

Meeting of the Federal Open Market Committee  
July 6-7, 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, July 6, 1993, at 2:30 p.m. and continued on Wednesday, July 7, 1993, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman  
Mr. Mullins 1/  
Mr. Angell  
Mr. Boehne  
Mr. Keehn  
Mr. Kelley  
Mr. LaWare  
Mr. Lindsey  
Mr. McTeer  
Mr. Oltman 2/  
Ms. Phillips  
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry,  
Alternate Members of the 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, General Counsel  
Mr. Patrikis, Deputy General Counsel  
Mr. Prell, Economist  
Mr. Truman, Economist  
Messrs. R. Davis, Lang, Lindsey, Promisel,  
Rolnick, Rosenblum, Scheld, Siegman,  
Simpson, and Slifman, Associate Economists  
Mr. McDonough, Manager of the System Open Market  
Account  
Ms. Greene, Deputy Manager for Foreign  
Operations  
Ms. Lovett, Deputy Manager for Domestic  
Operations

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1/ Acting Vice Chairman in Mr. Corrigan's absence.

2/ First Vice President, Federal Reserve Bank of New York, attending as alternate member for Mr. Corrigan.

Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors  
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors  
Ms. Danker, Assistant Director, Division of Monetary Affairs, Board of Governors  
Messrs. Small, 2/ and Whitesell, 3/ Section Chiefs, Division of Monetary Affairs, Board of Governors  
Ms. Kusko, 3/ Senior Economist, Division of Research and Statistics, Board of Governors  
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors  
  
Messrs. Beebe, J. Davis, T. Davis, Goodfriend, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Cleveland, Kansas City, Richmond, and Atlanta, respectively  
  
Mr. McNees, Vice President, Federal Reserve Bank of Boston,  
Messrs. Coughlin and Guentner, Assistant Vice Presidents, Federal Reserve Banks of St. Louis and New York, respectively

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- 2/ Attended portion of meeting relating to a discussion of the uses of a broad monetary aggregate that includes bond and stock mutual funds.
  - 3/ Attended portion of meeting relating to the Committee's discussion of the economic outlook and its longer-run growth objectives for monetary and debt aggregates.

Transcript of Federal Open Market Committee Meeting of  
July 6, 1993

CHAIRMAN GREENSPAN. The staff has circulated a memorandum [on a monetary aggregate that includes bond and stock mutual funds] and I assume you've all read it. Nonetheless, it would be useful for us to have a broad overview from Ms. Danker.

MS. DANKER. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Ms. Danker?

MR. BOEHNE. What are the data gathering costs involved with having something like M2+ [unintelligible].

MS. DANKER. Well, most of the data gathering costs are incurred by the investment companies that provide us with the mutual funds data. We have access to these data entirely through the ICI at this point. If we want to enhance the quality of those data considerably, that entails at the first level dealing with ICI and convincing them that that would be a good idea or convincing them to let us deal with the funds one-on-one in terms of editing the data. There are, of course, alternatives--vendors that sell these data. But the ICI seems to have the best series on an aggregate basis.

MR. KOHN. We, of course, have no legal authority to force the mutual funds to report to us. It's not like the deposit data used to calculate reserve requirements. We have worked with the ICI in setting up their weekly data series--they consulted with us last summer about that--and on the money market funds data. They are torn; they would like to have data; they want to be cooperative. On the other hand, they don't want to put burdens on their membership. It is entirely voluntary and they hear a lot of complaining from their members if they call them excessively to clear up data anomalies. So, there's quite a bit of tension on this score with Board staff and ICI staff even on the money market funds data.

MR. PARRY. Are they going to an end-of-week collection anyway, independent of our prodding? Don't they now have end-of-month data?

MR. KOHN. Well, they had an experimental process under way to collect a weekly series on the bond and stock mutual funds.

MR. PARRY. But that's not a daily average?

MR. KOHN. No, it's not; it's still a one-day number.

MR. PARRY. And they plan to do it now, so that would be some improvement.

MR. KOHN. Yes, absolutely. Still, there's the issue of checking the data, looking for anomalies, calling the funds back and so forth, and there's not a lot of appetite for that. Now, maybe one thing we could do is to help subsidize them if that were a problem. But I think the problem is more the tension; they don't [want to] involve their members too much.

MR. SYRON. I happened to talk to about five people in the funds industry recently; I was doing it coincidentally. I raised the question of how they feel about this; this was after we got the memo. Two points: One is--these were economists from the funds--that they thought the idea was crazy in the first place. But beyond that, even if they were in favor of it, they expected they would have a lot of internal difficulty with their data processing people [at a time] when they are trying to cut costs; they thought it would be quite difficult. Then, they raised several technical questions about things we'd have to do. There's a lot of concern about this, including not having any theoretical foundation. Also, what is set as the boundary for what to include and not include that's spendable? But beyond that this would be a new venture for us, using data that we don't really control in some sense.

MR. KOHN. We do have the money market funds data already in M2 but it's a very small piece.

MR. SYRON. But even on a practical level, independent of what one thinks is the value of this--which I personally think is questionable--it would be quite difficult.

CHAIRMAN GREENSPAN. Are you getting an impression from them that they would be quite concerned about their numbers becoming part of policymaking and then having the Congress require them to do something?

MR. SYRON. Exactly.

CHAIRMAN GREENSPAN. Well, are we getting an objective appraisal of their view of the difficulty of getting the data?

MR. SYRON. No, probably not. There has been all this discussion as to whether they should be included in the CRA legislation and that sort of thing, so they have become very, very nervous about any step they see that makes their liabilities closer to being money assets. I wouldn't be surprised, say, in the case of that it would become quite difficult because the fellow who runs it--John LaWare can tell you--can be a feisty guy. They might just refuse to do it because they're very, very worried about being seen as a [depository] institution.

MR. PARRY. Well, in addition to that, we don't exactly have the strongest case that could be made for a need for it! As the study indicated, [M2+] really does have some significant limitations.

CHAIRMAN GREENSPAN. I think the only plausible possibility is to publish it for a limited period of time on an experimental basis. But if that's not possible or is too difficult or has the as you would say, there isn't much [promise] there. I thought Debbie Danker was more forthcoming toward this in her oral comments than in earlier versions [of the memo that] I read. This is very difficult to pick up without asbestos gloves!

MR. BROADDUS. It's hard for me to think that this measure would ever be very useful operationally given the changing asset values that will affect it. That's just a fundamental conceptual problem for me. I'd like to ask Debbie: Have you all thought about

doing anything like shift adjusting this, using inflow data--the way we dealt with M1 for a period back in the early 1980s--as opposed to using the stock concept? You would still have data problems and some other difficulties, but at least you'd get rid of that major conceptual issue.

MS. DANKER. I think the data on the inflows--rather than formally shift adjusting the aggregate--are very helpful in looking at the developments in M2 and in figuring out how it's [behaving] vis-a-vis its path. The Feinman/Porter work last year looked at using an aggregate that just cumulated the inflows. But that's not very satisfying when viewing it in terms of an aggregate and one thinks of the capital gains that occurred 10 years ago not counting as money today. But on a shorter-term basis thinking about inflows as some kind of shift adjustment I think can be helpful.

MR. KOHN. The problem is that if we just do that, the outflows could exceed the inflows because of that capital gain that people are taking out and we could have a very funny looking [number]. But we could use the inflow data to help analyze M2 rather than trying to build an artificial aggregate that doesn't have capital gains.

CHAIRMAN GREENSPAN. You can't really. What were the gross flows we used in M1 early on? I guess I'm not quite clear what you're saying.

MR. BROADDUS. Well, we did a formal shift adjustment of the M1 aggregate to take out--

CHAIRMAN GREENSPAN. A one-shot thing?

MR. BROADDUS. Yes.

MR. KOHN. That was when the NOW accounts were authorized.

MR. BROADDUS. Right. That's what I was thinking about.

MR. KOHN. We did surveys of consumers and did micro analyses of banks to see what was happening between NOW accounts and other accounts.

CHAIRMAN GREENSPAN. Yes, but that's a one-shot sort of thing.

MR. KOHN. Right.

CHAIRMAN GREENSPAN. Using growth figures with stock data can get very difficult. I don't see how one can do it.

MR. LINDSEY. Conceptually, why does that differ? People couldn't write a check against the capital gains of 10 years ago, to use your phrase. They can now. Isn't it really the innovation, the nature of the consumer product, that has made us more suspicious that this is M2-related? So [why] wouldn't a stock-adjustment-type [process] or looking just at flows be appropriate?

MS. DANKER. Well, if you think of it as a stock adjustment process, it's going to be over after some period of time and this

isn't a brave new world or something like that. So, maybe we'd just want to shift adjust it for a while. There has been an explosion in bank offerings of mutual funds that might make that appropriate. I don't know that we get a sense of there having been a discrete step so much as a somewhat more gradual broadening of assets.

MR. LINDSEY. But, again, to use the analogy of the capital gains that happened 10 years ago, [then] I may have been in that fund for reasons other than liquidity reasons whereas today I might put money in that fund for more liquidity oriented motives. That in my mind would be a reason for counting the flows in today or stock adjusting at some point. I agree with you that it is not a step function, but clearly the product is different today than it was 10 years ago, and some kind of adjustment might be [appropriate].

MR. PRELL. I don't think it's clear that the product is that much different from the perception of the investor; it's how he is really using it. Transactions, turnover kinds of measures, are not particularly high. Indeed, they are for many people a substitute for a time deposit or a very dormant kind of savings account as opposed to a transaction vehicle. Transactions are clumsy out of the mutual funds that have capital gains and losses because of the complicated tax accounting one has to do if nothing else. I don't think there is strong evidence that these are liquidity so much as investment holdings.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I have a couple of conceptual problems that relate to what Larry and Mike were just discussing. One has to be very careful about the distinction between the value of a dollar and the value of assets denominated in dollars. Even if we have no net inflows, if we have an environment where we're stabilizing the purchasing power of the dollar and the inflation premium and interest rates are coming down, we can have a capital gains that would indicate policy is expansionary when in fact it is anti-inflationary and the reverse. If we got into a period where people expected the value of the dollar to decline and interest rates to rise, the value of these funds would fall, indicating policy is restrictive. The comment about it being an accurate picture of the thrust of policy comes from relating it to nominal GDP. But if the Committee is accepting stabilizing the purchasing power of the dollar as its objective, we measure policy as a central bank from that objective--not targeting GDP but stabilizing the purchasing power of the dollar and not assets denominated in dollars.

MR. KOHN. I think that over time the two wouldn't be that much different. I would assert that the capital gains and losses would make it a not very good predictor of nominal GDP. It's partly fortuitous events--the changing way people react to the yield curve and the accessibility--that have made this velocity relatively constant over the last few years, and we can't really count on that.

MR. JORDAN. I agree. But even if it were, I'd have a problem with it.

CHAIRMAN GREENSPAN. Do we have any evidence that suggests there is a partial inverse relationship between stock prices and M2?

MR. KOHN. We do have the bond yields in the sense that we've put yield curve variables in our M2 equations. And when bond yields go up and the yield curve steepens, then we tend to get flows--

CHAIRMAN GREENSPAN. I'm asking whether in fact capital gains in stock funds or funds generally are substitutable for depository funds?

MR. KOHN. My guess is we just don't have enough experience with that. That's basically what this aggregate--

CHAIRMAN GREENSPAN. Well, I'm raising a broader question. We have the wealth effect occurring on savings, and a more general question is whether M2 is inversely affected by the level of stock prices.

MR. KOHN. I'm not sure. We had a huge runup in stock prices in '86 and '87 and we didn't notice much of a shortfall in M2 growth. When stock prices came down--the crash of '87--we had a little surge into M2.

CHAIRMAN GREENSPAN. What happened in 1987 would be extreme evidence of it. If you couldn't find a lot there, you're not going to find a little any other time.

MR. KOHN. The stock market is an alternative repository for savings. And peoples' expectations about future returns in the stock market will affect their assessment of what they're going to get out of a time deposit versus [the stock market]. So, there's going to be some relationship. But I would doubt that it's very strong.

MR. JORDAN. Your question implies a reversal of the signs because traditionally we would have said that wealth enters the demand function positively, but you're suggesting that this is a substitution effect.

CHAIRMAN GREENSPAN. Well, that's implicit in this discussion.

MR. JORDAN. Right.

CHAIRMAN GREENSPAN. It's curious that there's not the right evidence that would confirm that.

MR. JORDAN. It certainly goes against our theoretical framework.

CHAIRMAN GREENSPAN. Any other questions or comments? Let me ask a more general question. Does anybody think we should do other than Option 1--that is, nothing? Option 1 is just to leave it alone for the moment and look at it. Does anyone have a proactive view as to our even publishing it, not to mention going to targeting it?

MR. MULLINS. I wouldn't say my view is to be proactive, but I'd at least not be comatose exactly. Obviously, there is strong evidence that these [accounts] are substitutes for time deposits and CDs since one can observe people carting large sums of money from time deposits and CDs into these instruments. And it is true that it's

available to spend in the same sense as a time deposit, which is the logic of CDs. The basic advantage of not simply ignoring all this is that it provides some empirical content to the velocity story, which [per se] sounds a bit like a tautology or a bit artificial. Now, we haven't received a lot of flak lately so maybe we've been successful with that story and that's why I don't think [a new measure] is so important. I do think it's instructive to show these flows to people. I don't think we should anoint M2+ even as an experimental new monetary aggregate. I suspect were we to do so it would promptly blow up on us. But it is nice to point to something that is growing! [Laughter] And it illustrates what is going on; it's the story that we're giving behind the increase in velocity. I personally don't like calling it M2+; in my view that goes a little toward saying we're thinking about [using] this. But regularly making these flows public in some way would be helpful, although it seems to me that six months ago we had a much more contentious situation with respect to M2 growth, and the evidence from '92 clearly supported the distortion in the relationship between M2 and GDP growth. So maybe it's less of an issue--

CHAIRMAN GREENSPAN. You mean there's evidence in '93 as well.

MR. MULLINS. Yes, in '93 as well. But it seems to me the steam came out of the argument, really, with the fourth-quarter 1992 numbers. We were getting pounded regularly on this M2 growth topic and after that period--when all the data were in for 1992--it seems to me that it hasn't been an especially big issue. So, maybe it would be okay simply to do nothing, and I wouldn't bother the mutual funds. I do think it would be useful to provide the data at least for some period of time.

CHAIRMAN GREENSPAN. We can publish part of it.

MR. MULLINS. Yes.

CHAIRMAN GREENSPAN. We can just add it to one of the monthly releases.

MR. MULLINS. There are two ways we could do it.

MR. SYRON. The Board might want to publish it in the Bulletin rather than as a release. If we put it in the release it does start to look as if we're thinking about it for the money supply.

MR. KOHN. There are a number of alternatives that the Board could contemplate in terms of publishing this, including just making it available on an informal basis to researchers [and others] who call. We did include a chart of the flows in the Humphrey-Hawkins report last time--in the back where only the aficionados look--and we can certainly continue to do that.

MR. MULLINS. One could call it M2 plus the flows to stocks and bonds and mutual funds.

MR. KOHN. Right.

MR. MULLINS. I don't like the idea of having a new label. Another option is to have M2 and just publish the flows to the funds and then people could do the calculation.

CHAIRMAN GREENSPAN. You're taking about flows rather than stocks?

MR. MULLINS. Yes.

MS. PHILLIPS. Could I ask a question? Are any of the CDs that are included in M2 indexed in any way?

MR. KOHN. I think there are a few.

MS. PHILLIPS. Any with equity?

MR. KOHN. Institutions have offered them from time to time. I think it's a very, very small amount.

MS. PHILLIPS. With equity?

SPEAKER(?). Citicorp.

MS. DANKER. The only thing we subtract out of those are foreign currency denominated [assets].

MS. PHILLIPS. So we already have a piece in the CDs?

MR. KOHN. But it's minuscule.

MR. STERN. Don't those tend to have some sort of guaranteed component so we don't necessarily get big changes in net asset values?

SPEAKER(?). No.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I was just going to raise a general question. Is there a case to be made for doing some more generalized work in terms of household portfolio behavior?

CHAIRMAN GREENSPAN. I think we're going to be doing that anyway.

MR. MELZER. One of the things that's not particularly satisfying about this is that we're only capturing a piece of that total picture. If we're willing to commit resources to do more work, I'd be in favor of committing them more broadly and looking at that basic question of household portfolio behavior.

CHAIRMAN GREENSPAN. Let me ask this: Can I just get a general show of hands of those who would prefer that we publish nothing official, other than to include something in the Humphrey-Hawkins report periodically? The next question would be: Do we want to elevate it and put something special in the Federal Reserve Bulletin beyond that? So, who would prefer to do nothing more than we've been doing at this particular stage? [Secretary's note: Nearly all hands were raised.] Offhand it looks as if a majority prefer to

do nothing. Why don't we just keep an eye on it. I think what happened is that Debbie's memo soured a lot of views on the usefulness of some of this. I think the worst thing that can happen, if we start to focus on this, is that it may fall off the cliff, as Governor Mullins suggested. But we can keep the issue open and if at a future Committee meeting we want to change--

MR. KOHN. One addendum, Mr. Chairman. To the extent that members of the Committee are aware of people at their own Banks or also people outside who are doing research on this issue, we'd be glad to share our data.

CHAIRMAN GREENSPAN. Oh, yes. That's what we're doing now unofficially.

MR. MULLINS. Where are the data available currently?

MR. KOHN. Well, we've sort of put together a series. We're almost a troubleshooter! [Laughter] That wasn't fair. The ICI publishes monthly data. We've been trying to adjust them to take out the IRA/Keough accounts, to separate the [holdings of] institutions from [those of] non-institutions, and generally to put them more on an M2-type basis in terms of trying to put together a data series that is a little more comparable with the concepts--

MR. MULLINS. How much difference is there between our internal version and the ICI version?

MR. KOHN. In dollar terms?

MR. MULLINS. Does it give a really different picture?

MR. KOHN. I doubt it but I'm not 100 percent certain since I think those things move pretty slowly. On some of these we only have once-a-year data, the level on December 31st. So, we just smooth between two December 31sts.

MS. DANKER. For example, the aggregate value of these things is about a trillion dollars, but only about half of that will show up in M2+ because of the institutional and IRA/Keough accounts.

CHAIRMAN GREENSPAN. Okay, shall we move on? The Foreign Desk is next on the agenda. Mr. McDonough.

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

CHAIRMAN GREENSPAN. First, are there questions?

MR. BOEHNE. In these joint discussions with the Treasury, which side do you think had more enthusiasm for the intervention?

MR. MCDONOUGH. If you were to ask which side had less enthusiasm, the answer would clearly be ours. I don't think [ ] had enormous enthusiasm either. Rather, there was the notion that with the cacophony of official statements, it had just become so confusing as to what the policy was that some clarification once again was in order.

MR. BOEHNE. And was there some attempt within the Administration to try to reduce all those voices out there talking about the yen?

MR. MCDONOUGH. Yes, I think so. We were promised that there would be an effort. And I think if you look at what has not been happening, including in the first 24 hours or so of the Summit in Tokyo, the silence is remarkable.

MR. TRUMAN. President Boehne, I think there are two points to be made on this. One is that, clearly, the Administration has not gotten itself into the position of saying they don't want the yen to appreciate further. That's going too far in terms of all the irons they have in the fire. So, they are somewhat exposed inevitably. But, for example, when they lifted one of the veils--I guess that's the right way to put it--around the proposals for this framework discussion, they had already who were involved that [unintelligible]. I was told one story about [someone] who got up to answer a question at the press conference; the question was not on the yen but he gave the yen answer as part of this discussion. So, I think at least to try to keep it out [unintelligible]. Obviously, the central players--

MR. MCDONOUGH. They got their stories straight.

MR. LINDSEY. What are your bets on what the market will do after the Japanese elections on the 18th?

MR. MCDONOUGH. If you assume that the likely outcome is a very uneasy coalition, I think there's a fairly decent chance that the dollar would strengthen a little. But the single most important aspect is that the fundamentals, with that tremendous current account and even bigger trade account surplus, point toward a gradually strengthening yen and a weakening dollar. And we don't have the conviction, as I mentioned, about a stronger dollar against the European currencies. From what we can see of the more speculative players, they find the yen situation sufficiently confusing that they'd rather go and play somewhere else where they can figure out the odds better.

MR. LINDSEY. So, a weak government is pretty much built into the market right now?

MR. MCDONOUGH. Yes. The market assumes the weak coalition.

CHAIRMAN GREENSPAN. If that happens, it means the market could remain unchanged or go in the other direction.

MR. MCDONOUGH. Yes.

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

MR. KELLEY. So moved.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

- CHAIRMAN GREENSPAN. Without objection. Let's move now to the Domestic Desk and Joan Lovett.

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

CHAIRMAN GREENSPAN. Messrs. Prell and Truman.

MR. PRELL. Thank you, Mr. Chairman. We've distributed to all of you a package of charts labeled "Staff Presentation to the FOMC." [Statements--see Appendix.]

CHAIRMAN GREENSPAN. Thank you. May I just ask for a clarification on Chart 9, showing automotive products as a share of domestic absorption? That includes parts and that's the reason why the numbers are--

MR. TRUMAN. That includes the measure for parts excluding tires. We figured that was what people counted too much!

MR. KELLEY. I'm glad you asked!

MR. LINDSEY. [You said] "workers' comp." That's workmen's compensation?

MR. PRELL. For political correctness reasons, it's now called "workers'" compensation. I knew it would cause confusion. I was tempted to say "workmen's" compensation, but I didn't!

CHAIRMAN GREENSPAN. What is happening to all the statutes! Questions? President Boehne.

MR. BOEHNE. With regard to this analysis that you did on inflation and what you had at least in the written report of the briefing to the Board last Friday: The speed effects as I interpret them really say we have to look not just at static comparisons of unemployment versus inflation but also the kinds of changes that are being made. If you look back over the post-World War II period, there has been a tendency over those years for inflation, when it escalates, to escalate from cycle to cycle. We've also had examples in the 1950s and again in the 1980s of disinflation from cycle to cycle so that on the upside of these cycles we end up with peaks in the later cycle being higher than the previous cycle. The same [is true] for the floors; when inflation de-escalates, we make progress from cycle to cycle. One question is whether that is just a variation of the so-called speed effect. If there is something to this speed effect or the cycle-to-cycle kind of phenomenon, should it be so strange that as cycles mature there ought to be times during those cycles when we make more progress against inflation where things flatten out? If you look at it from cycle to cycle, what we want to do is to keep inflation from escalating so that in a subsequent cycle we can keep bringing the rate of inflation down. My question is: How much have you looked at this cycle-to-cycle phenomenon? It does strike me that it is part of this dynamic or speed approach to looking at inflation.

MR. PRELL. I guess in the abstract I don't view this speed effect as relating to the kind of phenomenon I think you're talking about. The effect should in essence wash out over the course of the cycle as you get back to the same unemployment rate level. You've gotten the bad part on one side and the good part on the other side of that cyclical movement. But I suspect what has been more at work over the postwar period has been a gradual, and at some points maybe not so gradual, escalation of inflation expectations, which have gotten rather deeply embedded and have not been reversed from cycle to cycle. And as we attempted to move the economy back to higher levels of employment through macro policy, taken as a sort of base is this higher level of inflation expectations. We don't seem to be headed into this pattern this time where over a long period of time now there has been a lower inflation. I think we've made some progress in lowering inflation expectations from what prevailed a decade or a decade and a half ago. I think such expectations are the more critical element probably in this movement to higher inflation levels from cycle to cycle. But I don't think we've really investigated things in that particular cyclical context.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mike, on Chart 12, referring to the household sector, down in the lower right corner you have the cash flow burden and the fixed-rate mortgage is shown. But I wonder if you have it for all consumer debt?

MR. PRELL. Obviously, the nomenclature here has misled you. This is the cash flow burden of owning a home: How much the monthly payment on a home is relative to disposable income. What we plotted here is a new home, constant quality price measure, and a current fixed-rate mortgage. So, this is what it would cost to buy a home today, setting aside issues of the down payment. And the down payment, as I noted, seems to be a big hurdle for a large segment of the population, particularly the younger group; relative wages have not worked to their advantage in recent years. If you're looking at debt service burdens in general--

MR. KELLEY. Yes.

MR. PRELL. We've seen a significant decline in those burdens over the course of the last few years; debt has grown less rapidly, interest rates have come down, and refinancing opportunities have opened up. We're not expecting quite that rate of improvement but there may be some room for that in our forecast largely through the rollover of debt into lower rate loans. Debt growth in this forecast is certainly keeping pace with income in the household sector.

MR. KELLEY. How far is that overall debt service level still above what one might call the "norm" back a few years ago, maybe in the '70s?

MR. PRELL. Well, it's certainly back down a considerable way relative to the mid-1980s. To go back much further than that we can look at the table in the Greenbook, page II-2.

MR. KELLEY. I'm sorry I missed it. Okay.

MR. PRELL. As you can see, we're still above, by at least a small margin, the levels that we had through the '60s and '70s.

MR. KELLEY. That's what I was looking for, thank you.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. A theoretical question on sacrifice ratio, which supports the question about speed effects: Would that necessarily wash out over the cycle, depending upon how quickly the economy accelerated and decelerated, or is it [not] neutral in a sense? One can conceive of patterns in which it wouldn't be neutral.

MR. PRELL. My colleagues can correct me, but I think mechanically as one conceives of this model it will wash out as we move back to the initial level of unemployment. Now, there could be problems that arise as inflation expectations build so that a dynamic process is created here that works against us. But in terms of just isolating this conceptually, it should be no net effect.

MR. SYRON. What are your thoughts on the sacrifice ratio now, given what we're seeing on inflation expectations?

MR. PRELL. That is very hard to judge and even difficult to characterize in our forecast because the sacrifice ratio is a sort of net effect observed ex post. Ex ante one can think about what the slack effect in the model should be and then one can parcel all these things out. Our past experience is, as we noted, that in the first stage of this disinflation we seemed to be getting unusually good tradeoffs. It was well below the traditional two-to-one rule of thumb. In the recent period, we've been getting either nothing or very little, depending on how one dates this. On average, it hasn't been much of a departure from our rough rule of thumb. But, indeed, this may be a reflection of the speed effects, which worked favorably through at least a good part of 1992 as unemployment was rising. It has been working against us more recently.

MR. SYRON. It could be a very long distributive kind of function on people's expectations. And as we get down toward [price stability] it could be that the portion of people in the labor force who remember the '50s level of inflation as compared to those who think that 3 percent is favorable has diminished. [That would have] unfavorable implications in terms of the sacrifice ratio. Maybe people think inflation can get only so low.

MR. PRELL. Well, that is probably one of the elements of the stickiness of inflation expectations that we've seen. I think we're clearly a long way from breaking through that barrier.

CHAIRMAN GREENSPAN. On the speed effect, if you were using the "seasonally adjusted" seasonally adjusted CPI, would that have any effect on the slope of this chart or the correlation coefficients in it?

MR. PRELL. Well, I seriously doubt it, given that we're looking at some annual numbers over a long period of time. I don't think that would have a great [effect].

CHAIRMAN GREENSPAN. I'm sorry, these are annual numbers?

MR. PRELL. You're looking at the middle panel, the scatter diagram?

CHAIRMAN GREENSPAN. Those are annual numbers?

MR. PRELL. Yes.

CHAIRMAN GREENSPAN. Oh, I'm sorry.

MR. PRELL. I'm sorry. That really is poorly labeled. It is 30-odd years of data; it goes from 1960 to 1992.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mike, Chart 13, the capital-labor cost ratio, is an exciting chart, if I'm reading it correctly. I don't know if I am or not.

MR. PRELL. I hope we calculated it correctly! [Laughter]

MR. LINDSEY. If I interpret this correctly, between '88 and '94, say, the relative price of capital, the user cost of capital, has fallen 40 percent relative to the wage rate, roughly. Am I reading it correctly?

MR. PRELL. Yes.

MR. LINDSEY. Do you have an historic series on this?

MR. PRELL. Yes, we can provide you with a longer time series.

MR. LINDSEY. Is this an unusual amount of change?

MR. PRELL. The computer prices have been falling fast for so long that if we stretched this back--at least going back to the '70s--I think we'd probably still have a pretty steep drop.

CHAIRMAN GREENSPAN. But the rates have changed.

MR. PRELL. Yes, it may be more in recent years.

MR. LINDSEY. If you're talking about computer prices, okay. But when you use cost of capital, there are some tax effects and interest rates and weighted cost of equity and debt and things like that in there. And the compensation rate is something like an hourly wage rate?

MR. PRELL. Yes, we've used the ECI here.

MR. LINDSEY. And this has been falling like that since the '70s?

MR. PRELL. Well, undoubtedly, you [have to] go back to a period when interest rates were moving sharply enough to have significantly moved this.

CHAIRMAN GREENSPAN. The computer prices are falling now at rates that are very large; and when you consider the size of the computer industry itself there is [unintelligible] effect [unintelligible] earlier period.

MR. PRELL. Certainly, this would be the case going back several years before this, but I don't have data going back much earlier.

MR. SYRON. This would forecast a real investment boom over a long period of time.

MR. LINDSEY. Well, it also forecasts problems in the labor market.

CHAIRMAN GREENSPAN. That's what part of it is.

MR. LINDSEY. That's a part of it, but what's the good rule of thumb for cross elasticity substitution?

MR. PRELL. I can't answer that.

SPEAKER(?). Fudge!

MR. LINDSEY. Even a tiny number there when you've got a 40 percent decline is going to knock a heck of a lot off employment.

CHAIRMAN GREENSPAN. It explains a good deal; the plant and equipment numbers are low.

MR. LINDSEY. They are, yes. My heavens! Thank you.

MR. PRELL. I have a chart on the growth rate of the cost of capital and it clearly has been falling on average since the beginning of the 1980s expansion. There were a few periods when there was some increase but we have seen a significant decline over time. It is faster in this period than it was earlier by a significant margin.

MR. LINDSEY. When the crush is off, you can send me a copy. I would appreciate it.

CHAIRMAN GREENSPAN. One of the interesting inferences from these data is that depreciation charges currently coming on are coming off equipment from 5 and 6 years ago when the prices were much higher.

MR. LINDSEY. Yes.

CHAIRMAN GREENSPAN. So, the cash flow is very large relative to--

MR. ANGELL. To the investment.

CHAIRMAN GREENSPAN. So incentives--. It's a fascinating process in many different ways that we're looking at. And that's why the capital goods markets are--

MR. ANGELL. And lo and behold the credit demands are not robust!

CHAIRMAN GREENSPAN. Exactly.

--MR. LINDSEY. Because the internal flows--

CHAIRMAN GREENSPAN. The cash flows are very large, no question. President Parry.

MR. PARRY. Mike, I have two questions. The first is on the measurement problems issue. I wonder if you could talk about that just a little. I know there's a discussion in Part II of the Greenbook and I'm not sure exactly how this problem originates. Is each of the series seasonally adjusted except those series where there apparently is not a statistically significant seasonal adjustment factor? And then is it added and the combined unadjusted apparently has a seasonal factor?

MR. PRELL. That's right. As I understand it, BLS does not like to use seasonally adjusted sub-components unless at a more detailed level there are indications of seasonality in them. If they can't find it at the very detailed level, they won't do it for that major sub-component of the CPI. And most of this residual seasonality appears to be in the not seasonally adjusted components of the index.

MR. PARRY. So, at the end is there a seasonal adjustment of the entire series?

MR. PRELL. No, it's an aggregation of seasonally adjusted components.

MR. PARRY. Okay. So, it's almost like a deflator that they see when they publish that. There is a number which is called the index [unintelligible] implicit.

MESSRS. KOHN and PRELL. The weighted average.

MR. PARRY. The weighted average, okay.

MR. PRELL. One of the things BLS has pointed out and which gave us pause--we thought about this some months ago in terms of whether we should expect something--is that it is hard to find at a detailed level a consistent pattern in recent years. Certain commodity groups were behaving in a way that suggested there was a seasonal problem. One year it was one thing and another year it was another, and that gave us pause. But the accumulation of evidence now certainly shows, at least at a statistical level, that there's something going on there. As I said, it doesn't explain everything. The best you can get out of this is that the pattern this year looks much like the pattern last year.

MR. PARRY. Yes.

MR. PRELL. The question is: Why [isn't] the pattern this year better than the pattern last year, given the ongoing slack in the economy?

MR. PARRY. My other question is: In Part I of the Greenbook, and you also referred to it here, you have a table on the relationship between tax increases and expenditure cuts, and for 1994

it's rather interesting. Will it be possible at some time in the future to get that out through the entire program? It would be rather interesting--

MR. PRELL. Certainly. When they pass [some legislation], then we can do something similar. Let me just say--

MR. PARRY. It's very interesting because now we see in the newspapers that Boskin has the ratio at 9 to 1 and somebody else in the Administration is saying it's 1 to 1.

MR. PRELL. Part of the problem here--I touched upon this in my comments a few minutes ago and unfortunately we didn't emphasize this in the write-up in the Greenbook--is that this is not all of the deficit reduction that is occurring in essence.

MR. PARRY. Oh, I know that.

MR. PRELL. This is more or less the mandatory spending and the tax changes that are in the package.

MR. PARRY. Right.

MR. PRELL. The ceilings on discretionary spending would have required significant cuts. That is where, for example, the defense cuts are coming in.

MR. PARRY. I think in assessing the program you have the right data.

MR. PRELL. Well, we hope it's relevant and not throwing people off.

CHAIRMAN GREENSPAN. Incidentally, on the seasonal adjustment issue, has anyone looked to see what the bias in the CPI does to the deflator for the fourth and first quarters and, therefore, the GDP estimates for those quarters?

MR. PRELL. We've looked at that. And our finding, tentative though it may be, is that it probably doesn't have significant implications for the deflator. There are different indexes used for some things and different seasonal adjustments. It's not clear that this feeds through in an obvious way to the GDP number.

CHAIRMAN GREENSPAN. Does Commerce seasonally adjust the price indexes separately? [Unintelligible] I think they may be doing something of that nature which would pick this stuff up.

MR. PRELL. Well, we've talked many times, at least to the staff, about differences in the seasonal pattern for food, for example, where they have used seasonal factors that were sufficient to alter the picture of the PCE deflator from what one would think [looking at] the CPI. There are also different weights, too, in some of these things. So, it really is hard to translate.

MR. SLIFMAN. Even within consumption, [for] their PCE, there are some places where Commerce does not use the CPI. For example, I think for air fares, which as you know has been a player in this

seasonality problem, they use independent information rather than CPI information.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mike, a question on capacity utilization, the lower chart on the lower panel on Chart 14: In the past it seems to me that when we got the capacity utilization to a sustained 85 percent we had price increases. But with so many industries now becoming global, the question is whether this is really a meaningful indicator at this point. Isn't it entirely possible that we will see domestic capacity moving up to the higher levels but at the same time we'll continue to see prices coming down?

MR. PRELL. Discerning flash points is difficult. Certainly, a level of 85 percent is a very high level, and any time we've been in that area I think we've been in a period of significant inflation. People have declared lower levels of capacity utilization to be flash points. We're not sure that's a particularly robust result. In our forecast I don't think we get into the zone where, unless we're getting some speed effects as well, this is particularly worrisome. You're right, though: The more open the economy is, the more [important] the cost of transportation or the lower relative value of the products and so on, [and] we're going to have more of a potential role from foreign supplies in the market. The question is on what terms. And exchange rate developments, obviously, would affect what the price pressures--or the depressing price pressures--would be from foreign capacity. But, indeed, currently in our forecast there is ample capacity abroad. We think the exchange rate movement will be favorable in this regard, so it removes still further the concerns that industrial capacity limits are going to be a major source of inflationary pressure.

MR. KEEHN. Thank you.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. A couple of things. First, a comment on your exchange with Larry Lindsey on the cost of capital. The major computers buy millions of instructions per second generally. And if you compare the price of a million instructions per second on a 1980 computer with the 1982 computer when [unintelligible] chips came out it's a factor of one-one thousandth in the cost. But the problem is worse than that because we don't include software in capital stock generally; it's a perishable factor input. And a lot of software we're using today didn't even exist in 1980, so we can't even make that comparison. And businesses' real costs of that kind of capital, at least versus labor costs, has fallen far more dramatically than 40 percent.

MR. LINDSEY. But what surprises me--I understand with computers--but in the cost of capital equation [1 minus] ITC minus tau z over 1 minus [tau], the only things that have changed would be either a rise in the real term or a fall in the true depreciation of plant and equipment. The tax variables haven't changed since 1988. I suppose--I made a quick calculation--that if you took a seven-year piece of equipment, the [unintelligible] has gone up 19 percent in real terms, but that's going to work through to maybe a 6 or 7 percent

change in user cost over that time out of 40 percent. So, Jerry, I think all the computer effect would have to be in the [unintelligible]. You're saying that computers have caused the real return of capital to rise.

MR. JORDAN. You can say it that way. I think a part of the problem is that you're not measuring output the same anymore. You're focusing just on the input part.

MR. LINDSEY. Right, right.

MR. JORDAN. But you also have a problem on the output part. The other comment is really a question to Mike. I want to go back to the questions that Ed Boehne and Dick Syron asked earlier about secular and cyclical inflation and your response to them. If I look at your numbers, the implications of the central tendency of the bond yield, essentially you're saying to us that compared to '92 or a couple of years in here we may have a cyclical increase in inflation but that we are still on a secular downward trend. Whereas it would appear from household behavior and other things like forward rates that businesses and households are assuming that we have seen a secular low in 1992--holding aside whatever cyclical peaks and troughs from this point forward--and we have not only a cyclical increase [ahead] but probably a secular increase. Households and businesses also seem to be assuming that we have seen a secular low in tax rates beginning with the '90 tax rate, whatever is going to happen after. So, if you make the assumption that businesses and households alike are acting in the belief that from this point forward we will have a generally higher drift of both inflation and tax rates, how do you factor that into your split between your kind of growth and inflation?

MR. PRELL. It's a complicated question; I'm not sure I can give a good answer. I'm not sure that the perception is that we've reached a secular low in inflation, though I find it hard to argue with that. I certainly think there was a notion that with a growing economy we probably had reached a cyclical low in inflation. Now, it may be that many people thought we'd never go below 3 percent; I don't have a basis for judging that, but maybe that's true.

MR. JORDAN. Wouldn't you say that mortgage refinancings and corporate debt issuance, quite aside from the surveys, are at least consistent with the view that the household and business sectors are assuming we've seen the secular lows?

MR. PRELL. Everybody is operating in an environment of uncertainty, and people get to a point where they are satisfied if they can make a gain that's worth the transaction cost. A household may indeed feel that if they knew or really were convinced that interest rates were going to go down another point in the next three months, they'd hold off. But not knowing for sure and having seen rates come down a good deal, they see they can make a saving. They also see that some have refinanced a couple or even three times, so they haven't foreclosed that possibility. Corporations may be in the same boat; a corporate finance officer knows he can lock in a reduction in the coupon on his long-term debt and doesn't want to be criticized for having missed that opportunity if rates back up. He'd have to be very certain at some point that the rates were going to go down still further not to go ahead and jump. If you look at bond

issuance over the years, it seems to be motivated as much by the movement in rates as by the level. And that, I think, would correspond to this kind of logic, at least to an extent.

MR. JORDAN. And the same holds for taxes.

MR. PRELL. On taxes, I guess it's plausible to assert that people feel that the bottom in the marginal tax rates may have been reached a few years ago. How that is affecting the various decisions at this point isn't entirely clear. It presumably affects decisions about capital structure and so on. There is a wide range of things that could be affecting [decisions]. As I suggested, it's probably the notion that taxes are headed up, including possible taxes relating to medical care. This whole situation is probably making many people feel poorer than they did a year ago. So, there are a lot of things going on here which may relate to the kinds of perceptions that you're talking about.

MR. JORDAN. Even if you cannot do it formally in your model, wouldn't you say that at least theoretically that should be factored into a forecast of the growth in output and the composition of that growth?

MR. PRELL. Sure, in various ways. And as I said, one of the things that has disinclined us to follow the models to significantly lower inflation rates over the next year or so, which would seem to be implied by an unemployment rate near 7 percent, is the notion that it may be difficult to get those inflation expectations to move down to the 3 percent rate of inflation that we've observed over the past few years. We seem to be a long ways from that point. Now, if there was something that suddenly brought a collapse in expectations, then I think we could have a much better result: more growth or less inflation, or both.

CHAIRMAN GREENSPAN. Vice Chairman.

MR. MULLINS. On your seasonal adjustment--you partially got into this--how about the other GDP measures, such as the ECI, the average hourly earnings, and all the other ones that have tended to accelerate over the past few months?

MR. PRELL. We did some investigation of the ECI. I don't remember the numbers but it smoothed things out some but still left some acceleration on the double seasonal adjustment.

MR. MULLINS. I assume as soon as we discover this it starts to work against us! [Laughter] How much should we add to the next core CPI number to adjust for the seasonal bias? Four-tenths?

MR. PRELL. A tenth or so per month. It's not a great deal at this point.

MR. MULLINS. Okay.

MR. PRELL. This is a quarter in which we are getting the advantage of this, but I don't think month by month there's a big effect.

MR. MULLINS. Okay.

"CHAIRMAN GREENSPAN. Well, June is one of the big months; it's .1.

MR. MULLINS. It was .1 in May, too, wasn't it?

CHAIRMAN GREENSPAN. It was less than .1 in May.

MR. MULLINS. I won't hold you up but we might just look at that as we start to smooth it out. I just had one question on [Jerry's] comment. How do we interpret the rather large increase in the number of 50-year maturity, noncallable debt offerings? Do we see that as indicative of the secular bottom of rates or a very long cycle?

MR. SYRON. It's longer than a Kondratieff; it's the Mullins' cycle!

MR. PRELL. I don't have anything to contribute to the debate!

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mike, I just want to make sure I'm reading correctly the upper left panel of Chart 14, which deals with the seasonal factors. As I'm reading that now, the increase in the measured core CPI through May was at an annual rate of about 4 percent. And if you assume there is a seasonal in the seasonally adjusted data and this accurately measures it, what you do then is to take about five-tenths out of that so the corrected measure would be 3-1/2 percent.

MR. PRELL. That's right.

MR. BROADDUS. That is still an uptick from the 3.1 percent last year; that's the way that has been structured?

MR. PRELL. Right.

CHAIRMAN GREENSPAN. Any further questions?

MR. MCTEER. Just a comment. In Texas what they call seasonally adjusted, seasonally adjusted data is refried beans! [Laughter]

CHAIRMAN GREENSPAN. Would somebody like to start the Committee's discussion?

MR. FORRESTAL. Thank you, Mr. Chairman. I think what we've just heard in the Chart Show is very similar to what is going on in the Atlanta District. Growth in the District has been decelerating. We led the nation in growth for much of 1992 but now the gap is narrowing. And I think the weaker activity we've been observing is pretty evident in our survey of manufacturing plants in the District. Even though the margin of favorable responses remains positive in several of the categories, it has been eroding. Also, the early data for June suggest a further weakening in expectations of activity and

spending six months from now, and that includes about 80 of the 120 or 130 respondents. So, the trend in manufacturing continues to be down. Consumer spending had been quite strong but it appears to be losing momentum. At the same time, demand in the interest sensitive sectors, including single-family homes, is boosting purchases of housing and related items. And the demand for new automobiles and trucks also looks reasonably good. Business loans apparently have been growing at the national level and banks appear to be making more effort to book loans. That's true to some extent in the District but I'm still hearing a lot of complaints about the famous credit crunch and the difficulty people have getting credit, particularly small business people. I was in Orlando about two weeks ago and I got an earful from about eight or ten small business owners who have had long relationships with banks and are now finding it very difficult to get credit. Housing developers also are reporting that credit is hard to get even in cases where market conditions are favorable. Inventories of unsold homes are small. Nonresidential construction appears to be bottoming out. There are some new projects under way in some parts of the District, particularly build-to-suit kinds of projects. Again, as I have reported many times over the past several months, price pressures are virtually nonexistent. Business people are reporting very highly competitive market conditions.

The main problem is the same one that I and many others reported last time, and that is the uncertainty about fiscal policy and the health insurance situation. Everyone seems to be expecting negative impacts, and I think that's having an effect on business planning and on business fixed investment at the moment. So, that's the situation in the District. Our regional economy is still relatively strong compared to the nation but it is weakening, and the momentum seems to be fading to some extent.

Now, with respect to the national outlook, our forecast is somewhat stronger than the Greenbook throughout the [projection] period. To a large extent our forecast assumes that the economy will return to a stronger path of economic recovery when this uncertainty lifts, whenever that might be. Even with the revisions to capacity utilization, there is still enough slack to support growth that is somewhat above potential, for a while at least. The only area where we have a more pronounced weakness than the Greenbook is in net exports. And consistent with our higher GDP, we have a lower unemployment level and a less optimistic price forecast than the Greenbook. In the case of prices, we are less certain that pressures from the interim tax can be confined in the economy. In addition, we're looking at the seasonal adjustment problems and we believe that 1993 doesn't show any improvement in inflation over last year.

Even with that stronger forecast, Mr. Chairman, I myself feel that the risks to the economy are asymmetric in the sense that I think the risks are on the down side. It's very difficult, of course, to estimate the risks and the cost of uncertainty and what that is doing to the economy. But I do think the uncertainties we have in the economy at the moment may very well threaten this expansion, especially if resolution of our fiscal policy and the new health care program is delayed any further. And while the employment numbers have been fairly good up until recently, the continued public announcements of layoffs, particularly by large corporations, are clearly in my judgment eating away at confidence. Finally, I continue to be

concerned about the continued deterioration of the economies of our trading partners and the severity of their recessions and what that means for our economy. So, I think we're in a very difficult period, Mr. Chairman. Again, I would repeat my judgment that the risk is on the down side.

CHAIRMAN GREENSPAN. President Jordan.

MR. PRELL. Mr. Chairman, may I just interrupt to answer a question? Our guess is that the core CPI is depressed by half a tenth in June.

CHAIRMAN GREENSPAN. Yes, but that is [unintelligible]. President Jordan.

MR. JORDAN. Thank you. I've continued to tour the District, visiting not only with bankers but with a lot of their customers, mainly small businesses, and staying away from the big guys because they all continue to shrink anyway. What has stood out in all of this is the extraordinary increase in the utilization of technology [in areas] that I would never have imagined. It's one thing to see a very high level of software development and computer usage in something like titanium hip replacement parts and to see how strong their market is on a global basis, how much their volume is increasing, how much their prices are falling, how proud they are of having reduced their work force, and how determined they are to do more of the same. But we've also visited turkey processing plants, agricultural feed products, and an egg-laying operation producing 350 million eggs a year with 70 workers and a bunch of 486 PCs. Again, the emphasis of all these people is on the reduction in their work force--how many fewer people they're able to get by with than they were five years ago. When people talk about a perceived shortage of something, they talk about people with the right software to [fix it]; they say they know they could automate if somebody could just get the time and learn how to do it with the software. What stands out in this somewhat casual impression that everybody's emphasis is on substituting [technology] for labor is that if this period is in time generally viewed as something comparable to, say, a third industrial revolution, as some writers have already started to argue, then trying to measure the economy in terms of jobs and the number of people employed is going to lead us far astray of what's really going on out there.

At the beginning of this century the largest employer in North America was the U.S. ice trust. Had we had the emphasis on preserving jobs at that time we would have made a terrific mistake for the national economy. It might have precluded air conditioned houses and offices, which might have helped out on the side of the government but otherwise probably would have held the economy back very considerably. So, I think we have to be very, very careful in interpreting all of the output numbers because we're having more difficulty in just conceptualizing using the 19th century framework, which is based on tons and numbers of things when we look at output. We have to be careful about productivity. The whole retail trade sector is shown to have had negative factor productivity for more than a decade mainly because its output goes to the benefit of the consumers, these optical scanners and so on. And I think it defies all reason to think that the retail trade sector has negative

productivity gains given what they're doing; [the same goes for] the banking industry and so on.

Turning to just a few sectoral comments about the District, our agricultural sector is very strong. Our farmers are delighted with the floods and problems in the Mississippi valley area. They're looking forward to higher prices; they have their crops in and they look for good volumes. The disturbing aspect is that some bankers--and this is not farmers themselves talking so I don't know how much reliability to attach to it--are talking in terms of the price of an acre being up as much as 25 percent from a year ago. Some of the prices they quote--what they say they're getting on loan requests--look unrealistic to me related to the values of the crops associated with [the land]. Our contacts point out that these prices remain well below the peak of the agricultural bubble back a decade or so ago, but they are still very, very sharp increases in land prices.

Confidence of the smaller businesses I would say is still very, very negative; [it stems] from their perceptions of Washington. In our discussion in May there was a question as to whether this was just political bias--usually these small businessmen are Republicans--but my sense of that now is quite the contrary. John LaWare was with us at our joint board meeting in June and he heard one of the comments made by one of the directors who comes from a district where the Democratic registration is 8 to 1, and they are the most upset. [The mood is beginning] to take on a jilted lover effect; those who had high hopes and aspirations and expected the most from this Administration are the ones who are most angry. So, I don't think it's politics when they tell us how upset they are about things.

Other conditions in the District generally have not changed. It's still probably the strongest region in the country. The retail sector is very good; exporting is very good; auto sales in our area are very good. There's really nothing there of a negative tone. I do want to comment and ask a question, too, about the Greenbook and these FOMC central tendency projections on Chart 16. Maybe I misunderstood what they are. When I look at the Wall Street Journal's summary of everybody's forecast or any of these other [forecasts], it's one thing that [unintelligible] is going to happen. I don't think in terms of [a forecast] by the central bank when it comes to putting down numbers for inflation; rather I think of these as our objectives because it's our policies that are going to produce these [outcomes]. And [it bothers me] to see the Committee raise the central tendency for this year and also to have the central tendency for next year the same as it is this year and above where inflation came in in 1992. Am I to understand that the consensus of the Committee is that inflation is not going to go down anymore because we're not going to try and produce lower inflation? Is this an objective or is this a prediction?

CHAIRMAN GREENSPAN. This is a prediction and I've made a very special point to avoid any implication that any of these [data] are goals. [We do this] because we are required by statute to present this sort of [stuff]. If we ever put down actual goals, then we really will have problems. So we fudge it for the Committee as best we can.

MR. JORDAN. How do you handle that then when it says that the Committee's policies are related to inflation? Our objective is to go to price stability, but we're predicting that the rate of inflation is going to be sticking in the 3 to 3 plus percent area.

CHAIRMAN GREENSPAN. Well, the implication of this is that it's not clear whether it's pre-policy or post-policy.

MR. JORDAN. Don't you announce them at the same time you announce our policies?

CHAIRMAN GREENSPAN. I purposely never ask anybody around this table what policy assumptions they are making when they make these forecasts. So, I feel free to make the statement I just made!

MR. SYRON. The problem you'd clearly have when you get into it on other side is that someone would note that some people have raised their estimates on unemployment and would ask if that is our objective on real growth of employment. It seems to me pretty perilous if you are going to have to talk before the Congress and say our objective is this on prices with this employment figure. You are in just an intolerable position.

CHAIRMAN GREENSPAN. Yes, it's an intolerable position. The whole process is. We would be far better off just dispensing with this, but we can't. It puts us in an impossible situation.

MR. JORDAN. Well, there are a couple of things [I'd say] about that. One, the numbers that we provided are not a prediction of what is going to happen. When we put down a number [for inflation], such as the number [we gave] in February, the way I interpret it is that it's the intent of policy to try and achieve a downward trend. And I think it's different than unemployment or real GDP or anything else like that because those are not part of the ultimate objectives of our policy. Our ultimate objective is to stabilize the purchasing power of the currency.

MR. SYRON. Wait a minute. I thought our policies ultimately were to maximize real growth and that what we did on prices was a way of doing that.

MR. JORDAN. I agree, but in a one-year ahead [framework] like this--

MR. STERN. Well, you could say the same thing about prices if you really want to get into that and talk about lags. After all, there's uncertainty as to how quickly things react to whatever policy moves we might make.

CHAIRMAN GREENSPAN. If you all get too detailed into this issue, I will not be able to plead ignorance for the Committee!

MR. JORDAN. Well, one final question: Are the ranges [showing the central tendency of our forecasts] for 1993 and 1994 to be taken as acceptable to the Committee?

CHAIRMAN GREENSPAN. The answer is no. President Parry.

MR. PARRY. Thank you, Mr. Chairman. New data paint a weaker picture in the 12th District than I reported at the May meeting. Employment revisions and subsequent monthly releases show a continued deterioration in employment in California. Rather than flattening in early 1993, the new payroll data show a continuous rate of decline. Preliminary numbers for June show employment down 1.6 percent from a year ago and falling at a 2 percent annualized rate between May and June. Only services have actually shown gains in employment in the last year. The household survey, which had shown a stronger employment picture, reported a decline of 187,000 jobs in California between May and June, bringing the level of employment in that survey slightly below that of a year earlier and raising the unemployment rate to 9.1 percent. Now, economic conditions elsewhere in the District are somewhat better. But even there conditions appear a little less positive than they did at the time of our last meeting. Outside of California employment is up 1.7 percent from a year ago, with employment growth exceeding 3 percent in three of our states: Idaho, Nevada, and Utah. However, all states except Hawaii and Utah reported month-to-month declines in employment between April and May. Also, our Beigebook respondents have become increasingly cautious and pessimistic about the national outlook. Moreover, our contacts in the District report that investments in business expansion are being slowed by uncertainty attributed to tax, health care, and trade policies.

The state and local governments are facing rather substantial fiscal problems in the coastal states. California just put in place a few days ago a budget that closed a \$9.3 billion shortfall. The agreement, however, created significant problems for local governments by shifting \$2.6 billion of property taxes away from them. They obviously are going to have to make adjustments in their budgets, which will have a significant negative impact at least for the current year in many counties and local areas. Oregon is facing the possibility of a 20 percent cut in state expenditures because of lost property taxes or tax revenues due to Measure 5. And Washington, which closed a \$1.8 billion shortfall earlier this year through a broadening of the sales tax base and cutting expenditures, is facing a ballot measure in November that would reverse the tax increase. In summary, for the District the news is not particularly pleasant.

If I can turn to the national scene, our forecast is very similar to that of the Greenbook. We do have a second-quarter growth rate of around 2 percent. Clearly, the more recent statistics with regard to inflation are more optimistic, but I would say that the inflation outlook is still very uncertain. We really only have had one month's data that suggest improvement. And I must admit that the measures of the degree of slack in the economy are clearly uncertain; some of that was referred to in the discussion by Mike Prell. All of this would suggest to me that we have to continue to focus on the inflation numbers over the next several months because it's really too early to see what the trend is likely to be.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Thank you, Mr. Chairman. Our District economy continued to grow in May and June although at a very moderate rate. We do a couple of surveys prior to the Beigebook, and the latest one shows that retail sales edged a bit higher in this two-month period.

Manufacturing activity in our District seems to be steady. I think the manufacturing situation in our region is probably a little stronger than nationally because of the composition of our manufacturing base. Textiles is a big industry in our District and that industry has been doing reasonably well recently. I think most business people in our area expect both the regional and the national economies to continue to grow slowly in the months ahead, but at least some of the anecdotal commentary I'm hearing has been less positive over the last several weeks. Concerns about tax increases and uncertainty regarding the prospective additional tax increases accompanying health care are part of the problem, but I think the prospective military base closings in our District are the central current worry. If the Federal Commission's recommendations are accepted, and I guess most people think they will be, that's going to hurt the Fifth District particularly hard, especially the states of South Carolina and Virginia. The Charleston, South Carolina area has estimated they would lose about 14,000 jobs. One local newspaper referred to that as another Hurricane Hugo coming through prospectively. In Virginia, combined potential losses in Norfolk and northern Virginia would amount to about 18,000 to 20,000 jobs and those estimates don't include the multiplier effects of these direct losses on local job markets. So, that's a cloud hanging over at least two states in our region.

Regarding the national picture, our basic forecast is not terribly different from the Greenbook. Our real GDP projections are a little higher for both '93 and '94 but close to most of the private forecasts I've seen. On the other hand, our inflation projections are similar to the Greenbook's, which generally are more optimistic than most private forecasts out there. Still, on balance, we're a little more optimistic than most people which gives me a bit of a pause. But this optimism is relative optimism. It's justified because we base it--and I don't want to get too detailed here--fundamentally on the assumption that this Committee will do whatever it has to do to help increase the credibility of our longer-term strategy. And if we do that, I think that will allow for both continued moderate growth and continued disinflation. Obviously, some of the latest data are pretty discouraging, especially the June employment report; but it strikes me that the overall picture is not all that bleak. As the Greenbook indicates, aggregate hours worked in the second quarter were up quite substantially, so I think the bounceback in real GDP growth in the second quarter, as the Greenbook is forecasting, is certainly plausible; and it could even come in a little stronger than that. Beyond this, we in Richmond think it's reasonable to expect at least a moderate further acceleration in the quarters ahead. In particular, it strikes us that economic conditions are improving in a number of our major export markets; some of the data that Ted recited reinforced that view. It's possible, therefore, that exports can be a somewhat greater source of strength for us going forward than is generally anticipated. That's not to say there are no downside risks. Obviously, the potential substantial tax increases are especially big negatives. But my own feeling is that the moderate projections in the Greenbook and the slightly higher projections that we have are both plausible outcomes despite the fiscal drag.

With respect to inflation, the rate of increase in the core CPI in the first five months of the year, even if it's a little less than the published data, is troubling. My own view is that the

increasingly widespread perception in the financial markets and to a certain extent in the broader economy is that we at the Fed are prepared to act to hold any potential increase in inflation in check. I think that's already beginning to have a measurable effect in holding inflationary expectations down. I think we see that in the bond markets recently. If we can maintain this posture and communicate it, I think it's reasonable to expect at least the modest further improvement in inflation [projected] in the Greenbook.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, with regard to the national economy, our forecast really is quite close to the staff's forecast. But it is interesting that when we first made a forecast for 1993 this time last year, we started off lower than the staff forecast. We were at the time somewhat pessimistic but as we've gone through the year [unintelligible] and at this point the differences aren't that large. Our outlook for inventory levels and residential construction is somewhat stronger than the staff numbers. This is perhaps reflective of conditions in the District.

In the District, the level of economic activity continues to expand but the pace of the increase is beginning to show signs of moderating. The auto industry continues to be our bright light. Retail sales are continuing at good levels and inventories are in good balance. The third-quarter production schedules, which have been set about 18 percent over last year, seem reasonably firm at this point. The heavy truck business continues to be solid; retail sales of heavy trucks are forecast at about 129,000 units this year; that's a good year for them. But some of the strength is being driven by pending changes in regulations rather than normal market forces, and there are some preliminary indications that the heavy truck order rate is falling; indeed, there are a few signs of order cancellations.

In the steel business, while the order and production rates continue at good levels, the significant development has been the preliminary settlement of the contract the USW has been negotiating with the first company. It seems to be coming out on a non-inflationary basis. The contract preliminarily agreed to calls for a \$500 signing bonus, a \$500 lump sum payment in the second year and a \$.50 per hour wage increase in the third year; there are no wage increases in the first and second years. There's also a \$1,000 lump sum payment in 1996 if the company earns over a specified level in 1995. Given the substantial changes in work rules and the substantial give-back on health care, the company feels that it can easily cover the higher cost through productivity increases. That deal is far better than what they had hoped for at the outset of the negotiations.

Retail sales in the District have been reasonable thus far, running about 3 to 4 percent over last year. There is some strength in appliances and home improvement items. In the agricultural sector, we have something [akin to the reverse] of what Jerry Jordan referred to. His good news, of course, is our bad news. I will say, though, that the ag equipment business has been very good up until now. Therefore, based on these higher sales levels, at least one manufacturer has increased its production schedules for the second half of the year by some 13 percent. But the miserable weather that we've been having and continue to have is a real downer. The corn

crop planting is in one sense complete, but as of late last week it looked as if in Iowa alone some 6 percent of the corn crop would have to be replanted. The soybean crop has been badly delayed and I think it's not going to get completed. It's clear that we're going to have an acreage shortage in soybeans once things get straightened out. It's going to take quite a while to assess just how much damage is going to result from all of this rain but, clearly, that has not been a plus for the District.

On the inflation front, despite the discouraging numbers that we've talked about for the early part of the year, I really don't sense any significant upward pressures on prices on a broad basis. Competitive conditions remain very, very intense in the market. Certainly, this is true in the retail sector where it takes significant sales and discounts to move products. One manufacturing company that I talked with follows the cost of their purchase materials very closely; it's a large manufacturer. They had been forecasting a decrease of 1/2 percent in the cost of their purchase materials this year. They re-forecasted just last week and they now expect the cost of their purchase materials to decline by 0.9 percent; they really have a very constructive look on the price of their purchases. As for wage costs, with the steel contract seemingly settled on a non-inflationary basis, the bargaining focus will shift to the auto negotiations which just started. It's far too early to tell just how that's going to work out, but that certainly will be a key item on the wage front. Net, while the economy continues to expand, it just doesn't seem to have that much strength, and I think we could be facing a pretty mediocre outlook. Thank you.

CHAIRMAN GREENSPAN. Did you say something on whether you sensed that the capital goods markets are being affected by the tax uncertainties?

MR. KEEHN. There's no question about it. People are very uncertain; the level of uncertainty caused by the discussions [in Washington] has led people to hold back.

CHAIRMAN GREENSPAN. You know of projects on hold as a consequence?

MR. KEEHN. I don't think I could be specific about major projects on hold, but I know that capital purchases are clearly being affected by this.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Bob Forrestal's discussion of the Southeast economy pretty much describes the Southwest economy. During the recovery and expansion we have pretty much led the nation, but as we moved into 1993 that gap was narrowing. And possibly in April and May, based on employment numbers, we may have fallen behind the nation's pace of growth. So, things are weakening relative to the rest of the country even though they're still moving forward. One of the changes has been that Mexico, which had been a major source of strength both to our manufacturing industries and to retail sales along the border, may be turning into a weakening factor as they've had slower economic growth and as they've continued the collection of duties at the border that they imposed at Christmas. Bob mentioned

that the credit crunch was still alive and well. I think that's true in the Eleventh District as well. Although we get more and more indications of banks going out and aggressively marketing loans now, I don't have a lot of indications that many more loans are being made; but at least on the surface that seems to be improving. In addition to the uncertainty surrounding the tax and spending plans of the Federal government, we have some added uncertainty in our part of the country over the prospects for NAFTA. There is some anxiety about that, which is probably slowing things down just a little. Also, the energy tax probably did more to slow things down in our area of the country than it did in the rest of the country, but that has faded somewhat given the way they're changing that.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. The District economy continues to be mixed. I'm not sure that overall it is deteriorating sharply, but its growth has been slower than the nation's all along. And while the gap may be narrowing some, that's not so much because we're picking up but because the rest of the nation's economy seems to be coming to meet us. We have seen the same quite noticeable deterioration in the manufacturing sector that Bob Forrestal pointed to and it is continuing into this month. That's affecting employment plans and has cut significantly into the capital spending plans of the manufacturers in our region. While manufacturing has been showing this noticeable weakening, the retailers seem to have been doing better--certainly the second quarter was better than the first quarter--although in recent weeks that seems to have flattened out some. Nonetheless, I think the tone in retailing is better. The residential construction people are feeling better. Not only are sales of new homes moving but there also is new residential construction. The nonresidential area continues to be a big drag and will be, I think, for a number of years.

One of the areas that has been a mainstay of strength in the Third District, particularly the greater Philadelphia area, has been the health care industry. And that is changing. Where that has been a plus in employment gains, I think we are going to see that turn negative. The hospitals, which had been adding people, have made a number of cutbacks; and some of our hospitals are laying off people. In terms of defense, I think the best way to describe it is that the District economy expected to be hit by a cannon ball and it's just a shotgun blast and not a cannon ball, so it feels better because at least it's not as bad as expected. Overall, employment has increased but not a great deal. The financial institutions are out there trying to drum up business. They report some uptick in lending activity, but it's still rather flat on the whole. As for inflation, there just do not seem to be upward price pressures. Wage rate increases, however, do continue higher than one might expect in this kind of market, at around 4 percent or so, I'd say, rather than decelerating.

As far as the nation goes, our forecast is somewhat higher than the Greenbook's in this slow-to-moderate growth range that I think we all see. Nonetheless, I think the uncertainties that are out there do put the risks on the down side. There are these macro risks that we all talk about, the budget package. In some ways I think the business community is more concerned about health care reform than the immediate tax increases. But for the individual, at the more micro level, the uncertainty instead of abating, if anything, is increasing.

I think people are as much if not more concerned about their own jobs, their own companies, their own futures; and they sense that the margin for error is not very great. We are in one of those situations where the unexpected shock--all shocks by definition are unexpected because we don't know what they will be--[would be troublesome]. I don't think we can take a very big one at this point.

On the inflation side, I think we can continue to make some progress but we are at the point in the cycle where the gains on inflation are just not going to come as easily as they did earlier. My own sense is that we have a way to go in terms of secular gains, and I think we could continue to get inflation down on a secular basis. But we ought not to deceive ourselves: The gains are going to be very tough as this cycle wears on.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Thank you, Mr. Chairman. Activity in our District continues not unlike what it was the last time I reported. Farm income remains good within our District, helped by continued strong cattle and livestock prices; and our wheat harvest should be reasonably good. Construction activity is being led importantly by residential construction in the Denver and Omaha areas; nonresidential building remains brisk through the second quarter. Oil and gas drilling has picked up ever so slightly; thus that industry is remaining stable after some period of pretty significant decline. Manufacturing for us, as you've heard from others, remains sluggish. Some companies are hesitating; in a couple of conversations I've had, particularly with those in food processing and the nondurable goods areas, my contacts said they had just put off some additional expansion. And one company's chairman said that they do not hire without his permission. These are companies with several hundred employees. So, the uncertainty is having an effect, I think, on some of these activities in the manufacturing sector.

Looking ahead for the District, I think farm income should continue strong, with good harvests and continued good prices in the cattle area. In construction the flow of new contracts is good, so we think activity there will remain good for our District. With some weakening in the prices in the oil and gas area, it appears that this slight improvement that we've seen may not be long-lasting; we just don't know at this time. Manufacturing, until we get some of the uncertainty out, I think is going to remain a little more sluggish than it might otherwise be.

I have talked with individuals about credit and credit access in our region. That has improved although we do still get some feedback that it's hard to get loans; that is much less the case than it was a few months ago. And the evidence, in terms of increases in credit outstanding, would suggest that that area is improving.

At the national level we, like others, continue to see modest growth. Our forecast is also somewhat stronger than the Greenbook, led not by consumption but by somewhat stronger projections in residential activity, business fixed investment, and not quite as negative a change on the government spending side. What that suggests to us, though, is that in this world of uncertainty--and especially as it relates to inflation--without some change in policy over the

forecast period we could see inflation at a somewhat higher level than is projected in the Greenbook. Thank you.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. First, with regard to the outlook for the national economy, just like about everybody else who has already spoken, I think the very modest recovery that we've had is likely to continue. So I have no real disagreements with the central tendency [of the members' forecasts] or the Greenbook forecast. That, in my judgment at least, is how things seem likely to play out. I don't see a lot of vulnerability to [such a forecast] at the moment. As far as inflation is concerned, I also agree with those who said that it doesn't look as if there's going to be a lot of further progress in bringing down the rate of inflation at least over this forecast horizon. And that is my greatest concern. I don't have a sense that expectations are working for us. My sense is that expectations are that if inflation hasn't hit its low for this cycle, it's close to it. So, that's not a favorable factor. I have a sense that the general thrust of government policy is, if anything, going to add to inflation. That just says that our job is not going to be made any easier by a variety of other things that I can contemplate over the next 18 months or so. That's my greatest concern about the outlook at the national level. I think progress on the inflation side will be tough.

With regard to the District, again, there's not a lot of news to report. The regional economy has been in good shape for an extended period. That largely continues. There have been more broad-based and frequent reports of banks becoming somewhat more aggressive in trying to meet their loan targets and finding some frustration in their inability to do so. Of course we, too, have been affected by the floods. And although that's [concentrated] in a rather narrow band, it has affected or probably will affect corn and soybean output in the District and will have some spillover effects for tourism as well. Finally, there is ongoing concern about the fate of Northwest Airlines and their potential Chapter 11 filing. I was told that they did reach agreement with the pilots today, but I haven't been able to confirm that. The pilots are undoubtedly the key, but they're not the only union involved. So that situation remains iffy at the moment.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Looking at our economic projections, we're at the high end of the central tendency for 1993 and we are clearly an outlier on the high end with respect to 1994. I wouldn't make policy based on these projections, but basically how we look at it is that we've had a very stimulative thrust of policy for a couple of years running here and that's showing through to the real side a little in 1993 and more of that would show through in prices in 1994. If that were to happen, though it's quite possible it's just an inflationary bubble, the question would be this expectations issue that we've been talking about. Even if we thought our policies were on a course that would gradually bring that back down, how do we deal with expectations in the meantime? So, I see that as a potentially tough issue for us to deal with. The other issue I see is one that Ed Boehne, Gary Stern, and others have touched on, which is this longer-term question

as to how we approach some concept of price stability and over what time frame.

With respect to the District, we're still showing strong numbers. I've heard a number of people say that they see less gap between their Districts and some of the stronger Districts. I guess we see that too, but I would be more inclined to view it as [an indication] that the rest of the nation may be catching up as opposed to our losing steam. We're still, in the latest three-month period for which we have figures, getting strong growth in both manufacturing and non-manufacturing employment, basically in the area of 2-1/2 percent at an annual rate. In the manufacturing area that's across most sectors except chemicals and transportation. Interestingly enough, despite this strong pattern on the real side, we're not seeing much growth in bank credit demand. For large reporting banks we'll see the numbers up one week and down the next week; and C&I loans on an annual basis are still down about a percent from the prior year. Recently, we had a group of homebuilders in and they said they are looking ahead to a very strong third quarter--that's already built in --and they expect to see significant follow-through in consumer durables. On the other hand, some people in the commercial area--and this is just anecdotal information from a group we talked to--see capacity basically being disassembled. They see the entrepreneurial developer really not being able to get financing and that is beginning to spill back to the contractors and general contractors. Some of those contractors can hang on for a while, but even the stronger ones --looking ahead a year or two--are wondering how they're going to keep going. In that conversation I heard the comment--[mentioned] before by Gary, I believe--about the impacts of certain government policies and the concern about that. When I asked about inflation, these people mentioned the price of cement, which has gone up about 50 percent in St. Louis. That has to do with the plants that produce it just being unwilling or unable to spend the money to put on the environmental controls. So, it's a short-term supply problem. I think the people at that luncheon and generally the people I talk to view things like that as aberrational. They don't seem to be generally concerned about a build-up of broad inflationary pressures; I think they are more concerned about real growth. That about wraps it up.

CHAIRMAN GREENSPAN. First Vice President Oltman.

MR. OLTMAN. Our projections are pretty close to the Greenbook projections, a little higher on GDP for 1993 but well within the [Committee members' central] tendency. I must say I have to repeat the theme of uncertainty. Among those we've talked to within the District, that theme is repeated often. It seems sometimes only to be a [matter of] what is in fashion to cite as the focus of the uncertainty: the health care reform or the fiscal package or the state of overseas economies affecting exports. Overall economic activity in the District seems to be slowing somewhat but still growing at a modest rate. There's almost a reluctance to concede this on the part of some of the people we talk to; they seem to want to make sure that we don't misunderstand that, yes, things are a little better but they're not as much better as they ought to be [so] don't get the wrong idea.

As far as inflation is concerned, Gary Stern's observation holds for much of what we've been hearing as well. There does not seem to be too much concern about inflation but there is some suggestion that [this view] results from the feeling that [the current level of inflation] is probably about as well as we can do and it's so much better than it has been, so let us not worry too much about that. Some of our manufacturing contacts, for example, have experienced some mild increase in activity but without expectations that price increases are going to occur over the next year, or the next six months at any rate. Credit demand, to hear the bankers, is not there; to hear the small businessmen the demand is at least a lot stronger than the bankers would have you believe. When you begin to dig a little into that, you hear the familiar story of demand for higher collateral and a lot more paperwork, all of which is read by the potential borrowers as efforts to discourage them. The bankers on the other hand insist, as some others here have said, that they are going out and beating the bushes and mounting serious campaigns to bring in borrowers. How to square that is difficult to say; there probably is some truth on both sides. To the extent that the borrowers are prepared to put up more collateral--in the case of small borrowers, for example--very often it is personal collateral, mortgages on personal residences and things of that kind. That means an uncertain atmosphere generally for economic activity and a little more than a lot of uncertainty for the small business borrowers. So I would say the overall mood is reluctantly positive.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, the theme all afternoon here has been about expectations and perceptions, and I'd like to make a few comments in a couple of areas along that same line. First, it seems to me that fiscal policy may be coming back into our dialogue a bit more strongly, assuming the dominant role that it may have had in earlier eras. Recently I think the economy has been working on its own dynamics, and monetary policy has been key while fiscal policy has had its effect largely by its absence. I think it's coming back. Like monetary policy and the course of inflation, I think fiscal policy has two facets to it. One relates to how the numbers actually flow and the other is this matter of expectations and perceptions. And right now expectations and perceptions in the form of uncertainty are very, very dominant. No doubt the numbers are going to begin to have an effect as time goes on and, as the Greenbook says, [that will happen] as tax policy gets settled and some of these other issues such as health care begin to have their own numerical impact, which undoubtedly is going to be contractive. But I have an idea that over time sentiment may just start to flow the other way because I think this uncertainty has a life of its own. So to some extent, maybe a large extent, when clarity begins to emerge--almost regardless of what that clarity tells us--it's going to help. We may get more help from the clarity side than a contractive impact from the actual effect of the numbers. I have some fear in saying that because the reality could be so negative! [Laughter]

Secondly, on the outlook for growth, we all look for an engine for growth in the various components of GDP and we can't find one. It's just not there. But there may be another, if you will, off-balance sheet engine that's at work and has been at work all along. And that is just the basic restless, nervous energy of the

American people and the inherent optimism we undoubtedly have. I ask myself how, in the face of all the very severe shocks we've had in the last several years in this economy, we've been able to experience a mild recession followed by eight straight quarters--this will be the ninth--of recovery from the recession. And all of this has occurred in the face of these famous head winds we've been talking about for a long time. I think the answer may lie in this very positive underlying attitude toward progress, this restless energy to improve things that is still in my opinion very much the dominant ethic of the American people and the American economy. Our nation's basic orientation in that direction may prove to be the engine that isn't there in any specific quantitative component of GDP. Right this minute I think that's being repressed by these uncertainties, just to kind of close the circle. But as these uncertainties begin to clarify and take on identifiable characteristics, we quite likely will get a breakout on the up side from that inherent dynamism.

CHAIRMAN GREENSPAN. Vice Chairman.

MR. MULLINS. With respect to the real economy, I don't know that I have a lot to add. I still see moderate growth--others might call it slow growth--at a rate of perhaps 2-1/2 to 3 percent. On consumer spending, I as yet see no compelling evidence that we're falling off the path of sustained moderate growth. Auto sales continue to be quite strong. Nothing else continues to be very strong, but at least auto sales seem to be holding up. The way I read consumer confidence is that the Michigan current index is near its recent high; the most recent month at least is only a bit below March and April, the recent peaks, and is above every other month before that. The expected index has fallen off--there is this uncertainty about the outlook that Mike was talking about--but it's still above where it was in October. I also remain hopeful that the housing recovery, despite some fits and starts, will pick up steam. We have the lowest mortgage rates in 21 years. And I do believe, when I hear it around the table and wherever I go, that we may be beginning to see evidence that this could affect business spending. Now business spending has been quite strong. The uncertainty affects business spending and it could decelerate a bit due to concern about the tax proposals. I find that hard to see convincingly in the data yet; even in the survey data on capital spending, which have come down marginally, we haven't seen a big drop-off. Presumably, there is concern about taxes in the budget proposal. I agree with Ed Boehne in that the bigger concern I keep hearing about is the health care proposal. That is unfortunate because the tax uncertainty presumably will be resolved soon, though it may be a close vote; but the health care uncertainty is not likely to be resolved soon, even if the proposals are presented in late summer or early fall.

CHAIRMAN GREENSPAN. September.

MR. MULLINS. Yes, September. The Administration has shown that it is willing to alter firmly held beliefs as things move through Congress. This could mean next year. Now, capital spending is not a huge part of the economy [but] it has been the most reliable component of the recovery; it's that little engine we've had going. And the Greenbook has it decelerating only a bit. Loan demand seems to be picking up nonetheless, so I think even here it's a mixed picture. The positive thing I see is that employment has shown steady growth

despite the weak June numbers. We've seen more jobs created in the first half of 1993 than in all of 1992, roughly a million jobs in each case. Despite the talk about the reduced propensity to hire, monthly job growth in the second quarter is 161,000 jobs a month on average, virtually the same as in the first quarter. The hours and overtime still suggest that continued slow growth is likely to spill over into more moderate growth in employment. The pattern of job growth in the last several quarters, the gradual improvement, I think will contribute to the durability and sustainability of the recovery as a self-reinforcing process, and in my view that reduces the downside risks.

So, when I total it up I still see 2-1/2 to 3 percent real GDP growth where perhaps before I saw 3 to 3-1/2 percent. With a normal quarterly variation around that mean--and the variation has been, if anything, smaller than normal in this period--it's inevitable that we will see quarters below 1 percent and up near 5 percent. I look forward to seeing the latter soon. Now, it is true this is thought of, at least in immediate terms, as a weak or fragile economy. And, of course, I remember a weak economy. My first three quarters on the Board were all negative quarters. As Mike mentioned, we've had nine consecutive quarters of growth and, I suspect, six quarters or 1-1/2 years with growth averaging between 2-1/2 and 3 percent. We can continue to hold our breath with each quarterly draw from the distribution. Instead, I think it's useful to try to detect significant changes, deterioration in the underlying forces which have been gradually and steadily pushing the economy forward for a year and a half now; and I don't see the hard evidence of that deterioration yet, though I must admit the anecdotal pessimism is a bit high. But, again, I think some of the uncertainty will be resolved.

On the inflation front, it's nice to get some good news for a change even if it's only one month's number, as Bob Parry mentioned. I think the positive way of viewing it is that in two out of the past three months we've had favorable inflation data. Unfortunately, in my view, it will take a while to extinguish the trend. The negative way to view it is that for eight months now, since the end of the third quarter, core CPI has averaged roughly 4 percent versus about 2-1/2 percent for the previous six months. That's the most negative way one can carve it. The seasonal adjustment problems may have exaggerated the trend, but it bothers me that the CPI hasn't been the only troublesome index. Both the implicit price deflator and the fixed weight index have accelerated over the last couple of quarters--the former from 1.8 percent to 3.5 percent. The fixed weight index, which is perhaps the more traditional measure of inflation, bottomed in the third quarter of last year at 2.2 percent and the recently revised first-quarter number is 4.3 percent. The employment cost index for total compensation bottomed in the second quarter of last year at 2.9 percent and accelerated to 4.2 percent in the first quarter. The Purchasing Managers' diffusion index has registered five consecutive quarters of increases after a few months of negatives before that. The trend, if one projects these numbers, is not encouraging, of course. So in my view it has been a long blip and one reflected in a number of broadly based inflation measures. And it's one that has persisted for six to eight months in an environment of slack and slow growth. However, the immediacy of the inflation concern, the forcing nature of the argument, has to do with the developing path of future

inflation and not really the past six or eight months and importantly the extent to which inflation concerns infect the market.

In my view so far this year we've had two episodes where inflation fears have affected the bond market. The long bond rate has backed up by 25 basis points, not all due to the inflation concerns but at least its coincidence with the release of inflation numbers would suggest to me that it was a major contributor. The first was in March and early April when the long rate advanced to 7 percent following the poor January and February and fourth-quarter inflation numbers. That was doused by the favorable March numbers. And then following the poor April numbers the long bond again flirted with 7 percent; the good inflation numbers for May revived the prospect that the upturn in inflation might give way under the weight of economic fundamentals and the market returned to a wait-and-see attitude; the long rates retrenched to new record lows aided by the success of the President's program in Congress. While the inflation fears in the bond market have receded, obviously some commodity prices continue to be a bit troublesome. On balance, when I look at the data I think the recent evidence weakens the case for an immediate action on the federal funds rate. Nonetheless, the concern about inflation, at least my concern, was not created by poor performance in a single month's data nor is it likely to be extinguished by a single month's better performance. Importantly, in the upcoming intermeeting period we shall be receiving a significant quantity of new information on inflation, not only the CPI and the PPI but also the two GDP quarterly measures and the ECI measure as well. And I think that should provide some important input into the developing trend going forward. I might add that the average hourly earnings for the second quarter, which we got the other day, had decelerated to essentially the bottom reached last year, and that's a hopeful sign. Still, we are particularly vulnerable to negative surprises in the bulk of the data coming out.

One thing that is already apparent from the numbers in Chart 16 is that the FOMC has changed its view of '93 inflation and so has the staff. The central tendency is up by about a half percentage point; the staff's estimate is up by 0.7 percent. It's also true that we've marked down our real growth perceptions as well. But even though our view of '93 inflation has changed significantly, the federal funds rate has not changed. As to why all this is happening, I found the staff's presentation very interesting. The speed effect--and I have no really fresh insights--does suggest that we can affect inflation over this period. It's not a very pleasant prospect to suggest that growth of 2-1/2 percent is a lot more favorable than 3-1/2 percent; one hates to punish growth as a way to achieve it. When I review the past six months or so and look across the different measures, I tend to attach more weight to the simple expectations hypothesis, although it is also related to Mike's speed argument. I think we recognized last year that even though actual inflation fell, long-term expectations didn't seem to change very much. And some of us even talked about a period of testing to resolve the dissonance between expectations and inflation fundamentals. I suggest that that's exactly what we've been experiencing over the past few quarters. Businesses restrained price increases during the couple of very weak years we had. In the second half of 1992 the economy grew a little over 4 percent and I think they returned to the norm of trying to pass through 4 percent inflation. In an environment of slack and slow growth of money and credit, this should not be sustainable. But

it has persisted for a couple of quarters and I would not underestimate the staying power of firmly held expectations because many economists and business people simply do not see inflation as a problem at 3-1/2 or 4 percent; they see it as the norm. I might also add that we had an interesting experience last week in the Board room when we had in the American Bankers Association panel of bank economists. Their view is very similar to the Blue Chip forecast, which we've talked about before, and also I think to the [view cited in the] Wall Street Journal this morning. None of them sees a problem with inflation. It's going to continue to rise gradually up through the 3 percent range even though they're projecting large, ample slack continuing. There just seems to be enormous gravitational pull to expectations, and I suspect we're in the midst of an extended battle between expectations and fundamentals. This battle is at the core of any attempt to achieve lasting reductions in inflation, which is going to require reduced inflationary expectations. And I feel our stance and our actions, including how we respond to higher-than-expected inflation, are also quite important to the ultimate outcome of that battle.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. Just a couple of points because it's late and we've gone over a lot of things. As far as the region goes, there is not much change. What there is has involved some deterioration and a slightly softening mood. There has been a deterioration in the business mood from uncertainty to somewhere between resignation and fear. I would tell the same story that everyone tells; it's virtually universal among almost everyone I talk to. We're not two sentences into the conversation when they raise health care, taxes, and all of these other subjects. I think Mike Kelley is right that some clarity would help, but I'm not sure we are going to get it in a hurry.

Very quickly, retailers have seen some softening most recently. Manufacturing is more mixed but the really strong spot we've seen in manufacturing in our District has been related to autos. Everything else seems to have softened a bit, including aerospace, as one might expect. Loan demand shows some slight improvement but is still soft. Ed Boehne talked about an unexpected shock [unintelligible] would get here. Actually, we try to keep in touch with financial people and it's interesting that they have expressed some concern about all this money flowing into mutual funds and about what will happen when we get a little market correction and people find these funds are not really CD-like in a nominal term sense. I would say the mood of these people and the fund managers is perhaps understandable; it's fairly sensitive. They're really quite concerned about this and think we might be in a fragile situation.

Talking to the same general group of people about prices demonstrates the rather tough position we're in [because] it's a little like what David Mullins said. They say inflation is not really a problem. We ask what they have factored into their forecast or their budget when they buy things and they answer 3 to 3-1/2 percent inflation or something like that. They say they don't really see inflation going anywhere. One of our directors did a survey and found very low expectations about solving the inflation problem. But when we talk to people about what they think about monetary policy, what

comes out is that they see this as not a monetary policy driven inflation, though they're not saying it can't be influenced [by monetary policy]. But in terms of their expectations, they have a deeply held conviction that the American economy has some inflationary bias built in of around 3 percent whether it comes from steel protection, workers comp, or other kinds of things. Essentially, a lot of people I've talked to think that it's so expensive to get inflation below what they see as an asymptote of 2-1/2 to 3 percent that it's not likely to happen.

As far as the real economy goes, I have little disagreement with what the Greenbook says. Our own forecast is slightly stronger. I think the Greenbook is probably more correct, to tell the truth. [Laughter] One place that I do have some concern is Europe; the news I hear from talking to people just seems to keep getting worse, whether it's American manufacturers with facilities there or people selling into that market or European bankers coming here. Now, maybe we're coming to a trough on all that as well. The long and the short is that I think the risks to the economy are probably centered, but they could easily go on the down side as well as the up side; I [can] see this going [either] way. And I think the probability of another decline is certainly greater than zero.

In terms of what we do about all this with policy, it's hard to think about much change but I would be heavily influenced by how the Chairman wants to convey things in his Humphrey-Hawkins testimony. When we get to the very fine minutia of how we word things, that would be a significant factor in deciding.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Thank you, Mr. Chairman. I'd like to identify myself very closely with Bob Forrestal's analysis expressed earlier. I, too, feel that the primary risks are on the down side at the moment. People are anxious about jobs, and they don't see any developments either in terms of government action or in private sector actions that will generate new job opportunities. And that makes for a very cautious attitude on the part of consumers, which then gets reflected in the willingness of manufacturers to make long-term commitments. I think auto sales are an aberration caused by the advanced age of the auto inventory in the hands of consumers. [The age of the auto stock] is at about the highest point it has been in some time and there's a lot of replacement buying that is seen by consumers as necessary. It's not that they get overwhelmed with the desire for a new car; it's a necessity kind of move.

Underlying all of that, I'm worried that we're beginning to see a disillusion on the part of the public with the political process in this country. With that disillusion is a lack of any confidence that either the Administration or the Congress is going to find an acceptable way out of this problem. I don't know what the technical definition of stagflation is, but if we continue to make revisions in our forecast that go along the lines that we have recently done here for 1993 looking into 1994, it tends to look more and more like stagflation. And stagflation is a nightmare for monetary policy because the very solutions that solve the inflation problems are likely to tank the economy in terms of growth. That's a condition

that we don't want to get into, but I don't see what we can do about it at the moment. So, I'm somewhat dejected at the moment.

CHAIRMAN GREENSPAN. I sort of picked that up. Governor Angell.

MR. ANGELL. Well, I don't think I've heard such pessimism in a long, long time. I'm not sure what has changed. I don't know what it is that's getting worse. I don't know what business profits are declining. I do not know that nominal GDP is really going to come in for the entire year as the staff suggests at 4.8 percent when in that lousy first quarter nominal GDP was 4.4 percent. But maybe I'm seeing things somewhat differently.

I would like to focus just a minute on the lag in monetary policy. Even though we don't have an M2 that works the way we want and we don't think M2+ would suffice either, there is a concept of a kind of pure M out there. That is, there are transaction balances that we've created over the last 10 to 12 years. Investment money has been mixed up with our [measure of] deposit money, so we don't know what that pure M has been doing. If we did know what it was doing, we would have some sense of being forward-looking. Since we don't know what it's doing, it's almost as if we're faced with looking at last month's CPI or last quarter's CPI. And, frankly, it's very, very scary to me to think about our trying to run monetary policy based upon last quarter's GDP or last quarter's rate of change in the CPI. Certainly no one, I presume, expects that there's much we can do about the CPI rate of change in 1993. Can monetary policy now alter what happens in 1993? It seems to me we're working on monetary policy with regard to the rate of inflation for 1994 and, indeed, even into 1995. I don't have the ability to see 1995 clearly enough to do monetary policy based upon that fact. And since there's no M2 or other monetary aggregate out there to guide us, I think we have to look at some other matters.

Now, a bit contrary to Ed Boehne's view that we're at the place in the cycle where we're not going to get much more inflation improvement, it seems to me that we have several factors working in our favor in terms of [moving to] a lower inflation rate. We have not had any minimum wage increase in 1993; that's not in the numbers. We haven't had any major supply shocks throughout the world, no oil shocks, no [unintelligible]. We haven't had in the United States any significant impact of employment cost conditions that would in a sense be a driving force for inflation. We've existed in a world in 1993 in which use of resources is way down. This ought to be a very desirable time to be getting inflation rates down. We're in a period where we have some real productivity gains, as has been noted; and those productivity gains ought to be helping us to get more than cyclical improvement in inflation numbers. Now, inflation in my view is not a micro-economic deal; it is a monetary policy deal. The rest of the world, the other six countries in the G-7, are running a rate of inflation a full percentage point below what they were running even though only Japan has more flexibility in wages and prices than we do. We're the most favored country in the world to get the inflation rate down and yet the outlook is that it's not there.

It seems to me that the conclusion one can draw from this is that monetary policy in 1992 was really not as stringent as we thought

it was. A year ago I was in the camp that thought 2-1/2 percent [inflation] was possible and by February I'd given up and had gone back above the 3 percent level. But my inflation forecast isn't an outlier at all. It's just exactly the same as the staff forecast of 3.3 percent. But I consider this 3.3 percent in a period of such favorable opportunity to mean that monetary policy has really missed its restraining force, and I don't know what's going to happen to cause that to change. It seems to me that monetary policy is indeed getting easier and easier as inflation expectations rise.

I don't get letters too often, but here's a letter: "My wife and I have been married 51 years. We worked very hard for every penny we earned and have been extremely frugal, saved for old age. I can't tell you how much I hate inflation for what it does to those savings. Our circumstances dictate that they be invested conservatively and all of the interest we've been getting from our investments is lower than the rate of inflation. It is taxed as income, which is not taxation but confiscation of capital." Now, they go ahead and give me a little bit of praise regarding my position on inflation, but they finish it off and say "Although I'm not optimistic that you will be successful, I can't thank you enough for your efforts." Well, I guess that's about it! [Laughter]

You know, there's a lot of loose talk around. Everybody has an opinion about gold prices. There's a lot of gold going into India and it flows into India because clearly people there want to hold gold rather than rupees, a paper currency that goes down in value. And clearly gold is going into Indonesia and into China as people there choose to hold a more reliable safeguard against these crazy paper currencies that have terrible inflation rates. But the price of gold isn't being affected by a little increase in the number of Chinese who are buying gold. The price of gold is pretty well determined by us. For many things, like land prices, long-term interest rates can have a significant impact. But the major impact upon the price of gold is the opportunity cost of holding the U.S. dollar. No other currency has a reserve base that causes someone to be able to say: "Well, I don't like holding my own currency." If you don't like holding your own currency, you always have the option of holding dollars instead. But we set the stage. We have a low interest rate that causes this saver out here to say he and his wife have been had. And I understand how they've been had. We're in a period in which we're going to increase some income taxes; but I'm not one who believes that people who are making more than \$250,000 a year are going to cut back their consumption because their income tax rates go up. I think their saving rate is going to come down. We're in a period of being impacted by inflation expectations, and it shows up in the price of gold. We've had a 20 percent increase in the price of gold since last February's Humphrey-Hawkins meeting. Now, [yearly] world production of gold only runs 2.3 percent of world stocks. I thought it rather dramatic--I had not thought about that with the price of gold at \$390 an ounce--that the value of the world's stock of gold is a measly \$1.4 trillion. Now, a lot of that is held by central banks. But we were at one time in a restraining mode, making it unprofitable for central banks to hold gold. But I think this year those who have held gold have said they've got the best deal going as the [value of the] world's gold stock has appreciated \$234 billion since our February meeting. We can hold the price of gold very easily; all we have to do is to cause the opportunity cost in terms of interest rates and U.S.

Treasury bills to make it unprofitable to own gold. I don't know how much change in the fed funds rate and the Treasury bill rate it takes to do that, but I'd sure like to find out.

I'd like to have some education here. I certainly understand the feeling [of those] on the Committee who would say: Is this a time to increase rates? I would tell you that I don't think this is a very good time to increase interest rates. But, unfortunately, our interest rates are way too low, and there won't be a good time to increase interest rates. If we drive every household that saves conservatively to buy stocks they don't feel they are knowledgeable enough to buy or to buy junk bonds or whatever else--they ought not to be trying to do radical things but if we drive them, and it's up to us--then it seems to me that if we then ever have to catch up on interest rates, those investments in common stocks and junk bonds could really fall off the table. Talk about a mess you don't want to be in! I don't want to be in that mess. If we had been very, very lucky and the rate of inflation had gone down to 2 percent, we might have gotten by with a 3 percent fed funds rate. But we didn't get that lucky and, consequently, we now have a fed funds rate that is just clearly out of sight in regard to world reasonableness. And it seems to me that there ought to be some real thought on our part as to whether our job is to decide which way to change rates or where rates should be to provide stability for people like this man who have their savings all there together. I better stop.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Let me say first of all that it's clear that this first-quarter slowdown we've had seems to be a return to a pattern of slower growth--you could call it moderate growth if you like--[near the] 2-1/2 percent rate that we've averaged over the last 18 months. I don't have the same sense that I might have had a year ago that we're going to lapse back into negative real growth. There has been considerable job creation; we have had enough job creation to lower the unemployment rate over the last year, but we're just barely keeping up with the demographics, so the unemployment rate hasn't gone down. There are some real areas of strength or potential strength: autos, housing, durables, capital equipment. But, again, I'm really quite struck, as I listen to everybody talk, by the big differences from region to region. And the uncertainties that remain are really quite considerable: the continued layoffs; the deficits of federal, state, and local governments; the whole restructuring process; and the international weaknesses. The uncertainty is casting a pall over spending and the expansion of investment. We are getting investment for capital equipment, but the focus is on productivity and efficiency; it's not as much on expansion [of capacity].

I think it's quite appropriate that we've spent as much time as we have this afternoon on inflation--the increased emphasis in the Greenbook and the increased emphasis and analysis in the Chart Show presentation on inflation. It is feasible that we could have some additional progress but I think it's quite right--and I've forgotten who said it--that any additional gains in inflation are going to be extremely hard to come by. As the recovery continues, manufacturers and distributors are going to continue to try to make those price increases stick. It's going to be incumbent upon us to try to discern whether or not some of these short-term supply distortions that we

have seen are short term, as Tom described in the case of cement or lumber, or whether [the suppliers] are going to be able to increase prices and make them stick generally. I don't think we know the bottom line yet of how the weather situation is going to affect our inflationary situation. The deceleration in labor costs appears to be leveling and we've not seen much break in this inflation psychology that has been discussed as we look forward and move away from trying to look back at where we've been on inflation. We've seen a ratcheting up in inflationary expectations in the consumer confidence indexes and also in the steepness of the yield curve. David described a couple of bouts that we've had recently on inflation expectations. I find this very anomalous. If people really expected inflation to start rampaging, we would start to see consistent shifting into real assets. We're not seeing that so much in this country. We've not seen it in housing. We've seen it some in durables, but one could probably explain that as the replacement of old cars or on the business side as firms trying to deal with improved productivity. We have a ways to go in terms of dealing with inflation, and we need to keep working on the analysis of inflation because I don't think we have a full handle on it.

I also hope that we will continue to work on the monetary aggregates. I agree with Governor Angell: There is a concept of money that should be our guidepost. Our problem is that we don't have it well measured. We don't really know how to measure it, in part because of this [admixture] of capital and money accounts. So, I continue to hope that we will focus on that; maybe M2+ isn't the right measure, but I do think we need to keep working on that.

CHAIRMAN GREENSPAN. Governor Lindsey will round it up.

MR. LINDSEY. See, you weren't last!

MS. PHILLIPS. I wasn't last!

MR. LINDSEY. I thought the Chart Show was very, very interesting, particularly on why inflation has picked up. It reminded me a bit of the story of a tenth here or a tenth there and that pretty much explains it. Interestingly, Charlie Schultz when he was explaining what happened in the Carter Administration described something very similar. He said suppose we raise the minimum wage, what's that going to cost us? He estimated about a tenth. And the next idea to come down the track will cost about a tenth. So a tenth here and a tenth there sounds pretty much like what happened in 1978. It adds up, though. The staff has raised its forecast for 1993 inflation by seven-tenths. On average at this table we've raised ours five-tenths. And the Michigan survey is up six-tenths. This is all from the beginning of the year. I think we also should look a little bit at other prices. Jerry Jordan mentioned that farm land prices are going up. I also sense that--

CHAIRMAN GREENSPAN. I must say that the Chicago Bank's survey did not show that.

MR. KEEHN. That's right. Jerry Jordan is saying they've gone up in his District; they have not gone up to that extent in our District.

MR. LINDSEY. Yes, but you are all under water!

MR. KEEHN. It's highly liquid!

MR. LINDSEY. I worked to register wetlands. The definition of a wetland is something that has pooled water on it for 14 days out of the year or is spongy for 21. And that's the entire state of Iowa at this point.

MS. PHILLIPS. Switch to rice!

MR. LINDSEY. Yes, switch to rice. Well, enough of that. On the inflation side, [our central tendency] is 3.1 percent. I think we're going to be lucky to hit that. To get 3.1 percent for a year we can have 30 tenths over the 12 months. We've had 17 of those tenths in the first five months, which means we've got to go from an average of 3.4 percent to an average of 1.8 percent, or cut our inflation in half for the next seven months, to hit our forecast. So, if you ask where the risks are, I think they're on [the side of] higher inflation. Let me also say that I agree with John LaWare and others that the risks are on the down side for the economy. Why? Well, the staff has estimated that the budget will be a \$37 billion drag on the economy in '94. Is that fiscal 1994?

MR. PRELL. Yes, but that's not total budget, that's--

MR. LINDSEY. That's an incremental fiscal drag.

MR. PRELL. Right, those programs--

MR. LINDSEY. Yes, it's an incremental fiscal drag of six-tenths of a percent of GDP. Roughly the first year multiplier on fiscal drag is close to one; it probably goes up a little after that. So, that means we're going to knock off six-tenths of a percent from whatever [rate the economy] would have grown--I don't know what that rate would have been but we're talking about a number between 2-1/2 and 3 percent--just from normal old fiscal drag. If I knock six-tenths off, I don't get our median forecast; I get something below that. So, again, I think the risks are on the down side. Nor do I think that this is your run-of-the-mill fiscal drag. I think this is putting the economy in chains; in fact everyone around the table mentioned it. This is not a normal tax increase; it's a tax increase on small business in addition to which we're shutting down the defense sector and the health care sector. When you have a targeted fiscal drag, the capacity for individuals who lose their jobs to find jobs in other sectors quickly is reduced relative to an across the board fiscal drag where, say, it takes \$100 out of everyone's pocket. So, I think the downside risks for next year are substantially more than what we are talking about here. At the same time, the risks of inflation are also more than what we have here. That adds up to John LaWare's forecast of stagflation. I would [agree with] his prediction that the deficit will not go down by as much as is being predicted by the Administration and I'm willing to take bets with anyone around the table on that one.

MS. PHILLIPS. You're not going to get any takers.

MR. LINDSEY. I'm not going to get any takers! What do we do if we have stagflation? Well, how did we get out of the problem the last time we had stagflation? The first point is that the basic solution is not monetary policy; it is fiscal policy. It is not to do the things that everyone around the table mentioned are going to be the problems. The 19 of us don't have any votes on that, so we may as well forget that. What else does monetary policy do? I would again commend the way we got out of the last stagflation. While we do the right thing on fiscal policy we also hold the line on prices because if we don't, then the easy path out is more obvious. So, I don't like the situation we're in any better than anyone else. It is only going to be worse next year; it is not going to get any better. And on that cheery note, I will commend exactly what President Syron said, Mr. Chairman: Given that we don't have any easy way out and you're the one who has to go up there and wheedle your way through the [Congressional] Committee, I will defer to your sense of logic on what will appeal to them to get you through it. But I do think that we should also have to face the fact that for us to make the tough call it is only going to become more difficult as time goes on.

CHAIRMAN GREENSPAN. Thank you all. I trust you all remember that we have a 7:30 engagement at the British Embassy and it is now 6:16 p.m. I will properly adjourn and we will continue the meeting tomorrow morning at 9:00 a.m.

[Meeting recessed]

July 7, 1993--Morning Session

"CHAIRMAN GREENSPAN. [I want to wait until] lunch to discuss the question of how we handle the issue of leaks. Since it has very little, if anything, to do with Bill [Wiles's] luncheon agenda, it strikes me that we probably could get more done by having a general open discussion on how we want to handle this sort of thing. So if you wouldn't mind, I think we will just stay in [session] through lunch rather than [adjourn]. I'd like to call on Don Kohn to start our discussion on the longer-run ranges.

MR. KOHN. Thank you, Mr. Chairman. After my recent experience I'm tempted to say that the hour exam will cover both the lecture material and the texts, Bluebook and Greenbook!

CHAIRMAN GREENSPAN. Do you grade on a curve?

MR. KOHN. Actually a few aides will be grading this, Henry Gonzalez and Don Riegle.

CHAIRMAN GREENSPAN. One thing that's sure about it is that it's not a normal curve!

MR. KOHN. The first lesson will be on IS-LM and Phillips curves, starting on page 8 of the Bluebook. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Thank you. Questions for Don?

MR. ANGELL. Don, suppose we ended up adopting alternative II or alternative III for 1993 and 1994 and there was a surprisingly strong resumption of disinflation and the CPI numbers moved down more like they are projected in the tighter scenario II on page 8 of the Bluebook. In that circumstance if the Committee decided to [move] against too rapid a pace of disinflation and lowered the fed funds rate, is it likely that we would have a problem of getting monetary growth above those ranges in alternative II or alternative III?

MR. KOHN. I doubt it. The question here is if short-term rates went down whether long-term rates also would be going down because of disinflation.

MR. ANGELL. Yes, I would think long-term rates would come down even more.

MR. KOHN. Right. That could give a pretty good push to money. I agree with the thrust of what you're saying. It's hard to determine; we don't have much experience with yield curve-type variables. On the one hand, we could see the decline in long-term rates; there would be [unintelligible] capital gains and that might damp M2 for a while. But I think a flatter yield curve would help. Now, depending on how much short-term rates went down at the same time, I think such a [structure] would tend to push up M2; whether it would violate a 3 or 4 percent upper limit [I don't know]. You might have trouble on the 4 percent upper end of alternative III. It's possible it could be pushed up there, but it would take a lot more interest [rate] response than we've seen from M2 recently. But your general presumption that having long-term rates go down and short-term

rates go down would push in that direction I think is correct. It's just a question of how fast and how hard it would push.

MR. ANGELL. So what interest rate or what possible shape of the yield curve might likely result in getting outside the range on the top side on alternative III?

MR. KOHN. I guess it would have to be a sharp decline in both long- and short-term rates. It would depend on the size of that [decline], with the yield curve effect pushing money out of M2 but the short-term interest rate effect pulling money in. I'm sorry, but partly because I don't have much confidence in our projections of these elasticities I don't have a good notion of how far interest rates would have to drop to do that. My guess is that both long- and short-term rates would have to drop quite a distance to push M2 growth beyond 4 percent.

MR. ANGELL. Thank you.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. I'd like to go a little further out in time if I could. This would be in a world where the transitional effects of new financial products have disappeared and we have a stable interest rate environment and we have discovered a new M2, which may turn out to be the same M2 or M2+ or M2- or the square root of M2 or something like that! What is your sense of the relationship that that money aggregate would have with respect to nominal GNP?

MR. KOHN. Our presumption, Governor Lindsey, was that as we got out into the years '96, '97, '98, that is "after a while"--

MR. LINDSEY. "After a while."

MR. KOHN. --that some of these shifts would be over, that people would have adjusted and that something like an M2 aggregate would reemerge with the old relationship to nominal GDP. That is, it would react somewhat the same way with respect to interest rates and income. Obviously, we can't know in advance what that would be like. The other point I'd like to make is that I think we sometimes risk idealizing the way M2 used to be. This Committee violated deliberately or ran very high in its M2 ranges frequently in the '80s and ran low sometimes as it moved interest rates against the thrust of changes in spending. It did a pretty good job moving M2 around and stabilizing nominal GDP. So M2 velocities from year to year always were highly variable; one could make an argument that stabilizing nominal GDP, given shifts in spending, forced the Committee to have variable M2s and variable velocities. The notion of M2 we came to toward the end of the '80s was that even if there were questions raised about it year to year, the Committee should at least examine what it was doing if M2 seemed to deviate a lot up or a lot down, cumulated over long periods of time--the old P\* notion. And the innovations of the last two years have called even long-term stability into question. I think it's quite possible that over time long-term stability will reemerge to a certain extent, but I don't think we'll ever have a short-run relationship such that the Committee could count on setting a tight M2 target for a given year and assume it would get

a particular nominal GDP for that year. M2 is just one of a number of indicators of what is going on in the financial system.

MR. LINDSEY. Right. Given that we're talking about the period after 1994, would you bet any money one way or the other on whether the velocity trend would be positive or negative or zero?

MR. KOHN. Well, the logic of what I was saying is that it'll return to something around zero.

MR. LINDSEY. Right, okay.

MR. KOHN. I think the chances are, though, that there will be continuing innovations. A lot depends on what happens to depository institutions [and whether] they continue to shrink as a proportion of total intermediation. It depends on whether you think we're in a sort of stock adjustment period in terms of depository credit or in a continuing decline. I lean toward the former rather than the latter, but I certainly don't rule out the latter. That is, I think there will be a nub of credit [extensions] that depositories are well suited to making and will continue to make. Now, if they start securitizing small business loans and that sort of thing, depository institutions may just continue to fade as important intermediaries, in which case the upward trend in M2 velocity would continue for quite some time.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Don, I have a question which is a bit pedagogic in nature; it has to do with how we communicate. The place I start is that regardless of which of these alternatives we choose, I don't think it's going to have much effect, at least in the shorter term or in what one might call the intermediate term through '94 and '95 and maybe '96, just given where we are on all of these things. Therefore, I think the question is how in this terribly difficult period we convey to Congress and the markets and the public as a whole what we are trying to do here. The question I had is: Given the increased difficulty we've had, because of unstable velocity, in setting a range for any aggregate, has that in your mind been associated with an increase in the expected variance of velocities? What I'm coming to is whether there is an intellectual case here for a wider range.

MR. KOHN. I think there is an intellectual case in the following sense: In my response to Governor Lindsey I said there are questions about the underlying trends in the economy and the depository sector; we're not tied down to something like a  $V^*$  that we thought was constant. On the other hand, as I noted in my remarks, we haven't been that far off in our predictions of velocity and M2. Our annual predictions have been remarkably close though some of that is offsetting errors, which I'd be the first to admit. But even the velocity predictions since the middle of last year, when we sort of caught on to what was going on, have been off by maybe a percentage point or less on a half-yearly basis. So, my guess is that it is no more and may be even less than we had in the '80s when we thought we had a stable range over the long term. So, in theory, you're right. If you don't know where things are going to go, where the equilibrium is, you're more uncertain about where you are in every year. On the other hand, we do understand something about these processes; we think

we do anyhow. And I'm not sure we're much more uncertain about the second half of 1993 than we were about the second half of 1986 or 1985.

MR. SYRON. My concern isn't from a policy perspective or what you've done here; it's a concern I have from a communications perspective.

MR. KOHN. Well, I think the Chairman has done a very good job communicating.

MR. SYRON. I agree with that. But I think the difficulty we have is that if we keep changing the ranges and we don't think we can hit [them] where we [want to] change them and we change them part of the way, what does it get us in an absolute sense?

MR. KOHN. Right. Well, in some sense, that's what drove me to put in those very low ranges, 0 to 4 percent or whatever.

CHAIRMAN GREENSPAN. I must say I think this issue is significantly diffused from where it was six months ago. I think our big fight was six months ago and, frankly, the behavior of velocity at this stage has so undercut those who are arguing that M2 is a meaningful notion that it's very hard for the pressure to be anywhere near what it was. One can make the case that if velocity were what it used to be and the relationships were what they used to be, real GDP would have been going straight down for a long period of time. So, [given] the lower number we [set in February] on technical grounds, I think we can basically do that [again] this time. I must say I happen to agree with Don that we might as well lower it so that they can use that joke about the dart being thrown--

MR. SYRON. Draw the circle after it's thrown!

CHAIRMAN GREENSPAN. Draw the circle after you've thrown the dart. I don't think this is a big issue. We may get attacked on it for other reasons, but it's a very easy reed to knock down because [our critics were] just so obviously wrong. If we stay where we are, we then have the problem of a slight element of hypocrisy. But frankly it's not a big deal either way and I don't think we'll have trouble defending whatever we do.

MR. ANGELL. Are you arguing for alternative III rather than II?

CHAIRMAN GREENSPAN. No, I'm arguing for II.

MR. ANGELL. Do you have any concern if we go to II and then still undershoot?

CHAIRMAN GREENSPAN. Sure, and then we go to III.

MR. ANGELL. Okay.

MR. FORRESTAL. Are you talking about 1993 or 1994?

CHAIRMAN GREENSPAN. I was talking about both.

MR. SYRON. But you think it's still desirable to maintain the current width of the range?

MR. ANGELL. Sure.

CHAIRMAN GREENSPAN. Yes, because we cannot simultaneously argue that the M2 data clearly are deficient for the moment and for the interim period. Once we start to get sophisticated about that and try to make it better than it is, presuming there's more there than we're trying to say--

MR. SYRON. But any change presumes that we know something.

CHAIRMAN GREENSPAN. Yes, we know something, namely that the technical reasons for the deviations in velocity have, if anything, been somewhat stronger than we would have expected. And that clearly would require this type of adjustment. I would also argue, and I think it's probably desirable [to do so] in testimony, that when the balance sheet strain is removed and we're getting more normal funding of GDP from credit markets as distinct from cash flow, one would presume we'll get a more normal relationship at that point. I think we have to be very sensitive to [when we expect] that. It surely isn't '93 or '94. And the one thing we can't do is to say that M2 is basically worthless, that we don't think there's any other new track that we can [unintelligible]. That gets us into unnecessary discussions. We can talk about M2, or M2+, or the square root of M2, which I like--that has some real pizzazz to it. But I think we've just got to stay with the technical problem at present and battle it through, because I think it's going to be easier this time. President Broaddus.

MR. BROADDUS. Don, I'd like to go back to page 8 of the Bluebook. In developing the tighter scenario did you take any account of credibility effects? And if not, would it be fair to say that the outcomes for real GDP and the unemployment rate, especially in the early years, were on the more pessimistic side of the range of possible outcomes?

MR. KOHN. No, President Broaddus, we did not take account of credibility effects, as I think we put in a footnote on the next page. The tighter and easier scenarios were keyed off of the baseline. And since the baseline is like the Greenbook forecast, as you discussed yesterday it is a little more pessimistic on inflation relative to output. That carried through in a sense to the tighter and easier alternatives. You're right that if we had some credibility effects we could get inflation down faster for the same output or we could get higher output for the same inflation gain. I think the evidence on that in the past has been mixed. We may be on the verge of getting some [credibility effects] beyond what we've gotten so far. But we did not assume changes in credibility [in the tighter scenario] nor did we assume that losses in credibility on the easier side would adversely affect the numbers.

MR. PRELL. It's hard to look at the recent period, which has been concerning all of us, and [say that] if strong credibility had been established--if there were absolute credibility that we would bring things back quickly into line--people would have discounted the recent signs of inflationary pressure. So, despite a long period now,

the evidence of our having gained a lot [of credibility] in affecting this tradeoff is pretty limited.

MR. BROADDUS. We'll have to take another step, I guess.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. You stated that you'd be emphasizing the technical nature of the adjustments if we adopted alternative II. Would there also be an attempt to talk a little about the longer term and the fact that these ranges could well be consistent with longer-term expectations or do you think that would be premature?

CHAIRMAN GREENSPAN. I think it's premature because once we start to do that, we're conveying a level of insight which I don't think we have. We're not even sure that the definition of M2 will hold into 1995. So, I think we ought to fudge on that; the reason is that I see very little advantage in doing that because it's not credible. We can't on the one hand say that M2 is a highly deficient indicator and then put any substance on the potential meaning of the ranges.

MR. PARRY. Except that if one talks about the long term, that certainly wouldn't indicate that one thinks there is a short-term applicability. And if we are, in effect, unwilling to talk about the long term and we think this is a problem that is going to persist forever, why are we doing what we're doing?

CHAIRMAN GREENSPAN. That's the reason why I think we have to suggest that, in our judgment, when the balance sheet adjustments come to an end there's every expectation--presuming that the depository institutions are not in a severe downward contraction--M2 or something close to it will again be restored to the more normal velocity relationship with the economy and that at that point we will have far more confidence in the usefulness of this proxy for monetary policy.

MR. PARRY. It may be constructive then to say: By the way, this range is probably pretty much consistent with that and reasonable price stability as well.

CHAIRMAN GREENSPAN. That presupposes where the M2 is going to come out.

MR. KOHN. Mr. Chairman, I think the tighter M2 path, which as I was discussing with Governor Lindsey had underlying it the notion that things would come back to more normal alignment, suggests the difficulty of doing that. We have 4 and 4-3/4 percent M2 growth partly because the yield curve is flattening. I think that's the other factor, as you mentioned before. If the yield curve is flattening from its highly unusual alignment right now, then that process--it's sort of what Governor Angell has been saying--will push up the M2 growth at least for a time. So, it's hard to know what's consistent with price stability.

MR. KEEHN. Would you be uncomfortable going into the testimony simply saying that we continue to move through this period of extreme uncertainty. We will obviously continue to follow the aggregates very, very closely, but in an interim period to make a

change to reduce the ranges implies some level of certainty that we just simply don't have. And then leave it as it is now. I guess my questions are: (a) Would you be uncomfortable in taking that kind of position; and (b) What are the risks?

CHAIRMAN GREENSPAN. First of all, I don't think it's necessary to do it. I would feel uncomfortable because we are trying to forecast M2. We're basically forecasting it by ad hoc adjustments to velocity, but we are forecasting it. If the Congress insists on our focusing on this issue and we have been committed statutorily to actually making these projections, I would feel uncomfortable basically saying that all this stuff is nonsense and why are we doing it. That's because the next argument, if we leave the ranges unchanged and are saying they're not worth anything, [relates to] why are we publishing them. Are we not deluding the public? But what we're doing is that we're trying to forecast M2. What we are saying is that the old relationship of M2 to the economy has broken down but we're still forecasting M2 and it's better to try to forecast it and improve the chances to get actual growth in the range than basically to say we're not even trying. I think the crucial question is not this at all. The crucial question is the relationship between M2 and the economy. And if we argue wholly on technical grounds that we are forecasting M2 as required and our best estimate is 1 or 2 percent [growth] and the range we're setting is 1 to 5 percent, for example, then at least we're forecasting the M2. We're not saying it means all that much and we've argued that it doesn't mean very much, but at least we're not saying it means nothing. It's not a big deal but if you ask me if I would feel more comfortable going up there with 1 to 5 percent than no change and saying the thing doesn't matter, I must say I'd feel a little more comfortable with the 1 to 5 percent range. If it's the Committee's view that we should do nothing, then I wouldn't find that I'm unable to make that case; it's just that I've got to think it's a weaker case. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, it's my opinion that many out there view the M2 target as similar to or actually in lieu of a nominal GNP target because we are not asked for the nominal GNP target. And this would be across the spectrum, say, from Milton Friedman to Paul Sarbanes.

CHAIRMAN GREENSPAN. You've just disturbed your colleague to your left!

MR. LINDSEY. In that case, and I do think that's a widespread view--

CHAIRMAN GREENSPAN. I'm sorry, what is a widespread view?

MR. LINDSEY. That our announced M2 target range is a proxy for our nominal GNP target range because there is a continuing perception, based on history, that over the long run the trend velocity is zero.

CHAIRMAN GREENSPAN. That would be true if we didn't say otherwise.

MR. LINDSEY. Also, when the trend reasserts itself--while no one is betting any money for sure--our best guess of the trend in the

long-term future is zero. Lowering the target range now, therefore, invites one or possibly two charges. The first is that we have lowered our nominal GNP target now to a midpoint of 3 percent and not a midpoint of 4 percent. And I think 3 percent is probably a low target for nominal GNP. Or, even if we can get around that problem--and I'm sure you can in the testimony--when we finally get to the long run, it will be necessary for this Committee, I think, to raise the M2 target in order to hit the nominal GNP target. I don't know in what year that will come, but I'm very much worried that it would send the signal that we are backing off on inflation. So I would prefer to keep the 2 to 6 percent range--though I understand what you're saying --to avoid the short-run charge that we're cutting our nominal GNP target and to avoid a long-term risk of re-raising the target range and, therefore, looking weak on inflation.

CHAIRMAN GREENSPAN. I'm not sure I agree with that. I think we're talking about 1995; that's the period. At that point we will either be credible on the inflation issue or we will have failed. And I'm not sure that what we're doing on this range will make all that much difference.

MR. LINDSEY. Credibility on inflation? Let's take the baseline CPI projection in the Bluebook. Assuming that comes true, we will have had 3.3, 3.1, and 2.9 percent. What are we credible on?

CHAIRMAN GREENSPAN. Look, you're raising an issue of what we will be doing with respect to the ranges two years from now. I don't even know whether or not the M2 we'll be using is the right [measure]. I would not want to say, because I'm not sure we really know, that the best estimate of velocity change is zero. I would say it's a guess. I wouldn't even dignify it with the concept of a forecast at this point. It's a very loose sequence of events. And the [point] is to preserve a position of the type that we want to preserve. I don't disagree with the obvious logic you're raising, but it presupposes a number of possibilities which I think [involve] very wide ranges of error. If you took the present value of being in that position two years from now, I'm not sure that I'd give it very much value. I think it [has to be viewed as] a very highly discounted position. If you're asking me if the events turn out the way you suggest would the proposition you're making now be the wise one, the answer is yes. I would agree with that. The trouble I have is that it's much too dubious a forecast to rest on. President Hoenig.

MR. HOENIG. Mr. Chairman, I understand where you're coming from with regard to moving these targets now. I have some concern because we have spent a lot of time talking about the uncertainty of these M numbers and where they're going and trying to discount them in a sense as targets. If we now go in and lower the targets, I think we are risking a great deal in the sense that if we change the targets, [the implication is that] we must know something; that will be the presumption if we bring it down. If we aren't sure at this point, aren't we better to say we aren't sure and that, therefore, we're leaving the range unchanged until we know more, rather than raising suspicions?

CHAIRMAN GREENSPAN. I would basically say that the staff's best estimate is that the rise in velocity will continue. If that is in fact the case, our best shot at this point is to lower [the range].

That is not [intended] to create a view that this is all that important. All we're doing is forecasting M2. So long as we maintain the position that the relationship between M2 and everything else is unattached, then this argument is an academic argument that doesn't have legs.

MR. HOENIG. But what we are then doing is changing the concept from one of targeting to one of forecasting where M2 might be given [emerging] circumstances--some of which are out of our control--in terms of its velocity.

CHAIRMAN GREENSPAN. I think we have to emphasize up front what we have done. And, indeed, the staff's velocity forecasts have not been bad. Basically, what we have to do is to argue that this association has occurred and it would be more [prudent] policy to [base] our judgments on this. But we continue monitoring the money supply; indeed, we should. And in our judgment, or basically the staff's judgment since we want to make it a technical issue, we would be more likely to be right with a somewhat lower cone.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I have a lot of sympathy for what Larry Lindsey said. I could live with what you're proposing, Alan, and I think it can be explained that way. I think the other way can be explained as well. I have trouble with the concept that all this is useful; in a sense M2 ranges for the next 12 or 18 months were really never all that helpful in that velocity over those periods of time could be quite volatile. Probably where it was useful, in my mind, was in a very long-term perspective with zero trend velocity over those periods of time and [an expectation that] gradually we'd get down to some range that was consistent with price stability. In that context, then, as Larry explained, we open ourselves up to the arguments about what sort of nominal GDP we are in effect projecting. And possibly we get into this problem of eventually having this bounce around. Then what does that mean? Up until recently my own view has always been to work the range down gradually to where we think we ought to be in a longer-term context and then leave it there; and if we're going to miss, we explain the misses. So, my preference would be to leave it and explain that we're going to miss. I can live with what you're proposing but it raises a question as to how we convey our longer-term intentions to the public and what they can look at as some sort of indicator. Right now, of course, there isn't any. If they want to know, there isn't any.

CHAIRMAN GREENSPAN. Well, Tom, as I said, that is a valid argument. It's not one that can be readily undercut. It's a judgment as to what particular strategy we wish to work our way toward.

MR. MELZER. Right.

CHAIRMAN GREENSPAN. Ultimately, if money gets back [on track] and becomes viable again, we're going to have to make a judgment as to what particular level we want to maintain for the long term. We can basically say that. And if the question comes up, I will not argue that this is a long-term projection. I'd say, indeed, that when we have a much better fix on M2 or whatever the money supply

variable will be, we then have to view the question of what the appropriate ranges are. I don't see what else we can do.

MR. MELZER. Given that this is essentially a forecast for this horizon--if I heard you correctly, you sort of detach it from the policy debate by saying it's purely technical and it's a forecast--then even if we miss this lower range, that doesn't imply any policy response.

CHAIRMAN GREENSPAN. In fact, if you argue--as I would intend to if the Committee wishes me to--that this is a wholly technical question and is disassociated from the economy, I would be continuously emphasizing the fact that policy has to be based on looking at a broader set of underlying financial and economic conditions and that we are bereft of this proxy at this particular stage. We hope it will come back; in fact, one form of it or another almost surely will come back after the [ongoing] balance sheet adjustments are completed. But it's premature to make a judgment as to when that might be. President Broaddus.

MR. BROADDUS. Well, I just want to support Larry's and Tom's position. They really made the points I want to make. From my standpoint, the real purpose of this longer-term range is to signal our continuing commitment to our longer-term objective and, at least as importantly, the steadiness with which we [plan to] pursue it. With that in mind, if we lower the range in the middle of the year to chase an unexpected shortfall in M2, I think we risk muddying the waters and muddling that message.

CHAIRMAN GREENSPAN. How would you argue on keeping it [the same for] this year and lowering it next year?

MR. BROADDUS. I would support that. I'd like to see us keep it [the same] this year and lower it perhaps a half point further next year. That would seem to me to be consistent with the steady approach we have taken and tried to sell.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. In general I support the notion of putting this in the realm of a technical adjustment. But I would like to pursue a couple of aspects of that. As I understand it, what you're going to say is--and these are my words, not yours--that the relationship between M2 and the economy has broken down. We know that it has broken down in the direction of higher velocity; that is, we know something, but we don't know a lot. Point one is that it seems to me one has to know more to make a change than to keep something the same, so it's a matter of judgment as to whether we know enough to make that change. The second point is that you say that we're forecasting M2 but we're not targeting M2. So, how do you then answer the question: You know enough to lower [the range for] it and you know enough to forecast it, but it is a monetary aggregate and, as a central bank, can't you influence it at all? And if you can influence it at all, why don't you try? So why doesn't this forecast have some element of target to it? I think what you're really saying is that we're just forecasting it; we're not trying to target it. But it seems to me we're in a grey area here where we know enough to do what we're doing but we don't know enough to influence it.

CHAIRMAN GREENSPAN. Well, that's the other side of the argument; that is a legitimate argument. And the question basically is whether we want to be wholly agnostic on the potential pattern of M2 or whether we want to make some judgments about it. As I said, I would lean to saying something about it if we want to and indicating that we haven't completely abandoned any view of monetary targeting. But it's a close argument.

MR. BOEHNE. Well, it seems to me you're going to have to do more explaining and answer more questions--there's nothing wrong with that--if we make a change, especially for this year, than if we don't. I agree it's a close call and you're the one who has to [testify]. And it's a close enough call--

CHAIRMAN GREENSPAN. Well, let me ask Don: What are the pros and cons of staying where we are this year and lowering it tentatively for next year?

MR. KOHN. I'm fairly confident, which isn't very confident I agree, that we are going to come in under the range this year. You could always say that. When we wrote our Humphrey-Hawkins report last year, the experience of writing it was that it was difficult to say we've got this range but we're ignoring it. Well, why do you have the range? You changed it in February; you thought you knew enough in February to change it. It conveys something about our longer-run intentions, but it doesn't convey anything about what we want to do this year or what we think will happen this year. We can write that; we can do that, but it's a little more awkward than saying: Well, given the velocity developments in the first part of the year, we think this is going to happen. I think there's an additional vulnerability this time--and I don't know which way it cuts--which is that M2 growth is 1 percentage point below the range and you have revised down your nominal GDP forecast. So, Senator Sarbanes can get religion again and say: See, you missed that and you missed nominal GDP at the same time. I'm not sure which way that cuts. I think if we don't lower the range and we miss it, then we are vulnerable. If we do lower the range, we're vulnerable to the question that Governor Lindsey talked about: That is, does the lowering mean you've lowered your nominal GDP? Well, we have a little. But even if we don't lower the range--

CHAIRMAN GREENSPAN. Not now.

MR. KOHN. --and start falling short, we're vulnerable to the continuing flow of letters over this half of the year. So, it really is somewhat of a tossup.

CHAIRMAN GREENSPAN. I must say that I don't feel strongly about this issue because, frankly, I think we had our fiercest battle six months ago and I think we came out on the right side of that. I don't think the pressure is there. Either way it's a club to beat on us and they like to beat on us. The question is where do we want our head to be when they take a swing at us! [Laughter]

MR. BOEHNE. Well, it's your head, so where do you want it?

MR. MELZER. Well, just picking up on Ed's point, rather than [talking about] our ability to forecast lower growth a better defense

may be that we're not at all convinced at this point in time that in the long run trend velocity won't return to zero. I'm not saying it will. We don't know that it will, but we don't know that it won't either. And on that basis that's why we continue to set a range.

MR. ANGELL. But, Tom, it may very well be that when velocity goes back to zero, it will go back to zero at a different level. That is, when the rate of change of velocity goes to zero does it go back to zero at that higher level or does the level go back? It seems to me that one might make a very good case here that it will go to zero at that higher level, and I think that's what Don is suggesting. I guess I don't understand why those who want to pursue a gradual reduction of inflation that gets these numbers down--1 to 5 percent certainly encompasses that picture--[object to a lower range]. There is not a money projection out here that gets above 5 percent with that kind of projection.

MR. MELZER. I think where we end up may be for the wrong reason.

MR. ANGELL. Now, if this Committee doesn't want to proceed toward getting inflation down to zero, I think we ought to shut our mouths and quit talking about price stability. I just don't understand how we can talk about price stability as being desirable and then not want to take the money range down [to where] with, velocity returning to zero, it is consistent with price stability. And it seems to me that 1 to 5 percent does that. Doesn't 1 to 5 percent permit us a midpoint of 3--or even of 2 percent and then a velocity of 3--and a nominal GDP of 5 percent? It seems to me that the velocity we're predicting is almost like targeting nominal GDP at 5 percent.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Well, most of what I wanted to say has already been said. I think you're quite right that the arguments are very finely balanced here. Let me say first of all that it seems to me we've been talking for a long time about the difficulties with M2 and the uncertainties surrounding it and that if we were to change the range in midyear we would be drawing more attention to M2 than I think it deserves. It really reflects more precision than we agree we have. I think it would be desirable to lower the ranges for 1994, but I think it would be better to let this year run and not change the ranges for 1993. We'll be accused of chasing M2. And more importantly, in my mind that would just draw more attention to the aggregate than it really deserves. Now, 1994 is a different question; and I think we ought to announce that in February and not now.

CHAIRMAN GREENSPAN. Don, let me ask you a question of probability. What is the probability, in your judgment, that M2 could all of a sudden accelerate from here in the context, say, of the economy continuing to move up modestly? In other words, basically, what is the probability that velocity will fall?

MR. KOHN. My judgment is that the probability would be small, given the current shape of the yield curve.

CHAIRMAN GREENSPAN. How small?

MR. KOHN. A major acceleration in M2 growth?

CHAIRMAN GREENSPAN. Well, there's another issue that nobody here has raised that is implicit in what Governor Lindsey was talking about. Suppose we were to lower the range and all of a sudden we get a surge in M2; that would put us in a position where velocity is going in the wrong direction and it was an awful forecast. M2 would still be disassociated, but that's a different type of disassociation.

MR. KOHN. I guess I don't see those forces [that are affecting M2] abating. As I've said, I think the risks on our forecast are balanced. I think there's some possibility that M2 could come out around 2 percent, but to have a big surge would be highly unlikely given what we know is happening with mutual funds, sales in bank offices, and--

CHAIRMAN GREENSPAN. Yes, I understand that. And then if the stock market--

MR. KOHN. If the trend of the stock market--

MS. PHILLIPS. If there were a stock market correction--

CHAIRMAN GREENSPAN. Then everybody would rush out of mutual funds.

MR. KOHN. That's possible. And that would be a good example of an M2 surge which you'd certainly want to accommodate. If the stock market were dropping, you'd have trouble explaining why you weren't reacting.

CHAIRMAN GREENSPAN. Well, that's one of the reasons one would want 2 to 6 percent instead of 1 to 5 percent. President Stern.

MR. STERN. Well, I have some considerable sympathy for the position you described initially, especially for 1994, for the reasons that have been discussed. In addition, if the staff is right and we're going to get M2 growth this year of about 1 percent, it seems to me that next year's range at least ought to embody that or we're making a rather strange commentary on the way things are turning out this year. For 1993, I don't have a strong view about what to do with the ranges. We've done it both ways in history; that is, we've either undershot or overshot kind of knowingly and haven't reacted--haven't changed the ranges. But I wouldn't be troubled in this case if we did. There probably is a pretty good case for changing the range. Beyond those two years, 1993 and 1994, I must say at the moment that I'm not very confident about making any presumptions about M2 or its velocity. In thinking about some of the work that was done with regard to M2+, if you believe that the stock and bond mutual funds really are good substitutes for some of those components in M2--and I guess I do--and we came to the conclusion that we didn't want to construct an aggregate at least at the moment that included those [funds], the logic of that is that M2 itself perhaps was not a very good aggregate in the first place. It may be that in the long run this all will wash out; that is, all the substitution will have been done and we will get a cleaner, improved, or better M2. But I'm not in a position to reach that conclusion and I have a suspicion that wherever we end up three or four years down the road, it may be with

something very different from the concepts we are currently talking about. So, I'm not terribly troubled by the long-run implications of whatever ranges we select at the moment.

CHAIRMAN GREENSPAN. Vice Chairman.

MR. MULLINS. I doubt that M2 is worth this much time. [Laughter] I think the fundamental problem is a conflict between the concept of mortal M2 and Governor Angell's hypothetical money [which he talked about] yesterday and which we probably ought to call imaginary money and explain as involving the square root of negative 1. But the discussion of where we should be long term and of nominal GDP targets and the like all relate to that conceptual, hypothetical money. The people who have shown up in town and argued that that midpoint is a nominal GDP target can be shown to have been demonstrably wrong empirically over last year. We've won that battle and that's why we don't hear that anymore. We could have made a decision early on either to keep the range long term, based upon this hypothetical money case, or to make these technical adjustments. In my view we made the decision in February to go with the technical adjustments; and to the extent that we move back and forth or have double elements in the message, we muddle the message. I think we've been very successful in diffusing this whole argument this way. We have had success in understanding and forecasting velocity shifts. Our forecasts are much better than those of the critics. We started down this path of adjustment and if we adjusted it in February, given these sorts of forecasts, it's not clear why we wouldn't be adjusting it this year unless maybe we're even tighter with these technical adjustments. So, my view is that we ought to be consistent and stick with the battle we've won on this. Again, there's a lot of uncertainty about the future. I don't think we know enough to bind ourselves by the potential constraints out there. I might add that other central banks who do have credibility, like the Bundesbank, will raise the ranges and lower them for technical reasons; they go both ways. But it seems to me that we fought this battle on the technical nature of this and won, and the safest thing to do is to stick with it. So, I'm way back with your initial proposal.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. If we were to lower the range and if your testimony could refer to the staff's expectation of an increase in velocity and in addition an implied increase in velocity from the economic projections, it seems to me it would go a long way in answering Governor Lindsey's concerns.

CHAIRMAN GREENSPAN. I'm sorry, I didn't quite get what you said. Could you repeat that?

MR. PARRY. If you were to note that the staff is expecting an increase in velocity and at the same time that our projections seem to imply an increase in velocity as well, that would go a long way toward alleviating the concerns that Governor Lindsey has that we in effect have a lower nominal GDP target [when] we don't have a lower GDP target.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mr. Chairman, I think this discussion indicates that we can talk ourselves into or out of anything and, therefore, we could probably talk anyone else into or out of anything. [Laughter] So, we've probably made too much out of it. After hearing all this, I have some substantial sympathy for leaving things alone right now and doing next year whatever is going to be done for the following reasons: If we do make a change now, it's difficult to change it as far as we need to and have a great deal of confidence that growth would come in within the range this year. If we change to a range of 1 to 5 percent, the center of that being 3 percent, the GDP forecast-- and I agree the forecast looks pretty good in this difficult world-- the point forecast sets us up for the criticism that while we know this is only a technical matter, we can neither control nor forecast it. Maybe we could explain it given all those things we've talked about. So, in my mind if we were going to change the range, that would [lead] us to Governor Angell's suggestion of going to where we center-weighted it to alternative III. But then I think we would have a problem: What do we do next year from that? So, that in my mind argues for leaving things where they are right now and--

CHAIRMAN GREENSPAN. What do you do for '94?

MR. SYRON. For '94 I would probably go to 1 to 5 percent.

MR. MULLINS. How do you explain the fact that the forecast is out of your range for 1993?

MR. SYRON. This, I admit, is a Hobson's choice; there is no good answer here. I would say that there are uncertainties which continue to evolve and that in our communications with the American people and the Congress we don't want to come forward with a technical forecast. We don't want to imply a degree of expertise in forecasting this from a basis [akin to shifting] sands that is not accurate.

MR. MULLINS. Our best guess is outside the range!

MR. SYRON. Our best guess is but we don't have sufficient confidence in that best guess to imply that it could be interpreted [as the basis for] controlling policy.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I would prefer to go with your original proposal, which was to change the 1994 range to alternative II. I could live with alternative III, but alternative II is certainly a compromise I'm willing to make. If we're changing the tentative 1994 range in July of this year to 1 to 5 percent, it seems to me quite reasonable to change this year's range to 1 to 5 percent because we know there's just zero chance that it is going to be exceeded on the top side for the rest of this year. It seems to me there will be less of an impact to do '93 just like we're going to do '94.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I perceive very little difference among us on substance. This is a matter of perception, and I think David is right that we've already spent more time on this than we should. I certainly would be comfortable for you to argue in the way

you are most comfortable with on this matter of perceptions. However, for my part, if we change in the middle of the year for the succeeding six months only, that would be the riskier course in the sense that I think it runs the risk of changing the nature of the message that we're sending. When we send a message out at the first of the year about the succeeding year, it's the best forecast we can make. It sets a benchmark similar to budgeting for the year; it gives a benchmark against which to evaluate and analyze performance, analyze events, and make comparisons. But when we change in the middle of the year for the remaining six months based on six months' experience, I think that changes the range into becoming a target. Ed made that point a while ago. And that sets up a whole different set of dynamics. We're indicating that we're determined to hit that target and that we think we know how to do it. That puts pressure on us to do it. And particularly given the dynamics of velocity that we've discussed here, that is not something that I think we want to allow ourselves to get into. Once again, I think it's a matter of which argument you are most comfortable making, and I'll certainly support you either way. But if I were the one who was going to go up and present this testimony, I'd be more comfortable supporting no change for this year and then changing over to alternative II for 1994.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. You raised a question a few minutes ago about what the chances were of a sharp velocity decline. I had looked at the Bluebook table on page 8 and noted that the numbers imply significant velocity declines in 1998. I was trying to think my way through what set of circumstances could produce that result even out then, let alone this year and next year. We may not know much about what should or shouldn't be in M2 or what's going on with its velocity, but we do know that debits still equal credits--the two sides of the balance sheet are still equal--and that will help guide us a little. In order to have negative velocity, given that there is little further potential for running off non-deposit liabilities of the banking system and there is substantial potential for running off security portfolios in order to accommodate loan demand, we somehow have to imagine that total intermediation through the commercial banking system--the total assets of the banking system corresponding to those liabilities--have to rise relative to total spending in the economy the way we measure things. I'm having a terrible time imagining that circumstance coming about no matter what the yield curve is doing. So, I think that we could put aside the idea of a velocity decline even out in 1998. I [unintelligible] something to fill that case.

As for the ranges for this year and next year, very early in this discussion Al Broaddus asked a question about credibility and Mike and Don referred to that footnote on page 9. A part of what we are trying to do is establish some credibility of a regime in which people believe that any increases in inflation and interest rates are temporary and they'll go back down so that the central bank [unintelligible] them to do that. I don't see how it helps us to start building on that credibility if we are below our target range and are not trying--or claiming that we're trying--to do anything to be within the range. So, whether we call this a target or a forecast of what money is going to do, it's just arithmetic at this point for 1993. We have to lower the range and be willing to make these

[unintelligible] as they may be, just as a step to get our own credibility up. When the focus is on this ratio of GDP to M we call velocity, a lot of the discussion is about the denominator; in earlier remarks, especially Larry Lindsey's remarks, it was that we were using the denominator as a handle to try to hit the numerator. Well, I don't think that we should be targeting nominal GDP, [unintelligible] total spending. I have enough trouble with what's in the numerator in measuring economic activity in today's world to think that we should fiddle with the denominator to hit the numerator. A lot of this discussion about velocity gets us off track. Instead we ought to get out [the message] more clearly that [our goal] is price level stability--that we're going to stabilize the price level at some point in the future. Whether we're fiddling with the fed funds rate or fiddling with various reserve or money measures, [the message should be] that we haven't lost our focus on stabilizing the price level. And all of these other discussions about where we are on the Ms or their velocities are sort of distractions.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Well, this is much ado about little. I came to the meeting with a slight preference for keeping the ranges unchanged on the grounds that we have to know more to change something than to leave it alone. But it's only a slight preference and I can easily go with II or I. However, if we're going to change one, it would be better to change both. If we're going to draw attention to it and explain it on technical grounds, presumably we know more about the next six months than we know about next year, particularly since we think we're going to have more M2 growth next year than this year. So, I would prefer either to stay the same or make the change for both years.

MR. ANGELL. That's a good point.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Mr. Chairman, for some reason this discussion reminds me of the Aggie who failed to show up at home one night. He came in the next morning and his wife asked him where he'd been. He said: Well, honey, I did actually come in last night but you were already asleep and I didn't want to disturb you. So I slept in the hammock on the back porch so I wouldn't wake you up, but I was here all night. She said: You know, I sold that hammock two weeks ago. And he said: Well, that's my story and I'm sticking to it.  
[Laughter]

CHAIRMAN GREENSPAN. I'm waiting for the policy implication!

MR. MCTEER. My story in the past year has been that M2 has been sluggish because money has been spilling out of the banking system, primarily into stock and bond funds. I think that's a story we ought to keep alive because it's the only story we have. I think we were a little hasty yesterday in dismissing this. It may be that M2+ doesn't make an ideal substitute for M2 for the future, but even though it's not satisfying econometrically, as Yogi Berra would say: "You can observe a lot just by looking." Just looking at what is happening [tells us that] the banking system is shrinking; it's becoming less important as an intermediary. When we talk about this

to the general public they understand it; they're all out there seeking higher yields than they're getting at their banks. I called home last night and learned that my wife had just bought her first lottery ticket. That's how far it's going right now! So, I think we ought to keep that [story]--

MS. PHILLIPS. Do we put that in M2?

MR. KOHN. That's M2++!

MR. MCTEER. We should put the kitchen sink in there if it would stabilize velocity. So, my suggestion would be this: We have an opportunity now to lower the M2 target range to 1 to 5 percent, let's say, for technical or arithmetic reasons. We can explain it; we're going to miss any range that's higher than that anyway. Then, having lowered it for 1993, we go ahead and lower it for 1994 at the same time and we'll have it where we want it for the future. So, we have an opportunity to lower it for technical reasons and have it there for more fundamental policy reasons later. So, I would suggest 1 to 5 percent for 1993 and 1994.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Like others, I think, I certainly don't feel strongly about this either. If I hear you correctly, you would be reasonably comfortable either way on this; you don't feel very strongly about it. I must say I have a preference not to change the range either for this year or next year. If we did reduce the range this year and made a technical adjustment, in the cool light of hindsight, frankly, it seems to me that will be viewed as a mistake. I think we simply ought to leave the range where it is, make the case in the testimony that there's an awful lot of uncertainty, we're doing a lot of work, and we will report back to the Congress as we develop more information to shed some light on this issue.

CHAIRMAN GREENSPAN. The only difference I would take on that, Sir, is that I feel a little uncomfortable about complete know-nothingness on the issue. It's one thing to make a forecast which we don't think has significant policy significance. It's another thing to say we're absolutely at sea. If you listen to this discussion, there's literally zero policy question here. It's all a perception of how people are going to react to what we say. We're not talking about real stuff. What we're talking about basically is whether we wish to position ourselves into a know-nothing position. I personally feel uncomfortable with that. If you told me I had to argue [the case], I could argue it. I would not feel as though it's a policy issue. But it's strictly a style question. And knowing who we're dealing with up on the Hill, I think it's a little better argument, frankly, to--

MR. KEEHN. You get the political reaction by not making a change. We'll be worse off than--

CHAIRMAN GREENSPAN. I don't think so. I sensed when I went up there in February to make the technical argument that we had them at a major disadvantage. The reason is that it's a really different dialectic when somebody says this isn't working and somebody else is trying to say it is. If somebody says to me that M2 is really

important and I'm trying to say they're [wrong], from a dialectic position [my argument] is much more plausible.

MR. KEEHN. Thank you.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Well, I can certainly support the 1 to 5 percent range for both the balance of this year and next year. I would have a slight personal preference, if I were the one doing it, for leaving the 1993 range where it is and then in my testimony going to some length to discuss [our broad policy objectives] and simply say we're trying to foreshadow the projected change for 1994 and if we confirm this trend in velocity, then it would be appropriate to reduce the range for 1994.

CHAIRMAN GREENSPAN. You know, that is one technical way of coming at it; it's a good [point]. First Vice President Oltman.

MR. OLTMAN. I would go to 1 to 5 percent both for 1993 and 1994. That was not my first instinct here. I started with a feeling that changing the range at this point would imply that we know more about the process than we do. But I've been convinced by the argument that this offers an opportunity to emphasize the technical nature of this and to further the divestiture of the policy component.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I'd go ahead and lower the range to 1 to 5 percent for both 1993 and 1994. We have a half a year of information for 1993 and it seems to me that we'd look pretty foolish if we didn't recognize that. And I'd vote for that [lower range] for 1994 because I think it may in fact put us where we'd like to be for [substantive] reasons. I would urge, along the lines of President McTeer's comments, that we have some discussion in the written testimony somewhere on M2+ because I do think that helps in terms of the explanation.

CHAIRMAN GREENSPAN. I agree. I think that's absolutely right. In discussing what it is we know about M2, it's not zero; we do know that something is there.

MS. PHILLIPS. We know something, yes.

CHAIRMAN GREENSPAN. We're going to make an argument that eventually it's more than likely to be restored but one has to be able to understand the process involved. I think it's very important for us to be very analytically sharp on what we think is happening concurrent with our judgment that the relationship to the economy has veered off for a protracted period. Look, we're the central bank. If no one in the central bank understands what is happening to money, we are in really serious trouble. What we have to say, basically, is that we understand what's going on. Our presumption is that a structural relationship shift has occurred for reasons x,y, and z. Therefore, to target M2 as a monetary policy vehicle is temporarily inappropriate.

MS. PHILLIPS. And from all of this analysis that we have done this last year we have learned a lot more.

CHAIRMAN GREENSPAN. Exactly. And I think we've basically improved our status in that respect.

MR. LAWARE. Can we call one of them real M2 and the other one nominal M2? [Laughter]

MR. KELLEY. How about unreal M2!

CHAIRMAN GREENSPAN. I like Governor Mullins' view of M2-i because they are imaginary numbers. I'm sorry, Gary Stern, I didn't get down what your preference was.

MR. STERN. My preference was your initial suggestion.

CHAIRMAN GREENSPAN. I realize that we can play this in a number of different ways. I would argue two things. One is that the argument for going to 1 to 5 percent is persuasive, but I think the argument to do it for both years is very persuasive. In other words, whatever we do, we ought to do for two years. And while we are technically voting separately on each, I would urge us to consider the implications of making this a highly technical issue. And in my judgment we do it best by staying where we are [next year]. Can we vote, separate votes?

MR. ANGELL. Mr. Chairman, why don't we vote on 1994 and then after you announce that vote on 1993.

CHAIRMAN GREENSPAN. That's a very good point. I would propose 1 to 5 percent for M2 and the equivalent for M3 and debt for 1994.

MR. BERNARD. I guess we'd be using the wording in Option A, which refers to retaining the '93 ranges as revised at this meeting. The first sentence of the paragraph would remain the same: "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output." And then [we'd use the language under] Option B starting at the bottom of page 24 in the Bluebook: "For 1994 the Committee agreed on tentative ranges for monetary growth measured from the fourth quarter of 1993 to the fourth quarter of 1994 of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the monitoring range for growth of total domestic nonfinancial debt at 4 to 8 percent for 1994. 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. ANGELL. Mr. Chairman, as I understand it, we're voting on 1994 now, aren't we--just the bottom of page 24 as Norm read it?

CHAIRMAN GREENSPAN. That is correct. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Acting Vice Chairman Mullins	Yes

Governor Angell	Yes
President Boehne	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President McTeer	Yes
First Vice President Oltman	Yes
Governor Phillips	Yes
President Stern	Yes

CHAIRMAN GREENSPAN. And I'd like to propose the same for 1993. Would somebody move--

MR. MULLINS. What do you mean "the same"?

CHAIRMAN GREENSPAN. The same 1 to 5 percent on M2.

MR. ANGELL. The 1 to 5 percent.

BERNARD. Do you want me to read [the language] or just call the roll?

CHAIRMAN GREENSPAN. Why don't you read it again.

MR. BERNARD. Again from page 24 at the top, entitled Option 2--Reduce Ranges: "In furtherance of these objectives the Committee at this meeting lowered the ranges it had established in February for growth of M2 and M3 to 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee anticipated that developments contributing to unusual velocity increases would persist over the balance of the year and that money growth within these lower ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt also was lowered to 4 to 8 percent for the year."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD. For 1993 then,

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

CHAIRMAN GREENSPAN. Okay. [Don.]

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

CHAIRMAN GREENSPAN. Questions for Don? If not, let me just raise a few issues that I think are relevant to this outlook. It strikes me that we clearly have been quite successful in diagnosing the underlying causes of the problems that have been associated with this economy. I think we picked up the question of strain on balance sheets very early on. We've tracked the forces that have engendered mild disinflation and economic growth on a path somewhat above 2 to 2-1/2 percent. The general view which has been implicit in our actions--essentially the stability of policy over this very long, I guess almost historically long, period--is a view of the way the economic system is functioning. That view presupposes that it is still going to take a while for the strain on balance sheets to work its way out and that eventually the economy should be on a new and stronger upward path. For us to take the position at this point that there is cumulative weakness in the economy of a nature which might require our next move to be down rather than up would require that we essentially alter our view. Now, obviously, if events occur that make that required, we will have no alternative. But there is little or no evidence to suggest that the underlying basis as to what is causing the system to function requires a change in policy at this point. I think we had a significant indication yesterday with those auto and light truck sales figures. If this economy were undergoing a process of contraction, it's very difficult to imagine where those numbers were coming from.

Nonetheless, we do have a very odd combination of effects here in that the fiscal package is creating a lot of uncertainties so far as the forecast is concerned. If we look at the extent of that fiscal restraint in the context that the Greenbook did, by any measure it is a relatively modest degree of restraint and one cannot readily argue that there's much in the way of ex post receipts and expenditures that is significantly altering the economic environment. What is quite interesting, and I think apparent, as one looks at this process as it develops is that the psychological or anticipatory aspects involved in this fiscal package really are of an order of magnitude that seems to be almost larger than the actual impact. I'm not saying that's true; I'm not saying that is an incredible perception. I don't know how much of the long-term interest rate reduction is attributable to the expectation that there will be a credible reduction in the deficit somewhere out there. I suspect most of it is, rightly or wrongly. [Lower interest rates] have unquestionably been a major factor in the improvement of balance sheets and increasing consumer incomes as a consequence of the reduction in the fairly substantial debt service burdens. It's rather obvious at this point, however, that the offsetting impact on the negative side--on the contraction in the real variables--is on the tax side and, at least based on the anecdotal discussions around this table yesterday, on the capital goods markets with respect to a number of projects being put on hold. It's very tough to see that in the data as yet. The only place it actually materializes is in the nondefense durable goods numbers. Surely, it doesn't get picked up in any of the broader measures or in any of the actual measures of capital expenditures concurrently.

So, if there's anything out there, we'll learn about it in two or three months; but at the moment it's hard to find any hard statistics which demonstrate that. I think we're getting something of a slowdown in the rate of growth in medical employment, which I

suspect may be a reflection of the expectation that something is happening on the fiscal side relating to medical care and the like. So, what we are looking at is an economy which arguably is being affected both positively and negatively by the deficit issue well in advance of any actual changes in either receipts or expenditures. And I don't think we have very much in the way of history to know how to play this. If this economy is going to start to weaken far more than we expect, it's not credible that it will occur as a consequence of the actual hard numbers that are out there in the budget proposal, all of which are out sufficiently in [the future]. One can't really say that in econometric terms we've had any real response. But to the extent that anticipations [are having an effect]--for example, to the extent that the [proposed] individual income tax rates are having an impact on the behavior of small business and subchapter S corporations, which almost surely is happening--it is a negative effect. So, it's hard to measure how this is moving.

I would conclude, unless and until we have some very hard evidence that the psychological impact of the budget package is of such an order of magnitude to upset the balance of this economy, that we almost surely are best positioned to maintain [conditions consistent with] our general view [of the outlook], which is largely reflected in the Greenbook. It's reflected in the views of pretty much everyone around the table. The outside economists hold about the same [view]; their number for growth is 3 percent, plus or minus. The range [of forecasts] is incredibly narrow in the private sector, which proves absolutely nothing except that they all feel warm from being close to each other. It doesn't have anything to do with the accuracy of their forecasts.

So, I do think that we're all looking at the same process. And unless and until we see clear evidence that things are not materializing in that way, I can't see any basic purpose for us to change [our policy stance]. In looking at the data, I suppose one can argue in principle for symmetry or for just staying where we were the last time. My own preference is to stay with asymmetry but with [the understanding that] a Committee discussion would be indicated in the event that anything emerges that requires a change. We have maintained this particular monetary stance for so long, and I think very successfully, that I don't think we should move until the Committee has a chance to evaluate and discuss the incoming data that could make a move necessary. As I look at the data [scheduled] to come out before the next meeting, we will have two sets of price data and two [months] of retail sales. And I think we're going to get a fairly clean view, hopefully, of the way this system is emerging. And while I would like to stay asymmetric, I don't think it's appropriate in this type of environment to move at the discretion of the Desk without fairly extensive further discussions on the part of the Committee. So, my inclination at this stage is to stay pretty much where we were and leave it at that, although I can't say that I can argue strenuously against symmetry because obviously in this context that is also a credible position. So, that's what I've got to say. And President Syron is [next] on the ticket.

MR. SYRON. Mr. Chairman, I would strongly support what you want to do. I had questions the last time as to whether we should have gone to asymmetry, given that we weren't there. I think actually it worked out pretty well.

CHAIRMAN GREENSPAN. I think in retrospect it was the right move.

MR. SYRON. In retrospect it was. But now that we're there, I think we want to continue to give the signal that we'd react relatively quickly--I'm trying to recall Norm's exact phrasing--were we to get [clear signs of an emergence of higher inflation]. And I have some concern about the market reaction we might get were we to switch back [to symmetry]. I also have some concern about what a switch back might signal in terms of people saying: Well, does the Fed really see the economy being much softer than they saw it earlier? Also, I think your suggestion was particularly appropriate that, given how long it has been since we have made a change, there should be some Committee discussion. That would be in my view the optimal approach to take.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. I strongly support your position also, Mr. Chairman. We all deplore the leak at the time of the last meeting, but the fact of the matter is that I think the markets and the public reacted very favorably to the news that we had moved to asymmetry last time. I think Dick is right; if now or later on they learned that at this meeting we switched back to symmetric language in the face of only one month's disappointing data--not all of which incidentally is disappointing, as you pointed out--I think that would do us some damage. So, I support your position.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Well, Mr. Chairman, when I read those forecasts in the Wall Street Journal yesterday I became very concerned because everybody seemed to be warm and cuddly together! [Laughter]

CHAIRMAN GREENSPAN. You know, they really were remarkably close.

MR. FORRESTAL. They are clustered. Well, I would certainly support your prescription with respect to no change in policy. I think everything that's going on in the real economy, the uncertainty, and the fact that we've lowered our GDP forecasts a little, all argue very strongly for a stable monetary policy, particularly in view of the fact that the inflation numbers have improved somewhat. So, I think no change in policy is clearly the right prescription. I have a preference for symmetry, if only on a theoretical basis, in the sense that it seems probable to me that we will not move in either direction, and that in my mind calls for a symmetric directive. However, having just had an asymmetric directive, I can understand that there may be some problems in moving to symmetry. So, I would certainly not object to asymmetry, particularly in view of your statement that it wouldn't presuppose any policy action.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I would support your recommendation. I think a case could be made for symmetry but, given where we are today and also given my own utility function with regard to inflation, I would just as soon [retain] the asymmetry.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I think the case for a steady policy is a strong one, and you've laid it out. On the issue of symmetry or asymmetry, if one looked just to the decision today without regard to what happened in the current [intermeeting] period, I think one could make an intellectual case for symmetry. But having moved to asymmetry, I think the balance of the evidence says we ought to stay where we are with the asymmetry.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. While I might have had a slight preference for symmetry, I very much support your recommendation primarily for the reason Al Broaddus mentioned. If there were another leak reflecting a change from asymmetry to symmetry this time, it would be very awkward in the marketplace. And, therefore, I think what you recommend is appropriate.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I support your proposal.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I also support it. I was swayed last time by the argument that we needed to be on record as being concerned about inflation. It seems to me that we have less reason to ease or tighten now. I do think that at some point we're going to have to address negative real rates. But it doesn't appear to me that at this time they are causing particular harm to the economy. And it seems to me that we're best staying the course and best staying with an asymmetric toward tightening directive. I think a change would signal a lack of concern about inflation, and that would not be a good thing to do.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. I would support no change at this time. I would have a slight preference for symmetry; but having heard the arguments for having already made one change, changing back may be awkward now. But on the merits of it, I think symmetry would be appropriate.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. I support your recommendation including the asymmetry for the reasons that everybody else has given. However, I do think there are some serious downside risks that we have to be alert to. I was struck by Bob Parry's recounting yesterday of the state budget problems that are leading to conservative fiscal actions and pushing those problems down to the local governments. At the national level we're about to have a huge tax increase. State and local governments all over the country are [also raising taxes] and are cutting back spending. Businesses are able to shrink their way to prosperity, but I think the country may be engaged in a fallacy of composition--and Keynes must be spinning in his grave right now--because we're all trying to save and tax our way to prosperity. So, that is a concern. I support your recommendation.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I fully support your recommendation. I think the interesting debate that we're going to have is how to respond to a supply shock; we're not going to have that debate today. But if, unfortunately, the supply shock continues, the fair question would be: Can you cure an adverse supply shock with easy money? And I look forward to the intellectual discourse that solving that problem will produce.

CHAIRMAN GREENSPAN. President Stern.

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

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Alan, I support what you say. I think I heard implicitly in [your comments] that we really need to be watching things pretty carefully here and that we need to be prepared to move promptly. I suspect that market participants and probably a lot of people in this room breathed a big sigh of relief when we got the PPI and CPI numbers; and in my view that's probably not justified. As I see things, we've had a very stimulative policy in train for some period of time--when you look at the narrower aggregates or when you look at the level of short-term rates--and we're going to have to get that rope back in at some point in time. And it's not going to be any easier down the road, as I view it. In fact, it will probably get tougher. Your analysis of the budget may well be exactly right. The facts may be worse than the expectations but politically my guess is--

CHAIRMAN GREENSPAN. The other way around.

MR. MELZER. Yes, that would be the other way around--once they enacted something. In terms of market expectations, once it becomes absolutely clear that we must move and we're looking at a structure of rates that anticipates the Fed is going to move x basis points within the next month or two months or whatever, it just becomes harder and harder to catch up. In other words, we've been fortunate in a way that we've had a few signals here, a few warning shots, and we haven't been compelled to move. But eventually the time will come when it's no longer a warning shot and we will be trying to chase a train that already left the station. Other people have said that over time at these meetings. I think what you've suggested for this meeting is quite appropriate. But I just hope we will be attentive in the direction that I'm expressing here as we move forward.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, we're talking about a very narrow range of differences here and, regardless of whether one's personal preference is asymmetry or symmetry, the overriding point right now with this narrow range of differences is that we not change. And as a consequence, I will support your recommendation.

CHAIRMAN GREENSPAN. First Vice President Oltman.

MR. OLTMAN. I support your recommendation, Mr. Chairman. Perhaps if we were starting from scratch, I would have some preference for symmetry but I don't think we ought to change [from asymmetry].

CHAIRMAN GREENSPAN. Vice Chairman.

MR. MULLINS. I support your proposal, Mr. Chairman, and I also agree with Tom Melzer's arguments as well.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Well, I'm clearly not in tune with the other members of the FOMC. I don't see any need to wait for any information. The markets provide indications every day as to whether or not we've provided more liquidity than is called for. And when we lowered the fed funds rate from 4 percent to 3 percent, my guess is that made very, very little difference in the rate of real GDP growth. The destabilizing factors that have led people to hold, shift, or use their balances as much as they have was, I think, a drag against the stimulus that was already in place. A 4 percent fed funds rate already was providing a lot of stimulus. We already had pegged the fed funds rate well below the natural rate of interest. We now have evidence, and we see it in our own staff's forecast, that the expected rate of inflation has moved up 0.6 or 0.7 percent just [since the May FOMC] meeting. Now, in that environment, policy is not stable. We do not have the same policy that we had at the last meeting because the real rate of interest by our best estimate has fallen to even more sharply negative territory. We clearly see in the price of gold that people are making bets out there. And we continue to lock in to a fed funds rate that will only aggravate that kind of speculation and it only detracts from the role of the U.S. currency as the stable currency for the world. The cost to the world of the United States pursuing inflationary policies in the late 1960s and the 1970s is unbelievable. We're still paying the cost because many other central banks with no confidence in us think they have to be Rambo-like in beating their chests because in some sense they've got a track for the inflation-induced environment that the Federal Reserve as the world's reserve currency provides. This is the time for us to move real interest rates back at least to zero. I would be satisfied to do a measly 1/4 percentage point, which would not get us back to zero, but there would be intervention value in that. There wouldn't be any harm in it. Is there anyone who really believes the U.S. economy, regardless of what is done on the fiscal [side], is going to suffer because the funds rate goes up from 3 to 3-1/4 percent? Now, I read Henry Kauffman, as many of you must have, and it's just absurd. Well, I must be the one that's absurd! Thank you.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I also am not happy about the fact that inflation this year is not going to come in where we talked about last February, and the judgment has to be that our policies are not at the moment moving us in the direction of our long-term objective. We ought to correct that.

CHAIRMAN GREENSPAN. The general consensus appears to be "B," asymmetric.

MR. BERNARD. [The directive would read:] "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with modest growth in the broader monetary aggregates over the third quarter."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Acting Vice Chairman Mullins	Yes
Governor Angell	No
President Boehe	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President McTeer	Yes
First Vice President Oltman	Yes
Governor Phillips	Yes
President Stern	Yes

CHAIRMAN GREENSPAN. Norm wants me to remind you that any changes in your forecasts should be submitted to Mike by midday Friday, July 9. Also, of course, the next meeting is August 17th. Now, why don't we just take a short recess and then come back.

MR. KELLEY. Let's just press on.

CHAIRMAN GREENSPAN. Okay. Well, unfortunately, we're going to finish before lunch! [Laughter]

MR. BERNARD. Someone is going to get Don Winn.

CHAIRMAN GREENSPAN. The subject matter, as you know, is how this Committee wants to handle the problem of stories or leaks and the like. I've asked Don Winn to join us. We got an extended letter from Henry B. Gonzalez on this leak question; I got it late yesterday. I think it would be useful to read it. I was planning to raise these questions, as I indicated yesterday, before we got this letter; and clearly we have problems we're dealing with up [on the Hill], so it's useful to read this.

MR. SYRON. Are we into triple digits in counting his letters this year?

CHAIRMAN GREENSPAN. It's close! I think the productivity of Mr. Auerbach is extraordinary. He must have been Fed trained! Don, would you circulate those letters. Why don't we all just take a minute or two to read this and then we can have a substantive discussion.

This actually is the most thoughtful letter I've ever received from Mr. Gonzalez. It is a very credible letter and strikes me as very much to the point. He's not pounding on the table; he's making a very serious point. The basic notion is that leaks and public statements about FOMC meetings are a very serious matter that calls into question the credibility of the Federal Reserve to manage its own operations. That's an argument that is very difficult to get at. The issue about leaks is really part of a much broader problem, and I think we've got to give it some thought. Clearly, with the demise of fiscal policy there has been an extraordinary point of focus on the fact that this organization is a powerful element within the government and, indeed, considering some of the other aspects of the way policy is implemented, I don't think there is any question about that. Secondly, in large part as a result of the extraordinary elevation of the press as a consequence of the Watergate episode, we've created a very large increase in investigative reporting capacity. There is a much larger number of very competent, economically educated press people working in the world of finance than at any time in my memory. When I was at the CEA--that was only 1975-76--there was nothing like the technical capability that a lot of these reporters have. You could just feed them pabulum and they pretty much accepted it. That clearly has changed quite dramatically.

Now, I thought about it yesterday when I was sitting here listening to the economic discussion, and listening to each one of you talk about the way the economy is functioning through economic activity, inflation, the outlook, and all in words that most of you will use in public. And I sat there and wrote down what the monetary policy [stance of] each individual in this group was. Let me tell you: If I can do it, so can they. The presumption that you can go out there and talk about the economy without conveying something [about your own policy views] strikes me as really off the mark. I personally do not think that the Wall Street Journal leak came out of this room. [David Wessel] almost invariably will say that this information came from Fed officials, senior Fed officials, Administration officials, or government officials. I don't know if you remember his article but he said "people familiar with how the Federal Reserve functions," which to me is a code word for about half the people out there and was probably meant to mean somebody who used to work here and knows how the System works, of which there are legion. Had he direct information, I suspect he would have said so. But the point is that he didn't need direct information. One can infer quite reasonably what the policy outcome of the last meeting was if one just sits by the teletype screen and reads what each one of us is saying. Now, I'm not saying that's either good or bad. Indeed, part of our job is to communicate to our various constituents. But it would be naive in the extreme to believe that we can do that the way we do it without communicating very significantly to the outside as to what this organization is essentially all about.

We all have to remember that the press is interested in us because we all have access to FOMC deliberations. The general presumption of any intelligent reporter is that whatever we say will reflect that. The probability that we are not conditioned by what is going on here is zero. In fact, even if it is not zero, that is the general presumption. We have an extraordinary amount of information in this group; we talk to each other. There is a sense in which there is an information system which exists in the Federal Open Market

Committee; there is a combined knowledge of what everybody thinks and what, therefore, policy is going to be. There is a property right that the Committee has, and those of us who work off the data system and talk in great generalities about what is going on are on the edge of infringing that property right. It is a right which essentially belongs to all of us collectively. I think we all ought to remember that if we were private citizens, the phone would not be ringing off the hook. We are called to talk to the press because we are members of this organization. We get invitations to speak all over the place because we are members of this organization. And it's terribly important for us to remember that we cannot talk with impunity. Indeed, what constitutes the leaks that occur on occasion, in my judgment, are not the result of purposeful actions on the part of any member in this room. I think what happens is that in conversations with people on the outside, we forget that there's an IQ on the other side of that phone. And I will tell you that if I were a reporter and got into a long conversation with any member of this organization and if that person was at all open or honest in any way, I would bet with a high degree of probability that I could forecast not only your position but also a lot about what other people in this room thought because one tends to [convey] that. It's not something people are aware of sometimes, but I've observed it time and time again, and I've been around this town for a very long period of time. It's really an issue that this Committee has to confront [and decide] what it is we want to do. We can acquiesce in this type of request, which essentially means we issue something [like a statement]; as Don Kohn has indicated to me, he doesn't seriously believe that will alter the configuration very much. Rather than my repeating Don's words why don't I just turn the floor over to him so he can tell you what he has told me about this question and get it on the table.

MR. BOEHNE. Before you do, may I ask a question? I think that your analysis of the Wall Street Journal article is conceivable and believable. But when I read on the screen and when CNBC says that we had a unanimous vote and then an hour and a half later it says no it was not unanimous but 10 to 2, I'd say they need to have more than IQ to get that.

CHAIRMAN GREENSPAN. The CNBC thing was a pure, unadulterated leak. It was not inferable except with a probability outside the significant limits that anyone of us would use in our statistical analyses. That was as pure a leak as you can get. The reason I say that is that they had the correct vote. The probability of that happening by chance approaches zero.

MR. BOEHNE. Right.

MR. SYRON. And they got it shortly after they had [announced something that was] an error; clearly, someone called them or they talked to someone in that interim period.

CHAIRMAN GREENSPAN. That is correct. I must say to you that I have a suspicion that I know how that all occurred; that is not a great secret to me. All I'm saying is that the initial issue that emerges here is the Wessel article, and my best guess is that Wessel picked up the asymmetry without a leak.

MR. SYRON. Can I pursue this? Your guess is that he wrote the article based on [his analysis of various comments]. You're right, I think, that if you look at what people have said in testimonies and a number of situations, [a reporter] can put it together. But did he then in your scenario, if I can call it that, call around to people to get what he thought was confirmation of it?

CHAIRMAN GREENSPAN. Yes, and I think he failed to get it.

MR. SYRON. So, you think he wrote the article before the meeting and he could have written a similar article before this meeting, unconfirmed by information post-meeting in time?

CHAIRMAN GREENSPAN. Now, let me tell you that my sole evidence rests with my knowledge of how the Wall Street Journal reporters write about their sources, which is not accidental. It comes as official policy. He would never have used the choice of words he used had he either Federal Reserve or Administration sources.

MR. SYRON. I don't remember the exact words, but I thought he effectively eliminated Federal Reserve sources but did not eliminate Administration sources.

CHAIRMAN GREENSPAN. No, he said sources familiar with the way the Federal Reserve works.

MR. KOHN. It's on page 2 of Mr. Gonzalez's letter.

MR. LINDSEY. "Familiar with the Fed's deliberations," that's different.

CHAIRMAN GREENSPAN. That is a phraseology that he does not use if he has actual sources. As I read in the paper, some Wall Street wag--I've forgotten what firm he's with--said: "Well, this could easily be me. I'm familiar with the deliberations of the Fed."

MR. BOEHNE. Are you saying that you believe somebody like David Wessel can write that article and not talk to anybody in this room after the FOMC meeting or a week before?

CHAIRMAN GREENSPAN. I think he talked to a lot of people who formerly worked here: former governors, former staff people, and the like. Look, I'm telling you, my sole evidence is my knowledge of how they designate their sources.

MR. BOEHNE. I have a feeling that if everybody in this room followed the basic rule of not talking to a reporter one week before or after an FOMC meeting--or in the case of the Humphrey-Hawkins meetings until after the testimony--we'd make it pretty tough on people like David Wessel to write a story like that. And I know we wouldn't have a CNBC problem.

MR. SYRON. And if you expanded that to what I thought our rule was--that we not only don't talk to anyone but that we give no speeches--. I thought we were to say we weren't available for any comments X days before or X days after; I thought it was 10 days before or 10 days after.

CHAIRMAN GREENSPAN. In fact, we do have a listing of the types of things which over the years have provided guidance. Let me read it to you; I'd be curious to get reactions on it. This is titled "Guidelines for Public Speeches and Talks with Journalists and Others about Monetary Policy and the Economy." Under the "Do Not Discuss" section are:

- (1) Future movements in interest and exchange rates.
- (2) Recent decisions or discussions at FOMC meetings; the minutes speak for themselves. The prohibition includes comments on what positions people took at the meeting.
- (3) Anything about the economy or policy one week before or one week after an FOMC meeting. The blackout period in February and July extends to the day of the Humphrey-Hawkins testimony.
- (4) The detailed outlook for the economy, which can be construed as [having] implications for near-term policy.
- (5) The performance of other government officials.

Under "Issues Available for Discussion" are:

- (1) Broad trends in the economy, provided the discussion is sufficiently vague and balanced to make drawing implications for future policy impossible.
- (2) Broad policy objectives and the mechanism and techniques of implementing policy.
- (3) Any matters on the public record, such as recent testimony.
- (4) Economic conditions in your region.
- (5) Background economic research already publicly released.

Needless to say, in the areas of bank regulation, community development, and a whole variety of other things which are in the Federal Reserve's bailiwick, discussions are perfectly appropriate and desirable and in that respect there's an awful lot to talk about. Does anyone have any basic objections to this set of guidelines?

MR. MULLINS. I think it should be distributed.

CHAIRMAN GREENSPAN. The only problem I have distributing it is that it may leak!

MR. MULLINS. You don't think they are a good set?

MR. ANGELL. Well, I guess I had only one question on the next to the last one. Would you read that again about the outlook?

MR. MULLINS. The detailed outlook for the economy?

CHAIRMAN GREENSPAN. The detailed outlook for the economy, which can be construed as [having] implications for near-term policy. Let me just say that it is a very tricky issue; I think we all are aware of where the line is. It may well be that the safest thing we can do at this particular stage is for none of us even to answer a press request or go off the record until after the Humphrey-Hawkins testimony because we're opening ourselves up to trouble. And what do we need it for? In other words, why do we have to do it?

MR. ANGELL. I strongly believe that in a democracy public officials have a responsibility. And one responsibility we don't have is to engage in chicanery with the press and to give any background or off-the-record information. If everyone who talked to [a reporter] said "I only talked to you because you're using my name," then that embarrassment will discipline each person. I do not believe that anyone from this organization should ever talk to any reporter on background or off the record. That's what constitutes the problem. In a democracy public officials do have a responsibility to communicate. There is an educational program. The Federal Reserve if it is to be successful in regard to accomplishing our primary objectives must be able to say clearly what our objectives are. And [education] becomes a very, very important part of that. And for us to react by saying no speeches, I'd say no. I agree with the no speeches 7 days before and 7 days after [an FOMC meeting].

CHAIRMAN GREENSPAN. That's the important period.

MR. ANGELL. That's the important period. But if anyone talks to any reporter, I think we should keep a log of who we talk to and make that log available to each other. That is, any time we talk we ought to make a log. We'd say I talked to so-and-so on this day and put it down. And we ought to share it with each other. Now, I don't understand this CNBC thing. It seems to me you're dismissing that a little too lightly, if someone from this organization absolutely told someone what they had no business telling them in regard to that vote. No one had the right to correct the mistaken vote that CNBC reported. No one had the right to do that. No one has the right ever to say what they think my view is; I am the only one who has the right to say what my view is. I don't have the right to say what David Mullins' view is or what anybody else's view is. I don't have the right to say what the Board might do; I don't have the right to say what the FOMC might do. I want a different distinction than is being made. I think the obligation in a democracy is very, very strong. And I [don't] think the best thing for us to do is not to talk and never to give our views.

CHAIRMAN GREENSPAN. I don't think that's what this says.

MR. LAWARE. The only reason we have to have this elaborate list of do's and don'ts is because we insist on preserving this six weeks of secrecy with regard to what goes on in this room. If we made a prompt announcement of what went on in this room, we wouldn't have to concern ourselves with this; and we might throw a few undeserving reporters out of work. I'm surprised that you feel that this is a thoughtful letter [from Chairman Gonzalez]. This is part of the same attack on this institution that has been coming from Henry B. Gonzalez for some time. Just listen to the way this reads: "I believe that most objective observers would agree that the above examples indicate the Federal Reserve on occasion disseminates information"--that sounds like deliberate disseminations--"through leaks and random public statements by Federal Reserve officials." He seems to regard this as an accepted practice of this institution!

CHAIRMAN GREENSPAN. Well, I accept your amendment. I didn't mean to imply that the letter was without--

MR. ANGELL. But unfortunately there are some instances in which that is the case.

CHAIRMAN GREENSPAN. I was going to ask Don for a few remarks relative to this question because I think we have to make a statement. Do we want to issue something? I think, substantively, it's bound to inhibit somewhat this organization's function. Don.

MR. KOHN. Mr. Chairman, I perhaps just ought to remind the Committee very briefly that on several occasions over the last six or eight months it did consider this question of whether it should release information immediately. We had a Mullins' subcommittee on this and a full and open discussion on the issue. While a few members of the Committee tended to favor immediate release, they were, I think, a minority; certainly, no one moved to change the situation. The concerns of the Committee at the time were the questions of flexibility in policymaking, whether an immediate announcement of a directive, say, like the asymmetric directive in May, would constrain the Committee from going to asymmetry because they wouldn't want the announcement effect. In fact, the effect was that it did have markets raising interest rates; if they weren't sure, they were going to raise rates. By constraining [the ability of] the Committee to take actions to go to an asymmetric directive or off asymmetry to symmetry, it would in some sense remove by very small amounts some of the flexibility of the Committee. That was the concern the Committee had.

The other issue that you need to think about if you're considering going to an immediate release is what to release. If in May, for example, right after its meeting the Committee had released the fact that it had gone to an asymmetric directive would that have significantly called off the reporters? One has to wonder. At least I would have to wonder whether the reporters wouldn't be all over the Committee members wondering why you had done it and under what circumstances a change would be made. [But] it would help [to release such information] and in most meetings it would stop right there, I think, once the Committee announced its decision. But then you do have the question of what you release along with that and how far to go. So, there are a couple of issues that were raised when the Committee last discussed this.

MR. LAWARE. I didn't intend to make a brief for immediate release. In any case, even if I believed that was the right way to go--and I'm not sure I do--I wouldn't do it in light of this because this Congressman would declare victory and say "Now I've got them." I wouldn't sit still for that.

CHAIRMAN GREENSPAN. I must humbly retract my statement with respect to the quality of the letter because I'm more inclined in your direction than not. To be exact, there are a few sentences in it that I think are reasonable.

MR. KELLEY. I think what you said, Mr. Chairman, was that the letter is the best you have seen of those he has sent to us. [Laughter]

CHAIRMAN GREENSPAN. I think Governor LaWare more appropriately characterized it.

MR. PARRY. I have two questions. This prohibition of 7 days before and 7 days after a meeting is something that Joe Coyne has repeated quite often in the 7 years I've been here. But there are a number of people who obviously disregard this completely. Very often when I get back the next day I'll see three or four people have given a speech the day after [the FOMC meeting]. I assume they think for some reason that that [prohibition] is a mistake. If that's the case, I'd like to hear what their objections are. It may be legitimate that we shouldn't have it. I frankly think it has been a wise thing, but there obviously are some people who feel as though we should not have such a prohibition because they violate it all the time. So, if they violate it all the time, I assume they would not be unhappy talking about why.

MR. ANGELL. Bob, I'm not as concerned about the people who violate it with their names as I am about those who violate it without their names.

MR. PARRY. I'm not talking about talking to the press. I'm saying that speeches are scheduled; they get on the wires, etc. Yet, I thought there was a consensus that we would not give speeches dealing with the economy 7 days before and 7 days after [an FOMC meeting]. Obviously, some people don't know that or, knowing it, don't think it should be respected. It would be interesting to know what it is.

CHAIRMAN GREENSPAN. Does anybody have a speech scheduled between now and Humphrey-Hawkins?

MR. PARRY. Well, I can go back and look at--

CHAIRMAN GREENSPAN. No, I'm not denying the truth in this case. You're talking historically; I'm talking from here on.

MR. PARRY. Okay.

CHAIRMAN GREENSPAN. I will say this: If none of us answers a press call, then the only way anything can leak is if we tell somebody else who then tells the press.

MR. ANGELL. Well, telling someone else is every bit as bad, if not worse than telling the press.

CHAIRMAN GREENSPAN. Of course.

MR. LAWARE. Sure.

MR. ANGELL. Telling somebody else is even more suspicious.

MR. PARRY. I had a second question. I'm not sure I fully understand the point made about talking about the economy in such a way that has policy implications. If one has concerns about inflation, for example, are you saying that that view should never be articulated in public?

CHAIRMAN GREENSPAN. No, I'm saying, for example, if you get out in public and say that inflation is a very serious problem and we have to do something quickly, that is a statement of where our

position is on monetary policy. If you say it's the role of a central bank to maintain stable prices, that's a philosophical judgment with respect to the nature of our institution, which hopefully we all subscribe to. The broad principles are something we should enunciate whenever we can.

MR. ANGELL. You're [able to] read [people's views on policy] better than I. I hear people saying that inflation is a problem and I don't know how they're going to vote after I've seen them make a statement about inflation being a problem. There have been four or five people who have made statements about inflation being a problem and, frankly, I don't know how they're going to vote based upon what they say. I don't understand how you think the reporters know how they're going to vote.

MR. LAWARE. We don't make that mistake about you, though!

MR. SYRON. Consistency.

CHAIRMAN GREENSPAN. Remember what the problem is; we are all on the record six weeks after the fact. So, it's a question, really, of how one characterizes things. My main concern, frankly, is less about what we each are saying about our own views but what we are inadvertently conveying about the nature of the position of the Committee overall. There are times, and I can cite innumerable instances, where sentences of members who are sitting around this table have slipped out in Q&As and the like--[sentences that] have characterized [the view of] this organization as a whole. And I think that is something we have to be very careful about.

MR. FORRESTAL. This business about talking to other people raises a question in my mind that I've had for quite a long time. The question is whether or not the Administration might be leaking some of this information. Is there any kind of arrangement we have in which we talk to the Administration?

CHAIRMAN GREENSPAN. Let me put it this way. Up until about two years ago, I would say, it was the conventional thing for the Chairman of the Fed to convey to the chairman of the CEA what our policy was; it was part of the discussion. But it became apparent to me that that was a hole as large as one can imagine. I have not talked to either the Bush Administration or the Clinton Administration on any policy matters initiated in this Committee room. And I must say that one does not see Administration officials--

MR. ANGELL. As much as one used to.

CHAIRMAN GREENSPAN. That's right.

MR. FORRESTAL. That has been beneficial in one sense, but it makes the problem even more acute because we have two issues here. One is: Are these leaks deliberate? The CNBC report certainly pointed to a deliberate leak. First, to go back to John LaWare's remark about the letter, I agree that it's an attack; but that doesn't in any way diminish the seriousness of what he is pointing to. I think the credibility of this institution is really on the line with deliberate leaks. And if we know that there are deliberate leaks, I think we have an obligation to track them down and do something about

them. The inadvertent leaks through talking to reporters I think can be corrected to a very large extent by following those guidelines. And I think we all have to follow them very religiously and keep them in mind. The third point I'd make is that if David Wessel did get this information from sources outside the Fed, there's really nothing we can do about that, it seems to me.

CHAIRMAN GREENSPAN. Frankly, I didn't particularly mind the David Wessel piece if in fact what he was picking up was a guess or a judgment of how this organization might function.

MR. FORRESTAL. Yes, he's guessing and talking to other people.

CHAIRMAN GREENSPAN. And the reason it appears [that way] is that he didn't do something which is usually done, namely, quote a lot of people. It is conceivable that I am not characterizing this situation correctly. As I said before, my sole piece of evidence is my historic knowledge of the policy of the Wall Street Journal with respect to designating sources.

MR. FORRESTAL. Yes, I think that's a logical conclusion.

CHAIRMAN GREENSPAN. And if that is true, then I'd say-- Well, before Wessel we had a long period where we were quite secure.

MR. SYRON. But the difficulty is that it comes back to what John LaWare said about disclosure. This Committee did have a discussion about that. But at the time of that discussion I think we had a somewhat better recent history on leaks. Regardless of how one interprets the Wessel situation, the CNBC matter was clearly a leak of some sort or another. On the face of it, unless we can demonstrate in a relatively short period of time that this leak problem can be eliminated, over the course of time we will have no choice but to go to disclosure. It's that simple. We have not demonstrated as an organization a capacity to [prevent leaks] and [as a result] we're destroying the credibility of this organization and all the things that we're trying to do in terms of our objectives. So, unless we can really get to that point very, very quickly, then we better start thinking very seriously about what we want to release.

CHAIRMAN GREENSPAN. I couldn't agree with you more.

MR. ANGELL. I think that's correct.

MR. KEEHN. I think that's exactly right, but I just question whether we have the time to make it happen.

CHAIRMAN GREENSPAN. Well, we have two possibilities coming from right here. We can decide now that we want to change our disclosure [practices]; we could ask the Mullins subcommittee to review the previous [material on this] and come back with a recommendation. Or we can say that we don't wish to change; we think that the procedures we're using are most appropriate for the effective workings of this organization. Then, in the event there is a leak, we will request the General Counsel to ask for sworn statements voluntarily of all individuals in this room that they did not communicate with a particular press person. It gets down to the point

where we would ask for voluntary sworn statements. If that doesn't work, then I'd say we have no choice but to--

MR. SYRON. Because of the time constraints, I'd prefer you do the latter, too.

MR. KEEHN. Why would the statements be voluntary?

CHAIRMAN GREENSPAN. Because there is no legal means by which one can enforce a sworn statement of members of the Board of Governors.

MR. KEEHN. Well, I think you ought to find a way of getting [rid of] anybody not willing to give a statement.

MR. ANGELL. How would you suggest doing it?

MR. KEEHN. I think if the Chairman of the Board puts the freeze on anybody at this table, he's gone.

MR. ANGELL. Wait a minute. What are you talking about?

MR. KEEHN. If the Chairman puts the freeze on somebody, they are in effect gone.

MR. ANGELL. Members of the Board of Governors are not appointed by the Chairman. Did you have the impression that we were?

MR. KEEHN. I understand that.

MR. ANGELL. Now, there's no question that we have a pact that we should enter into, one with another. As the Chairman says, there is information that doesn't belong to each of us [as individuals.] But I certainly can't understand your comment, Sir. It just blows my mind that one of seven--

CHAIRMAN GREENSPAN. Well, why don't you just chalk it up to understandable frustration.

MR. JORDAN. Part of what I was thinking Bob Forrestal already referred to. When I read the Wessel piece I thought of the Administration. I think you're being generous to Wessel's IQ. If he had said people familiar with the way the Fed deliberates, I would have come to the conclusion you did. But he said "familiar with the Fed's deliberations" in both of these articles. I interpret that to mean somebody who claimed to be in a position of knowing what happened at that meeting [unintelligible]--

CHAIRMAN GREENSPAN. He's done it so often before and never used that phrase. It's much more credible to say: "A Fed official said that..."

MR. JORDAN. Yes, but if it's not a Fed official--if it's an Administration official--

CHAIRMAN GREENSPAN. Let me put it to you this way. I have been extraordinarily scrupulous in not indicating to the Secretary of the Treasury, the Chairman of the Council of Economic Advisors, or

anybody, what it is we did in that meeting. I never even acknowledged after the leaks were out that they were true.

MR. JORDAN. Well, whether it was a Fed official or not, I associate myself with Wayne's point about "for the record for background." Having worked in this town in '81 and '82, I took the position then that one just does not do off-the-record statements. You either do it on the record or you don't say it. But the trouble with this town is that not many people agree with me. And people in the Washington press know that, and people who work--

CHAIRMAN GREENSPAN. I must say I don't agree with that. I think the issue is not whether it's on the record or off the record or what it is you say because there are occasions when you want to convey [some] information without your name being known but [unintelligible] of this organization and to disabuse certain people of certain views without ending up with a confrontation or quarrel. So, I don't agree with that. Wayne knows that I disagree with him on that.

MR. ANGELL. Sure.

CHAIRMAN GREENSPAN. But where I don't disagree with him is on the content of what it is he's saying.

MR. MCTEER. As a practical matter, isn't the main argument against immediate release of the directive the problem of asymmetric directives?

CHAIRMAN GREENSPAN. That's the crucial thing.

MR. MCTEER. Why don't we just go ahead and stop having asymmetric directives and start releasing the directive before we leave the room with the understanding that we can have telephone conferences at a moment's notice for intermeeting decisions?

CHAIRMAN GREENSPAN. Because that is a much less efficient means of working than the way we're working.

MR. MCTEER. It would eliminate all the problems about speech-making and times before and after the meeting and all that.

CHAIRMAN GREENSPAN. I doubt that.

MR. MCTEER. Well, at least after.

CHAIRMAN GREENSPAN. No. David, you had a committee that concluded after looking at the possibilities--

MR. MULLINS. Yes. And basically I'm one of the people who believe that not releasing asymmetric directives measurably increases our flexibility and efficiency in monetary policymaking. I think it has served us well. That argument falls if it's released. I think one can't rebut the argument that we should accelerate the release. So, we may have no choice but to formalize the process and accelerate the release. Looking back on it, we've had a number of these episodes interspersed with relatively long periods of success. I personally would be a bit hesitant about making the move to early release of the directive in the heat of one of these episodes because I do view that

move as irreversible; and it will forever alter the opportunities available for the Committee. Again, I think [delayed release] has served us relatively well but we may have no choice. And I would agree that if we have another episode, it will be hard to rebut the argument. But my preference is to redouble our efforts at maintaining confidentiality with full knowledge that we're on the brink of losing this flexibility. Our subcommittee, when we talked about it, thought there was quite a bit of flexibility in the asymmetric directive. And there is inefficiency of essentially having the Committee in meeting continuously, which is pretty close to what we'd have if we required everyone to get together. We thought it was worth it but I don't know how much it's worth. It's certainly not worth losing our credibility over; and as a practical matter our credibility degenerates with the leaks. But our subcommittee, and I guess the Committee in its discussion as well, generally supported that notion although there were some people who disagreed. We have blackout periods of plus or minus one week, but then on the directive we have a longer period. Actually, it's that longer period in which I think we may have had some problems as well. So, another argument is to line up the blackout with the release of the directive.

MR. MCTEER. If we did release the directive immediately, it would possibly ease the pressure on us to reveal or release the conversations that take place.

MR. MULLINS. I think people would want to know why, though, wouldn't they?

CHAIRMAN GREENSPAN. Yes, they will always want to know why. I think we'd heighten the interest in that. Does anyone else want to [comment]?

MR. MELZER. Well, I worked with David on that subcommittee and I was not in favor of immediate release either; but I must say subsequent developments put it in a different light, and I wouldn't be against taking another look.

CHAIRMAN GREENSPAN. Let me suggest the following: That we make this effectively our last stand and that if we fail, the first thing is that I will request the General Counsel to ask for sworn statements so that we will at least have that on the record. For those who choose not to make such a statement, that's their prerogative. But Governor Angell is right. Members of the Board of Governors are appointed by the President of the United States with the consent of the Senate and are independent agents for good or bad. Some of that is both! [Laughter]

MR. KEEHN. Not to split a hair on that, but I thought at one point we had an opinion that this was confidential information and to release it was in fact breaking the law.

CHAIRMAN GREENSPAN. It's not a statute that I'm aware of; it's the rules of the Committee.

MR. MATTINGLY. It's part of the FOMC's Regulations.

MR. KEEHN. And that's not a law?

CHAIRMAN GREENSPAN. It's not a felony.

MR. MATTINGLY. Some of the information the FOMC has do violate those statutes, but the directive does not; it violates the FOMC's rules.

MR. KEEHN. Okay. But if you violate a law, it seems to me that's a different set of circumstances.

CHAIRMAN GREENSPAN. We are not a legislative body that can promulgate laws.

MR. MCTEER. Well, I like Governor Angell's objection. [I'd have it] cover the presidents, not just limit it to the governors.

MR. ANGELL. Well, [unintelligible] the statute is somewhat different. I don't think we want to have a huge difference in practice, but the statute is quite different in that the dismissal of a member of the Board of Governors falls under an impeachment clause. It's very specified. But the presidents serve at the pleasure of the Board of Governors. In practice, we certainly wouldn't want it to be that way; we'd look pretty silly if we ever--

CHAIRMAN GREENSPAN. It's a legal distinction which we cannot--

MR. SYRON. What are those five-year terms anyway? I think you're right; that's a separate issue.

CHAIRMAN GREENSPAN. I understand that's what the statute says. But as a practical matter we couldn't function as a Committee with a different status for different members of the Committee because it won't work. The most important thing I'd say at this particular stage is that when you get a press call, irrespective of from whom, until the end of the Humphrey-Hawkins hearings--on the 22nd of July I believe--you have laryngitis or something. If you think you can pick up the phone and tell somebody nothing, don't believe it. Believe me, it's a mirage; and all you have to do is miss once. I think we just can't afford it. Jerry Corrigan, as you may recall, said at the luncheon that we gave him on his farewell immediately following the last meeting of the FOMC that the one thing that could do this institution in is the leak question and the whole issue of the credibility of our operations. And I must tell you that Jerry is almost surely right on this. We have an organization that in my judgment has been extraordinarily effective through a very difficult period. The wisdom of this group has really been quite extraordinary. My impression, looking back at the history of our deliberations in the last two or three years, is that we look extraordinarily perceptive and effective. But that can all be undercut by a perception that we can't function in an effective manner with respect to this issue. So, let me just say in closing: Please be very careful. And if we can maintain confidentiality and carry through, I think we will effectively be able to secure the position of our deliberations and the status of the organization.

MR. LAWARE. What are you going to say to Henry?

CHAIRMAN GREENSPAN. I haven't decided yet. Well, that's a different question.

MR. LAWARE. Okay.

CHAIRMAN GREENSPAN. We are not going to tell him we're doing something. That's about as much as I can say. Unless anybody has anything further to add to this very difficult problem, I would suggest we adjourn for lunch.

MR. MELZER. Alan, the guidelines you read--are we following those?

CHAIRMAN GREENSPAN. My understanding is that we have not been following the guidelines with respect to blackouts a week before, a week after and up to the Humphrey-Hawkins testimony; we have not been doing that.

MR. SYRON. Are we agreeing that we are going to do that?

MR. MELZER. That's what I'm asking.

MR. SYRON. Should we do it?

CHAIRMAN GREENSPAN. I assume that the answer is yes. Unless I hear an objection from the Committee, that's the rule of this Committee.

MR. MCTEER. Does that apply to any speeches? Or are we talking about the press?

CHAIRMAN GREENSPAN. Yes. In other words, if you want to talk about the history of the American economy or the history of the old West--. [Laughter] But if you're going to talk about anything with respect to the immediate future, I would say to you that's [not appropriate].

MR. SYRON. It's important because we can't even talk about our region. Or we shouldn't even talk about our regions because if we do, it gets into--

CHAIRMAN GREENSPAN. Let me say this: One of the things that we ought to talk about is our regions outside of the blackout area.

MR. SYRON. Oh, yes, absolutely.

CHAIRMAN GREENSPAN. I think it's important that each of the presidents be viewed as the representative of an area and the chief government spokesman on the economy in his region. One way to do that is to get out there and talk about the characteristics of the region, what it's all about, what it's doing, what makes it different from the rest of the country, and why it's better. But if you start talking about the short-term outlook for the region, you can't get around the issue of talking about the overall economy.

MR. SYRON. Exactly.

MR. KELLEY. Mr. Chairman, I'm under the impression that the fact that we have this one-week blackout on either side of FOMC meetings is in the public realm now, that it is well known.

MR. SYRON. It is?

MR. COYNE. Yes.

MR. KELLEY. It's obviously not accepted by the press, but they are aware of the fact that that policy does exist in the FOMC.

CHAIRMAN GREENSPAN. Joe Coyne, is that a fact?

MR. COYNE. That's right; they are aware. They call it [unintelligible].

MR. KELLEY. That being the case, there is no reason why we should not simply decline openly to accept a question and answer time wherein mistakes can so very easily be made. Just say no.

MR. MULLINS. Just say no to questions on the--

MR. BROADDUS. One mechanical problem here just occurred to me, and that is that a reporter can print something that he's gotten from you much earlier and--

MR. MULLINS. They do that with me, too.

MR. BROADDUS. John Berry interviewed me about two weeks ago and he hasn't printed anything yet, so he may--

CHAIRMAN GREENSPAN. John Berry is one of the more responsible [reporters].

MR. BROADDUS. But that is a problem.

MR. ANGELL. It seems to me that we need to discipline ourselves with a little more reporting. That is, if anyone does have a speech scheduled, we ought to notify the Chairman's office or some office. We ought to go through a process of saying I have scheduled [a speech]. The Committee ought to be notified when we're going to speak in the blackout period.

MR. SYRON. In the blackout period, okay, but not for any speech to be given outside the blackout period.

CHAIRMAN GREENSPAN. Just remember that there was an organization called the Plumbers, and the last thing we need in the Federal Reserve is a 1993 version of same. Look, we can carry this thing too far. The basic purpose is solely to preserve the integrity of these deliberations, not to inhibit people in any way from talking. The [point] is that [talk] has been too loose. Anyone who has been observing this phenomenon can tell. Okay, shall we adjourn for lunch?

END OF MEETING