [the area]. Attitudes, I'd say, are generally good, although I continue to come across comments, as soon as GM or Sears or somebody makes a major restructuring announcement, such as: "How can you consider this a recovery when that kind of thing is going on?" I think that does reflect some of the concerns that are still lingering.

As has also been the case for some time, there really is not much, if any, sign of inflationary pressures. Business people are increasingly resigned to price stability, I might say, and are willing to live with it! That may have to do in a way with what we're seeing in productivity; if so, it would certainly augur well for at least the longer-term outlook. We're not a District that's particularly intensive in manufacturing, but I might mention that the manufacturers I have spoken with have generally been positive. One report was a bit of a surprise and I'll just pass it on: A businessman with operations in the Twin Cities as well as in the Seventh and Twelfth Districts said his business was improving in all three locations. But in the Twin Cities he has difficulty hiring and retaining entry-level workers at \$6.00 an hour. There's an automatic bump in that to [a wage] in excess of \$7.00 an hour after a year.

CHAIRMAN GREENSPAN. That's the first time I've heard that phrase in years.

MR. STERN. Well, I thought it was interesting. I don't know that it can be generalized, although certainly the help wanted signs--at least in the Twin Cities--are popping up with greater frequency.

CHAIRMAN GREENSPAN. It's not as good as Boehne's "winging it," though.

MR. STERN. I'm going to get to the winging it part, the part derived from our model! With regard to the national outlook, unlike Richmond, we run a big complicated VAR model. For better or for worse, it also produces something quite comparable to the Greenbook forecast in terms of real growth in 1993 and is even more optimistic about inflation in 1993. My own views are perhaps a little more optimistic, at least as far as real growth is concerned. My views are based in part on the tenor of the anecdotes I've been picking up and

in part just on the notion that I didn't see any great aberrations in the second half of last year and, of course, the economy grew at about a 3-1/2 percent annual rate. I have a hunch that it can do something like that again in 1993.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. As I listen to this, it really is striking how much variance there is, not only around the country but within areas. I would say the tone in New England is very similar in many ways to that in San Francisco. The economy remains mixed although improved from the first quarter of last year. Retailers had a much improved Christmas and their inventories are quite lean now. There are the usual complaints about margins; people expect to be able to increase margins, and there haven't been the post-Christmas sales we often have seen in the past. One strong sector has been the nonbank financial services sector, particularly in greater Boston. That has had an impact not only on the housing market, which has stabilized and actually turned up a little, but also on the commercial real estate market, which also has stabilized. However, [commercial rentals] have stabilized at around \$22 a square foot, I'd say, for top Class A space, which translates to the space being worth somewhere around \$120 to \$150 a square foot; it was built at \$250 to \$400 in a lot of cases. So, there is an adjustment clearly going on.

CHAIRMAN GREENSPAN. They doubled [in] New England dollars!

MR. SYRON. That's right. We used to be a manufacturing intensive District but the manufacturing that we still have is really soft now, I'd have to say. There's a little strength in some specialties--instrumentation and that sort of thing--but manufacturing is not doing well at all. A lot of that [reflects] unique structural problems. There are a lot of complaints, though, about softening in Europe because trade is very important for us. We see a lot of this restructuring that people mentioned is also going on elsewhere. Pratt and Whitney, which produces aircraft engines, is in the process of laying off 10,000 workers, and that is having a very strong impact; that's nondefense related, but there are other defense cuts in that area. The cumulative impact of all these things is that in New England anyway employment is still declining at about a 2 percent annual rate. In the states that we have data for we tried to understand the difference, similar to [the way we look at] the national data, between the household series and the payroll series to see if new firms [help to provide an explanation]. A little digging shows no increase in such things as telephone or electric company hookups, which one might expect to be associated with new firms starting up.

As far as the national economy goes, I have little difference of opinion with the Greenbook. I continue to be concerned about the export situation. I think none of us understands the full dynamics of this restructuring process and its impact on prices and employment. Now, we think in a simple two-sector model a lot of this stuff was produced in the defense sector and it wasn't entering the measurements for consumer prices anyway. There's a lot of labor flowing from the defense sector into the other sectors of the economy, which is consistent with the decline in real wages we've seen and makes me more

optimistic, actually, on the price front. Really, I'm quite optimistic on the outlook for prices for some time to come. Consistent with that, if I had any question, it would be whether we would see the roughly 130,000 per month increase in employment shown in the Greenbook. That's the one concern I have. As a final point, I would say that while I'm very optimistic on prices, we have paid a big price for this; and that in my mind emphasizes the value of keeping the gains that we've had. We don't want that to be in vain.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. There's nothing really new or remarkable to report in the Eleventh District this time except that we have America's team and their win assures the country of a rise in stock market prices!

CHAIRMAN GREENSPAN. Who are they, the Arkansas Razorbacks?

MR. KELLEY. Arkansas is in the St. Louis District!

MR. MCTEER. It seems to me that the fourth-quarter GDP report was about as good as it could get. The 3.8 percent real growth rate got the attention but final sales were much better, at 4.5 percent. And the [individual] categories were good. Not only did we have strong consumption but investment was even stronger and government was weaker. About the only way it could have been improved would have been for exports to have improved a little. And the couple of numbers that have come out since the fourth-quarter GDP release have been very, very positive--the durable goods orders and the purchasing managers report. So, we've got a lot of good momentum going right now and it's very encouraging.

But we don't make policy looking back at real variables; we've been making policy looking ahead at nominal variables and the monetary aggregates. Last year we benefited from strong growth in M2 velocity that more than made up for the shortfall in M2 below the midpoint of the target range; growth in velocity was in excess of that difference and we were very fortunate. But while we benefited from velocity growth looking back, I'm a little nervous about counting on that to continue over the next year. It's one thing to benefit in the past but it's another to count on it happening again. And I think we're probably on the verge of acquiescing in a near-term decline in M2 rather than just a slow growth. We've had negative M2 growth in the past two months in the context of a slowing M1 growth. So far, the economy feels okay. But as Governor Mullins put it last time, we've been running on fumes for a while now, with velocity growth instead of money growth and with productivity growth instead of jobs growth. And given the rapid productivity growth that we've been getting, perhaps we've been too cautious about the potential growth of the economy. Maybe that potential is at least temporarily higher and we ought to be a bit more ambitious in the way we're planning to stimulate [aggregate demand].

It's tempting to call for further ease in this context, but I'm not sure what ease would look like. Short-term interest rates appear low enough. I look at those and see no need to have them any lower, and there's nothing we can do to push long-term rates down except to be cautious at the other end. I really believe that if we

eased, we could cause M2 and M3 as currently measured to shrink even faster than they have been. But if we do believe that, and I think I do, we need to do a better job of explaining it and selling it to the public. I think it's dangerous for our future to have the political spectrum from Milton Friedman on the one hand to Paul Samuelson on the other bashing us for tight money based entirely on M2 when we could make the case that slow M2 growth reflects easy money rather than tight money. We need to figure out what slow M2 growth means and then either change it or defend it a little. And as far as our public posture goes, I also feel we're in a bad situation, seeming to acquiesce in the lack of job growth. I'm afraid we're going to come across as being satisfied enough to have productivity-led growth in the absence of job growth. I just worry about what our silence on that question might do to us. In sum, I worry about how we are perceived right now. But as for the economy itself lately, it has been going strong and our expectation is that in 1993 it will be stronger than in the Greenbook forecast. But that's winging it!

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Thank you, Mr. Chairman. I must say that for the last year or so I've been arguing that the dynamics of the economy were in large part based on the confidence factors that were present or not present in the economy. And now we seem to be entering or at least approaching a new era of good feeling, based on what I've heard around the table in general terms. This may sound a little too empirical, but I think a large part of that was based on campaign promises that began to emerge in the third quarter and that raised a general expectation that things were surely going to be better. As a result, economic activity began to pick up in the third quarter and continued to do so in the fourth quarter, and it was rather a dramatic change. But the negative factors in the economy are still there. We have export markets that are a lot tougher than they have been for a while. We have the defense cutbacks continuing and in all probability they're going to get steeper. We continue to have this commercial real estate slack, which is not going to resolve itself quickly. And we still have the overhang of the remaining resolutions in the Resolution Trust Corporation. We have this phenomenon of corporate restructuring, which I believe is a phenomenon of the '90s that isn't going to go away in just another couple of years. I think it's going to continue for some time. And that means layoffs, plant closings, and CEO executions.

Now, on top of all of the continuing uncertainties, we see a reneging--or a back-pedalling at least--on some of the [campaign] promises that were made. We see wobbling on deficit reduction; we see the job stimulus programs [and other] fiscal programs being cut back in terms of what everybody was expecting; we see middle-class tax reductions being talked out of the picture; we even see gays in the military not going to happen. So, some expectations in almost every sector of the society have been disappointed or are about to be disappointed. Coupled with that we have the new and unexpected threats from the architects of national sacrifice. We have a discussion going on right now about the possibility of reduced Social Security COLAs. Now, that sounds like a minor event, but the grey panthers of this country are a very powerful force and they are a very important part of the consuming public. We have the possibility of higher taxes on Social Security income, a move from taxes on 50

percent of it to taxes on 85 percent of it. We may have higher middle-class taxes instead of reductions in middle-class taxes; we have the possibility of energy taxes, which really touch every American where his love is [greatest]--his automobile--and also his oil bills. The cumulative effect, it seems to me, could be to reverse the confidence in recovery that has been so important to this recent economic performance, and it could choke off all this consumption-driven growth that we're experiencing. The problem, as I see it, is that there's probably not a darn thing that monetary policy can do about it. I agree with the observations that there is not a lot of moving room for monetary policy as far as further stimulation to the economy is concerned. So, even though I feel some of that era of good feeling, I'm nervous about these other effects out there that could begin to choke it off a bit.

CHAIRMAN GREENSPAN. The original era of good feeling lasted a while!

MR. LAWARE. Yes, and hopefully it will happen again!

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. It seems to me that we're the only game in town in regard to economic policy, and the only explanation for the significant rate of recovery that has been under way has been monetary policy. And that has been occurring in an environment in which the head wind seems to be decreasing because monetary policy has worked to strengthen the net interest margin of the banking system, and that does mean that a great deal of impediments to lending are moving away.

When I look at my forecast for 1992--I know the performance came in at 3.0 percent Q4 over Q4, which was higher than I anticipated --I ask myself why I underestimated the performance in 1992. And I think it centers on the fact that I anticipated that the saving rate would rise more than it did and consumer spending as a result turned out to be much higher. Indeed, if we look at gross domestic purchases in the second half of 1990, they were declining at a 3.7 percent rate; and in the second half of 1992 gross domestic purchases were increasing at a 4 percent rate. That's a rather significant turnaround. If we look at real GDP in the second half of 1990, it was falling at a 2.8 percent rate and in each half-year period since that time it proceeded to move up from negative 2.8 to negative .7 to positive .9 to positive 2.2 to positive 3.6. And I ask myself if monetary policy was successful in generating this accelerating recovery--though it was very modest at first--what in the world is going to stop it at this stage? Will it be our interest rates? The staff is forecasting lower interest rates in what I think are the most relevant portions of the yield curve, so that wouldn't seem to be a factor. I must admit that I'm not quite as optimistic on long-term and intermediate-term interest rates as the staff is in its forecast. When I look at commodity prices I ask myself, Mike: How, after so many FOMC Humphrey-Hawkins [meetings] of having the Federal Reserve's experimental commodity chart in [your Chart Show] did you happen to take it out just at the time that the commodity prices are beginning to show something? The ex-food, ex-energy experimental commodity price index shows a rather significant change upward, which for the first time really goes with the kind of economic recoveries that we had in 1983 and 1987. This rise in commodity prices may not be

sustained. How could commodity price moves ex-food, ex-energy be as strong as they are with M2 growth very slow and [recently] declining? Well, I just don't know how to judge M2 growth, but I do know that when commodity prices start moving upward it is an indication of what's happening on monetary policy showing through. So, the bottom line is that I end up with a forecast that I guess is the highest of the lot, or at least at the top of the range. I end up being slightly less optimistic than the staff on inflation for the first time since I've been a member of the Board of Governors. I've been equal to the staff's expectation of the CPI but I've never been higher in any previous discussion.

I do think FASB 106 is still going to be somewhat of a drag on productivity. But I think there's a modification here in that the companies that had the high post-retirement medical benefit programs are the ones that are contracting and the small to medium-size firms that do not have the generous post-retirement programs are where the expansion is. So, I end up with a somewhat lower unemployment rate at the end of the period. All of this makes me a bit puzzled to be positioned as I am in relation to the staff, but I'm going to be honest with you about it and not try to cover it up!

CHAIRMAN GREENSPAN. To differentiate with other times!
[Laughter]

MR. ANGELL. I don't know. I must admit that I really felt that 4 percent [GDP growth] was quite likely but modesty and restraint in regard to a drag from net exports caused me to bring that back down. I do think we need to recognize that the personal bankruptcy safety net means that this adjustment period for consumers is not as severe as it was in other long major cycle adjustments. And it seems to me that that's consistent with the consumer spending that we have. I, like Bob McTeer and others, worry a little about what we are targeting. I don't have any appetite for targeting M2. But the lack of appetite for targeting M2 does not make me feel comfortable targeting interest rates as a means of running economic policy.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, Bob McTeer made a reference to America's team. Being at least in the resident state of the other side, I have a little different view of that. But there is something about the Super Bowl that crossed my mind too, Bob, which is that I think we're at a point here where we have to be a little careful. At the end of the game it didn't matter that a defensive lineman was cruising down the field with the ball hanging out there and somebody came along and swiped it out of his hand. Well, I don't think we can afford to have that happen here, Mr. Chairman.

CHAIRMAN GREENSPAN. If monetary policy fumbles...!

VICE CHAIRMAN CORRIGAN. For me [the picture] is a little more complicated than I think it is for some others. Clearly, on the anecdotal side, the tone is better across the board. Big business, small business, the man on the street, the woman on the street--and as a matter of fact coming back to Bob Forrestal's point of reference, even the CEOs that are still on the job in the big companies--seem to have graduated from flat to modest, if that puts things in a little

perspective. I forget who made the point--it might have been Bob Parry--that he had gotten some anecdotal reports about surprisingly strong retail sales in January coming on top of what were very strong retail sales in the Christmas season. We, too, have heard that. On the other hand, and several people have made this point, we still are getting the same message from small and big businesses that this restructuring has by no means run its course. And some of the multinational companies are conveying a sense of their experience in Europe that I translate [as indicating weaker economies there] than the standard forecast, whether it's our own or the IMF's or the OECD's. Now, those are obviously not sophisticated forecasting comments, but I interpret the attitudes of big companies that have [operations] in Europe as worse than most of these standard forecasts would imply. If we took our own forecast--and I don't know precisely what that forecast method is, whether it's a Stern version or whatever--when I put my own body English on it I end up with a forecast that you could just about put a postage stamp over it relative to the Greenbook. They're virtually identical. But I myself don't have any real conviction at this point as to where the risks lie. On the one hand, I am worried that in part because of the restructuring and all the rest that even modest employment gains may not be as readily forthcoming as would seem to be the case. And if that is not the case, then I think the consumer sector is not a "gimme putt," even though I appreciate some of the arguments that the saving rate may have a little more give in it than it might seem just by looking at the raw numbers. Similarly, the net exports sector, as I've said before, is a real risk in part because of this impression I have about Europe but also because I think there is a rapidly building financial constraint on our export performance to the developing world, especially Latin America. So, it wouldn't take a whole lot for some downside risks [to materialize] that are not inconsequential.

On the other hand, I think we do have a situation where we see some signs cumulating on the up side. Indeed, if I let my mind wander a little, I could easily see a 3-1/2 percent growth rate or maybe more. And that worries me because, while I'm a firm believer in inflation being fundamentally related in a technical sense to slack in the economy, we could start to see some deterioration in the inflation outlook sooner rather than later, even with slack, because I think the speed factor is still a reality. I don't think the business community and the economy at large have yet bought zero inflation by a long shot. Now, putting that together, one could say that's the way it should be. A forecast should say there is this risk and that risk and they all tend to wash out. But that's not how I look at it. As a matter of fact, I feel fairly certain that 1993 will not look like the forecast. But I can't quite decide on which side is the greater risk. And I might add that either side has problems. So, it looks like a nice easy walk in the sun for the next couple of quarters or so, but I'm not so sure of that.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. John LaWare's comments reflected the kind of things that I've been hearing over the last couple of months in conversations with directors and others around the District. In the fall, during the latter months of the campaign, there was this attitude--reflected in the media, of course--that we were not getting all the government we were paying for, that something was wrong and

nobody was fixing it. And now there's a very sharp increase in concern that we may in fact get all the government we're paying for and it's not good. The numbers look not so bad to me. The attitudes, if anything, have deteriorated. I'm not sure yet. I have not been in Cleveland a full year and in traveling around the District I don't know whether I have to seasonally adjust them; maybe it's simply impossible to [be optimistic] at this time of year in that region of the country! We have had very good employment numbers recently. When I point that out, people say: "But it's not the right kind of jobs. It's minimum wage jobs; we're losing high-wage jobs for low-wage jobs." We had very good sales numbers in December; everyone was very pleased by that; they expected sales to fall off in January and they did not fall off. Again, there's no comfort in that, but concern that the pickup still is not sustainable. I look at initial claims numbers. In January we were 32 percent below a year ago, indicating a better job market; but none of the business leaders among my directors or the labor leader on my board point to any of these things with any encouragement. The headlines are still dominated by stories of layoffs all over the District. Maybe it's a part of being an old manufacturing District that is still restructuring, so the news about whatever's going on in motor vehicles continues to pervade everybody's attitude. Even the small businesses do not indicate a willingness to talk in terms of employment increases. They talk about their productivity gains and they talk about improving profitability without price increases, but they do not talk about adding workers.

When I discuss the issue of inflation, and I tend to be on the more optimistic side [expecting] lower inflation, I'm met with total skepticism. As for the idea of price stability being where inflation does not enter into the decisions of people, it is certainly entering into the decisions of these people. They believe that inflation is going to pick up. And I certainly haven't had any success in persuading them that anything can and will be done about it. There's an inconsistency, especially among small manufacturers and [a] few of the large manufacturers outside the motor vehicles industry where they say they see no prospect of increasing prices in their businesses. They are not worried about their cost side, especially from labor. However, they believe national inflation is going to go up. In banking, consumer lending was very good in the last couple of months. C&I continues to be flat; there's nothing there. In fact, some banks are still indicating declines in C&I volumes. Mortgage lending fell off after the boost in the fall.

When I look at the national forecast in the Greenbook, my main problems with it are on the [underlying] assumptions. I tend to think the inflation outlook is going to be better than the Greenbook. We probably put a little more weight on the P* kind of relationship than what's built into this. But I have trouble with the velocity assumptions. When I look at the conditions of a year ago versus today, we were coming off two quarters of very little growth in the second half of '91. If I look at the yield curve, the components of the various aggregates, the M1s and M2s, or the level of interest rates, I don't see any of the conditions that I think contributed to the rise in velocity that we had in 1992, so I'm simply not comfortable with that set of assumptions. That is, if we were to get the kind of outlook shown in the Greenbook, especially in terms of nominal spending growth, I think it's going to be associated with faster growth in money. If we have the kind of broad money growth

that's suggested by the Greenbook, I am skeptical that we're going to get the nominal GDP growth.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I would agree that recent data remain quite encouraging. Many observers have pointed out that the fourth quarter was very good--about as good as it could get, as someone said--but many observers view that as unsustainable. They viewed the third quarter as unsustainable. There's a preliminary indication that we may have yet another quarter of unsustainably high growth and could have a string of unsustainably high quarters for as long as the eye can see. We really don't have any data yet on this quarter, although the purchasing managers report was surprisingly strong as were the orders data for December. The job growth is not evident. I can't help but believe that with a string of quarters around 3 percent we will break through into some real job growth. The saving rate continues to be a concern. The observation that the Chairman made and Gary Stern raised again about realized capital gains on residential housing I suspect has something to do with it. Coming from Boston, I don't speak with recent personal experience of large capital gains. With the lower long rates, I see the housing market continuing as a little mini-engine here. Businesses, I think, have gone a long way toward cleaning up their balance sheets. We still have pretty low rates and high stock prices and I think they will turn now to capital spending. And we should see some of the effects of pent-up demands both from businesses and consumers, the deferred spending. I would also agree with the Greenbook that inventories appear to be able to play a supporting role.

There are a lot of uncertainties, and I get some sense of what President Corrigan talked about in terms of discontinuities. A lot of the uncertainties focus on fiscal policy. There are questions, such as how much fiscal stimulus does an economy growing at 3 percent need. There are questions about the deficit implications of the Administration's proposal. Also, there are the microeconomic proposals of the Administration, which we haven't talked about, which might somehow be worked in through the years. Here again there seems to be some reason to be encouraged. All indications are that the new Administration might propose only a modest stimulus program. But just in the last few days the talk has gone from \$15 billion to the \$31 billion presented in Mitchell's office last night, according to the reports. The Administration also seems very serious about deficit reduction over the medium term. And it is true that long rates have come down a lot just in the last few weeks. When you look at the implied 1-year forward rates and the yield curve, I think virtually all the reductions have been concentrated in the short- and intermediate-range, suggesting that it is fiscal restraint which is primarily responsible for the reduction in rates and not the speculation about the change in the issuance of long-term Treasuries. Here, too, there's plenty of room for skepticism. First, one would hope that this deficit reduction package, to pull it along, would be legislatively linked to the stimulus package. But we still occasionally hear that [the Administration] would like a quicker stimulus package. I'm sure they have plenty of people, such as Mr. Rubin, who understand the importance of that, because I wonder how well the deficit package will fare if it is a separate stand-alone piece. More generally, it has to be very encouraging that a

Democratic Administration appears to be willing to take on deficit reduction, but the jury is still very much out as to this Administration's ability to get a credible deficit reduction package through Congress. Given how the markets have set this up, it could be very disappointing to the markets and, as Governor LaWare mentioned, to the confidence that seems to be building. But it could be especially disappointing to the markets, it seems to me. Of course, even if we had this credible deficit reduction package and long rates fell, it's not clear that we should respond by lowering short rates because we could have a stimulus program in the short-term, the stimulative impact of a fall in long rates. But the actual fiscal drag from the deficit reduction would be in the distant future, so that could total up to a fairly stimulative outlook.

I think our best course continues to be to keep our eyes on the important indicators of our monetary stance, money and credit growth, and to respond should those misbehave in either direction for whatever reason. I will admit that this argument would be more compelling if those indicators were not misbehaving as I speak or if we had more compelling [evidence] on what the important monetary indicators are, because I share some of the concerns that Bob McTeer and Wayne Angell raised about targeting and trying to explain M2 and also about depending on an increase in velocity when by all accounts the head winds have diminished this year.

So, we must make policy amid these uncertainties. I, like the staff, took a look at the Blue Chip forecast this time, and I think Mike Prell has pretty well worked it over. I looked at it for another reason. At a recent NBER conference, Bob Hall and Greg Mankiew presented a study suggesting that the Fed should take these consensus forecasts pretty seriously looking out a year or two because these [forecasters] have a strong economic self-interest to incorporate all information in the forecast. And if that forecast is way out of line with what we expect, we should have reason to pause. They tried to show evidence suggesting that these consensus forecasts are very good indicators of the future path of nominal income and that adding M1 and the federal funds rate add virtually nothing to them because they already incorporate these variables. It's a fairly naive approach, I would admit. But the idea is that they do it for a living, they've heard and evaluated our public statements, including all the arguments about velocity, they've observed slow M2 growth, slow credit growth, fast M1 growth, fast base growth, and they use econometric models and judgments and come up with a forecast. Mike has presented that forecast; it's very similar to the Greenbook except primarily that inflation, instead of trending down as the Greenbook has it, turns up again and is 1-1/4 points above our forecast by the fourth quarter. This is not explained by the speed factor. Their GDP growth is about the same. Their unemployment is a bit lower, but that can't explain it. Short-term interest rates are much higher than we're projecting and real rates are about flat; that answers Bob Parry. The only thing I would add to this is that the Blue Chip consensus is indeed a consensus. For 1993 only three of the 50 forecasters see inflation as low as or lower than in the Greenbook forecast. But it is true that for 1993 10 of the 50 forecasters do at least see inflation below 3 percent. By 1994 only 2 forecasters out of 38 have inflation as low as the Greenbook. Only 4 of 38, about 10 percent, project inflation below 3 percent, while 6 project inflation

above 4 percent; two-thirds of the forecasters see inflation as greater than 3-1/2 percent by 1994. So, it's not close.

The overwhelming majority of Blue Chip forecasters essentially see about the same growth, about the same unemployment, higher short rates, and higher inflation. There are many hypotheses; I won't go through them. Perhaps the best is that they just made different analytical judgments and they're wrong while we are right. We have analytical bases to make these judgments. Some might suggest that they are projecting an upward impact on measured inflation from some of these Administration proposals for business mandates and taxes. I think that's not likely this early. Others might suggest that they are somehow sensitive to the fact that this Administration has signaled that the number one short-term goal is eliminating slack in the labor market. But I think what they're probably doing is just betting the odds, because from an historical perspective 1992 inflation was very good. You have to go back two decades on core CPI to find a better performance and about a couple of decades, it seems to me, on overall CPI with the exception of 1986. In the employment cost index, the wage component was the lowest ever in the 17-year history of the index. And if you take into account the measurement bias in the CPI, actual inflation was probably in the 2 percent range in 1992. So, I think they're saying, given the historical precedent, that this disinflation trend is simply too good to be sustained in a growing economy. I'll admit I have no punch line to this analysis, just as Mike didn't, and I wouldn't overstate the significance of this divergence. It's probably not so significant. We're likely right and they're likely wrong. But I would only note, as we wrestle with the vagaries of velocity and the metaphysical meaning of M2 and M1, that private forecasters who do this for a living are observing this debate and looking at all the indicators and projecting that inflation will be going up.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I am more optimistic than the staff about 1993 and more pessimistic than the staff about 1994. Two meetings ago I made a comment regarding the difference between the expectation of fiscal policy and the reality of fiscal policy. I'm trying to think how an academic would put it delicately, but I think I got the coefficients right and the sign wrong. I had been anticipating that there would be an expectation of stimulus without the reality. Instead, what I think we have is the expectation of deficit reduction without the reality. As a result we got a fall in interest rates, particularly on the long end, buoyant attitudes, and yet no bite from either tax increases or spending cuts. I, as a gambler, would say that the deficit reduction package isn't going to happen. And I get that feeling from everyone I talk to inside the Beltway. I'm not a big believer in conventional wisdom about anything that happens inside the Beltway, and that's what we're talking about here. First of all, I think the Administration is sincere. In Mr. Panetta and Mrs. Rivlin in particular I can't imagine more sincere deficit cutters. Unfortunately, when we go down the list and compare it to whom they're going to have to offend, it gets tough. Someone, a good friend inside the Administration, told me that the February 17th date was picked because they had to get out of this endless circle of not being able to find something to cut and it was a way of imposing a deadline on themselves. Students of political history remember that

Ronald Reagan did this very, very effectively. But that's why we're having it inside the Administration. If you look at anyone on the Hill such as the trade associations and the truckers, they have the xeroxes all lined up to go out as soon as February 17th's speech is over about how you can't raise gas taxes without putting it into a trust fund and infrastructure improvement. I'm sure AARP has their February flyers all ready to go. Even the recent experience with gays in the military shows that Congress won; they know it and they're feeling their muscles. So if I may mix some metaphors, I heard here today that the deficit reduction train is moving on fumes and Wall Street is inhaling.

My other fear, Mr. Chairman, has to do with the supply side. I have some fears about what is happening in that regard. I think the \$10 billion tax number is almost a mind-boggling one--\$10 billion more in tax receipts largely because of expectations of what is going to happen. To put that in context, \$10 billion is about 2-1/2 percent of all personal tax receipts. But a more meaningful number is that it's close to 15 percent of tax receipts from people making over \$200,000. Another way of looking at it is that it is larger than the combined annual gains we would get by putting in both the 36 percent bracket and the millionaire surcharge. So, we're talking about big swings in fiscal policy in the anticipation of what's about to come. Second, Labor Secretary Reisch mentioned a minimum wage. That was the first time I heard that one. I'd heard of it being indexed but the word [he used] was "increase." I think that's a sign that adverse supply side policies are in the making. Finally, just before this meeting, I met with Griff Garwood who's in charge of the Consumer and Community Affairs Division [here at the Board]--this would be a seasonally adjusted factor--and he mentioned three agencies that want to talk to us about ideas that we would not consider good ideas. I'll leave it at that. All three of those agencies do not have their political appointees in place. I remember this from when I signed on in the Bush Administration on January 31st. The first thing that confronts you is a pile of absolutely horrible ideas that are percolated up from bureaucracy. My sense is that that pile of ideas is not under control. So my fears are, first of all, that the market is going to be disappointed with what is actually going to happen on deficit reduction. I don't know when that will happen, but when it does I could see a rise in real rates. Second, and this will be a longer-term effect, as supply side effects take effect growth and employment gains will become more difficult. And I'm afraid that's going to lead to increased frustration in the Administration and Congress. And that unfortunately is where monetary policy is going to come into the story.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Well, my story is probably going to be a bit like Larry's, but let me start with the economic situation. Certainly we have the strongest or best prospects we've had since I've been at the Fed in terms of growth, production, productivity, and spending. The financial sector, something we haven't discussed much, does seem to be in better shape, not just the banking system but the financial system generally, for a provision of capital. Consumer confidence is dramatically improved, perhaps stronger than the fundamentals would imply, which is exactly the opposite of what we were talking about some six months ago here when we were saying that confidence wasn't as

strong and should be stronger based on the fundamentals. The variance among the Districts, from what we've listened to in this discussion, seems to be widening. The report from Bob Parry is that the Twelfth District doesn't seem to be getting any better. So, that's certainly a disturbing wrinkle on the economic scene. As John LaWare said, we still have some of the same continuing drags that we've had in the past. We're making some progress, but we still have [weakness in] non-residential construction, the international slowdown may in fact be worse than even we've been led to understand, the federal deficit is still there, and state budget constraints are still there. So, we have a number of the same kinds of constraints that we've seen before.

As for the balance sheet adjustments that we've all talked about, we are clearly making progress but I don't think anybody really knows how much or how much more progress we still have to make. What is the right amount of debt either for corporations or for individuals? There is this whole question of operating restructuring --Si Keehn's macho terminology, or right-sizing, down-sizing, and de-layering. We're seeing a lot of it. The corporate executives who are losing their jobs are certainly affecting all the other corporate executives who are not and who might be feeling the heat from some of their boards of directors. I suspect that is going to keep pressure in the area of remaining tough on layoffs. Certainly there are some real things that are driving this restructuring: the drive for an increasingly competitive international environment, increased productivity, and so on. Nevertheless, we've been saying for a long time that computers were really going to change our lives and now they definitely are changing our lives and changing the way corporations are assessing their needs in terms of their work force. And it goes not only from middle management analyzing these various kinds of statistics to all of us who are now getting more facile at looking at the statistics directly, but also to just-in-time inventory management. We're seeing it even in manufacturing. Somebody, I don't remember who it was, has labeled this the second industrial revolution. The social acceptability of these moves in corporate America seems to be continuing. So, I think we're going to continue to see those pressures. I think the employment situation remains the key to the sustainability [of economic growth]; it's certainly what the market is watching now. People are not watching as much what's happening with the new growth measures but are waiting more now for the employment reports. So, that remains a concern. I'm hopeful that we're going to get that 130,000 a month increase in payroll employment, but that may be a bit optimistic.

I'd like to follow up on some of Larry's comments with respect to the new Administration. If you just watch your [computer] screen for a couple of hours, you can see trial balloons going across the screen at an increasing rate. I'm certainly encouraged by the general direction that the new Administration is taking with respect to trying to address the deficit [and to enact] a small fiscal package. Certainly the stated goals are something we'd all like to see happen in terms of jobs, deficit reduction, and even banking reform. We're hearing some discussion about the need to examine the regulatory environment. As a former manager I recognize, as I think we all can, that good ideas are in fact a lot easier to come up with than actually to get done. I certainly hope that we're going to achieve all of these things, but I think we have to recognize that we're still in the trial balloon stage now.

CHAIRMAN GREENSPAN. Thank you. Cleanup hitter.

MR. KELLEY. Cleanup hitter, yes sir.

MS. PHILLIPS. My gosh, I wasn't last. I can't believe it!

MR. KELLEY. You caught Norm Bernard's eye too quickly! It becomes a cleanup hitter to be brief and I'll try to do that, Mr. Chairman. I'm comforted, as I think all of us are, by the statistics in the last couple of quarters. And I certainly like what I'm hearing from most if not all of the Districts about the tone of things. While I do feel better, I must say that I can't really get comfortable as long as this restructuring continues and as long as all of these structural imbalances are still being worked away. We cited the literature two or three times here today as we have many times before, and we've got some problems on our hands. I think Governor Phillips hit the nail on the head a minute ago: The tale is going to be told in what happens to employment. If we get an adequate number of jobs in the next few quarters, this [recovery] will probably get going and be self reinforcing. If we do not, then [the economy] could easily slide back. And I think it's a pretty doggone close call as to which way it's liable to go. This leads me to be in the camp of those who view the Greenbook forecast as being the best bet. I guess it was Jerry Corrigan who said a while ago that he thinks it's probably going to be wrong but he doesn't know which way. I think what happens in employment may turn out to be [the key to] which way it swings. I will remain concerned about the downside risk until we begin to see these imbalances and restructuring begin to work their [way] out of the economy, and I don't see that yet. So, I continue to fear that we have some downside potential there, although I'm optimistic that we're going to get over the hump and achieve the Greenbook forecast or better.

CHAIRMAN GREENSPAN. The meeting has come to a temporary pause and we will reconvene at 9:00 a.m. tomorrow morning. In fact, I have to read a note that Norm has given me, which says that Bob Parry has scheduled a meeting of the presidents in room 4001 immediately.

MR. LAWARE. In five minutes.

MR. PARRY. Five minutes, okay.

MR. TRUMAN. We have some reading material for the Committee that we will pass out. This is what was promised in the last line of the memorandum that Don circulated. It relates to the last item on the agenda [concerning the release of confidential FOMC information and covers announcement practices] and organizational structures of major foreign central banks. If you have insomnia tonight, you can read some of this.

[Meeting recessed]

February 3, 1993--Morning Session

CHAIRMAN GREENSPAN. Good morning, everyone. Let's continue on [our agenda]. Don Kohn will brief us on the long-run ranges for the monetary aggregates.

MR. KOHN. Thank you, Mr. Chairman. I will be referring to the Bluebook in the course of my remarks. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Don?

MR. BOEHNE. Don, I respect your judgment in this a good bit and I think you've approached it in a reasonable way, given all the uncertainties. I wonder, however, if you were debating with yourself and making the case that M2 might grow several percentage points higher than you estimate, how would you go about making that case?

MR. KOHN. Well, first of all I'd like to say that I think our forecast of 2 percent M2 growth in 1993, given the Greenbook forecast, is balanced. I wouldn't want to leave the impression that I think all the risk is that M2 will come in higher and velocity will be lower. I think I'd go about making the case for higher M2 by saying that as the economy gets going, bank lending should pick up some and banks should be a little more aggressive in seeking deposits. The case might also be made by saying that we've had a lot of portfolio adjustments so far. Time deposits have been running off for a while and the sticker shock aspect of seeing new low rates on time deposits should be wearing off, so perhaps an awful lot of that adjustment may be behind us and only a little more ahead of us. Also, banks have been rather prompt to reduce deposit offering rates and maybe those rates won't be coming down quite so much in 1993 as one ordinarily would think since they've done a lot of that ahead of time. But for every argument I just made I could make a counterargument.

MR. BOEHNE. Right.

MR. KOHN. One of the counterarguments might be to look at the first quarter. We are getting very, very weak money growth; the economy looks okay. And, if anything, we're going to get our projections of 7 percent plus velocity increases in the first quarter.

MR. BOEHNE. Thank you.

MR. PRELL. Could I add a point that Don and I have discussed many times? One thing you want to remember is that our money numbers are conditioned on our forecast. The members' forecasts for nominal GDP are a bit higher than the ones that were built into this, which easily could add a fraction of a percent to what you might want to anticipate for M2 growth.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Don, I know that table on page 8 is based upon the new Feinman/Porter model, but there's one thing I would just ask your opinion about: Do you find it rather hard to believe that 1/4 or 1/8 point variations in the funds rate are likely to produce such differences in the levels of real output and prices?

MR. KOHN. No, I don't find it incredible. I think what happened in putting the simulations together is partly driven by that model. We've speeded up the changes in long-term interest rates. I think I noted here two changes in short-term rates. So, a given change in short-term rates has a bigger effect because it's almost forward-looking. You could argue that perhaps that's not a terrible idea although the model hasn't done too badly with this backward-looking yield curve so far. So, the baseline has the declines in long-term rates that Mike noted and actually extends that out. And then the easier policy has even sharper declines. So, if that would add some bigger changes in the funds rate, that has the same real--

MR. PARRY. Okay.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Don, do you have any estimates of what these money projections would look like if they were adjusted for growth in the stock and bond funds?

MR. KOHN. We haven't projected the growth in stock and bond funds. I think a memo was circulated to you yesterday about last year, and my rough guess would be that those would taper off a little over time. Part of what's going on here--look at the baseline picking up over the time period--is that the yield curve is flattening and some of the yield curve effects, of which the bond and stock funds are a symptom, are ebbing over time. So, I would say we'd probably add a couple percentage points in '93, maybe a few less in '94, and then see it ebbing over time as the yield curve flattens and as the portfolio adjustments have already been made.

CHAIRMAN GREENSPAN. Was the chart on velocity that you sent to the Board members that included the bond funds distributed to everybody?

MR. KOHN. I think so. Was it, Norm?

MR. BERNARD. Yes, it was.

CHAIRMAN GREENSPAN. How does that chart look for the opportunity cost figures?

MR. KOHN. Well, when we've been trying to work on this issue of an alternative monetary aggregate--adding back the bond and stock mutual funds--one of the problems is defining the opportunity costs when we have bond and stock funds in there because we've got interest rates all up and down the maturity spectrum. It's really the opportunity cost relative to spending, I guess. It's not clear what the alternative asset is as one makes the monetary asset definition wider and wider. So, one of the problems in working with this is defining a demand function that has prices in it. Obviously, it's related to income and spending or wealth perhaps--

CHAIRMAN GREENSPAN. That velocity looks so much better than I would have expected.

MR. KOHN. The old opportunity cost isn't operative.

CHAIRMAN GREENSPAN. No, I understand that, and that's the reason I raised the question.

MR. KOHN. In the back of the Porter/Feinman study, you'll remember, there is a section about these alternative monetary aggregates. They found, looking at things like the variability of velocity and whatnot, that the velocities of the [money] stock with the stock and bond funds were slightly more variable than M2 and didn't do as well over time in these Granger causality tests with income. But the world is changing over time--

CHAIRMAN GREENSPAN. I think, as Governor Mullins mentioned, the check capability of a lot of these funds is a relatively novel situation, and that may be a relevant consideration.

MR. KOHN. My memory is that that has been developing over time. There was some capability even back in the late '70s but it has spread to more and more--

CHAIRMAN GREENSPAN. Back then you were allowed two checks or something; that's per generation! Governor Angell.

MR. ANGELL. Don, on page 8, assuming that the fed funds targeting is really designed to produce those M2 changes and nominal GDP changes, I noticed that with a fed funds rate of 3-1/4 percent, V2 is 3.1. And then when the fed funds rate is brought down, eased to 3 percent, V2 moves up to 3.3. When it is brought down to 2-3/4 percent, V2 in a nonlinear fashion moves up to 3.8. What happens to V2 if, for example, [the economy is weaker or stronger]? Jerry Corrigan was saying yesterday that he has this feeling that it might be stronger. On the other hand, it might be weaker. Suppose we ended up with a weaker [situation], so much so that the fed funds rate were taken down to 2-1/2 or 2 percent. What in the world happens to V2 at, say, a 2 percent funds rate? Does it accelerate the way it does here in a nonlinear fashion?

MR. KOHN. Well, there are a couple of things going on here. One is that there are lags, and it's hard to line things up year-by-year. The other is that velocity is being driven a lot by the long-term rates and the spread. The Porter/Feinman M2 is pretty darn insensitive to short-term interest rates. So, in effect, if you had a weaker economy--I'd have to hear the rest of the story, say, in the Corrigan scenario--and short-term interest rates were lower, I'd expect somewhat more M2, somewhat less nominal GDP. Maybe you'd have two offsetting effects on M2; it's hard for me to sort them out.

MR. ANGELL. Okay, what you're saying is that since you really have intermediate rates trickling off a fed funds rate, I presume that that would be a scenario in which the intermediate rates are moving downward anticipating the fed funds rate to produce that kind of V2.

MR. KOHN. Right.

MR. ANGELL. Now, to put another scenario out: Suppose we were to have a rather aggressive easing of the fed funds rate ahead of anticipations of weakness that might cause intermediate rates to move

backwards, as they did after our December '89 fed funds rate cut, instead of moving with it?

MR. KOHN. You could get a perverse effect on M2, as I think President McTeer was alluding to yesterday.

MR. ANGELL. Yes.

MR. KOHN. In general, I'd expect that the decline in short-term rates would mean we'd have smaller increases in M2 velocity. Now, that's what happened in 1992; if short-term rates hadn't been declining, velocity would have been even larger. So, if we did have this perverse effect--if we had short-term rates declining and long-term rates going up--then the yield curve effect would outweigh the short-term effect and we could get a smaller M2. It's not clear what's being held constant here, but for the same number--

MR. ANGELL. Of course, I think we have to keep in mind that since May of '89 we have had that perverse effect almost 1/4 of the time we've been easing; other times we've been able to do it in a way in which we haven't had that perverse effect. Would this be relevant to the Chairman's Humphrey-Hawkins testimony in some sense regarding those who argue that the Fed made a mistake because we did too little too late? One might look back at the lack of perversity--that the intermediate yield when we were too little too late resulted in better M2 growth than we would have gotten if we'd been more aggressive.

MR. KOHN. I think the more general point, and one that Chairman Greenspan has made when challenged on this issue, is that in a sense we were working through this period with market expectations, as we discussed yesterday, that had inflation turning around, especially if you think about the [time around the] middle of the oil crisis. The Federal Reserve had to be fairly cautious or had to take account of market expectations when making its policy moves. [It had to consider] consequences I think more serious than just what would happen to M2 growth, but what would happen to long-term rates, market expectations, and the balance sheet/portfolio restructuring process if inflationary expectations had gone the wrong way.

MR. ANGELL. In other words, I'm not misreading the bottom line here that if the economy [developed] further weakness and we delayed our easing but were forthcoming as the market expected, we might get better movement in intermediate rates and consequently more effect on M2.

MR. KOHN. I agree with what you just said.

MR. ANGELL. Thank you.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Don, at Monday's staff briefing, you mentioned something that did not come up in your answer earlier to President Boehne. It has to do with what happens to M2 when there are capital losses in stock and bond funds. We had an experience of that in 1986. I was wondering if you thought that might be another reason why M2 growth might in fact be better.

MR. KOHN. Right. If, contrary to our expectations-- contrasting the System's expectations with the market's--long-term rates were to go up, then we might have some people surprised by that. We had some evidence of that in 1992 as far as the [unintelligible]. This is a bit in response to Chairman Greenspan about what the opportunity costs are. Are realized capital gains to be included in the returns and all that sort of thing? It's a little hard to see exactly, but one can make a case I think that those flows slowed down for a little while, particularly when the stock market and bond prices went down on a few occasions. I think if there were a major turnaround in the market, the initial reaction of investors would be, of course, "I've got capital losses; these things aren't as safe and as liquid in some sense of certainty about return as I thought they were." Now, the end result would be a steeper yield curve. So, I think the initial reaction might be [a move] out of stock and bond funds, assuming both the stock and bond markets were going down at the same time, for a while and perhaps a little less enthusiasm over time. But I would have a steeper yield curve in the end, so that would be working perhaps over the longer period of time a little against M2. But I agree with your analysis. If we had a major break in stock and bond markets, I think that would make people think twice about where they were putting their time deposits.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Don, at these Humphrey-Hawkins meetings you usually show some alternative longer-run projections done with a forward-looking model, which took greater explicit account of credibility effects. I notice you didn't do that this time, but it strikes me that that might be especially interesting now. Did you do anything like that?

MR. KOHN. No, we didn't. I think actually, President Broaddus, in the past we've done what we did this time, which was to use the same model but note in the write-up of the tighter policy scenario that if there were credibility effects things would be better; we'd have lower sacrifice ratios and a faster return to price stability. I don't think we've ever done a simulation. Now, we have done the P* simulation, but given these projections for M2 and the implied shifts in V*, the P* model, which is on the last page of the Financial Indicators tables, shows deflation in 1994. We thought there would be some internal dynamics. For instance, if that's what was happening, M2 growth would be faster if we weren't getting the shifts somewhere showing this.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Reading this and then listening to your opening comments about this table on page 8 of the Bluebook and where the economy is, I was struck by the emphasis on how close we are to potential output or full employment, in part because it reminded me of some of the discussion that we heard in the late 1970s about heavy reliance on the gap of potential and NAIRUs and all that. I also was struck [by the fact that] in this table we get this after just two years of 3-1/2 percent real GDP growth, [which] suddenly drops to 2.2 percent under the alternative III with the idea that [unintelligible] after 2 years or so of that kind of growth. It looks rather modest. In view of all the discussion that we've been having in this group and

discussions among members of the profession, over the last year or so anyway, about the restructuring that's going on, the information technologies, the tremendous amount of churning especially in the industrial sector of the economy, how comfortable are you talking about potential output or where the NAIRU is?

MR. KOHN. Well, Mike may want to comment on this, but I think we take account, as he did yesterday in his Chart Show, of an increased trend in productivity in calculating the potential that's implied here. Also, as noted in the write-up, there's a sense that perhaps the NAIRU right now might be restructuring itself; raising the growth rate of potential might also raise the NAIRU since there are a lot of people between jobs who need to find jobs. The matching of the jobs and the people, which is one of the things determining the NAIRU, might be particularly difficult right now--especially with the downsizing in the defense industry and in other areas as well. We could see more frictions in the job market. We've actually assumed here for the purpose of these simulations that the NAIRU is 6 percent for a couple of years before dropping back to the 5-3/4 percent that we think it was over the last few years.

MR. PRELL. I think Don has covered the point. We've always been uncertain; the concept itself is not airtight. But even in estimating it, one has to [allow for] some considerable range either with the potential output concept or the NAIRU. But I think the two are working in opposite directions, as Don suggested. For one, we may be getting faster expansion of potential output currently but there are many displaced workers. And experience suggests--from the churning we saw in the first half of the 1980s in the manufacturing sector when the dollar appreciated so much and we had what seemed to be a lot of restructuring in manufacturing--that displaced workers take some considerable length of time to find their way back into jobs. One can see the likelihood of some of this happening again. That may be one of the reasons some private analysts seem to have this worse inflation/output tradeoff in the short run. I wouldn't want to push that far, but I think there is the risk that this structural element in the unemployment situation now might be a little greater and that we have effectively less room to run in terms of reduction in unemployment before we get those labor market pressures. The markets for particular skills that are useful in this automated environment--people who can do the programming and so on--may be relatively tight. We can see some of the dispersion in recent wage numbers.

MR. KOHN. It might take a higher real wage to get them to move from southern California.

CHAIRMAN GREENSPAN. Tom.

MR. HOENIG. Don, I've read this and listened to what you said. One thing that bothers me as we look at these simulations of alternative strategies is that you've given reasons for and against why velocity can increase, but this is very dependent upon having the velocity at a rate that has only been reached, I think, three times in decades. How confident then can you be on the arguments for why velocity should continue to be very high?

MR. KOHN. Well, obviously, there's a wide spread around this [forecast]. As I noted, I think the spread is evenly distributed

around it. I can think of reasons why [velocity] might be even faster. So, it's not a tight relationship, particularly given that as last year went on, there was [considerable] evidence that the credit flows continued to bypass the banking system. The banks are faced with restraints on growth or at least incentives to keep very high capital ratios or face increasing costs of regulatory deposit insurance. That would cause them not to bid so aggressively for deposits. Businesses and households are both borrowing in long-term markets. They're not seeking bank credit or thrift credit particularly, and that's being accommodated as they leave the banking system and go into the bond and stock markets through the mutual funds. I think this process will continue, and I'm fairly confident that under the Greenbook projections for nominal GDP and relatively flat interest rates, even without necessarily the decline in the long-term rates, that we will have a reasonably substantial increase in velocity this year--whether it'll be 3-1/2 percent or something else. I find it much easier to predict an increase in velocity than flat velocity. There's enough evidence that this readjustment/restructuring process is continuing.

CHAIRMAN GREENSPAN. It's called the demise of commercial banking.

MR. KELLEY. I'm afraid that's right.

MR. KOHN. And the thrift industry.

CHAIRMAN GREENSPAN. Any further questions for Don? If not, let me get started on the round table. As I've said before, I think the evidence continues to mount that as the result of the policies we've put in place--wisely or luckily--we are looking at what seems to be a continued disinflation path. That is bringing the consumer price index and the general inflation indicators to what I suspect is a glide down a path to as close to a noninflationary environment as one can get in the real world. We obviously are beginning to get the signs that individuals are responding in a way that several of you mentioned. It's fairly apparent that as expectations of price inflation in the longer run diminish, we begin to get the restructuring actions that a lot of companies are undertaking. In other words, rather than endeavoring to increase profit margins by moving prices, they are being forced to take it out of the cost side, which is another way of saying that productivity is improving. As Governor Angell mentioned the last time, as I recall, we are beginning to see the effects of price disinflation on output. If one looks at the characteristics of the way one wants the economy to function, one wants businesses to be improving their profit margins by taking it out of the cost side and not moving on the price side. And in that respect I think that we are on an extraordinary path, as I say [unintelligible]. Nonetheless, it seems to be working out that way.

That essentially means that if we sit still and do nothing at this stage, we're likely to be very pleased with [developments] both on the economic activity side and on the price side. In fact, they'll be basically related. This raises the very important [question] of what is the policy role of targets. Targets were imposed on us in the Humphrey-Hawkins legislation and we have been employing them ever since, first with M1 and then M2 and M3. We go through the process of forecasting what these targets are pretty much in the manner Don

described. And for want of a better term, it's essentially a projection of nominal GDP, and a forecast of the money supplies, whichever ones fall out from an analytical procedure that strives to get velocity. While there are some obvious interactions, it is mainly functioning in that manner. We have looked very closely and have adjusted policy on innumerable occasions when credit behaved abnormally, when the money supply behaved abnormally. But I must say --I don't know about the rest of you--that as far as I'm concerned I almost never cared in those instances if we were making a judgment that something was abnormal about where the money supply was relative to the targets we had put together sometime earlier in the year. And I think what we're viewing at this particular stage is something which is basically related to this. I frankly don't think that whatever targets we agree to today are going to make the slightest difference in the way this Committee functions in the next year because whatever is going on we will respond to it. What we decide today will be an interesting thing to look at, but I would be very surprised if anybody here really is driven by the fact that we are on one edge of this target [range] or the other. I may be exaggerating for some of the people around this table, but I'm not exaggerating for myself!

This leads me to conclude that the target issue that we are discussing today is not a policy question. It's a political perception question. Having said that, I then get to the question of what we know about the perceptions that are likely to happen. The first thing I ask myself is how good a forecaster are we of what we now define as M2 with all its components. And I must say that the verdict on our forecasting capabilities is probably not publishable. Take a look at how badly we have done in the last year! We have, with the most sophisticated analytical techniques, veered continuously off the actual short-term path, which is another way of saying that monetary policy per se is not likely to make all that much difference as to where M2 shows up one way or the other. Don suggested that if we were to lower the funds rate by 1/2 point or more as he put it--I heard the "more" very loudly--we might edge growth of M2 up 1/2 percent. Well, I submit to you that whatever happens to M2 over the next year, 1/2 percent is going to be in the de minimis area; no one could care less. What is going to drive M2 probably has very little to do with what we do; it will have to do with the outside market forces because the disconnect that has occurred between bank reserves on the one hand, and the monetary base, the funds rate, and M2 is really quite extraordinary. [In response] to talk that says we can significantly influence this--or as the phraseology goes that if we lower rates, we will move M2 up into the range--I say "garbage." The chances of that are at the lower end of the probability ranges of what we're talking about. I don't know where M2 is going. My own guess is that Don's forecast is as good a forecast as we can get. But I'd hate to have to figure out what the standard error of that forecast is because it has to be awfully large on the basis of all the other things that we don't know.

Having said all of that, I then ask myself: "What should we be doing?" Well, we have a statute out there. If we didn't have the statute, I would argue that we ought to forget the whole thing. If it doesn't have any policy purpose, why are we doing it? By law [we have] to make such forecasts. And if we are to do so, I suggest that we do them in a context which does us the least harm, if I may put it that way. And that is the reason why I think we should view what we

do today in terms of the perceptions as distinct from policy and think in terms of policy in a somewhat different context, which we will be discussing later. In any event, I conclude from all of this that we probably would be best off by moving the targets down 1/2 point--in other words adopting a 2 to 6 percent range for M2 and probably 1/2 to 4-1/2 percent for M3, leaving the debt range unchanged for the reasons Don mentioned. I would have some sympathy for leaving the upper end of the range for M2 alone. I don't feel strongly one way or the other. My concern about doing that, frankly, is that it would be interpreted, I regret to say, as our caving in to pressures from a number of our friends on Capitol Hill. If it weren't for that, I could see the logic of it, remembering that we are viewing it as a perception question not as a policy question. Having been exposed to at least two [Congressional] hearings and the type of responses that we got on this issue, I would congratulate our [colleague], Governor Kelley, who was very perceptive at our last meeting in suggesting something not dissimilar to what has been going on. As a consequence, I would merely say that I find the arguments overwhelming for us to do something modest, define it as a technical issue, not get involved in the policy questions, and leave it at that. Governor Angell.

MR. ANGELL. Mr. Chairman, you can count me on board as not having exaggerated my feelings in regard to [the role of] M2. I wholeheartedly agree with your statement. I also agree that it's a political perception question that we're dealing with here and I'd like to ask you a question in that regard. Since it's a political perception question, if we go to a 2 to 6 percent range--which means we've made a move--and if actual growth comes in below 2 percent, are we not putting ourselves into a very difficult political situation?

CHAIRMAN GREENSPAN. I would say it depends wholly on what is happening in the economy. If the economy is doing what it's doing now, that issue will just fade into insignificance.

MR. ANGELL. Yes.

CHAIRMAN GREENSPAN. If the economy is doing poorly, we're in trouble even if the money supply goes up.

MR. ANGELL. Well, for political perception reasons, I would prefer to go to 1 to 5 percent on M2, [lower] M3 to 0 to 4 percent, and leave the debt range alone. My reason is that in my mind we are going to take political heat for the 1/2 point [reduction]. And we're going to take 90 percent of the political heat if we go to 2 to 6 percent that we would take if we went to 1 to 5 percent.

CHAIRMAN GREENSPAN. I think we've already gotten the political heat at 1/2 point; that's what everyone expects. I think we're taking on more than we need to; I frankly don't see the purpose of doing more.

MR. ANGELL. My view is that there's just too much uncertainty here. Let's suppose we move this range [down by 1/2 percentage point] and the economy is performing just like the staff forecast and it is not adequate to get the kind of job growth that politically is desired. I believe that with our staff forecast and the lack of job growth and a range of 2 to 6 percent, if M2 is at 1.8 percent, we'd be in a pack of trouble.

CHAIRMAN GREENSPAN. Let me say this. If we were to go down a full point, all we would evoke is Senator Sarbanes re-quoting Paul McCracken's story about that guy who shot a hole in the [barn door]. All I can tell you, Wayne, having been up there, is that it is not an academic discussion;

This is raw politics

I must tell you that I would feel far more comfortable going up there with a 1/2 point [reduction] and I wouldn't even mind if we kept going under that; I don't think that's a particular problem. I think we would be provoking more noise than is necessary by going more than 1/2 point, and I must say that I would prefer not to do that.

MR. ANGELL. Okay. By and large in this case, this is your story in the Humphrey-Hawkins setting, even though I don't quite agree about the political risk. That is, I would rather face his continued unhappiness right now when I think we're okay than I would to take it on the chin a year from now. As far as the members of the Committee are concerned, if we were to go to 1 to 5 percent or even 2 to 6 percent and if conditions changed--for example, if the velocity picture changed and other leading indicators were suggesting that M2 ought to be growing [above] the top of the range--I would feel it very strange not to be able to accommodate such growth of M2 under some conditions.

CHAIRMAN GREENSPAN. I agree with that. In fact, one issue that I think ought to be on the table here is whether in the Humphrey-Hawkins testimony we should suggest that. How to play it is an interesting question. But as a policy question, I absolutely agree with what you're saying.

MR. ANGELL. Well, I'm not going to vote against a [1/2 point] decrease in these rates, particularly in this situation where it seems to me that what we're doing is backing you up as the Chairman making a presentation. Even though I like 1 to 5 percent a lot better, I think in a sense that it's your call. I feel rather strongly about it, but at the same time I feel very supportive of your position.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mr. Chairman, I support what you suggest. I think you're right that, given the relative variances coming from things we can control and things we can't control, there isn't any policy consequence within the ranges of change that we're talking about here. I would think in that environment that if we had not already committed to doing something--I'm attracted by the notion of doing something modest and the limit of modesty is nothing--I'd probably do nothing at all. But I think we have committed to it; and if we have to pay the price, I think we have to do it.

CHAIRMAN GREENSPAN. Yes, doing nothing now would look like we caved in.

MR. SYRON. Exactly for that reason I think we have to do it. But I have some sympathy for widening the range to 2 to 6-1/2 percent because that is consistent with the notion [of how we view] this number. If we were really being honest about it or if we were unconstrained--I'll put it that way--from a political perspective,

we'd say, given what we would like to see happen to the economy, that this number could be anywhere between -1 and +10. That's an exaggeration, but I [wouldn't] go up [to testify] with the same range, even though it is a slightly wider range than it was at some earlier points. Widening the range says something; it's consistent with the notion that this is a very uncertain thing to think about. And if we're going to widen it, I think you're right that we're committed to lowering the bottom band; it would look like we were caving in if we did not. But I would leave the top at 6-1/2 percent.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I think your point is well taken; this is largely a political decision. Politically, I think we can all agree that 5-1/2 percent nominal GDP is good, so it won't cause us any trouble. And I understand your case for lowering the average range 1/2 point. I would suggest a slightly different twist. If I were going to go out there and with a straight face use these M2 ranges as a political signal, the signal that I would send is that the first thing we want to do is to prevent a relapse into recession. And second, I would want to signal a willingness to prevent a resurgence of inflation. That adds up to me that what we want to do is cut the top end to, say, 5-1/2 percent and leave the bottom end at 2-1/2 percent. If we really believe what we're saying about 3-1/2 percent velocity, then 5-1/2 plus 3-1/2 is 9 percent nominal GDP growth. I can't imagine anyone seriously thinking they would support a policy of 9 percent nominal GDP. On the other hand, 2-1/2 plus 3-1/2 gives us 6 percent GDP, which is only 1/2 point higher than where we think we were last year. So, I would say that if we believe the forecast, what we want to do is maintain the bottom end of the range and cut the top end of the range.

There's a second possibility and that is that it's not wholly a political issue. I would recommend the NBER Conference Papers, though I was not able to attend the conference. Academic economists-- it's almost a shock compared to what we're thinking--not only want us to focus more on M2 and nominal GDP but they actually have quarterly adjustment processes; [they suggest] that we should look at what happened last quarter to determine what we should do with money next quarter. And that is so far from what we're talking about at this table--

CHAIRMAN GREENSPAN. And reality.

MR. LINDSEY. And reality. But given that academic economists can be our most important constituency when times get tough, if we are moving that far out of the academic ranges, we should be a little concerned. I have the numbers in front of me. It was pointed out earlier that in the last 7 years on a quarterly basis there have been only 3 out of 28 quarters where velocity has been more than 3-1/2; there have been only 5 when velocity has been more than 3. I would think that, if anything, the conditions that led to a large velocity shock last year are less in place than they are this year. As President Jordan said yesterday, we've had no big increases in the narrower monetary aggregates. In addition, there's more bank aggressiveness, not less, going on. Restructuring has occurred more, not less, than a year ago. And we've already seen a substantial amount of CD runoff. So, I would say that if we want to avoid what

Jerry Corrigan was afraid of, and that is an outcome outside our range of expectations, we'd want to have a range of 2-1/2 to 5-1/2 percent. That's just to throw another option on the table.

MR. MULLINS. A narrower band?

MR. LINDSEY. A narrower band.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I would support the recommendation as you have made it. It seems to me it would be desirable to make 3 points in the testimony. The first is the one you emphasized, that this is a technical adjustment designed to accommodate a decline in money demand and, therefore, it wouldn't be expected to produce lower growth in 1993. The other thing that might be worth noting is that the adjustment is really consistent with our prior inflation goals and doesn't represent any attempt on our part to increase the pace of disinflation. And, finally, we all have been talking about the uncertainties associated with this whole exercise, and I think it may be well just to confront very directly the possibility that M2 and M3 could undershoot even this adjusted target; I'd make that point clear.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I had some similar thoughts, but I would favor alternative II, though I could certainly live with what you have suggested. I think some reduction in the M2 range is important. I don't think one can emphasize too much this credibility point that you made and [the need to avoid] any perception whatsoever that we're caving in to political pressures. It's not just a question of the Fed's credibility as an institution. I think it's very important to U.S. economic policy right now in general that we guard that credibility. I have suggestions similar to Bob's with respect to things that could be said. There is the technical issue. I think the way to deal with Bob's point on inflation may simply be to say something along the lines of: "Just recognize the progress that has been made in bringing inflation down." That in a sense is a technical argument, too, that ought to be recognized in the ranges as a technical point without any implications with respect to rattling the saber. As to the future, I think Bob's point on controllability is a good one, as is what you said about controllability; it's something I've agreed with for a long time. I think the value of M2 when it was behaving was never as a target but as an indicator of what was going on in nominal GDP and not something that we could influence. I guess that raises another possibility in terms of things you might say, a la Steve Axilrod's suggestion, but it might not be a bad idea to point out at this time that we need to look at a broad range of things: other monetary indicators, the behavior of the economy, etc. It's just a good time to make the point that we're required to set these--you've made this point before--but we look at a broad range of indicators in making policy decisions. When you said "forget the whole thing," I trust what you were talking about was that at this point in time, given the uncertainties, it would be a mistake if we as the central bank backed away in a long-term sense from trying to understand the behavior of money and having money in some sort of--

CHAIRMAN GREENSPAN. No, I was referring wholly to the target issue.

MR. MELZER. At this point in time?

CHAIRMAN GREENSPAN. At this point in time.

MR. MELZER. Okay.

CHAIRMAN GREENSPAN. Not backing away from money. The financial system is what we respond to. Money is one of the proxies we employ to understand that system. We can't get away from that. It's merely the rigidity of the Humphrey-Hawkins statutory requirements--

MR. MELZER. Right.

CHAIRMAN GREENSPAN. I would feel more comfortable dropping them at this stage, but we don't have a choice. President Stern.

MR. STERN. Thank you, Mr. Chairman. I have some considerable sympathy for the position you've taken and for the considerations that go into it. I'll only add two observations. One, it seems to me that one consideration to lower the range, and particularly the lower end, is of course that we got 2 percent or so growth in M2 last year. And to the people who want to attribute that to us it would be a rather strange commentary if we say that in some sense we are unwilling to have that kind of growth again this year. So, I think that consideration suggests that the range ought to go down. In listening to your discussion, it seems to me that what you're suggesting, and I certainly agree, is that M2 and the other aggregates are information variables. We have a whole host of those variables that we look at constantly. Having some sort of range, aside from the fact that it's required, is a good idea because we need to evaluate the incoming information against something. If we were to follow that approach rigorously, we would establish a range that would be either centered around the midpoint of Don's forecast and/or would be centered around a growth that we consider consistent with a noninflationary environment in the long run. I think both of those would imply lower ranges than we're talking about today, and I don't think this is the time to move that aggressively. So, I'm comfortable with what you're suggesting.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I would support the plain vanilla 1/2 percentage point cut on both ends. I'm not attracted to cutting the lower end to 2 percent and leaving the upper end at 6-1/2 percent, first because I think it appears to be a bit cute. Politically, I think we would hear about drawing the target out just a bit to capture that last shot. And I don't think people are too worried about very rapid M2 growth and our slamming on the brakes right now; they're worried about slower growth. So, I'm for a plain vanilla, 1/2 point cut on both ends.

I am growing a bit concerned about this whole targeting process, even though I'm comfortable with policy. I think we're headed for trouble because even if the economy performs well, we're

going to show a negative [growth rate for M2 and M3] in the first quarter of 1993. And if real GDP is 3 percent, we're still going to hear the criticism--not just the political criticism but the academic criticism--that we are holding back the pace of this recovery, restraining it. This is what we've heard even though we've had two quarters of 3-1/2 percent GDP growth. I've become a little disenchanted with trying to explain it as velocity changes because I think that's not selling especially well. We're simply not targeting M2 at the current time in the sense that low M2 growth will not lead to a policy change. We are jointly targeting M2 and velocity, which suggests to me that we're implicitly targeting nominal GDP. I feel much more comfortable with a nominal GDP target than I do with an M2 target, but in some sense we're not revealing the nominal GDP target. So, this causes a lot of confusion. As this goes on, I think we're going to have to explore other more structurally satisfying ways to explain this phenomenon. I like the notion of capturing the distortion in the other aggregates and, for example, pointing out that M2 adjusted for the yield curve is growing, M2 plus bond funds are growing, and M2 and bank deposits are growing; it's only the S&Ls that are not. Obviously, I don't think at this stage that we should consider monitoring ranges or anything like that. All these aggregates have problems. But something is going to remain unsatisfying about a process in which we show very, very low M2 growth and then say it's sort of okay, we'll make it up on velocity. Again, for the time being we're on this path and I don't think we can do much about it except that we should continue to think about it because we're going to be forced back to the issue. In the interim, I think you're exactly right: The least disruptive thing to do is to take a plain vanilla 1/2 point cut, which I believe is fully discounted.

CHAIRMAN GREENSPAN. There is one thing we could do to come to grips with your question and that is to publish a couple more Ms and put targets on them.

MR. MULLINS. Or we could have monitoring ranges. I don't know that we'd want to paper the world with Ms just to try to confuse the issue!

CHAIRMAN GREENSPAN(?). I think Arthur Burns had 7 Ms.

MR. MULLINS. [Having more Ms] does get more directly, in an understandable manner, to what is happening in that it involves moving out the yield curve. And we could actually show that some broader aggregates would be growing, which might be encouraging. So, I think we should continue to work on these and supplement our velocity argument. I, too, have been surprised, even in the academic setting, at how unsuccessful the arguments on velocity have been even though they're very logical. I think people can't see behind velocity. It might be easier to look at an alternative measure. As you have pointed out in other settings, there is a distressing shortage of scapegoats in the political arena.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I understand where you're coming from on your proposal and I don't see many options. Like others around here, I am very bothered by it because we are setting a target that we know we will not be making any time in the near future. And

that will cause us a lot of grief as those who are pushing us follow up on this and see that we cannot and did not make it. That perhaps emphasizes Governor Mullins' point that we've got to find a way to explain by other means what we're doing or we will be under heavy, heavy, criticism going forward despite the fact that we dropped the range down 1/2 point. But it's a 1/2 point that I think we're not going to make right away and that really bothers me.

CHAIRMAN GREENSPAN. I think Governor Mullins has raised a very important issue here. And it might not be a bad idea for us to be thinking about this prior to the next meeting and see how we can confront this. In principle, in a very long-run sense we really have been targeting nominal GDP. The trouble with GDP is that it's a very fuzzy number; it gets revised; and it's always late. We don't know where we are; it's not forward-looking. And we've always used some of these financial aggregates as advance signals or informational indicators of where in fact GDP is going. If the indicators collapse, one goes back to the original source and looks at it directly. But we may well be able to find a number of different proxies that we might want to publish in a supplementary sense. And I will tell you that to do so would diffuse a lot of the politics because [observers] would not know what to think at that point. It's as if we were to drop small time deposits from M2 and republish it. People would have a terrible time [evaluating M2] because the argument as to why it's out of the range--I don't care what we say as to why it's out of the range--almost doesn't matter. They would be looking at a number [that simply could not be interpreted.] It would be very tough to make a judgment as to what really is going on.

MR. HOENIG. You're suggesting that if we dropped small time deposits out we'd have a fairly fast growing M2, which would only add more confusion.

CHAIRMAN GREENSPAN. That's right.

SPEAKER(?). But we already have M1! [Laughter]

CHAIRMAN GREENSPAN. I will suggest to Don Kohn, however, that he give some thought to this, and perhaps we ought to spend a little time at the next meeting in March and go a little further on this question. I think we'll learn a lot, depending on how the Humphrey-Hawkins testimony ultimately emerges, and we'll know a lot more about first-quarter GDP. At the moment my guess is that the statistical risks of the first-quarter GDP forecast are on the up side, not on the down side. Remember, we're [now] looking at the fourth quarter. It looks as if fourth-quarter growth is going to be under that in the third though, to be sure, the third quarter was revised down. But the first quarter may surprise us, and that will do a lot to the configuration of how we are perceived [and] how we behave. President Broaddus.

MR. BROADDUS. Mr. Chairman, I would personally prefer a full point drop in the M2 range to 1-1/2 to 5-1/2 percent. I think Don makes as strong a case as one can make for any forecast. But obviously there is plenty of uncertainty in forecasting money demand and velocity, and your approach of 2 to 6 percent would certainly be acceptable to me. I think the one thing we can't do is nothing. That would be absolutely the wrong signal. The bond market would punish us

severely if we tried something like that. In that connection, I agree with Governor Mullins' [comments] yesterday in that I would have some concern about widening the range. I think people would perceive that as trying to have it both ways. And that could do some damage to our credibility. If we adopt 2 to 6 percent, Mr. Chairman, it strikes me that you might want to consider saying something in your testimony to the effect that the Committee will take a particularly close look at the current range when we review it at the July meeting. And you might even go so far as to say that in the current circumstances there's some possibility we would consider lowering the ranges at such time. Historically, if I'm not mistaken, we typically have not made a move on the current range at the July meeting. I know we're vulnerable to the McCracken kind of story, but it strikes me that in the current situation, with all the technical problems we face, that that would not be an unreasonable thing to do.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I have a lot of sympathy for a number of things that have been said here as far as descriptions of the way the Committee functions, [including] some of Larry Lindsey's remarks, Tom Melzer's, Dave Mullins', and your own comments about it. I don't really care at all where the debt or M3 targets are set because, with the tools available, I can't imagine any action by the Federal Reserve being influenced by whatever they do. What a central bank does is to set the discount rate, reserve requirements, and open market operations to peg the funds rate, letting that be endogenous. When I look at what actually is done, even M2 does not seem to have any relevance to what the Committee does or what the [Board of] Governors does. It would seem to me [reasonable] in the circumstances, [given] a sense of efficient markets and trying to improve the quality of information to decisionmakers, to say that we're going to put out an M2 range but it's not a target at all. It's a staff forecast and the FOMC has no intention of doing anything to try to stay within that range. I can imagine a set of circumstances, without putting a probability on it, where the yield curve could flatten dramatically, we could get 1 percent M1 growth and 8 percent M2 growth, and as long as we were getting something close to the central tendency [of our forecasts] or the Board staff projection on nominal and real GDP this Committee wouldn't do anything. It's inconsistent in my view to say "Here's a target for M2" and not seek institutional arrangements that help us hit it. It's not a target if we don't try to do something to hit it. So, why not explain that this is not a target and that we don't really have targets. We can set up monitoring ranges for M1 and the base, which might be useful for some purposes [in terms of] where we think they may fall, but they're not targets for the Committee. What is a target is either nominal GDP or various real indicators. And for better or worse, if that's the way the Committee is conducting its affairs, then I think that ought to be explained.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, as you went through your opening comments I completely agreed with what you said and how you said it but, honestly, I thought you were coming to a different conclusion. I thought you made a very good case for leaving the ranges where they were and not making a change. In a perfect world, frankly, that's what I'd prefer. But I do understand that we aren't in a perfect

world and that there are some political perceptions out there that we need to deal with. But there seem to have been enough changes since the correspondence we received indicating that we might reduce our ranges--and certainly the incoming data for this year suggest that the numbers are moving even further away from our expectations--that one could make a case that developments have taken place that make a change not seem appropriate. The uncertainties are very, very significant and, therefore, I would leave the ranges where they are. I'd prefer to keep them where we tentatively set them last July, but I certainly don't feel strongly enough about it to dissent. Therefore, I would support the case that you made because you seem to feel more comfortable in a political context with what you've said, and I'd support that.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Clearly, we have a lot of politics floating around; a lot of the discussion does seem to center on politics. Unfortunately, politics is a lot perception, and at some point perception and reality start to merge. And I worry some about our developing our own platform for criticism. I think we clearly have to do something and I think whatever action is taken shouldn't need lots of explanation. The action should speak for itself, which is one of the reasons I like the idea of lowering the bottom end but not necessarily the top end because I think [a wider range] would convey the increased uncertainty. Having said that, though, [one could] say that the top end is probably the most irrelevant part of the whole range at this point. I wouldn't wait until March or until our next meeting, though, to start discussing in the text that we are looking at some other types of Ms.

CHAIRMAN GREENSPAN. I'm sorry, what text are you thinking of?

MS. PHILLIPS. The text of Humphrey-Hawkins.

CHAIRMAN GREENSPAN. The report itself, you mean?

MS. PHILLIPS. The report itself. I might not shower them with all kinds of Ms, but I think an indication that we have been monitoring more than just M2--that is to say, we are looking at M2 plus bond funds, plus stock funds, adjusted for the yield curve, and so on--would be [appropriate].

CHAIRMAN GREENSPAN. You mean as a means of trying to explain the velocity question without getting to this velocity--?

MS. PHILLIPS. Right.

CHAIRMAN GREENSPAN. That's an interesting idea.

MS. PHILLIPS. One could think of it even as a sort of surcharge during this period when things are so unusual that it's appropriate to deviate from looking just at M2 or the traditional [measures] and to start looking now at more--

CHAIRMAN GREENSPAN. What you're suggesting is unbundling the Feinman/Porter analysis in a way that is more readily describable and not econometric.

MS. PHILLIPS. Right, understandable! So, I guess my preference would be President Syron's approach. I probably would end up supporting the 1/2 point [reduction] but with more explanation or some monitoring ranges [besides] just M2.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I buy into your recommendation on this. Given where we are, I think it's the least harmful way to deal with it. I would stress the technical side. I'd like to comment on the broader issues that have come up having to do with our explanation of the problems of M2. I think the velocity approach is a loser. I don't think it has gotten us anywhere. I view our strength as an institution as a real world strength: that we understand markets, that we have a feel for these, and that we understand institutions. So I would explain this in English rather than econometrics. And I think it has to do with long-term and short-term rates and the diminishing role of banks in the financial flows of the economy. That to me is the way to do it. And I would hope that you can do that in your testimony and maybe even elaborate with an appendix. I would be somewhat wary, however, of dropping M2 anytime soon even if we thought it seriously flawed. A better approach is to continue to have M2 but to get people used to an M2-A or an M2-B and to have several of these that we can look at over time. Then, as time goes on and people get used to these, M2-A and M2-B can become M2; but I think we have to get people used to the change. If we make definitional changes too dramatically without these kinds of parallel alternatives, I think we will run into some real problems. We can make this case better than we have made it and we can make it in a real world sense. We can use something else that the eyes can look at and then down the road we can make the definitional change and the shift [to a new M2 measure]. I believe it can be handled, and I think we ought to get on with it.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, first of all I'd like to say that I appreciate the long-term outlook that has been provided in the Bluebook; I think it was a very useful exercise. I agree entirely with your statement that the setting of these ranges doesn't serve any particular policy purpose. But we're faced with a statute. If we were operating in a nonpolitical context, the logic would suggest that we set the ranges to encompass what we think M2 is going to do. That's the honest thing to do. Unfortunately, we don't operate in a nonpolitical context and in my judgment the political considerations have to be paramount here. Not to do anything would play into the hands of our political opponents in the sense that they would sense a victory that might have adverse consequences in the market. So, I think the compromise, if I can describe it that way, of 2 to 6 percent is the right way to go. I think it would be confusing to everyone to try to fine-tune either the lower end or the upper end of these ranges. I would do it straightforwardly by a 1/2 percentage point reduction. I think Governor Mullins is exactly right: This issue is not going to go away. And I'm not persuaded that the technical issue, or the velocity issue, is a salable argument.

Many of the points that have been made are good ones in terms of your testimony. I would be inclined to stress the performance of the economy and the improvements in inflation and GDP, notwithstanding the lower range for M2. I just don't think this is the time for us to waste a lot of political capital on this issue. We're going to continue to get some heat, but I think setting a range of 2 to 6 percent is the best way to [proceed]. Let me say one final thing. You've taken already a lot of heat; you're going to take some more, I'm sure. And I would just hope that the Committee would be completely supportive of you in this because you're going to have a tough time, I suspect; I think we should be behind you all the way.

CHAIRMAN GREENSPAN. Thank you. Governor LaWare.

MR. LAWARE. I support your recommendation, Mr. Chairman.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Mr. Chairman, I support your recommendation for the reasons that you gave. But I would like to join everybody else in helping you write your testimony! [Laughter] I'd include what you said this morning: That if we weren't required by law, we probably wouldn't be doing this. I would say that very honestly and directly. I would call attention to the unusual behavior of M2 and M2 velocity in the past year or so and refer to it not just as a technical adjustment but explain what has been happening in very common sense language. I'd describe the bypassing of the banking system or disintermediation and point out that it's disintermediation caused by low interest rates rather than high interest rates, unlike what people learned earlier disintermediation was caused by. I'd point out that other measures of money--the base, M1, and so forth--have been growing at very rapid rates; and I'd point out that if we make very logical adjustments, such as adding in stock and bond funds, M2 would have been in the middle of its target range. I have a draft here that adjusts M2 for stock and bond funds minus IRA and Keough accounts, and it shows us right in the middle of the target range. I don't think many people understand that. When Milton Friedman and Paul Samuelson don't seem to understand it, I think there's an economic education problem out there that we have to deal with! If we don't publish a lot of Ms at least we need to talk about a lot of Ms. Maybe we should include an appendix, as someone mentioned, and follow the rule I suggested to you earlier that we shouldn't even show a chart for M2 without having other Ms on the same page so that they can't be separated. You might even refer to an earlier period in the '80s when we had the opposite problem, when the money supply was growing above the target ranges and nobody seemed to be complaining about that. So, I think there's almost a requirement that we do a better job of economic education. I realize that we're not going to convince the critics, but a lot of people watch C-Span and it's very depressing these days. But I support your 2 to 6 percent range for M2.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, a 2 to 6 percent formulation is a slam-dunk for me. But I have to say that I find some of the discussion around the table troubling on several points. First of all, as someone who has had nothing but distaste if not disdain for M2--even when people thought it was good--I'm not quite ready to

accept the point that there is no policy purpose to be served in the context of this discussion, even though I have no confidence in M2. But I also find troubling the amount of emphasis that you put on the point that this is basically a political thing we're talking about here. I don't agree with that. I think in the first instance the choices before the Committee are substantive choices. They are choices that in the current circumstances have to be [viewed] more in a context in which there's a lot of noise in the numbers as well as elsewhere. But I view this as substantive. And in my own kind of bimodal risk analysis I think it becomes very substantive, whether one likes M2 or not, because depending upon how the economy evolves, it could make a tremendously important difference in terms of both the perceptions about policy and policy itself. So, as I said, I'm not altogether enamored by some of the body English that has gone with this discussion.

I am also terribly concerned about throwing all these Ms out there. Now, you pointed out, Mr. Chairman, that that's what Arthur Burns did. Chairman Burns may have succeeded in confusing the Congress but he may have confused himself because, looking at the results of policy in that era, I'm not so sure they are something I would want to be associated with. I think there is a grave danger that if we get all of these Ms out there--[up to] M27 or something--everybody's going to be happy with one of those Ms but it's not going to be the same for everybody and we're going to end up with a convoluted policy. So, I've got to help you write your testimony too, but unlike almost everybody else I'd keep it really simple. I think we have a pretty good story to tell in terms of the whole policy process and what has happened in the economy. Go back to 1989 and the fact of the matter is that a soft landing in the economy has been achieved with a degree of success and precision that is almost beyond the human mind's capacity to imagine. I'd rather talk about that than M27.

CHAIRMAN GREENSPAN. I want to say something. In fact, we're already on that track with respect to early discussions about the testimony.

VICE CHAIRMAN CORRIGAN. As I said, the 2 to 6 percent M2 range is a slam-dunk, but I would try to keep [the explanation] as simple as possible. I would not get into these comments about how we're going to have to take another close look at this in July; it's just another trap. Here it is. Let's go with it.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Well, Mr. Chairman, I can also very happily support your suggestion and I will do so. We're dealing with large uncertainties, vitally important unknowables, and we don't use [M2] anyway for running policy. While a logical case can be made for various [ranges] that are a little higher or a little lower--one can be made as logically as another--they are not that much absolutely different anyway. So, it does indeed become a political question. If one is not responsible for conducting policy, it's very easy to stay with the tried and true, or at least with what seems to be the tried and true. That's done on a very sophisticated basis in academia and in a much cruder and more simplistic basis politically and perhaps largely in the media. But we are responsible, and we cannot rely on

what has seemed to be tried and true even though it might silence some critics in the short run. We know that it could get us in very bad trouble in the long run; we just can't do that. I'm delighted to hear comments around the table this morning, and certainly would like to add my voice, about the need to explain these facts in much more accessible ways and maybe to use more available and hitherto ignored channels to get out the story of what we're trying to do, why we're doing it, and how we're doing. We need to do that in language that's accessible to the media and the general public and our political critics and our political friends. So, I think the suggestions that Bob McTeer and others have made are right. Perhaps we're being forced into it; we'd prefer not to be there; historically, we may not have had to do it but that's where we are today. But to return where I started, I certainly think that your suggestion is as politically viable a way to project these targets as any other would be.

CHAIRMAN GREENSPAN. Thank you. I propose that we vote on the following ranges: M2, 2 to 6 percent; M3, 1/2 to 4-1/2 percent; and debt, 4-1/2 to 8-1/2 percent. Read the--

MR. BERNARD. I'm reading from page 22 in the Bluebook or, if you're using the other form, starting at line 36: "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 2 to 6 percent and 1/2 to 4-1/2 percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee anticipates that developments contributing to unusual velocity increases could persist during the year. The monitoring range for growth of total domestic nonfinancial debt was set at 4-1/2 to 8-1/2 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets."

MR. LINDSEY. Given the sentence on what we're expecting in regard to velocity, shouldn't we also make it clear that if those expected velocities come to pass we would expect M2 to be at the lower end of the target range?

CHAIRMAN GREENSPAN. We do that in the testimony as distinct from here. Call the roll please.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angel	Yes
President Boehne	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President McTeer	Yes
Governor Mullins	Yes
Governor Phillips	Yes
President Stern	Yes

CHAIRMAN GREENSPAN. Do we vote for coffee at this stage?

[Coffee break]

CHAIRMAN GREENSPAN. The discussion we have just had led me to think about how successful we have been in keeping our discussions within this group. You recall that up until the last several meetings we had what I thought was a very difficult problem for discussions of this group, and I think it's important to recognize that we have been exceptionally tight[lipped]. In the last several meetings I've seen no evidence whatever of any comments about the content or anything in these meetings getting out. And I would particularly advise that we not become lax, because the ability to be as frank as we have been is very important for policymaking. If we start to loosen up again, I think we're going to lose that capability. Having said that, I will call on Don Kohn to take us to the next stage of our discussions.

MR. KOHN. Thank you, Mr. Chairman. I don't see a lot of short-term policy issues in front of the Committee today, so I will be brief. I also heard Committee members say that they were militantly ignoring M2. I also note that it's crossed out of the table, but if we could devote about 2 minutes to that--. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Don? Vice Chairman.

VICE CHAIRMAN CORRIGAN. My question is not so much for Don but for Mike Prell; this has nothing to do with current policy. Mike, do you have any concrete sense as to what this \$30 billion fiscal package is and particularly whether it involves one-time [items] or [programs] that are going to be with us?

MR. PRELL. I don't have any inside information on this at all; I know only what I've read in the newspapers. My presumption has been, for what it's worth, that if there is an investment tax credit it will probably be a permanent feature. That's more consistent with the longer-run growth strategy that was outlined during the [election] campaign. That has some implication for how big the bang would be in the very short run. And we've assumed that on the infrastructure what they still seem to be talking about probably would also be more than a one-time shot, but in what magnitude I don't know. We've assumed that would be folded in and just overwhelmed in terms of the deficit effects by the other things in due course.

VICE CHAIRMAN CORRIGAN. I'm sorry for the interruption; it was out of context.

CHAIRMAN GREENSPAN. Further questions for Don? If not, why don't I get started. As has been indicated, I don't think there's very much terribly new here. I do think, however, that we are beginning to see some evidence that overall investment is beginning to move. We're seeing it obviously in capital goods; we're seeing it in residential construction. And I suspect inventories may be preparing to move, which is important in the sense that when we're asking where the job growth is coming from and where the income is coming from to sustain consumption expenditures--unless we believe that the low saving rate is a statistical artifact and there is at least some [evidence] that indeed that might well be the case--we really cannot continue to get moderate real growth unless it's investment-led in one form or another. Obviously, defense [spending] is coming down and there's no big element involved on the government side, even with

whatever the Administration has in mind. But I think the reason why we are seeing some momentum still coming through here is that we probably are getting a definite investment push, which is spilling over into consumer incomes and probably is a significant support of the levels of activity. I do think, as discussed earlier yesterday, that the turnover in existing homes and the realized capital gains that are being engendered as a consequence, coupled with the refinancing, are making a major contribution. But that can't go on indefinitely; it certainly can't grow.

However, the most unusual thing that is beginning to emerge is that as a lot of the negatives begin to fall away--as homebuilding starts to look somewhat more buoyant, as retail markets start to firm up, as the debt-service burdens seem to be declining--there now seems to be increasing evidence that the commercial real estate problem is having a larger macroeconomic effect than I think we fully realized. There is the issue of the value of these assets in the financial intermediaries, not only in the banks but especially in the insurance companies. There is clear and I think increasing evidence that the uncertain values in these markets are having a major impact on commercial banks' lending patterns. As I put it in the testimony I was presenting the other day, the fact that a lending officer or executive of a commercial bank cannot presume that commercial real estate mortgages can be unloaded expeditiously at a price that is reasonably forecastable has been a major factor stunting the growth in lending, despite the obvious very heavy liquidity of the commercial banks.

There has to be a reason why lending is as dull as it is. And while we can argue that it's fundamentally demand that's getting less and less credible, if you look at the aggregate amount of lending that's going on outside of the financial intermediaries, there has to be some very extraordinary reasons why voluntarily the commercial banks are moving their book capital ratios up as rapidly as they have been moving them up. One obvious reason is that it's a proxy for uncertainty with respect to the reserves for nonperforming loans. If that is the case, I suspect that as the underbrush is being pushed aside and all the negatives seem to falling by the wayside this hardcore element is sitting there. And, clearly, we're not going to get any rise in real estate values for years. But the question is: Are we going to begin to get a market which is increasingly liquid? There was an article in the New York Times--I think it was Sunday--in which there was an interesting review of all of the RTC operations. It discussed the extent to which a number of commercial banks are successfully unloading some of their dead loans, the non-performers; and there's some evidence that finally the offering prices of property are beginning to hit the bids and that we're getting some increase in transactions. But the [commercial real estate] markets still feel dead; there's nothing out there. Every time we do a survey, the thing is barely moving. And I suspect that we're going to find ourselves dealing with this issue for quite a long while. That's all the more reason why low mortgage rates, especially in the commercial area, probably are one of the most important vehicles for policy that one can look at. I've been trying to push the issue, and with some success I hope, that short-term stimulus to the extent that it moves intermediate rates up may well be counterproductive. But, so far as the general outlook is concerned, this [sector] seems to me to be the one remaining major factor holding the recovery back and I think it's

not an insignificant one. It's a very small part, obviously, of the gross domestic product, but it is a very large part of the collateral for the financial intermediary system and a horrendous part of the nonperforming loans which are particularly important because intermediaries are very highly leveraged. And if this doesn't go away for a number of years--I can't see how it will--at least we can expect to find a means by which we can get some liquidity into this market. Even if it happens that the prices are 50 cents on the dollar, I think we might--while we may not get a lot of construction--very well begin finally to get some lending in the small- to medium-size businesses.

The employment issue might be taking hold. And hopefully this recovery will lose all of its head wind, if I may use that phrase that I've got myself involved in. But as I said earlier, I think that policy is beginning to look better by the day in retrospect. And I find it hard to think of any reason why we would want to [change the stance of policy] over the next 6-week period. But if somebody has some great new insight, I would be most interested in hearing it. Governor Angell.

MR. ANGELL. Mr. Chairman, I agree with your prescription. I am very tempted, of course, to believe that we may be falling behind in regard to maintaining price level targeting by targeting the fed funds rate at 3 percent. I think all of us know the difficulty of targeting M2; we've all discussed that. Certainly, there's difficulty in targeting the fed funds rate. We know that's really no way to run monetary policy under changing conditions. Also, targeting nominal GDP poses real political dangers for us because it's just so difficult to go before the Congress and explain why we like 5-1/2 percent nominal GDP better than 6-1/2 percent when there's clearly a relationship between GDP and the unemployment rate. The unemployment rate at 6-1/2 percent GDP would be more desirable than the one at 5-1/2 percent. So, with Humphrey-Hawkins suggestions that we [emphasize] price stability as a second to employment and our knowledge that employment benefits from improvement in the inflation outlook, I'm inclined to believe that we ought to be thinking about tightening at this stage. But I just don't have the stomach for doing it, Mr. Chairman; I lack the courage to be what I think would be seen as somewhat rash. And it was that prediction of lack of courage on my part and your part that caused me some meetings ago to suggest that at some point in time we might find ourselves with the need for a very large-scale move. If you would turn to Chart 6 in the Financial Indicators package that Don has provided as he always does--I was mistaken in thinking the charts were missing from the other document because they're always in this document--you will see on that bottom chart for all commodities ex-food and ex-oil a price move that is somewhat of a preliminary indication of what happened at the end of 1982 and what happened in 1987. I don't have the courage to vote to tighten at this point, Mr. Chairman, because I'm hopeful that this will get reversed. And the price of gold being--

CHAIRMAN GREENSPAN. How much is lumber in there?

MR. ANGELL. Well, lumber was up 43 percent year-over-year the last time I looked.

CHAIRMAN GREENSPAN. And it jumped to the limit in the last two trading sessions.

MR. ANGELL. Yes, but of course the beauty of this experimental ex-food and ex-oil commodity index is that it's not a [unintelligible] phenomenon with lumber; it [measures] actual house construction that is moving up and increasing demand; and it provides an indicator not only of price levels but also of real economic activity. Now, if you look at the top chart on all commodities, which is the best predictor of CPI inflation, oil's decline and the behavior of food prices do not worsen the inflation outlook.

Well, Mr. Chairman, I would prefer the alternative of asymmetric toward tightness, but I certainly never find myself in the position of dissenting over the question of symmetry. However, I do want to call the Committee's attention to what I think is a possibility of our getting behind the curve by maintaining the fed funds rate at 3 percent for too long. Thank you.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. I agree with your recommendation, Mr. Chairman, but I may require some hand-holding over these next few weeks because I never dreamed that my first vote on this Committee would be a vote to shrink M2 and M3. As indicated on the chart following page 19 in the Bluebook, there are three alternatives and all of them are aiming down. And that reminds me of last November when Harvey Rosenblum and I went hunting. It was the first time for both of us. We were novices and our guide was concerned about our safety. The main instruction that I got from our guide was: "Always keep your gun aimed up; never let your gun be aimed down. If your gun is aimed down, you might shoot a dog." And I'm afraid we might shoot a dog here by aiming down. All the alternatives are down, so I guess "B" is as good as the others.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I agree with you. I would opt for alternative B and a symmetric directive.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. "B" symmetric.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. I would agree with "B" symmetric.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I agree with "B" symmetric. I would just like to offer a thought on the earlier discussion about the disaggregation of M2 or looking at alternatives. It's just a note of caution. I think we ought to do that and see what we can learn. But I would be very careful about making too much of anything at this juncture. While we can undoubtedly find one or more adjusted aggregates that we might like the looks of at the moment, my guess is that in two or three years, unless we are very careful, we're not going to like the looks of them. So I would be more than a little cautious about rushing to a proliferation of Ms at this stage.

CHAIRMAN GREENSPAN. I think you will find that the enthusiasm we all exhibited got toned down by the Vice Chairman, and I think advisably so. President Broaddus.

MR. BROADDUS. "B" symmetric, Mr. Chairman. But I would just like to say that I have a lot of sympathy for Governor Angell's comments.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. "B" symmetric, sir.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. "B" symmetric.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. In the earlier go-around I was commenting more on what I think is. Now, to be normative, I will comment on what I think should be. And that is that we should take monetary targeting seriously. I don't disregard what Wayne emphasizes about the commodity index, but I also don't disregard what P* and long-run relationships between M2 and the price level are telling us. The latter would suggest to me that we ought to find a way to do something to avoid a contraction of M2.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. "B" symmetric.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I favor "B" asymmetric toward tightening, but I could support symmetry. I have sympathy for what Wayne said, and in a sense it was all summed up in the discussion yesterday about our inflation forecast versus the Blue Chip forecast. If our staff forecast is right, 3 percent is probably not a problem; if the Blue Chip forecast is right, it's probably a big problem. And I think we have to be very sensitive to that.

CHAIRMAN GREENSPAN. That is well said. Tom Hoenig.

MR. HOENIG. "B" symmetric.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. "B" symmetric.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I support "B" symmetric.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I will vote for "B" symmetric. I am thinking about aiming down. It's one thing to shoot a dog, and I love dogs. It's another thing to shoot yourself in the foot, which is

a bit lower still. So, that may be a case for "A" rather than "B," but they are all down to me.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. "B" symmetric.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. "B" symmetric.

CHAIRMAN GREENSPAN. I think there's a fair consensus on "B" symmetric.

MR. KOHN. Mr. Chairman, what do you want to do about the language?

CHAIRMAN GREENSPAN. [Don Kohn has] suggested alternate language for the operational paragraph on page 23 of the Bluebook. Norm, why don't you read it.

MR. BERNARD. The alternate language involves the last sentence but let me begin from the start: "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period." The change would come here, though the sentence would start the same: "The contemplated reserve conditions are expected to be consistent with..." And substituting for the rest of that sentence would be "little change in M2 and M3 over the period from January to March."

MR. LINDSEY. How little is the change?

MR. KOHN. In the Bluebook we had a small plus for M2 and a small minus for M3. My guess is that the small plus for M2 has turned into about zero after the revisions today. That is, we had a +.4 percent for M2 over the two months and a -.7 percent for M3. Now, I guess it probably would be about zero for M2 and -.8 percent or something like that for M3.

MR. LINDSEY. That's little.

MR. KOHN. That's at an annual rate!

MR. BERNARD. Mr. Chairman, in the paragraph that has to do with the trade-weighted value of the dollar, Mr. Truman proposes an updating change given the fact that the dollar is now up something like 3-1/2 percent. When we wrote this we were looking at about 2 percent. The change would be in line 23. Very simply it would just involve dropping the word "somewhat" in line 23 so that it comes out to "rose on balance over the intermeeting period."

MR. ANGELL. You have unanimous consent!

CHAIRMAN GREENSPAN. Without objection! Can we vote on "B" symmetric?

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Boehne	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President McTeer	Yes
Governor Mullins	Yes
Governor Phillips	Yes
President Stern	Yes

CHAIRMAN GREENSPAN. Incidentally, before we go on to the next subject I'd like to mention that any revisions in the forecast that you submitted to [Mike Prell] can be made through close of business on Monday.

MR. KEEHN. Could I just ask relative to the testimony the presidents will be giving on the 10th of March: If we are asked specifically how we voted on the long-term ranges, given the visibility this issue has gotten, how do you want us to respond? I guess an issue is whether you are going to cover in your testimony anyway how we decided on that.

CHAIRMAN GREENSPAN. You mean the range?

MR. KEEHN. Yes.

CHAIRMAN GREENSPAN. Oh yes. In fact we're required to.

MR. KEEHN. I know, but are you going to say how the vote went? What if I'm asked in the testimony: "How did you vote on the ranges?"

CHAIRMAN GREENSPAN. If you're asked, I think you're required to answer.

MR. KEEHN. At that point the minutes will not have been released.

CHAIRMAN GREENSPAN. On occasion that has been done. In other words, it's not--

MR. KOHN. I think in the past Mr. Chairman, both you and Chairman Volcker have answered whether there were any dissents without necessarily naming names. In this case it won't matter.

MR. KEEHN. If you cover that, I think that will be a useful way of setting the stage for defense.

CHAIRMAN GREENSPAN. I wouldn't volunteer it because we never have, obviously.

MR. KOHN. Right.

MR. KEEHN. No.

CHAIRMAN GREENSPAN. I should be able unless--

MR. KEEHN. Well, if you don't say it, it's likely to come up when we're asked and--

VICE CHAIRMAN CORRIGAN. The easy way to deal with it if you're asked, even if the Chairman is not asked, is to say the vote was unanimous.

SPEAKER(?) Yes.

MR. KEEHN. If that's all right, I think that's fine. I just want to be sure that's okay.

VICE CHAIRMAN CORRIGAN. I think that's the way to do it.

CHAIRMAN GREENSPAN. There's no down side to that that I'm [aware of].

MR. KEEHN. That's my view.

MR. MCTEER. I wanted to ask this anyway but I think it fits in very well with Si's question. I thought Governor Angell's suggestion that we change the language in the directive on the ranges was a good one. The way it reads now it says: "The Committee anticipates that developments contributing to unusual velocity increases could persist." I think it would support us much better if it says "The Committee expects that to persist."

CHAIRMAN GREENSPAN. I think that's better handled in the testimony where we're actually explaining what we're doing.

MR. MCTEER. Do you think there's a down side to having it reflected in the directive as well?

CHAIRMAN GREENSPAN. I'm not sure. Don, what's your view on that?

MR. KOHN. Well, that sort of indirect language is there to give a sense of the uncertainty about it. The fact that it suggests that the Committee expects it but does so in this indirect language I think gives it the sense of maybe yes or maybe no.

MR. MCTEER. If we're really uncertain, I think we made a foolish vote. I think our vote was predicated on our confidence that it is going to happen.

CHAIRMAN GREENSPAN. Well, that is a point. Does anybody object to changing it as President McTeer suggested?

MS. PHILLIPS. Where is this?

MR. MCTEER. Page 22.

MR. STERN. Why don't you just change the "could" to "would."

MR. PARRY. I thought of the same thing.

MR. SYRON. That's a good idea.

CHAIRMAN GREENSPAN. That's a good idea. Why don't we just do that; it helps a little. I think you're quite right.

MR. KOHN. "The Committee anticipates developments contributing to unusual velocity increases would persist during..."

MR. ANGELL. How about "are likely to"?

MR. MULLINS. If we say that, it certainly will not--

MR. SYRON. "Probably would."

SPEAKER(?). "Are likely to."

MR. KOHN. "Are likely to," yes.

SPEAKER(?). I like that.

MR. ANGELL. That's better.

CHAIRMAN GREENSPAN. It's "are likely to."

MR. MULLINS. "Are not unlikely to"?

CHAIRMAN GREENSPAN. Now that you have the floor, you're on for [the next agenda item]. You may recall that we have discussed the question of confidentiality of FOMC information. We have a very interesting staff memorandum on this and Governor Mullins will lead our discussion.

MR. MULLINS. Don Kohn has provided for the Committee an outline which summarizes the issues identified by the subcommittee and also gives our tentative conclusions. It is provided as background to the Committee for thinking about these issues and as background for the Chairman in preparation for Humphrey-Hawkins testimony. It's not clear exactly what we would like to do with this today except to inform the Committee where we are. We consider this in some sense an interim report. There's work left to do. You saw some of it in the memo, which Ted handed out yesterday, on the arrangements in other countries. We would also like to do more research and get analogous information on release issues in other parts of the government, independent agencies and the like, to get as much background as possible. We don't yet have that. I won't go through the detail because it's pretty self-explanatory. The way we conceptualized this whole area was to suggest that our number one job should be to make the best monetary policy decisions we could. That is our chief objective. In a democratic society we should do that in a manner which is as open as possible consistent with making the best monetary policy decisions. And to the extent that the process is not public because we feel that a more open process would adversely affect the quality of monetary policy decisionmaking we felt that we would bear

the burden for making the case because there is this presumption of openness.

Now we will look through the several different proposals. As you see, the results were that we felt virtually all of them had problems in terms of adversely affecting the quality of monetary policy decisionmaking. The one in which there was some possibility for additional discussion, we felt, was the proposal to announce actions on changes in the federal funds rate target immediately. Some felt that would increase the efficiency of monetary policy by making it easier for the Desk to operate. Others were concerned that it would reduce our flexibility in very uncertain times and also have an announcement effect which could deter action. The other thing we gave a little thought to, but not much--and we would invite thought from the Committee--was the possibility of other options for meeting the objective of openness. Some that people mentioned were increased press conferences and things of that nature, which may draw more attention to the policy record. We actually put out quite a bit of information, although it doesn't get much publicity. We compared [our practices with those of] other countries; I think they testify a lot and they probably give more public press conferences. I've noticed that Henry Kaufman recently suggested that the President meet periodically with the FOMC; that was not high on our list. So I think it would be worthwhile, instead of just taking the suggestions that Chairman Gonzalez has provided us, for all of us to give some thought to what else we might do to contribute to the sense of openness. Also, I would invite Tom Melzer, Ed Boehne, Mike Kelley, or Don to make any other comments on our process or results.

MR. KELLEY. Let me make one quick comment if I may. As we consider changing how we do things, I'd say that the discussion that took place here before the break today is a very, very dramatic example that we might consider. That was a very important discussion, a very useful discussion, and one might speculate that it simply would not have happened if we'd been on some other regime such as those that have been suggested as possibilities.

MR. MULLINS. Yes, I think that's a good point.

MR. SYRON. Are we going to have a discussion of "E" at some point? I completely agree with what Mike [Kelley] just said and it seems to me that the only thing we might consider doing is the suggestion labeled "E." But how will that be pursued?

MR. MULLINS. I don't know; it's up to the Committee. Don, what did you have in mind on that?

MR. KOHN. I think the idea was, Governor Mullins, that we would like to know whether the Committee agrees with the conclusions on "A" through "D" and then whether the Committee thinks that "E" should be explored further. And then we would do that extra--

MR. MULLINS. We'd schedule a time to do that?

MR. PARRY. I think this is a good effort and certainly covers some of the drawbacks of these different alternatives. I came pretty much to the same conclusion: That "E" seems to be the one with the fewest downside risks. One thing I was thinking about, though, is

that it would to me be [ideal] if our actions could be expressed in terms of the effects on reserve pressures first. If we then wanted to be specific about the funds rate, that's fine. But there may be some time in the future when we'll be focusing on something other than the funds rate and that will then enable us to move quickly into substituting any discussion about the funds rate with maybe an aggregate or something like that. We do, of course, in the directive now start out by talking about reserve pressures and I think that communicates something standing by itself and obviously can be supplemented by [comments on the] funds rate or whatever.

MR. MULLINS. President Broaddus.

MR. BROADDUS. Let me first say that I think the subcommittee has done an excellent job of laying out the options and their pros and cons. And I agree completely with a number of the tentative conclusions. I agree that if we revive the Memorandum of Discussion, it should not be released promptly. I agree that any videotaping or literal transcription of the meeting is a bad idea and I agree that an expanded policy record with individual attribution probably wouldn't buy us very much. But I have at least a few questions about some of the other conclusions. I might just quickly make three points. First, I think that immediate release of the operational paragraph of the directive deserves some further study. It's possible that further study would show that the benefits are equal to or might outweigh the costs. For me the strongest argument against doing this, as the memo makes clear, is that fear of adverse public or market reaction might make the Committee reluctant to take actions that it should take. On the other hand, one could argue that it might be helpful in a lot of situations for the Committee to be able to have a vehicle for [preparing] the public and the market for major changes in short-term policy, especially changes in the basic direction of short-term policy, by being able to move to an asymmetric directive in the direction in which we expect to move and have that move be visible. For example, lately a lot of people expect that we will have to tighten policy at some point in the next couple of years, and it might be nice to be able to give a less disruptive first signal of that with a visible move to an asymmetric directive tilted in that direction before we make the actual move. Let me emphasize that I'm not by any means convinced that this is a good idea; I'm simply saying that I think it deserves some more consideration. It has some strong advantages. If we did that, we would be releasing all of the decision information we have and it would deal with the leak problem pretty categorically. So I think it has a lot to recommend it.

The second point I would make is that I hope we can find a way to revive the old Memorandum of Discussion, which I remember from my early days in the System, with a long delay in its release because I think there's a good bit that can be learned about monetary policy and about the monetary policy process from scholarly investigation of a detailed record of FOMC meetings. But as your memorandum points out, obviously the problem is being able to maintain a long delay in the release. And if we can't do that, I think we just can't have the Memorandum. But I would hope that we satisfy ourselves completely that in fact we cannot protect the Memorandum from a forced disclosure before we give up the idea completely.

MR. MULLINS. Al, what would satisfy you and make you feel comfortable that we had adequate protection?

MR. BROADDUS. That's the point. I guess if we had very specific legislation I would feel more comfortable, but I may not have thought that through. It may be impossible to do it and I recognize that. All I'm saying is that I would hope we think that through very carefully to make sure there's no way we can protect it definitively.

The final point I would make, and this goes to option "E" which the subcommittee appears to favor, is that I certainly agree that it's worthy of further study. But I would simply underline what the subcommittee itself recognizes: That there's some risk that this option would tend to lock us in to the current operating procedure, which amounts to fairly rigid funds rate targeting, and might make it difficult to move back to something like a borrowed reserve target or free reserve target or nonborrowed reserve target, in which case the funds rate would be noisier. That worries me. Still, if we go with this option, I hope we would consider that point.

MR. MULLINS. Governor LaWare.

MR. LAWARE. Have we heard from the Desk on this? In other words, have they commented on what the effect of--

MR. McDONOUGH. We've been in close consultation on the study through Don. The subcommittee's work certainly had the full benefit of both Joan Lovett's and my views on the subject.

MR. LAWARE. Which were positive or negative?

MR. McDONOUGH. On releasing the fed funds rate [target] we came down in balance that it should not be done, essentially for the two reasons cited in the study: That there can be emergency situations like the fall of 1987 in which our principal concern is liquidity and the last thing in the world we would want to do is to say what the targeted fed funds rate is; and secondly, that it would be very, very difficult, as has just been suggested, if we started publishing the fed funds target to ever get away from funds rate targeting. Those were the two reasons that led us to believe that it should not be done.

MR. MULLINS. Governor Lindsey.

MR. LINDSEY. I was going to speak in support [of the work done]; I thought the document was very good. My only comment was on your side comment about Mr. Kaufman's idea. I'm a great believer in the providence of the President of the United States. I don't see any reason why we should have any objection to the President of the United States meeting us whenever he deemed it appropriate. I don't think we should invite such a meeting and I would not necessarily counsel the President to meet us frequently, but I don't see any reason why we should not be open to that.

MR. MULLINS. I doubt that we'd turn him down.

MR. LINDSEY. I doubt it too, yes.

VICE CHAIRMAN CORRIGAN. Would he come here or we go there?

MR. MULLINS. At the Treasury maybe.

MR. LINDSEY. David, I wasn't sure whether your comment reflected that.

MR. MULLINS. I think it's worthwhile to try to think of other mechanisms we might use to contribute to this goal of openness. And it's not clear to me that meeting with the Administration is consistent with this topic; it may be consistent with other topic areas. Governor Angell.

MR. ANGELL. I was very sympathetic to Al Broaddus' statement and would associate myself with believing that continuing to look at these tradeoffs is somewhat worthwhile. In my letter to Chairman Gonzalez I came down on balance for not having the study, believing that it was better to end up supporting the position of the Committee on this topic. But the problem that I had, Al, in terms of getting there without further study, was whether or not early release of the directive would tend to cause us to be less likely to go to an asymmetric directive. And my conclusion was that early release would cause us to be less likely, but I don't know the [unintelligible] of the information available and that [unintelligible]. So, I would be open to the study.

MR. MULLINS. Governor Phillips.

MS. PHILLIPS. First of all, let me say that this outline helped to identify all of the issues and to focus the discussion. With respect to option "E," I agree that that's an area that we should continue to look at. I'd give some consideration just to making an announcement if there's an actual action and not making an announcement [if there is not]. And I probably wouldn't go with any explanation. At least at this point that's what I'd be thinking in terms of.

MR. MELZER. What do you mean by an "actual action" announcement?

MS. PHILLIPS. An announcement of an easing move, for example. I'd make an announcement if we were going to change the federal funds rate or make a big change in the [degree of] pressure on reserves.

MR. MELZER. How about intermeeting moves? How would you view those?

MS. PHILLIPS. The same.

MR. MELZER. Okay.

MS. PHILLIPS. I just see that as less confusing to the market--to announce when it's an intentional move as opposed to just being consistent with what was in the previous directive.

MR. MELZER. Okay. And that's embodied in "E," as you've said, right?

MS. PHILLIPS. Right.

MR. MELZER. Okay. I misunderstood what you were saying. I thought you were going beyond what was in "E."

MS. PHILLIPS. No, I don't think so. As for the other suggestions that were made, I think doing some kind of summary of the policy directive probably would give us a better chance of getting more coverage because a lot of information does go out and it seems not to get very much attention. It's partly just laziness on the part of the press. If we have a one-pager for them, they'll cover it.

MR. KELLEY. And we get our own [spin].

MS. PHILLIPS. Right. With respect to periodic press conferences, I'd give some consideration to that. I say that but I don't have a strong feeling about how often and so forth. But right now our major public forum is Congress and that's a bully pulpit. So, I think it might just give us a different forum for making a statement.

MR. MULLINS. Are you volunteering for the press conferences?

MS. PHILLIPS. No. I think you'd be great, David!

MR. MULLINS. Would this be after decisions or after FOMC meetings or quarterly unrelated to--?

MS. PHILLIPS. What I'm suggesting is that those are the things [to be considered], like you did with the rest of this outline. I'm just raising it as a possibility; I don't have strong feelings about [whether to do it] regularly or periodically. I would urge a follow-up on the items that were suggested in the appendix: the FOIA coverage, the practices of other agencies and the legislative and judicial [branches]. I think those are all fruitful areas to explore.

MR. MULLINS. President Syron.

MR. SYRON. Three points. One is, as other people have said, that I thought this outline was very useful to crystallize things. I'm in favor of further exploration, but I think we need to be cautious. And this outline process of listing the pros and cons is very useful to be sure that we've covered most things. I have some sympathy for what Al said except that as a practical matter I certainly wouldn't want to revive the Memorandum of Discussion if we didn't have legislation [to delay its release]. And I surely wouldn't want to see legislation just to be able to publish a Memorandum of Discussion. Finally, I think there is something to be said for pursuing option "E," along the lines of what Governor Phillips talked about. I guess my interest in that is somewhat tempered by what Bill [McDonough] said, but I have a question on that. It's not clear to me that, say, in the '87 case--if the Desk were doing something that hopefully was transitory in nature and wasn't a major change in policy and there wasn't a Committee meeting--that we'd have to go out and make an announcement that said in effect that because of the disruption in the markets, etc. we're changing what we're doing. I would presume that in such circumstance we'd always be able to do something like that.

CHAIRMAN GREENSPAN. Yes, I'm not sure that we would necessarily have to indicate a federal funds rate [target] if we actually were doing that because it always--

MR. SYRON(?). Exactly.

MR. McDONOUGH. No, we could certainly choose not to. On the other hand if, as is presently the case, we didn't have the policy of saying what the fed funds rate target is then there's no issue and no additional uncertainty in an uncertain situation.

MR. MULLINS. It seems to me that we can have uncertain situations in which we don't know what the market is like. One advantage of not having announced something is that the market may blow through something in very uncertain times. So we do have marginally more flexibility not announcing. But I guess your point is that in emergency situations we could--

MR. SYRON. I don't know all the details of this but I wouldn't think in that kind of situation that we'd have a very precise tight notion of where we wanted the funds rate to be.

MR. MULLINS. President Forrestal.

MR. FORRESTAL. Just a couple of points. I think a very good way to handle this whole thing is to study it more. But I have some real reservations about announcing a federal funds rate [target] for the reasons that have already been expressed. I think it would lock us in to that modus operandi. I wouldn't have any objection to resurrecting the Memorandum of Discussion, as I said in my letter to Mr. Gonzalez, provided that we had specific legislation that would protect it [from early release]. I think, though, that we really could go a step further. I really don't find any major risk to releasing the policy record as soon as it can be prepared after a meeting. It comes out six weeks later anyway. An earlier disclosure would not really be all that harmful and might very well gain us a lot of credibility; and it might silence some of this criticism about the fact that we're not open enough. There are some objections; obviously there may be some reservation about moving to an asymmetric directive. But I think the benefits to doing it would outweigh those small risks.

MR. MULLINS. President Hoenig.

MR. HOENIG. I think alternative "E" should be pursued and looked at more carefully because we are starting with an agreed upon premise that we should be as open as we reasonably can. And I don't think announcing an action, whether it's [in terms of] the fed funds rate or reserve pressure is inconsistent with that; I think it is consistent with being open. And I doubt that it's going to compromise our ability to have discussions and come up with reasonable policy. So, that is one avenue that we ought to pursue pretty vigorously.

MR. MULLINS. President Jordan.

MR. JORDAN. I thought the outline was an interesting piece for indicating the pros and cons of some things, but what didn't come out clearly was the ultimate criterion for information that we provide. Even the purpose of the Memorandum of Discussion [published]

with a long lag is not to foster PhD dissertations but studies that help improve the execution of policy to achieve ultimate objectives. And that's the criterion that should be used for announcing whatever. In the short run it should be that it helps us achieve our two objectives. I don't see how announcing the federal funds rate would do that. In fact, the way the Committee is operating right now, I don't see what would be useful to achieve the objective of price stability.

MR. MULLINS. Other comments? President Stern.

MR. STERN. Most of what I would have said has been covered and I won't repeat it. I agree with those who find at least some merit in a variety of these proposals and I think they deserve further consideration as a consequence. But I am particularly attracted to your other possibilities under "F," in part for the openness reasons that we've been discussing. But related to that--and I think Governor Phillips mentioned this--one of the things that has troubled me in recent years is that we seem to be in a position of either reacting to or not commenting on various press reports and interpretations of what we're up to and why. That was a bigger problem when there were leaks than it has been recently. Nevertheless, it strikes me that we can put some of that to rest through vehicles like press conferences, calling attention to things in the policy record, and so forth. And I would give some serious consideration to doing that because I think it would benefit us as an institution.

CHAIRMAN GREENSPAN. Would you have scheduled press conferences?

MR. STERN. No, I would do it on an as-needed basis when we had something that we wanted to communicate.

CHAIRMAN GREENSPAN. Yes, but a regular press conference doesn't automatically suggest that there's some important event. If we announce a press conference, it has an announcement effect.

MR. SYRON. An announcement effect of the announcement.

MR. STERN. Well, there's always going to be a transition problem whenever a new procedure or a new rule is introduced. Certainly the first couple times we announce a press conference I suppose people will sit up and take notice and cut positions and so forth. But ultimately they will come to learn the circumstances under which we do these things.

VICE CHAIRMAN CORRIGAN. Then they'll start [unintelligible] further press conferences.

MR. STERN. Well, they won't precisely know their content.

MR. MULLINS. Vice Chairman Corrigan.

VICE CHAIRMAN CORRIGAN. Fundamentally I have sympathy with all of the tentative conclusions. Now, if we could get the protection in Freedom of Information Act terms, I could associate myself with some kind of Memorandum of Discussion type document, but I don't know if we can get that protection. I also agree that the funds rate

[announcement] may be the most fruitful avenue to look at further. I don't worry so much about the very short-run problem of a stock market crash; that I think we can deal with. But I do think that the slippery slope here is making a conclusion, as I think Al said, in a context in which that conclusion is dominated by a mind-set that [involves] funds rate targeting. I don't think it's quite as portable to other policy regimes and that's the aspect of it that I think has to be thought about more carefully. The first crisis situation we could always [unintelligible]. Contrary to Gary Stern and Governor Phillips and maybe a couple of others, I'm not at all into this press conference thing. I just don't see how we can turn that into a winner. The closest institution that I know of to the Federal Reserve is the Supreme Court. I have some trouble with the thought of the Chief Justice deciding he's going to have a press conference to explain a couple of recent court decisions. The analogy stinks, but I think you do give up something when you get yourself into that business. I don't know, Dave, about your own experience but in the old days, which predated you, the Treasury never did [press conferences and the like] and then they got into it in spades. But I'm not so sure what the net effect of that has been in terms of [enhancing the] credibility of the President and the way it is perceived. If the Chairman really has something to say, I think he can always find a way to do it. Any time he wants an audience Joe Coyne can get him an audience [with no difficulty]. So I don't think the Chairman lacks instruments to get [a message] out there when he wants to. I think the press conference option is a very slippery slope. And if it ever slid into the perception that the Fed was marketing itself in some sense, I think it would be disastrous. And doing [press conferences] I don't think will cut off the kinds of [problems] Gary was referring to. So I am very dubious about that. But I know that is clearly an area where reasonable men and women can differ.

MR. MULLINS. Okay, that was very useful. The subcommittee will reconvene in the future. I guess I heard about the same type of disagreement [we had in the subcommittee] on the "E" issue on federal funds rate announcements. That's something we'll take another look at given the issues that have been raised. A number of issues have been brought up that were not raised by the subcommittee. Also the issue of whether there isn't something else we could do, like press conferences, is worth looking at. The experience of the Treasury and others who have gone to that is that it's tough to get [the genie] back in the bottle. Is there something we could gain in terms of the perception of the reality? I think we should take a look at that with some caution. Again, maybe the early policy record disclosure--the question there is how early could we do it--would make a difference. But that would get us into the problem of [using] the asymmetric directive and things of that nature. We will continue to compile [the information referred to in] the appendix because I think it is worthwhile to have a sense of where we fit within the broader context of other institutions. Another thing we'll look at is the point that Jerry Jordan raised, which is that another way to look at this whole area is [to consider] what we could do that would contribute positively to the quality of monetary policymaking. [We can see] if there is anything else we might find useful--as opposed to the way we looked at it, which was to start with the assumption that openness is a threat to the quality of monetary policymaking, as it clearly is in a number of these areas.

CHAIRMAN GREENSPAN. Okay. This Committee will stand adjourned until March the 23rd. We can go to lunch.

END OF MEETING