

Meeting of the Federal Open Market Committee  
August 17, 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, August 17, 1993, at 9:00 a.m.

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

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

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

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

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

Ms. Greene, Deputy Manager for Foreign  
Operations

Ms. Lovett, Deputy Manager for Domestic  
Operations

Mr. Ettin, Deputy Director, Division of Research  
and Statistics, Board of Governors  
Mr. Madigan, Associate Director, Division of  
Monetary Affairs, Board of Governors  
Mr. Stockton, Associate Director, Division of  
Research and Statistics, Board of Governors  
Ms. Johnson, Assistant Director, Division of  
International Finance, Board of Governors  
Ms. Low, Open Market Secretariat Assistant,  
Division of Monetary Affairs, Board of  
Governors

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

Messrs. McNees, Meyer, and Miller, Vice Presidents,  
Federal Reserve Banks of Boston, Philadelphia,  
and Minneapolis, respectively

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

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CHAIRMAN GREENSPAN. Good morning, everyone. The first item, which is not on the agenda, is to welcome our old/new colleague, the new President of the Federal Reserve Bank of New York. I gather from Norm Bernard--who is the world's greatest expert on all such issues--that Bill McDonough is not the first Manager to move up to the presidency of the New York Bank; Allen Sproul who was Manager in 1938 to 1941 did the same. But you can't be first in everything, Bill! We welcome you and are delighted to see you move up to this side of the table where I can hear you better.

MR. MCDONOUGH. Thank you, Mr. Chairman. I will continue to try to speak loudly and clearly.

CHAIRMAN GREENSPAN. That would be novel! [Laughter] The first item on the agenda is approval of the minutes. I would ask somebody to make such a motion.

MR. KELLEY. I'll move it, Mr. Chairman.

CHAIRMAN GREENSPAN. Is there a second?

MR. MCDONOUGH. Second.

CHAIRMAN GREENSPAN. Without objection. I'd like to call on Governor Mullins to move the election of the Vice Chairman, who will hold office through the end of this year and until the next election at the first meeting after December 31.

MR. MULLINS. Mr. Chairman, I would nominate for the position of Vice Chairman a person amply qualified to fulfill the recent Irish tradition, even if he speaks clearly, Bill McDonough.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Any other nominations? If not, we have one individual [nominated] and I will ask for yeas and nays. All in favor say "aye."

SEVERAL. Aye.

CHAIRMAN GREENSPAN. Thank you. I assume that there was somebody out there with a "no" vote, but you didn't want to know about it! Anyway welcome, Bill.

VICE CHAIRMAN MCDONOUGH. Thank you.

CHAIRMAN GREENSPAN. I'm looking forward to your working with the rest of us in this new position; the work is not all that much different from your previous activity, but it clearly has a very different spin to it and we wish you well.

VICE CHAIRMAN MCDONOUGH. Thank you. It's an honor and a privilege. Having sat at the other end of the table for a year and a

half, I can appreciate the very real importance of what we do here. It also gave me the opportunity to think about whether any sane person would wish to move from that end of the table to this end. And I came to the conclusion one should. Thank you.

CHAIRMAN GREENSPAN. That was not an answer to your question! For the first item of general business I'd like to call on Gretchen Greene to report on the operations of the Foreign Currency Desk.

MS. GREENE. Well, Mr. McDonough has set a very high standard for me. He says he'll talk loudly and clearly. If I don't talk loudly and clearly, please let me know; I'll try to speak either slower or louder.

CHAIRMAN GREENSPAN. The first thing is to make sure your microphone isn't covered up by anything!

MS. GREENE. I will try. [Statement--Ms. Greene's statement cannot be found in the Committee's files.]

CHAIRMAN GREENSPAN. I don't recall any evidence that the French or any of the others actually have covered their borrowed positions in any [significant] amounts against the deutschemark since the debacle. Is that correct?

MS. GREENE. It is correct that we do not have that evidence. What we don't know is whether they are succeeding in picking up some reserves and waiting to tell us of their operations when they are more successful. But you are right; we do not have any clear evidence that they have been successful. And until today the French franc had looked a little heavy. So, the opportunities really were not obvious for them to acquire marks.

CHAIRMAN GREENSPAN. Well, with the approximately \$70 billion--even with, say, a 3 or 4 percent decline in exchange rates or ultimately more--if they're going to have to cover at some point, this will be a very large hit on the budgets of those countries. I noticed that there was

Is that true of the other countries as well?

MS. GREENE. The accounting on reserves varies [greatly] from country to country, and the sharing of the loss in a case like this--where the French, for example, borrowed marks in an EMS arrangement--is also unclear to us. In other words, whether or not there's some kind of loss-sharing arrangement within the EMS that has been agreed to is something we are not fully confident we understand. But if it were true that the country that is doing the borrowing has to cover at market rates, you are right, the consequences in terms of the profits of the central banks on their foreign exchange transactions and how that is reflected in a fiscal deficit could be a significant number.

CHAIRMAN GREENSPAN. Other questions?

MS. PHILLIPS. Do you have any sense as to where the demand for the yen is coming from?

MS. GREENE. Certainly one important element is that the capital outflow, which had been a counterweight to Japan's current account surplus, has been far smaller than is typically the case. Now, obviously, there's a capital [outflow] to balance the surplus in an accounting sense. But the [ex ante] demand to send funds abroad by Japanese investors has pretty much dried up. They did invest a fair amount and they were very active investors in the second quarter in the European markets, taking advantage of the sharp drop in interest rates, particularly in countries of the EMS other than Germany. And, of course, they got burned by what has happened with the European monetary system. And we believe that one of the reasons why the yen advanced so much more rapidly than the dollar in July was that these investors were hedging their exposures in French francs and other [currencies]. We do not think they liquidated their investments because they thought that the breakup of the EMS would prompt a larger cut in interest rates than has taken place and they wanted to be there to get the capital gains. But apart from that burst of [what might be called] an outward investment into Europe immediately after the French elections, the outflow has been small by comparison to previous years. So that is probably the single biggest fact: The reluctance of the Japanese investment companies and insurance companies and investment trusts to make meaningful outward investment in other countries.

MS. PHILLIPS. So they're demanding more yen?

MS. GREENE. They are demanding fewer dollars.

MS. PHILLIPS. So it's just sort of a relative thing.

MS. GREENE. Yes. As this has built up, of course, we have seen the Japanese companies responding differently, as I mentioned. Previously they had believed that the dollar would recover and therefore they would be able to sell dollars at a higher rate, so they were willing to hold their dollar exposures. As that belief has faded, people are saying: "I have to cut my losses; I just have to get out of these currencies regardless of what the exchange rate is." And that's when we observed the Japanese exporters constantly reducing the dollar price at which they were willing to sell; in the past couple of weeks that has been an important additional factor.

MR. FORRESTAL. Gretchen, do you think the French are really serious about this imposition of exchange controls or is it just a public relations ploy to try to frighten the speculators? If they were to do this, it would seem to me to be another blow toward--

CHAIRMAN GREENSPAN. [Unintelligible] just a few minutes ago indicated that that was not his plan. That's not an answer to your question, I understand; but that's at least what he said in Tokyo.

MS. GREENE. I think there is growing concern about the type of market participants; these participants are difficult for the authorities to have contact with. In the past the large players have been banks which the central banks know and understand; now we have a class of market participants--call them hedge funds or investment trusts or whatever you want to call them--who exert enormous market power and for whom there is not the same kind of relationship with the monetary authorities. The authorities don't know who they are; they don't know why they do these things. And, of course, these funds have

built up huge investment positions in all countries. And when they get scared, the hedging of those portfolios--just because of the way the hedging is done--is enough to have a very sudden and substantial impact on the exchange rate, which comes at the most awkward time from the point of view of the central banks. So, I think there is a growing level of frustration, and I guess the question is: Where does that frustration ultimately lead?

CHAIRMAN GREENSPAN. Any other questions? If not, let's move to the Domestic Desk and Joan Lovett.

MS. LOVETT. Thank you, Mr. Chairman. I hope you can hear me down at that end also. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Ms. Lovett? I guess you covered [everything]. Would somebody like to move to ratify the actions of the Desk since the last meeting?

SPEAKER(?). So move.

CHAIRMAN GREENSPAN. Is there a second?

MR. KELLEY. Second.

CHAIRMAN GREENSPAN. Without objection. Let's now move on to our economic discussions with Messrs. Prell and Siegman.

MR. PRELL. I always thought being audible got me into more trouble! I thought the example set by Mr. Volcker and Mr. Corrigan might be the one I should follow, but I'll try to follow my colleagues' example this morning. Having asked the Committee to endure a very long presentation last month I shall be quite brief this morning. [Statement--see Appendix.]

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

CHAIRMAN GREENSPAN. Questions for either gentleman?

MR. SYRON. Mike, in looking at autos and at the pattern that we see before us, I was wondering if we had any feel on the leasing side on whether there is--and how much--an incentive factor that might come along like earlier incentives that we saw on prices. Specifically, I'm thinking about the leasing terms which seem to be in some ways similar to the direct price sales promotional devices we saw earlier. How much do they really shade the residuals very, very closely? Are they even going negative on the residuals as an incentive kind of thing? In terms of having some view of what is going to happen to sales going forward, I wonder whether this is likely to reverse at some point.

MR. PRELL. Well, I think we had some discussion of this in the Greenbook. Pinning down the amount of the leasing transactions with consumers is a little difficult. There is some survey evidence that we're aware of that suggests that perhaps a quarter of the consumer car sales have leases. And that does seem to have been the way that the major manufacturers have gone as a substitute to some degree for the kind of price shaving they previously had done--rebates and other techniques. Clearly, they've been trying to firm up their

margins. One step was to diminish the flow of cars going through the rental companies that come back as nearly new and are perceived as fairly close substitutes for the new cars. That was partly a response to a general rise in retail demand, which meant they didn't have to sell the cars on concessionary terms [nor did] the rental car companies. If demand remains on the uptrend we think we're seeing, and with the Japanese car prices likely to be under even more pressure than we might have anticipated in light of the further appreciation of the yen, there may be some further tightening up of that market, with some firming of prices either through less aggressive residual valuations on the leases or through other devices. But I don't think we have that good an insight into what trick they're going to use.

MR. SYRON. We have a feeling that this is the same sort of timing that happened before. We think that these [kinds of incentives] are going to be offered for a discrete number of weeks in some cases, never mind months, and that they will be removed at some point.

MR. PRELL. Well, they seem to have maintained incentives. They've broadened them recently. We don't think they are as deep or quite so broad as we've seen at the end of some other model year clearance periods because the stocks are pretty [low]. So, we might enter the new year with less overhang of prior year models. The "end of year" has gotten a bit vaguer. We see new models coming out at different times of the year; and in the case of Chrysler, one of the reasons they're pushing so hard now is that they're going to be bringing out new models at the end of this year, sort of a '94-1/2 [model]. So, there's a lot going on here. Our sense is that there is a more moderate level of promotional activity going on than there was [at the same time] a year or two ago. And that trend will probably persist for some period.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Thank you. Mike, there was an appendix in Part II of the Greenbook on the Budget Reconciliation Act that I think was very informative and interesting. It would seem as though the one-for-one in terms of tax increases and spending cuts looks fairly legitimate there. I also got the impression that perhaps it was not quite as backloaded in terms of expenditure cuts as originally had been the case. Are there any defining issues in terms of spending cuts that are making it less than the pure number? Are they of any significance, because I know that was a major criticism earlier in the process? And I wonder if you could just comment on how this has all changed because I know the last Greenbook had a ratio of 8 to 1 for 1994 in terms of tax increases versus expenditure cuts. And, of course, Boskin had that article in the Wall Street Journal that had a 9 to 1 ratio for the entire period. It seems as though there have been some very dramatic changes.

MR. PRELL. Well, to be honest I can't give you a neat accounting on this. We didn't perceive that the outcome was drastically different from what we've been assuming previously. The major change was the smaller energy tax than we'd been anticipating. We thought they'd come out somewhere between the House and the Senate [bills] and [in fact] there wasn't any concession [to the lower Senate version]. [Unintelligible] reduction number they moved them to full

retro-activity for 1993. Other changes were quite minor. And as we noted last time, the baseline from which we were measuring that tax deficit reduction last time isn't the same as the accounting that was going on here. We perceived [the reduction] to be rather heavily on the revenue side. A good bit of the indicated expenditure cut is attributable to the cumulative effects of the lower deficit on interest costs. I suppose it's legitimate--it's an expenditure--but whether it's a high powered expenditure or not is another matter. But we perceived that it's enough on the tax side and there's enough of a case to be made that the GDP aggregate demand effects of tax increases may be somewhat less than expenditure cuts to suggest that the damping effect on economic activity would be less than if they had gone as far as some had advocated on the expenditure side. But we still see it as a substantial fiscal contraction, depending on how one looks at this--liabilities or cash basis and so on. It's either a tremendous restraint in 1994 or a substantial restraint in '93 and again in '94. So, we're looking at the consumption behavior and so on, and we would allocate some of that restraint to 1993.

MR. PARRY. In some past times there have been fee increases that were counted as expenditure cuts; is there much of that?

MR. PRELL. I don't think there is a lot of that in this. There is obviously still talk of doing some things in terms of grazing fees and mining and so on; those aren't big dollars. But, no, I don't think there is much of that in here.

CHAIRMAN GREENSPAN. Any other questions? If not, who would like to start our tour de table?

MR. KEEHN. Let me start off, Mr. Chairman. Other than the flood, which certainly has been a serious event for those who are directly involved, I would not have to comment on any significant changes in the District economy since the last meeting. Broadly, things seem very much the same. The auto business continues to be strong. As we get closer to the end of 1993, the industry is raising its sales forecasts for the year. Third-quarter production schedules are running about 20 percent over last year and the expectation is that the fourth-quarter schedules will be higher than last year but that the margin will be much smaller. I will say, though, that there is something of a growing concern in Detroit that the auto business has run ahead of the national economy. And unless the employment and disposable income gains catch up, the sales levels could be at some jeopardy. Order flows for heavy trucks have slowed a bit but the industry doesn't, at least so far, view this as significant. They are coming off a very strong period and I think the current softness may well be a reflection of the summer doldrums.

In the steel business, the outcome of the trade cases, while certainly disappointing from their perspective, is anticipated to reduce annual domestic shipments by about 2 million tons. Also, this is going to have a limiting effect on price increases. They had announced an increase of 2-1/2 percent for October that is clearly not going to stick. And they now think that the next increase will not be earlier than next January. Despite this, though, the underlying business continues to be good and they are forecasting shipments this year at about 86 to 87 million tons. Contrary to the national numbers, retail sales in the District in July were comparatively good.



Some of the larger chains that had been having a difficult time experienced some pretty strong gains.

In the ag sector it is still, of course, premature to judge the full economic impact of the flood. But in a broader perspective, I don't think the effect will be nearly as large as one might guess by watching the television coverage on it. Growing conditions in many areas that are not directly affected have really been very good. And with higher crop prices, farm income this year is expected to be pretty good. But I will say that because the growing cycle is behind by several weeks this year--we got a late start you may remember and all the wetness has delayed the growing cycle--an early frost this year would be a much more significant problem than would normally be the case. In the ag equipment business, the level of activity continues to be pretty high. Retail sales from one manufacturer that I talked to are running some 20 percent ahead of last year and because their inventories are reasonably low their production in the current quarter is running some 25 percent over last year. One manufacturer of construction equipment notes that business is up because equipment is being used in the cleanup after the flood.

With regard to inflation, I continue to be impressed by how restrained the price pressures seem to be. Many manufacturers say the cost of their outside purchases this year will increase by only 1 percent or even a little less. One large manufacturer that I talked to says that in fact they are going to have a reduction in their outside purchase prices and costs this year of about 1 percent. Virtually everybody we talk to--it's true for retailers and manufacturers--says that marketplace pressures are very, very tough and that there just aren't any signs of widespread price increases. On a somewhat continuing somber note, I think the line on this restraint on hiring that we keep hearing about is getting harder and harder with the passage of time. [Firms] just will not take on additional full-time employees, and they are continuing to rely on overtime and out-sourcing to deal with their increased production requirements. While out-sourcing does increase employment, at least in an indirect sense, it's not the same kind of employment increase that we've had in past cycles. And I must say this employment restraint has become something of an absolute mindset among a growing number of CEOs.

Turning to the national economy, the outlook is almost surprisingly unchanged, very much in line with the forecast that we developed at the time of the last meeting of the FOMC. I think that at this point the risks are about evenly balanced. But I must say it does seem like a pretty unexciting outlook. Thank you.

MR. ANGELL. Si, the late start on planting: Is that pretty universal throughout your District all the way from Iowa to Michigan?

MR. KEEHN. It's certainly true in Iowa, Wisconsin, and Michigan, not quite so much in Indiana. Indiana is going to have a good year, much better than they've had in the past.

MR. ANGELL. And Indiana had ample moisture?

MR. KEEHN. Yes. Production in Indiana looks good and they are delighted with the high prices.

MR. ANGELL. And Illinois, I presume, is like [the others]?

MR. KEEHN. Not as good as Indiana. It's between Iowa and [Laughter]--it should be obvious it's between Iowa and Indiana!

CHAIRMAN GREENSPAN. I'm delighted to hear Illinois hasn't moved! President Parry.

MR. PARRY. Thank you, Mr. Chairman. Economic activity in much of the Twelfth District clearly remains weaker than that for the nation as a whole. District employment fell at a 2 percent annual rate in June, marking the fourth consecutive monthly decline. The fall in employment was due largely to job losses in California and Washington. California has now completed three years of recession; between July 1990 and July 1993 the state lost 560,000 jobs, with 180,000 of those jobs lost during the last year. However, the July employment report was somewhat more encouraging. We did see an increase in California of 34,000 as far as payroll employment is concerned. But half of this increase was due to a rise in state and local government employment that is linked to unusual seasonal factors. Civilian employment also increased during July. However, there was a very large surge in the labor force and it caused the unemployment rate to rise from 9.1 to 9.8 percent. Despite the July report, already announced layoffs and reports from contacts suggest continued weakness in several sectors of the California economy. We believe that the state will bump along the bottom and remain a drag on District growth for the foreseeable future.

Conditions in the state of Washington are also of concern, particularly in the Puget Sound area. Recent employment reports for the state have been disappointing; for June employment in the state actually fell at an annualized rate of 5.7 percent. Significant losses were seen in manufacturing, construction, and trade. In aerospace, employment has fallen 7.4 percent over the past year, largely as a result of cutbacks by Boeing. In addition, recent reports suggest that Boeing may cut its production more than called for by currently published plans.

Conditions in the rest of the District are mixed, with robust conditions in the inter-mountain states and flat or sluggish conditions elsewhere. A depressed visitor industry has stalled the Hawaiian economy. In contrast, the Nevada boom continues. Three major hotel projects will add 10,000 rooms in Las Vegas this coming winter to the existing stock of 76,000 rooms. Construction jobs in Nevada are up 20 percent over the past year.

Turning to the national economy, although one could certainly quibble with specific numbers in the Greenbook forecast, I think the basic message of moderate growth is certainly the most likely outcome over the next year and a half. I'd have to admit, though, that I'm a bit more optimistic about inflation than is the Greenbook. We have had three consecutive months of very low inflation, which is consistent with the view that a good part of the inflation scare that we had earlier this year was an aberration. And given the current slack in labor markets and also the prospects for continued moderate economic growth, it seems to me that inflation could come in a bit lower than is shown in the Greenbook. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Well, I think my report will be a little happier than Bob Parry's, Mr. Chairman.

MR. PARRY. That shouldn't be hard!

MR. FORRESTAL. Except for Nevada! Having said that, though, growth in the Sixth District is continuing to decelerate. Our expansion is still leading the nation but we anticipate that the margin will narrow, with the possible exception of Georgia. We're estimating that at the end of July the unemployment rate for the District was just under 6 percent; but at the same time our survey of manufacturing plants in the District suggests that little or no growth in employment is likely to occur over the next six months. In fact, the survey actually shows a decline, but we think there are some seasonal factors in there. But the clear message is that manufacturers just are not looking to add employees at all. The survey also suggests that production was weak in July even after taking account of what likely were seasonal declines in activity.

The areas of strength that we're continuing to see in the Sixth District have been in retail sales, particularly in durables, and in new orders for exports, although exports are not a major part of our District output mix. The strength in durables comes basically from good activity in single-family housing. While the pace of sales flattened in some areas in July, it was well ahead of healthy year-ago levels. The inventories of unsold new homes have been shrinking so new building has been quite brisk. The inventory situation has caused resales to do better and contract prices have started to rise in several places around the District. The multifamily sector is still stalled, but there has been some improvement in absorption.

Just to tick off a couple of particular areas of activity in the District, the Atlanta metro area is now beginning to see the first effects of the upcoming Olympics. The contracts for a couple of venues have now been let and some of the construction will begin soon. Also, office space absorption in the first half of this year was twice as high as [observers] had expected. Facilities and infra-structure building are continuing to add to employment.

On the negative side, base closings in Florida, which is our most populous state, continue to exert a negative pull on that state's economy. The pressures on state budgets are moderating, but this is largely due to special factors, particularly gambling [activity]. Gambling is adding significantly to the coffers in Mississippi. And as you may have read, Georgia has just started a lottery and the lottery ticket sales have been running well ahead of expectations. I'm not sure that's the most desirable kind of economic activity to have, but there it is. Higher natural gas prices have increased the rig count in Louisiana and they're helping that state considerably. Unlike the Midwest we've been experiencing drought; and in many areas in the Southeast that's hurting agriculture, although again that's a relatively small factor in our output mix.

So, on balance, conditions are reasonably good as they have been for some time. Concerns that I hear basically relate more to the national and international areas than to the District. Some of the

uncertainty surrounding the budget process has been removed with the passage of the legislation. But there still is a good deal of concern about the health [care] program and the costs that may be coming along in conjunction with that. There's also, interestingly, a great deal of concern about the NAFTA legislation--there's a good deal of support for NAFTA in the District--and that there may be some difficulty with passage in the Congress.

Looking at the national picture, our outlook for 1993 is the same as the Greenbook's. But we do see stronger real GDP and employment growth in 1994. We're estimating that business will start to add labor in the months ahead as some of these public policy uncertainties unwind and current staffing levels become too tight. I think that's got to be a gambling type of forecast because we certainly don't hear very much about employment gains. But the view of our staff is that there's going to come a point when business will simply not be able to continue with present levels of temporary employees and overtime. We have pretty much the same outlook for inflation on average, though upward pressures begin to emerge near the end of the forecast horizon. It seems clear to me that many of the fundamentals are in place for a continuation of the expansion. And that will take up some of the slack in the economy and perhaps move the expansion above potential at least for a while.

I think, though, that there are uncertainties surrounding the outlook. On the positive side, I certainly feel a little more comfortable about the European situation. I think their recovery will occur a little sooner than we had expected. Also, the recent declines in long-term interest rates will certainly be beneficial. On the negative side, we have the continuing uncertainties surrounding consumer and business attitudes growing out of the health care program and perhaps continuing contentious debate about the budget. But the major concern that I hear relating to uncertainty is that federal spending may not be cut as much as had been hoped and that the initiatives will end up being funded by indirect taxes on business payrolls. It's difficult to assess the net impact of all these factors, but I am a little concerned--or maybe more than a little concerned--that the forecast for real GDP this year has fallen by almost a full percentage point since our March meeting. And the Board staff estimate for 1994 has now been reduced by an additional 1/2 percentage point since then. So, in conclusion, I'm concerned that the risks to the forecast are that growth will remain sluggish for longer than we anticipate and that unemployment will continue to be at unacceptably high levels. Thank you.

MR. PRELL. Mr. Chairman, might I just add something? An earlier comment--the comment about the medical expenses--raises an interesting point. One of the major savings on the mandatory spending side is the cuts in Medicare and Medicaid costs. Economically one would anticipate a lot of cost shifting here, which might call into question exactly how one wants to view the quality of this expenditure reduction. There are also some user fees, things like the FCC auction expectations and so on; but I think that medical cost issue is a very big one, looking back.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. The District economy continues to muddle along. I could almost ditto my comments of a month or so ago. The pattern is essentially the same: sluggish manufacturing, soft retail sales, some improvement in residential construction, nonresidential in a deep hole, and slow employment growth. This attitude of not adding workers if we don't have to is very strong. Wage increases are probably in the 4 to 4-1/2 percent range; that is what one hears from most companies in the area.

On the national level, I think the moderate growth theme is the right one; 2-1/2 percent is the number if one wants to pinpoint it. It's hard to see major risks that would cause a significant break-out on the up side. Likewise, it's hard to see a break-out on the down side that would cause a cumulative downturn. Nonetheless, we have had this pattern, as Bob Forrestal just pointed out, of starting out the year more optimistically and then scaling down our growth forecasts. I think there is a business attitude that if you have a good quarter, you take it but you don't think it's going to continue at that pace; and if you have a bad quarter, you say well, maybe we ought to scale down the forecast. While we're not talking about major risks on either side, I suspect that if we're wrong we may have somewhat more sluggish economic growth. On inflation I think the numbers that we are seeing now do understate the underlying rate of inflation just as the numbers earlier in the year overstated it. My sense is that we're not likely to see an acceleration of inflation from the underlying fundamentals just as I doubt that we'll see much of a deceleration. I think we just are kind of stuck where we are with inflation. So, it's pretty much a no change, unexciting, and not particularly satisfying outlook.

CHAIRMAN GREENSPAN. President Broadus.

MR. BROADDUS. Thank you, Mr. Chairman. Regarding our District, there really hasn't been much change in our region either, like many other regions in the reports so far. Growth seems to be continuing at a relatively moderate pace overall. We are experiencing the same strengthening in housing activity that, at least from the Beigebook reports, I take it may be occurring in some other parts of the country, although I guess it doesn't conform very well with the figure you reported earlier, Mike. Also, tourist activity in our region has been very, very strong especially along the coast in recent weeks. Despite this auto episode, Mr. Chairman, the mood of most of our business contacts is less optimistic now than it was even as recently as the July meeting. I think people are worried about the tax increase that now definitely will be coming. If anything, they may even be more worried about what the health care reform package, when we get it, will do to them. And I think these concerns are clearly having a negative impact on economic activity, especially on employment in our region; that has been happening for some time. But it strikes me that, if anything, that negative may have intensified most recently.

As far as the national economy is concerned, I wouldn't argue with the Greenbook's real GDP projections at this point. Initially when I saw the 2.3 percent annual rate of growth in real GDP that you're projecting for the second half of the year, Mike, it struck me as a little on the low side in light of the strong final demand in the second quarter, the evidence of at least some strength in housing, and

the nice sharp decline in long-term interest rates. But the negative attitudes that the budget package has fostered, as I said a minute ago, are very real; and I don't think there's any doubt that it could put a significant drag on the economy in the months ahead. So, 2.3 percent growth strikes me as reasonable at this point. If I had to guess, I would say the risks may be just slightly on the up side but not very much.

Now, having said all of this about real economic activity, let me just say that I think the most important development since our last meeting has been on the inflation and interest rate fronts. It may well be that the recent price data are overstating the progress we're making, but I'm at least somewhat encouraged by what I've seen. Core CPI has risen at an annual rate of about 2-1/2 percent over the last five months, which is a pretty good hunk of time. And with the July figure, the annualized rate of increase in the core CPI so far in 1993 for the first time has dropped a little below the 1992 rate. Again, it may overstate the progress we're making but, as I think Bob Parry suggested, it strikes me that while we can't be sure yet we may finally be making some progress toward bringing the longer-term trend inflation rate down.

The other positive, and I think clearly related, development is the nice decline we've had recently in long-term interest rates. As I recall the projections that were made back at the beginning of the year, the consensus forecast for the 30-year bond rate was about 7-1/2 percent; and I don't believe anybody was looking for anything as low as 6-1/2 percent, where we are now. Clearly, the budget package has played a role in this either because of its prospective deficit reduction or maybe because people think it's going to knock the heck out of the economy. But whatever contribution the fiscal side has made in bringing long-term rates down, I think there's a good chance that our recent monetary policy actions and statements have also played at least an equal role, or perhaps even a greater role. The news of a tilt toward tightness at the May meeting, and the overall tone or emphasis of your comments at the Humphrey-Hawkins meeting, Mr. Chairman, I think have sent strong signals to the markets and to the public that, whatever may have happened in the past, this time around we are quite serious about keeping inflation under control as the recovery proceeds. So, in short, I think we've bought some additional credibility recently, and I think that has contributed significantly to the rally in the bond market. I would hope that with policy we won't do anything to reverse that progress because it strikes me that the improved financial conditions are probably the main thing the economy has going for it right now. Thank you.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. Well, similar to many other places, I'd say that the region's economy continues to muddle along; it's not accelerating but it's not slowing either. The only thing that is really strong--and this is a comment some other people have made--is the lottery industry and the gambling industry. In fact, you have to be an Indian tribe to have an operating permit. This has started a new cottage industry among bankruptcy lawyers who, fortunately, now are finding lots of work in trying to determine how many people are required to declare a separate tribe so you can get a

franchise to build a casino--I'm not kidding--because it really is an extraordinary license.

Our pattern is very similar to the country as a whole in the sense that the retail sector is mixed. It's not collapsing; inventories seem pretty good and there's very little price pressure. We talk to retailers and they're poised to try to increase margins but then complain that they can't. They say they have to increase margins at some point, but they haven't been able to do so. The manufacturing sector depends very much on the product line. I had a little concern from a regional perspective regarding the sectors that have been strong for us because we have a fair number of companies that supply the auto industry. They've done quite well, but obviously the outlook for auto sales influences that. Also, our computer companies, while not doing as well as those in some other parts of the country, are starting to see improvement. With regard to this funny situation between measuring output and [unintelligible] inputs, I was just looking at the data that we produce for regional production measures. And we see the computer [measure] is coming up; their employment is going down sharply and their revenues do not look terribly good, but there are more and more "mips" being produced out there. At some point one starts to wonder about how homogenous mips are, whether they are a good deflator for this whole [industry], and how much more output there is in fact. I just wonder how much of the dramatic increase we saw in producers' durable equipment, in computers particularly, is very heavily influenced by this measurement question on what is being produced. People in high-tech industries--instruments, medical equipment and the like--are expressing continued concerns about foreign sales, including some new signs of softness in the U.K., which a couple of companies talked about. Housing, as other people have commented, has improved; actually, it has improved a fair bit in New England. We see at least some firming of prices even in the second home industry.

In the financial sector, banks are starting to see some slight improvement--an upward trend in business lending and some improvement on the consumer side. The mutual fund industry continues to see very, very strong inflows and there is continued nervousness about where they're going to put the money. Harkening back to a comment Gretchen made about hedges in the foreign exchange market, in the institutional funds a lot of people are talking about having found inefficiencies in spreads in the overseas markets compared to the U.S. market--for example, looking at dollar-denominated versus pound-denominated GMAC paper--and are going heavily into those investments. They are doing the same thing in some of the other markets and then hedging heavily. Now, of course, we'll see how effective these hedges are, but people are talking about just enormous flows in that area. Consistent with what other people also have said, we've had a very, very good year for tourism, the best probably in four or five years. Some of this is weather-related. An explanation is that tourists prefer to drive when there is uncertainty.

CHAIRMAN GREENSPAN. You even got the President of the United States in your District!

MR. SYRON. That's right. He has not been welcomed with open arms by many of the people in Martha's Vineyard, but it's a unique place! But the way that most people are looking at it is that at

least it's an island, so they spin off from the rest of the region. The interesting thing is that President Bush's area of Kennebunkport, Maine draws more heavily now than when he was President in terms of a President-related tourism aspect. People--this is very, very micro--are less frightened about going there because they think it won't be as big a hassle. That area is actually busier now, selling T-shirts and all that stuff, than before.

As far as the U.S. economy goes, I think the Greenbook has it pretty much right. I would think that the risks are pretty balanced the way the Greenbook has it. I'm not sure that I'd put exactly the same weight on the consequences if we are right on one side or the other. But in terms of the likelihood of what is going to happen, I think it's about right. In terms of going forward now, no matter which side, an awful lot comes down to this question of what happens to employment and to incomes. That's because there is a question of how much longer we can continue seeing good consumption without the growth rate in incomes. This is the sort of tension that goes along, and history will see how it resolves itself.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Thank you, Mr. Chairman. In the Tenth District the economy, as I say every time, continues to grow modestly. Retail sales seem to be holding up. Construction activity has so far been strong; this strength is primarily focused, though, on the residential area. Oil and gas drilling has picked up in the past and that's primarily due to the gas portion of that industry. Coal output in Wyoming has slowed, though, primarily because of the transportation problems in getting that coal to the Midwest and South. There has been some interruption there but it should be very temporary since inventories are down. Manufacturing activity remains quite sluggish. We've seen some continuing drop-off in jobs in that sector just as we've seen nationally. The effect of the flooding is likely to reduce crop output in our area in Nebraska, Missouri, and a little in Kansas particularly in corn and soybeans; but there's not much effect on the wheat crop as we see it right now. On the whole, prospects in agriculture should remain healthy despite this reduction in crops because of price effects. Construction activity should remain good, focused on housing. We have one matter [of concern] in the Denver area. That airport has about 13,000 infrastructure jobs; the work is to be finished [soon] and they have to out-place that. And of course the vacancy rate in Denver, while improved, is still rather substantial, so I think they'll have a bit of a transition issue in that area. We also think that our natural gas drilling activity should remain fairly good. But as far as manufacturing goes, we see no real signs of strength except perhaps with the auto plants that should be at full capacity. Generally, manufacturing is very weak in our area.

At the national level, as I've heard many others say here, we are revising our estimates down; we are a little more optimistic than the Greenbook but not enough to matter. And we see inflation in check, but we are not of the mind that it's improving very significantly; we're still looking at around the 3 percent range. Slack in the economy, though, should keep inflation at least not worsening. And the outlook for growth in 1994 continues to look very modest to us. In one sense the uncertainty has changed from what the



fiscal package will be to what the effects of the fiscal package will be and then we add on health care [uncertainty] to that. So we see a very uncertain future and pretty modest growth going on into 1994.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. As far as the regional economy is concerned, it remains reasonably healthy, which is the report I have been providing for quite some time now. In general, construction is quite strong; retail sales are pretty good; manufacturing is mixed; tourism, at least in the western part of the District, has been strong. We did run a special survey of about 100 bankers in the areas of the District affected by the floods. I guess it's reassuring to report that they didn't have anything very startling to say in the sense that while crop losses in some cases are substantial, they are not expecting major spillover effects on economic activity.

CHAIRMAN GREENSPAN. Spillover!

MR. STERN. Yes, spillover. I'm glad you picked up on that; I was waiting for somebody to do that. They were not expecting major spillover effects in many other areas of economic activity. And, of course, we may get a little subsequent stimulus down the road from rebuilding and so forth.

With regard to the national economy, we have been debating whether this sort of "slow motion" recovery was going to accelerate and turn into more rapid growth; that debate is continuing at least internally. But for the moment I have concluded, as I have in the past, that the Greenbook has it about right. That is, I don't see the seeds of an acceleration in place. So I think this very modest expansion at the national level is likely to continue and, therefore, I find myself in agreement with what I guess is the consensus. As far as inflation is concerned, maybe in part because of the publicity surrounding the asymmetric directive and your testimony or whatever, a lot of people have gone out of their way recently to tell me that they aren't seeing any inflationary pressures in their businesses at all. And some people have gone beyond that to report that they've tried to raise prices and haven't been able to make those increases stick. That suggests to me that people are still learning. They are willing to go out there and send letters to their customers that as of a certain date prices on certain lines are going up, and I guess what they tend to hear in response is that their customers will not accept these price increases and that they don't care what the underlying rationale may be. So, I conclude that people are still learning about the state of the markets and their inability to make price increases last, and that probably [augurs] well for the longer run.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Last month I said that the Eleventh District economy had weakened a little relative to the national economy, but that appears to have been temporary. Recent statistics in the District appear to be somewhat stronger, particularly employment growth, and the anecdotal information is somewhat more positive. We seem to be benefiting in some cases from weaknesses elsewhere in the country. For example, the Austin area seems to be gaining a good bit

of employment from firms either expanding out of or moving out of California. We hear a lot about mortgage refinancing; just about everybody in Texas who didn't buy a house in the mid '80s and is therefore still under water seems to be refinancing their mortgages, including myself. I was doing that several weeks ago but I had to drop out of the market following your Humphrey-Hawkins testimony; it brought my rate up a little bit.

CHAIRMAN GREENSPAN. Sorry about that!

MR. MCTEER. So if you'll hold off until next Monday I'll be grateful! [Laughter] Since I haven't taken much time, I thought you might like to hear about a couple of comments from our Beigebook respondents. California seems to be on the mind of a number of them. One told our research people that a company wanting to plant a tree in Los Angeles County has to get permission from 8 different agencies; to chop it down requires 47 permits. And in Dallas County you can do either one of those things without a permit. A local banker told one of our people that a client of his in north Los Angeles was so frustrated with water quality standards at his plant that he submitted plain tap water to be tested, and the water quality agency judged that the water was not fit to be dumped into the sewer system. Finally, we would appreciate your support of NAFTA--all of you; it's going to be close.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. As far as the District goes, we generally have been outperforming the nation during this expansion although in the latest three-month period employment growth has been a little worse than sluggish; we've had slight declines. I don't think there's much flood effect in that, however. What I might do is just make a few comments on the flood; St. Louis has really been the center of that. And as Si said, for those who are directly affected it's very devastating. But what is striking is the small percentage of the population that is actually affected; it's about 1 to 2 percent. In the Bank we have 800 employees and 6 or 8 families that are affected in some way, and I'd say that's quite representative. I think the assessment that the broad economic impact is going to be relatively narrow is on target. Clearly, there have been some crop losses and some disruption of jobs, but really very little. One of the main ongoing effects is going to be the impact on transportation. We've had roads washed out and it will be a long time before the barge traffic can move on the river. Basically what I hear from our directors and others is that [transportation problems] are adding to costs somewhat and it's a bit of a nuisance, but goods are basically getting moved. I think that will be with us for a while.

Like Gary Stern, we did a survey of banks. We basically picked the counties on either side of the river--the Mississippi, Missouri, and Illinois rivers--and talked to about 200 banks. They constitute about 10 percent of District banking assets; and 80 percent of those banks are less than \$100 million, so they are principally small banking operations. What struck me through the whole thing--and Gary touched on this--was how little disruption to operations occurred. We picked this up on the survey although it would not have been obvious from our own activities. Thirty-one banks had some disruption in operations--either carriers having difficulty getting in

or out or actually having to make other arrangements, such as having their deliveries made to other processing centers or otherwise moving their processing. And 19 facilities, either head offices or branches, were evacuated because of flooding. We hear concerns about liquidity --no pun intended--but there has been only one discount window loan, an adjustment credit loan, that was at all associated with flood-related problems that I'm aware of up to this point in time. The big uncertainty looking down the road really is on credit quality. But, again, I don't think that's going to be a significant factor even from a District perspective. I would say most of the banks are looking for less than a 10 percent impact in terms of their loan portfolios. And of the 200 we talked to there are roughly 25 that think the impact will be greater than 10 percent. There will be a few banks--and these would be basically ag banks in small towns where both the agricultural loans and the business loans in the community would be affected--that could have problems. But they are relatively small. In fact, all of those 25 banking organizations have \$50 million in total assets or less. We will stay in touch with this. In a sense, while the crisis has passed, I think we're dealing with the worst part of it right now in terms of the cleanup and rebuilding. And that will take some time.

On the national front, just a couple of comments: Similar to what Al said, I've been very pleased with how expectations with respect to policy have shifted without really trashing the markets. It wasn't too long ago when the expectation was that we were on a one-way street for lower rates [and we've moved] to a period now, I guess, where expectations are fairly balanced. But the Chairman made it pretty clear in his testimony that there is the possibility that they will be moving up, and that has been very well received, I would say. Done differently, one could imagine a good deal of short-term turmoil in the markets, which we really haven't had with that shift in expectations. Who knows how to sort it out, but there may be some beneficial impact, as Al observed, in the longer end of the market. The other thing that is extraordinary, particularly given the perception the last time around, is that the pressures on monetary policy emanating from a deficit reduction package have really been muted and well contained. And I think that's quite an accomplishment from the politicians and the press.

One of the things I have a little concern about is the fact that to some extent we are a bit at sea internally in terms of what we ought to be looking at. We've had problems with M2; we went through the Feinman/Porter [study]; we talked about an M2+; the Chairman mentioned real interest rates. And I think one of the things that we need to be careful not to do is to convey a lot of confusion in the central bank about what we ought to be doing. This is, and always has been, basically a judgmental matter; and I think the judgments have been very good during this period. To the extent that we roll out too many different possibilities in rapid succession, in terms of what we ought to be looking at, it's possible we could convey a sense of confusion about what we ought to be doing when in fact I think there's a lot of credibility associated with the Fed's actions. In particular--and I suspect to some extent, Alan, what you said was misinterpreted in this regard--the real interest rate [issue] caught a lot of attention. There was a sense that people would question if we can't really control it in the long run and all we can really observe is a proxy and we can't really observe real interest rates and we

don't know what at any point in time the right natural rate is, it's very hard to view that as a target. I don't think that is what you were suggesting. I think you were suggesting that there is information there and that we ought to use it, and I agree with that. But as we go through this period of thinking about what we ought to be looking at, we ought not get too far from the basics. We ought to focus on the tools of policy and what it is we affect--reserves, the base, and all the aggregates related to that. I won't say any more about it today, but I'm struck by that chart in the weekly Board briefings that relates the opportunity costs of M1 to its velocity and how that has tracked--how certain periods stand out, at least to the eye, where there have been inflection points in policy. There may be more information in M1 than we're willing to give it credit for.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Reports from businesses, large and small, and from banks in the Cleveland District continue to be good--better than they previously expected--[but they are] associated with a pessimistic outlook. There is this continuing tendency to feel that whatever good sales volumes, good backlogs, or earnings are being experienced are not going to be sustained. Maybe it's that people are unaccustomed in the Fourth District to performing what they perceive as better than other places in the country. Certainly what they read about other parts of the country is more negative than what they're feeling in our District. Agriculture is good; both corn and bean crops are good; what's important is better prices and good farm incomes for the third year in a row. So the banks in the ag regions are feeling that farm credit is in very good shape. Land prices are firm to rising; agricultural equipment sales are very strong both within the District and nationally; Si Keehn commented about that. The auto supply companies are doing quite well, though they are nervous about the outlook. They've had a much better year than they thought they were going to have but continue to worry about the future. Our small communities are quite strong. A lot of the smaller cities around the District would describe their conditions as bordering on a temporary boom for them; there's construction of single-family housing, shopping centers, and some government buildings. But also there is a belief that this is temporary [and they should] enjoy it while it lasts because [business conditions] are going to weaken in the future.

I formed a new Small Bank Advisory Council that had its first meeting last Friday. After they had a very extensive briefing on economic developments, including a variety of measures of inflation, various measures of money, narrow and broad, nominal and real interest rates, credit flows and so on, I asked them to characterize monetary policy as they currently see it in view of the fiscal package and local conditions and what they're seeing in their banks. [Views] were about evenly split between those who said that they consider policy about right or too easy. Not a single banker was willing to characterize it as too tight. They consistently think inflation has already hit its low and is going to move up. We do feel we've had some success with both small banks and small businesses around the District in talking them into lowering their expectations about how much inflation is going to rise, especially as that feeds into their plans with regard to labor--their own salary budgets and their projections of what kind of increases they will be granting into 1994.

But they still [see inflation] in an upward direction from where it has been.

As far as the national outlook, I don't know whether the Greenbook forecast for inflation is a good forecast or not, but I do think it's unacceptable.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I've either been an academic all my life or else a government employee, so I've never had the opportunity to pay the kind of taxes that some people are going to pay. But--I have an example that's going around the table--I get my kicks either by buying lottery tickets when the pot gets really, really big or else figuring taxes for people who are very well endowed. What I'd like to do is to talk through briefly what the first quarter is going to look like for a self-employed business person who makes \$1 million. There are roughly 50,000 of these individuals in the country. If we reduce that to a half million dollars, we are talking about perhaps another 180,000 people, all of whom are in roughly this type of situation. The earnings for the first quarter for one making \$1 million a year are \$250,000. What is going to be due next April 15th are their first-quarter estimated taxes, which under the new bill will be \$92,000, and only one-third of the retroactive tax increase. The latter is a bit less than \$25,000; the total retroactive tax increase is on the order of \$74,000. And first-quarter FICA is about \$14,000. So, the total due on April 15th under the new tax bill will be \$131,000 out of the \$250,000 they will have earned in the first quarter. Now the thing I would point out--

MR. MULLINS. What about Medicare?

MR. LINDSEY. That's a part of the FICA.

MR. MULLINS. I wanted to make sure you had included that.

MR. LINDSEY. In the process of the tax bill, they got this interest-free loan provision in it so that on April 15, 1994 they would only owe one-third of their tax increase. Had that not been the case, these individuals would have owed roughly another \$50,000 on April 15th or another 20 percent of their first-quarter's income, meaning that they would have been working three-fourths of the first quarter of the year to pay their April 15th federal tax bill. There are no state income taxes in these calculations. Maybe the rich really are different, but anyone who has any kind of cash flow constraints at all and has to send 75 percent of his income to Uncle Sam I think would probably have been in an interesting situation April 15th. I think a lot of the pressure has backed off because of that one-third provision; it's a tiny little provision in the tax law, but it probably is going to help the economy quite a bit in the first and second quarters next year.

I did another calculation. Most people who go to accountants, of course, want to keep money in their own checking accounts and not give Uncle Sam an interest-free loan. You just have to pay 90 percent of your tax on an estimated basis. If that's true and you are rigorous about it, you will owe on April 15th \$151,000 instead of \$131,000 and that's 60 percent of your first-quarter

earnings. I think these are somewhat interesting numbers; I don't know how they're going to affect the small business sector. There is a lot of debate about it. Again, there's no behavior here or anything else; it's simply a cash flow issue.

My own personal anecdotal survey is that most people who are affected by the tax bill have underestimated how much they're going to pay. This millionaire, for example, will see federal taxes go up by 33 percent next year. Most people I've talked to figure their taxes are going to go up by 10 to 15 percent. I think a surprise of that magnitude next April 15th is something that may affect the economy.

Other than that, Mr. Chairman, I think the Greenbook has it about right.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Thank you, Mr. Chairman. I appreciate that tax instruction from Governor Lindsey, since I guess the date just passed for extensions!

CHAIRMAN GREENSPAN. I have a blind trust and I'm delighted!

MR. MULLINS. The thing I've noticed on the tax return is that box at the top where it says if you check this box \$1 will go to the presidential election campaign fund and it will not increase your taxes. I'd like them to take the rest of my taxes from wherever they get that! And the other provision I think we should have is that every Congressman should be required to fill out his or her own return to get the flavor for it.

I think the economy has been pretty well discussed, no pun intended. The '93 GDP has been revised down because the first half was weak. We had a weak second quarter, a weak first half. With growth in the first half at a rate of only a little over 1 percent, it's difficult to be too enthusiastic about this kind of performance. It looks a little better, maybe, if we average the fourth quarter with the first quarter and think of that as one. And it might look even better, although not so much on the Greenbook forecast, if we take the second quarter and the third quarter together, but I will withhold judgment on that. Certainly, when we look at the second quarter more closely, it is a more positive picture. Spending did hold up quite well. Despite all the talk about consumer pessimism, consumer spending advanced at almost a 4 percent annual pace; the personal saving rate dropped again. And we continue to hear the talk about business pessimism concerning spending and hiring. Business fixed investment advanced at a 13 percent annual rate in the second quarter amid this pessimism. And payroll employment, which I continue to hear is very weak, is running at a 2 million job pace for the year, double the number of jobs added last year, which in my view has to provide some measure of downside protection. Even if the jobs aren't great, the unemployment rate is almost a percentage point lower than it was last year at this time. It's 6.8 percent or 6.85 percent; and ex-California it's 6.4 percent but I guess that's unfair. The recent evidence on housing is a bit mixed, but on balance it suggests some acceleration in the housing expansion. The Mortgage Bankers Association survey of purchase mortgage applications is very positive as are homebuilders' assessments of current sales. Even though starts

were down a bit this morning, permits were up a bit; and it seems to me that for the first half of the year starts were up about 10 percent over last year.

So, I think the hard evidence is still consistent with moderate growth, and we've had six quarters [averaging] 2-1/2 percent. Nonetheless, there are perhaps a few clouds on the horizon or at least hints of haze that have appeared on the scene. The first is this auto story. We have had a little easing in the auto sales. And I think this is the first sign in hard spending data of perhaps something going on. Now, there is a special story--the inventory shortage. It's also true, as I think the staff has pointed out, that non-auto sales seem to have picked up if we look at the control category. I must admit that this is an extreme form of product substitution: If you can't find the car you're looking for, you buy a sofa.

CHAIRMAN GREENSPAN. As long as it's a convertible couch!  
[Laughter]

MR. MULLINS. I don't have to answer that! Still, I think the autoeasing may be the first sign of something going on. The other warning sign continues--

CHAIRMAN GREENSPAN. There is a question about the seasonalities in all these. If you look at patterns, it's clear.

MR. MULLINS. Yes. We've now had four or five consecutive reporting periods where auto sales have backed down a bit. I think there's enough noise going on and enough parts of the country under water and the like to take that too seriously. But before auto sales were a positive [factor]. People were buying cars and it was something that refuted concern. And this, it seems to me, is the one thing that has backed off a bit.

The other thing is that both consumer and business confidence continue to recede on surveys. What is new in the Michigan survey is that the decline is concentrated in consumers' assessments of current conditions, not vague fears about expected conditions which had propelled the earlier declines. Now, the current conditions index is still about 10 points above October of last year, but it had held up pretty firmly until very recently. When I total it up I still see self-sustaining momentum of moderate growth. And if the last six quarters were 2-1/2 percent, it seems to me it ought to average a bit stronger than that.

The fall in long rates should reinforce this momentum and should cushion, if not entirely offset, the fiscal drag. Another thing we haven't talked much about is that the deleveraging headwinds continue to diminish even to the extent that some have started to note--and we picked this up in a number of different settings--signs of the beginning of speculative excess in stock prices, especially the weak stocks. [We've seen] very low IPO volumes, the lowest in 15 years, low quality spreads on bonds, and very low spreads on junk bonds. And all of this has occurred without the realistic prospect of robust growth, which usually accompanies these sorts of developments. Some people also suggest, and it may be less likely in my view, that financial institutions' attitudes toward lending may have been easing up a bit. We can see things like land prices starting to get a little

better. We talked about this yesterday at the briefing. The Chairman pointed out that so far at least there is not a lot of evidence of net credit flows to fuel these speculative concerns. But I would point out that these factors do provide coincident indicators of easier conditions in the financial system.

With respect to inflation, I think there are two useful perspectives: the path of contemporaneous inflation and the medium- to longer-term outlook. With respect to contemporaneous inflation, what a difference a meeting makes! The last time I said the good news was that inflation had been low two out of the past three months; now it's four out of the past five months. As Al mentioned, the core CPI was 2.4 percent over the past five months compared with 4.6 percent over the previous five months. Inflation in that 10-month period since the end of the third quarter of last year is now 3-1/2 percent. This pattern of acceleration and deceleration over that period of a couple of quarters is also generally reflected in most of the broad-based inflation measures and even reflected in commodity prices, albeit over a different timeframe as you'd expect. And I think this is consistent with speed effects interacting with expectation effects. Indeed, I wonder whether speed effects are inherently "expectative;" it may not be two separate things going on there. If this is the good news, I think the bad news is that inflation apparently has settled down in the 3 to 3-1/2 percent range. That is somewhat higher, perhaps 1/2 percent or so higher, than we would have expected earlier this year; and that keeps alive this medium-term issue of the alignment of rates.

The Chairman said nothing about targeting real interest rates, and I would agree that they're not simply amenable to targeting. I think looking at real rates provides a rough conceptual framework which provides insight on some things, one could say, at the edges of it. When you look at that issue today you still see that rates look pretty low. The Board's staff has these simple models suggesting that short-term real rates are 2 to 3-1/2 percent below a neutral stance, where a neutral stance is defined as their estimate of the equilibrium real rate. One shouldn't ask about the standard errors!

MR. SYRON. Could you repeat that?

MR. MULLINS. Yes, they estimate real rates currently 2 to 3-1/2 percent--

MR. SYRON. Percent?

MR. MULLINS. Percentage points.

MR. SYRON. Yes, percentage points.

MR. MULLINS. --below their estimate of the equilibrium real short-term rate, which is currently zero.

MR. SYRON. Right.

MR. MULLINS. And they estimate the real short rate equilibrium may be 2 to 3-1/2 percent--with a standard error of 5 percentage points! [Laughter]



CHAIRMAN GREENSPAN. There's a concept which is credible for long-term real rates, which are stable. There is not one for short-term rates. In other words there's a cyclical characteristic--

MR. MULLINS. Which has shifted it around. I would not suggest that there's any precision here. I think it does suggest that by historical standards rates continue to look pretty low. With the possibility of some net fiscal drag from the budget deal, even net of the lower long rates, a stance on the accommodative side of neutral seems not inappropriate. The question is how accommodative and to what extent we might be asking for trouble down the road. Certainly, since inflation has receded there's no evidence of harm currently--no compelling evidence of damage yet, of building pressures of credit flows gathering momentum even though we might have some of these speculative excesses in financial asset pricing. Still, the absence of currently observable pressures doesn't give me too much comfort [given] the policy lags. We saw how quickly slack can disappear in the second half of last year. And once the pressures are truly observable and supported by fundamentals, it's pretty late in the game, requiring more precipitous adjustments and risks and economic adjustments as well.

So, looking to the medium term, I still think it's in everyone's interest to achieve a sustainable stance, one which supports economic growth but does not seem destined to require substantial adjustment timed with flawless precision to avoid instability. I think we're good, but I wonder how good we are in timing that. We may be very, very fortunate and back into such a decision if inflation continues to collapse. I think more likely than not we have a bit of work ahead of us. Now, overall, I do think this episode has been useful and quite successful. I don't know that I would go so far as to suggest that the upturn in inflation has yielded to the stinging lash of an asymmetric directive. That may be a little extreme. However, I do think we've educated the markets here; one need only read the assessments of economists and market participants and perhaps look at the record low 30-year implied forward rates to demonstrate that we've educated the market. It may strain credibility to suggest we've educated the political system; I wouldn't suggest that. We may have made some inroads there as well, though; at least the message has been delivered. All involved seem to have a better understanding of the Fed's attitude toward inflation, our commitment to price stability; they understand that we do not find 3-1/2 to 4 percent inflation acceptable. Even though no shots were actually fired, I think we laid down some useful groundwork in this episode.

I'd just close by saying that it may be a bit more tricky in the months ahead. The upturn in inflation and our response, as Tom mentioned, likely preempted talk and expectations of Fed ease to offset the budget deal. With inflation now "under control" at 3-1/2 percent, a very weak first half, and a budget deal enacted in law, I feel that sort of talk is likely to emerge. I've already heard some talk about monetary gridlock: The Fed on hold for a year while the economy inches along. While Congress and the Administration have done their part, some may look to us now. So with the backdrop of an already very accommodative stance in my view, looking medium term the risk is that that may entail [difficulties] down the road. And with a new cloud or two drifting onto the economic horizon, I safely predict an interesting period ahead.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I don't often find myself counterpoised against Governor Mullins and I run the risk, I think, of sounding like a broken record here, but I continue to hear the term fiscal drag around the table. My inclination would be to change that a bit to either fiscal anchor or maybe fiscal torpedo. It seems to me that tax increases of the magnitude we're talking about, which are not confined to the wealthy--and Larry has indicated here what the effects can be on, let's say, a subchapter S individual who has a healthy income--and spending cuts of the magnitude we're talking about, if realized, will displace a lot of workers for long periods of time and some perhaps permanently. Corporate restructuring continues and I think it may be even at an accelerated pace now and in the near future. The consumer confidence indexes, as we've all noted, continue their downward trend. And logic says that that set of conditions may inhibit consumer spending, although we have not seen startling evidence of that yet. But after all, the budget compromise is only a couple of weeks old. And certainly there are indications that it is at least causing the postponement of some business investment; and certainly business hiring is being diverted into temporary types of help instead of permanent employment. I continue to believe that those conditions will develop further as the full implications of the budget agreement are realized on a broader scale. At the same time, the health care discussions thus far seem to telegraph further costs both to businesses and to employees. And there seems to be a growing concern over the full implications for employment and investment inherent in the North American Free Trade Agreement.

In that [environment], I still think the risks to the economy are shifting toward the down side as uncertainties [abound]. We all accept, I think, that uncertainty inevitably inhibits growth. In that context a more symmetrical approach to monetary policy would seem to be logical but I'm not suggesting or recommending that simply because I think a shift in our policy at this time could create a very negative signal and one that might send things going in the wrong direction. But I am convinced that we are at a juncture here where the full implications of all of these major programs could be inhibiting [economic growth] to a much greater extent than is currently indicated by the data that we're looking at.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Well, Mr. Chairman, it seems to me that I'm in the consensus that I'm hearing around the table this morning. We've been for a long time taking two steps forward and one step back and that seems to continue. Some of the head winds we've been sailing into are diminishing: Real estate is beginning to stabilize; banks are strong again and seem to want to lend; deleveraging is slowing down. Some of the head winds continue: The foreign economies continue weak; defense spending continues to go down. There are favorable and unfavorable new factors. We've had a lowering of long-term interest rates for some time, but one could call it a new factor that it has gone into this very dynamic phase in the last several months. I think an important favorable factor is that the budget fight is simply over. Never mind how it came out; it's settled. I think that's going to help a lot. On the negative side, of course, is the fact that that budget deal contains some very serious taxes, as

we've heard here in the last few minutes. We've had some very good news and some disappointing news. The very good news is that more and more it seems that last winter's inflation surge was temporary. I've now learned that the new danger I didn't know about before is called "speed" effect. And there has been some disappointing news in the sense that, at least in my case, I expected real economic activity to improve more quickly and strongly than it has. So, the realities don't seem to me to have changed much. However slowly and torturously, the economy does continue to improve. Inflation now seems to be trendless, albeit at much too high a level. So, for the moment at least, I guess I would summarize by saying: Have a nice vacation. We're going to have work to do very soon, I'm sure.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, the economy of the Second District has weakened slightly in recent weeks and probably can best be described as bumping along a trough. The passage of the budget deficit bill following the military base closings in June is likely to add further downward pressure in coming months. The labor markets have been weak. Employment in the state of New York declined by 14,000 jobs in June, and 51,000 jobs were shed in New Jersey. In New York there were declines in manufacturing employment but in New Jersey they were spread throughout the whole economy. Retail sales have been very mixed. Some firms at the lower end of the market in prices have been doing rather well and the firms selling higher ticket items have been doing rather poorly. The budget bill is going to affect the Second District fairly negatively. A lot of our neighbors, especially those in lower Manhattan, make a great deal of money and would fit into Governor Lindsey's explanation. In addition, the cuts on top of the base closings in the bill especially affect New York, New Jersey, and Connecticut. So, the rather negative tone in the area is made somewhat worse by recent developments.

At the national level, we believe that the Greenbook forecast is essentially right on. The only area in which we in fact agree with the analysis but [where] I am somewhat concerned is that the strength for the export markets seen in Japan and in Europe may be slightly overstated. I think the political leadership in Japan is going to concentrate almost exclusively on electoral reform and do very little about the economy. And it's very difficult to exaggerate the degree of political dismay in Europe. Although I think the forecast for those economies in the Greenbook is the best bet, if there's any risk to it, I think the risk is that [the forecast] is overstated; and that could mean that our net exports would be even a bit weaker. The offset is that there would be some reduction in price pressures.

In market developments, I think it's fascinating that the 2- to 30-year spread as of the close yesterday was 235 basis points whereas for a very long time the spread was about 3 full percentage points. If this spread reflects inflationary expectations, we must ask what has reduced them. It's very difficult for me to see that the deficit reduction bill in and of itself reduced them significantly in the recent past. There certainly was at least in some quarters a breath of relief that the perils of Pauline had ended and the lady had been rescued from the railroad track and that the bill had passed. But the economic effects of the bill had been largely discounted. I

believe quite firmly that the reduction in the spread has come from two factors: One, the general expectation that economic growth will be moderate; but perhaps more importantly the move to an asymmetric directive on the part of this Committee and the recent Humphrey-Hawkins testimony. Even though we had a hiccup in rates after both events hit the news, once the market absorbed the significance of the actions of this Committee I think there has been a positive effect on the level of interest rates and on the yield curve and that we have had a very useful educational effect on inflationary expectations. Such expectations are essentially psychological and the fact that an asymmetric directive and the Humphrey-Hawkins testimony are also largely psychological has in my view been a very important and constructive offsetting effect. We've done some work at the New York Bank on the comparison between real interest rates at the present time and at a similar point in history, which was August of 1977. At that [earlier] time the real fed funds rate was zero or, if one wants to be exact, -0.2 percent. But other real interest rates were considerably lower. Although the core inflation rate at the time was 6.2 percent, the average prime rate for the month was 6.8 percent. Now, we have a core inflation rate of, let's say, 3.3 percent with the prime rate at 6 percent. And as you go out further on the yield curve, the real interest rates at the present time are considerably higher than they were then. That, I think, has two effects. One, it contributes to an explanation on top of the feel of both households and corporations that they should restructure their balance sheets. They have to note that the effect of taking on debt is quite expensive in real terms, and that would be another factor in the relatively slow growth. On the other hand, it still indicates that inflationary expectations are a great deal higher than I believe this Committee should find acceptable or satisfactory. So if there is some educational effort that we've been engaged in--and rather successfully in recent months--it would indicate that there are some educational efforts still lying ahead of us.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Well, I think I'm about in the middle here; we certainly are seeing slow or moderate growth no matter how we slice it. The labor market is seeing some improvement, but really only slightly more than handling the demographics. And the quality of much of that job growth has not been that good. Restructuring is clearly continuing. Consumer confidence, I think, is taking its toll. We're seeing hesitant consumers and the confidence problems spreading to the business sector with hesitance in some investment patterns. As for potential home owners, we've not seen as much growth in the housing sector as I think the fundamentals would suggest. Weak international trading partners, the defense downsizing, the deficits--federal and state--are going to continue to be a drag. We haven't talked as much around the table today about the state deficit problems, but we may be hearing more about that in the upcoming quarter. Then, of course, there's the realization of the budget package now that it has been passed. As Larry has demonstrated, people are now really going to be understanding what that tax package meant. And, of course, we still have to work through the flood problems and we still have health care on the horizon. So, a lot of these factors are contributing to the outlook for slow growth.

Now, having said that, we shouldn't forget or miss that there are some strengths in the economy that could bode well for the long run. The financial markets are really reasonably strong: The equity market is strong; the bond market is strong. Banks are in better shape and individual balance sheets are in better shape. There is at least a focus on trying to solve the deficit problem. I can't say that I'm all that confident that the current package is the thing that's going to solve it, but at least there seems to be a focus on the fact that something needs to be done about it.

We do have a number of anomalies that I think we're going to have to address over the coming months. There is this question of productivity. I haven't heard it mentioned today, but the fall-off in productivity in the first half of this year seems anomalous to me, given all of the downsizing and the focus on efficiency. I don't know if this is a bad harbinger or if it's going to go away. The persistence of low real interest rates, at least short-term real interest rates, doesn't seem like something that can continue forever. That can't be a stable situation. The weakness of the dollar is another anomalous situation. Certainly M2 remains another anomaly. I, like Tom, am a bit uncomfortable that we don't have a clear focus for monetary policy. So, I hope that we will continue to work our way toward trying to define what is happening to M2 and how long these temporary factors are going to be temporary. Maybe inflation fits into the category of an anomaly. I've certainly been more encouraged by the recent news--the fact that in this most recent inflation report the last 12-month core inflation number is lower than the previous 12-month number. So, there is still a possibility of making some progress, but we shouldn't think that the progress is going to be anywhere near as good as it has been in the last year or so. I don't see the possibility of a big outbreak of inflation. The usual indicia are simply not present: We don't see an overheated economy; cost-push pressures aren't significant, if you look at the slack in labor markets; we're not importing inflation; people aren't rushing to convert to real assets. So, I'm a little more encouraged on inflation. But, again, if we in fact are settling into this 3 to 3-1/2 percent range, we can't be satisfied with that. So, we may still have some work ahead of us.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. In the global economy, prices and interest rates do adjust depending upon conditions that exist throughout the entire world market. The one price that doesn't really move based upon global economic conditions is the fed funds rate because we at the Federal Reserve decide exactly what it will be. And the question can be whether or not the rate that's chosen is in equilibrium with other rates throughout the global market system. Six months ago it did appear quite likely that the rate of inflation for [1993] would be just exactly where it appears it is today. I think those of us that made [forecasts] around that median for the group of about 3.2 percent inflation [thought] that didn't look too bad then [and it] doesn't look too bad now. I never believed at the worst of the conditions in March that the rate of inflation for [1993] was going to accelerate. It just seemed to me that we were in a circumstance in which global forces were somewhat favorable in regard to a decelerating inflation rate in the United States and that the United States in [1993] should have been poised for a continued disinflation. I thought that we

should have ended up in [1993], conditions being ideal, with an inflation rate around 2-1/2 percent December-over-December. That has not happened and we now find ourselves in a position where, unlike March and May and maybe even July, it just would not make any sense for us to make an immediate change in the fed funds rate given the market conditions as they are today.

Certainly, I would agree with Al Broaddus and Bill McDonough and others who expressed the view that our posturing, particularly summarized by the Chairman's Humphrey-Hawkins testimony, has indeed worked very well for those of us who have a pragmatic inclination. That is, look at the bond market and see what has happened. It has really been an ideal arrangement, one which I think all of us have been concerned about as we brought rates down during the recession and slow recovery period. The reason we wanted to be slow in bringing rates down is because we understood that bringing rates down as fast as the market wanted would give us adverse effects on long-term and intermediate interest rates, and recovery would be slower rather than faster. So, I think it is always good news when things work out better than one might have expected. I think that posturing was beneficial and I share Bill McDonough's view that if it's not broke, maybe we ought not try to fix it.

But I do believe that there are some out-of-equilibrium risks that exist for us and that we ought to be conscious of them as we go forward. First of all, most of our studies of commodity prices show very clearly that the true pass-through effects in regard to the CPI and the PPI were clearly driven by oil; that is, using U.S. consumption weights to determine the right weighting on commodity prices gives us something like a 55 percent weight on oil prices on our commodity experimental index. Not all is due to monetary policy; we're in a favorable period in regard to oil prices and that provides a wonderful window for possible further disinflation. That window may not be open forever; just as oil prices sometimes get down toward the \$16 or \$15 range, we've noticed they tend to shift back up. So the prospects of somewhat higher oil prices could be somewhat upsetting in regard to future inflation, but I don't think that exists for the remainder of [1993]. Another probably more immediate worrisome out-of-equilibrium condition would be seen particularly in the dramatic change in the exchange value of the yen versus the dollar over the last year. Think about a 20 percent appreciation of the yen. It's sort of like when [a team] gets down to the final four: It doesn't make much difference how well it performed against the also-rans; it doesn't make much difference how it performed in December when it was playing those state colleges that almost paid money to come and play at your university. We are in competition, of course, with the Japanese yen as a reserve currency. We certainly lead the way in that regard. But if we take the G-3 countries plus Switzerland and look at their PPIS year-over-year, all of these countries but the United States have negative PPIS year-over-year. That is, Germany's PPI is lower than it was 12 months ago; Japan's PPI is lower than it was 12 months ago; Switzerland's PPI is about exactly where it was 12 months ago; and our PPI--I didn't look recently but I assume--is around 1.3 percentage points higher than a year ago. So there are some questions. And it seems to me that if there's any kind of edge of a cliff, it's the edge of a cliff in regard to the prospect for the soundness of the dollar versus the yen whereby the world not only doesn't know what the price of yen in terms of dollars might be next

month but many might say, if asked what it would be 5 or 10 years in the future, that there is a general expectation that the rate might favor being in yen assets versus being in dollar assets. Clearly our short-term interest rates do not provide reasonable compensation for that expectation and that kind of change.

Productivity has been a real puzzle for me. Clearly, if your forecast gets really thrown awry you say it's a puzzle; and part of my real economic forecast for [1993] has certainly missed the mark. I really just don't understand productivity. I don't understand how we can have a decline in productivity for the business sector of 1-1/2 and 2-1/2 percent two quarters in a row when productivity in manufacturing has been rising at 4-1/2 to 5 percent! Somebody really is doing very, very poorly; and if anyone knows who it is--who is really snuffing on the job--they haven't been spotted yet. So, that is indeed a real puzzle.

Over time, the battle against inflation is sometimes a battle of technology; whether technology will keep up is a question in the very, very expanding world. I [don't] want to sound too Malthusian because Malthus I think forgot or did not really understand how equilibrium price adjustments can take place to forestall what he would call such dismal outcomes. But when we noticed that the world's oceans finally produced less fish last year than they did the previous year, we knew something was going on. We have a lot of technology in regard to harvesting fish and that technology has been used by a lot of people. And it has interested me to note that fish prices of some of the good fish catches--I mean cod, salmon, and so forth--are relatively high at the grocery store. And yet I thought it was interesting to note that the value of all the fish harvested in the world was less than the cost of production, which is a rather interesting phenomenon. This doesn't tell us that we're going to run out of fish because we do know that aquaculture and other techniques will enable us to provide the demand that's there. But we will not do it at the same price that is occurring when we're doing some harvesting. I noticed that with all the attention paid to the floods in the Mississippi Valley and the entire region, there has been a lot of talk about corn production and soybean production, which I think is probably a pretty minor event, but very little talk about all that soil that went down the river.

Now, over the years as China enters [the global economy] and continues double-digit economic growth with a billion people and as the world makes more and more demands upon resources, we will have an adverse inflationary environment to look at in the long haul. And we have pegged the fed funds rate at a level that can't be changed right now, but it does need to be changed. Since we missed the March and May opportunities to get that rate up, I think we do want to be fully conscious of the opportunity whenever forces are such that we can get the rate closer to what I think the Chairman indicated would be more of an equilibrium rate; we ought to be ready to do that.

CHAIRMAN GREENSPAN. Thank you. We now adjourn for coffee.

[Coffee break]

MR. KOHN. I thought I would start my briefing with some thoughts on this topic using it to lead into the discussion of current

policy options. Those of you attending the Jackson Hole conference will note some similarity between the first two pages today and what you will hear on Friday. It's called "Economies of Scope." [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Don?

MR. SYRON. Don, I have a question that has to do with timing. Even if one thought the probability was greater that the next move would be up rather than down, what is the longest that we've had an asymmetric directive in one direction and not acted on it?

MR. KOHN. I don't know the answer.

MR. SYRON. Have we ever had one for five or six months?

MR. KOHN. We've had very few periods of five or six months where we haven't [moved] the federal funds rate. We had a period from September through December of last year in which we had asymmetry toward ease and didn't move. Our last move was right after Labor Day last year. We continued to be asymmetrical toward ease and didn't move over the ensuing months. Then we were neutral for several months and didn't ease. And, obviously, we've been asymmetrical toward tightening for two months and didn't tighten. We looked some time ago--I guess it was before the Chairman's Humphrey-Hawkins testimony--at periods of unchanged federal funds rates. We found a few of five or six months, but not too many. And I don't remember what the directives were in those times. My guess is that they were probably not biased rather than asymmetrical, but I don't know that for a fact.

MR. SYRON. Can I just follow up? I haven't looked at the data, which is what one needs to do, but how unusual would it be to have a period in which we went asymmetric in one direction or the other, then reversed and went back to symmetry, and then went back to that asymmetry?

MR. KOHN. It has happened from time to time, but it is unusual. We did look at that. We actually looked before the last FOMC meeting for one-month switches and I think we found one or two.

MR. MULLINS. We did it last year.

MR. KOHN. They were sometimes associated with things like stock markets [or other] external events.

MR. MULLINS. We did it in '92, maybe in May; we went symmetric for a time after being asymmetric.

MR. KOHN. That was the one.

MR. MULLINS. Yes, and then once the second-quarter [data] came in and unemployment went to 7.8 percent we went symmetric.

MR. KOHN. So, there are a few examples like that; they are rare but it does happen.

CHAIRMAN GREENSPAN. Governor Mullins.



MR. MULLINS. Just a technical point. In your discussion of real long rates, you were not talking about the nominal rate minus the observed inflation rate, correct?

MR. KOHN. In theory, obviously, it's the nominal rate minus the expected inflation rate over the period.

MR. MULLINS. Over that 30-year period!

CHAIRMAN GREENSPAN. The full maturity.

MR. KOHN. Presumably, in theory you'd want something that has the same duration.

MR. MULLINS. Yes, it has to be the same duration. So, what we're talking about is something that is completely and entirely unobservable?

MR. KOHN. Yes, we have these surveys but--

MR. MULLINS. It's tough to go out 30 years in a survey! There is a routine just to take the long rates and subtract off the current inflation rate.

CHAIRMAN GREENSPAN. That is the constant dollar value of the coupon.

MR. MULLINS. Yes.

CHAIRMAN GREENSPAN. Which is a different concept.

MR. MULLINS. Yes, it means something. Some people use that as the real rate and it is important to keep that straight. So, given that recent inflation has been about 3 to 3-1/2 percent and certainly the average over the past 10 years has been 4-1/2 percent or so and the average over 20 years is worse than that, probably embedded in the 30-year rate is an expectation higher than the current inflation.

MR. KOHN. I would think so, yes. Now, the Philadelphia Fed does surveys and I think they have about 3-7/8ths in the most recent one; that's several months old. The Michigan surveys are closer to 5 percent.

MR. MULLINS. Yes, they're 5-year maturities.

MR. KOHN. I don't know what they ask for--about 5 to 10 years.

MR. MULLINS. And the guy who is now at Dreyfus--

CHAIRMAN GREENSPAN. Hoey.

MR. MULLINS. He doesn't do [a survey] anymore?

MR. PRELL. A fellow named Hotchkis, his former colleague, does it. It's a little below 4 percent.

MR. MULLINS. That's 10 years?

MR. PRELL. Well, there's a 5-year and a 10-year rate; they are both in the same ball park.

MR. MULLINS. We have no CPI link, bond, or instrument that we could [use to] back out the implied--

MR. KOHN. Not that I'm aware of.

MR. MULLINS. Okay.

MR. MULLINS. Thank you.

MR. ANGELL. Don, I guess I always thought an asymmetric directive could [mean] two things. One is an indication that the Committee in the intermeeting period wants the Chairman to be alert to a possible move in one direction only. But I presume there's also another aspect of it and that is that with an asymmetric directive the Chairman wouldn't feel very comfortable, unless there was a very unusual circumstance, moving rates the other way without a conference call; that would not seem to be appropriate. I didn't hear anyone today talk about the need to lower rates during this intermeeting period. What I'm wondering is, if we went to a symmetric directive, whether there is any likelihood that rates would really be lower without a telephone conference call.

CHAIRMAN GREENSPAN. If we went to symmetric you say?

MR. ANGELL. Yes.

CHAIRMAN GREENSPAN. Remember that this is a relatively short intermeeting period.

MR. ANGELL. Right.

CHAIRMAN GREENSPAN. My suspicion is that something that would require us to move rates in this period would be such a startling event that I think we'd want to speak--

MR. ANGELL. Okay.

CHAIRMAN GREENSPAN. --just to [consult] each other on what is going on.

MR. SYRON. Mr. Chairman, I think there is a question about what asymmetry means. May I just ask Bill or the market people: What is the market perception of what asymmetry means?

VICE CHAIRMAN MCDONOUGH. I think historically--Joan, correct me if I'm wrong--it has been that there would be, if not a likelihood, a distinct possibility of an actual move in the intermeeting period.

MR. SYRON. In the intermeeting period.

VICE CHAIRMAN MCDONOUGH. Rather than a signal of [unintelligible]. Is that right, Joan?

MS. LOVETT. A predisposition.

MR. KOHN. But I think it shows that you're more ready to go in one direction or another.

MR. SYRON. In the intermeeting period. Thank you.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. I was going to say this later but perhaps now is the point to interject [my comment], given what has been touched on here. What is the purpose of the directive? In its narrowest sense we just heard that it is viewed by the market, and I think by some of us, as the [pre]disposition of the Committee to move within the intermeeting period. If there's no likelihood that we're planning to move one way or the other, the logic would suggest to me that the directive should be symmetric. If there is a different message to be conveyed by the directive--that in the longer term, beyond the intermeeting period, we're suggesting to the markets that the next move will probably be a move one way or the other--then an asymmetric directive I think is appropriate. If there's still a further longer-term message to be conveyed by the directive--that is, that the central bank is committed to price stability--then we should always have an asymmetric directive in favor of tightening.

MR. ANGELL. That's a good idea! [Laughter]

MR. FORRESTAL. Before we decide on whether we're going to have a symmetric or an asymmetric directive, it might be interesting to focus on what really is the purpose of [the reference to symmetry or asymmetry in] the directive. Again, in that narrow sense, which is how the market interprets it, it conveys what it is likely that we will do between now and September 21st. If that's the real interpretation, then it should be symmetric it seems to me.

CHAIRMAN GREENSPAN. Well, may I suggest that these are questions to Don Kohn?

MR. HOENIG. May I ask Don this question? [Laughter] If we leave it asymmetric for a long period of time and do nothing, do we not give away credibility with that kind of directive?

MR. KOHN. Well, if people think you're using it to posture rather than to take action, I think there's a little danger of that. But it seems to me the Committee needs to think about what its posture really is here. Is it more ready to move one way or another? Whether you move or not, that's what you're signalling with this. These are instructions to the Desk and the Chairman about how you would like to react to completely unexpected developments in the intermeeting period.

MR. PARRY. Coming back to Bob's question--

CHAIRMAN GREENSPAN. You're getting into policy discussion and that's out of order at this moment.

MR. PARRY. Okay.

CHAIRMAN GREENSPAN. Technical questions to clarify the position of Don Kohn? Any further questions of fact or interpretation

of what was perfectly clear on the part of Don Kohn? If not, let me start off because I'm going to be getting into exactly that question; let's do it a little more formally. Let me just say that I don't have terribly much to say about the economy as such. I think it's moving along moderately. I think our diagnosis of the forces driving the economy has been reasonably on the mark. Some numbers have not been exactly right, but they never are, and that's not really the relevant question. Qualitatively, I think we've understood that basically what we are dealing with is an economy confronted with balance sheet problems, problems of excess debt from an earlier period as asset values declined. And we basically were confronted with a situation in which we very consciously brought the federal funds rate down to levels below those we could expect to be maintained indefinitely into the future. We brought the rate down to 3 percent a year ago on the expectation that the economy would evolve essentially in the way that it has evolved. As a consequence of that, we have chosen not to change policy. In other words, the presumption is that we got it right a year ago and we've chosen to stay pretty much where we are. The concern that we were running into, which one could very readily capture in discussions of this Committee, is that we would fall behind the curve when we had to tighten policy; there was a latent concern that we would lock ourselves in and not move. The presumption that at some point we'd have to move the funds rate up as the economy continued to expand I think was fairly pervasive around this table. The only question that we kept asking ourselves was when.

Above all, I'd say the general philosophy of this Committee has been that, whatever we do, allowing something of the nature of what occurred in the 1970s and the early 1980s [to happen again] would be a real tragedy. [We felt] it was essential that we focus on being ahead of the curve [in anticipating inflation] just as we all considered that it wasn't all that terribly important to be ahead of the curve on the down side. In other words, this issue of price stability sometimes requires a different type of intermediate-term asymmetry, where we try to be lagging somewhat on the down side but ahead on the up side to offset the bias in our economic system. That bias is very clearly in an inflationary direction.

With our asymmetric directives early this year and with the Humphrey-Hawkins testimony, I think we ought to be reasonably pleased that we have altered the view of the markets such that the presumption that we will do too little too late on the up side has changed. One doesn't have to go back very far to read as a fairly general view that we would be behind the curve and that that would allow inflationary pressures to reemerge. Whatever one may say about the last several weeks, that issue has not come up. It's dead. We have changed the perception of the way the markets are functioning and we have essentially prepped them for an eventual rise in interest rates. I was interested as to the way the market would react to this posture that we took. It is very hard to argue that if the central bank takes a position that we are going to be vigilant on inflation that [such a position] would make long-term rates go up. Now, the answer is that it does happen, and for a very interesting reason. Clearly, inflation expectations cannot be perceived as going up, or else we've literally missed the mark. But what clearly has happened--and we've observed this recently on several different occasions with our asymmetric directive, with my testimony, and the like--is that we saw what the Vice Chairman called a hiccup. It is interesting to ask what that is

because I think it's important for us to understand what the markets are doing. If we eliminate the notion that what we have is [rising] inflation expectations, we are therefore led to conclude that what is going up is real long-term interest rates. And the question is why.

Obviously, nothing fundamental has changed in the economy, so it has to be something of an expectational variable. And the reason I'm certain is that what we are looking at is something we've all perceived all of our lives: namely, that whenever there is a major element of uncertainty, or more exactly a diminution in the state of knowledge, the position of a human being is to withdraw. As a consequence, whenever one is dealing with any type of asset in which there was a net long position, the creation of uncertainty--meaning the reduction in the state of knowledge of what is going on in the world--leads to a pulling back, a disengaging, which means "sell." That has nothing to do with the type of asset or what its long-term future is. It is not a change in the state of knowledge; it is not an effort to move toward improved liquidity or toward safety. Those are rational concepts which are made on the basis of knowledge. I'm talking about the proposition in which knowledge is diminished and uncertainty in the true sense of the word occurs. If that is in fact the case, what we would expect to occur under those conditions is effectively the type of hiccup that we're talking about: namely, it has to be a temporary affair because it cannot last very long. So, however one reads these events, they are clearly consistent with that phenomenon. But it's important for us to recognize that the presumption that we can go out and basically argue that we are going to suppress inflation and that, therefore, long-term real rates will go down or long-term nominal rates will go down, I think is a misperception and clearly one which is not supported by the data. But that is not to say that there's something unexplainable here. If long-term rates went up and stayed there, then we would be looking at a different phenomenon. But I don't think that's what this particular proposition was.

In any event, this whole period, as a number of you have noted, very clearly indicates that we should be quite pleased at the way everything has come out. That is, we are essentially in a policy position that we haven't changed for a year. That is another way of saying to ourselves, rightly or wrongly, that we think we got it right. And I believe the markets think we got it right. The fact that the stock market has moved the way it has, the fact that yield spreads have come down, as Governor Mullins indicated, the fact that long-term rates have moved appreciably lower suggest that all the [properties] that are related to monetary policy are behaving in a positive manner. One thing that is not is the rate of real growth, which is essentially [a result] of balance sheet restraint and repair, a process we have been observing for quite a long period of time.

I conclude from all of this--and this gets to the question of what we mean by asymmetry--that we can afford at this stage to move back to symmetry provided two things. One is that we are doing it on the basis that we are encouraged by the inflationary data we have seen and that, therefore, the [prospect] of having to respond to adverse inflationary information has lessened. But more important is that we reemphasize our longer-term views that this is not a change in our policy, that indeed we still expect that at some point short-term real rates will have to move higher. As a consequence of that, I'd say

that we have moved tactically, not strategically. Frankly, the reason I feel somewhat more comfortable with symmetric--although obviously I could readily be convinced that asymmetric is not a bad position to be in for a lot of reasons, especially those that Don Kohn raised--is my suspicion that we may have to sit where we are now for a number of months. And I'm concerned about the credibility of the Federal Open Market Committee sitting with an asymmetric directive time and time again when the purpose of that is essentially to signal an intermediate trend--a philosophy and a strategy, not a set of tactics. And while there was no way for us to convey what we have conveyed in a manner other than the way we have done it, I think having done it--and in my judgment having succeeded--we effectively can move forward and go to a symmetric directive. The argument for going to symmetric now is that if we don't do it now and the economy continues doing what it's been doing, we run into the tar baby effect. When then do we do it? In the same sense that I was concerned that we would get ourselves locked in at a 3 percent federal funds rate when the [inflation] pressures require us to move higher, I'm also concerned that we'd get locked into an asymmetric directive, which we would have great difficulty changing. We can change it now because the data are very encouraging and we can lock in. If we don't change it now, the rationale of going back to symmetric at a later time will have to be because we perceive the economy to be weakening, and that would involve a wholly different type of reaction on our part. If that were to happen, that would mean a different set of policies; that might even change the sense of where we are strategically because that is not implicit in the basic path on which we're going.

So, let me just say that I think the issues that are being raised here about the meaning of the directive are very crucial. And very importantly, while I don't sense the slightest indication of a desire on the part of anybody here that we should move and literally change the funds rate in the period immediately ahead, I think how we convey our posture at this particular stage will determine whether we in a sense harvest in an effective manner what is a very significant amount of central bank credibility or whether we create difficult problems for ourselves by sending confusing signals. So, as you can well imagine, while I'm inclined to go to symmetry, I recognize that there are arguments to maintain asymmetry. That is not, as I said, an incredible position. But I'd like to hear arguments against the symmetry position if that's the position that the Committee itself thinks is a more viable one. Governor Mullins.

MR. MULLINS. Well, first on the rate response, I think it's not all that clear that the market is responding negatively to the information, even short term. Our staff did an analysis of nine information releases, and I think they proved that when evidence is released in the market that the Fed is likely to raise the federal funds rate, short-term rates go up. This astounding result was [unintelligible] and it has proved conclusive. It's less clear what happens to long rates with these nine events, especially if we look at the forward rates. So I think we might take a look at that and not read the summary of it because the way I see it 10-year forward rates 7 days after were off 10 basis points. And the 1-year forward rate was up 12 basis points. Now, I know they're declining rates. It's also biased by one or two events. But I think that question is a bit up in the air.

CHAIRMAN GREENSPAN. Well, they did do a study in the other direction, when rates were going up. They looked at the extent to which the long end of the market came down when we raised the discount rate.

MR. MULLINS. Yes.

CHAIRMAN GREENSPAN. And I think we saw similar sorts of ambiguities then. In theory, if we move in a restrictive direction we would expect long-term rates to fall, or more exactly the forward rates to fall.

MR. MULLINS. Well, it's not clear to me that you'd expect that because you are reducing long-term inflation expectations but you might be increasing the long-term real rates.

CHAIRMAN GREENSPAN. How would you be increasing them other than the risk [unintelligible] issue that I was raising?

MR. MULLINS. Don, how do we do that? [Laughter]

MR. KOHN. It depends on whether you're talking about the forward rates 10 years out or the 30-year rate, which is heavily weighted by intermediate rates. If the markets perceive us as running a tighter policy for a time, that can raise real rates--

CHAIRMAN GREENSPAN. For 10 years?

MR. KOHN. Well, it's going to tend to raise the forward rates out a few years, I think. And then the question is: What are the weights of those in the 10-year security or the 30-year security?

CHAIRMAN GREENSPAN. But I think that's what is happening here.

MR. KOHN. Yes.

MR. MULLINS. You're right, but it should come down. It is not apparent to me that one would necessarily see that in the instantaneous response of traders, with all due respect to traders. It may depend more on their inventory positions. This is worthy of study. The best information comes out early [unintelligible] releases. Once you get expectations and people leaning, all you're talking about is differences in what happens versus what people anticipated would happen.

MR. MELZER. Just on that point about the behavior of traders: It seems to me that if they actually see the Fed moving, they could conclude from prior experience that the Fed may be late and that it implies the potential of higher actual inflation and maybe an economy that's stronger than they perceived and, therefore, higher real rates than they thought the market was discounting.

MR. MULLINS. You also get the other sort of signalling effect, that this suggests that the economy is stronger.

MR. MELZER. Right.

MR. MULLINS. Particularly in the Humphrey-Hawkins testimony, some people concluded that this was the first time policymakers in Washington had admitted that we were not on the edge of an abyss, holding our breath that at any time this growth could fall away. Anyway, that's an interesting topic. We had the same thing on the other side: If we are that concerned [and] cutting rates, doesn't that mean things are really weak?

MR. MELZER. Yes.

MR. MULLINS. The bottom line is that I, too, prefer returning to symmetric at this time. In my view there's no question, though, that the probability we will tighten in the intermeeting period is greater than the probability we will ease in that period. It comes out to two epsilons versus one epsilon! Unfortunately, neither probability rises to the absolute threshold that warrants an asymmetric directive in my view. If we went asymmetric it would be purely cosmetic. For me the last two asymmetric directives have not been cosmetic, the last one in particular. With two months of CPI and PPI and the ECI and the other quarterly data to be published during that intermeeting period, if the bulk of that data had come in very disappointing, it would have been a compelling case in my view for a move. I don't feel the same way this time. As a rule, I don't like cosmetic directives and in general do not favor trying to jawbone markets. I think directives should reflect an accurate portrayal of our assessment of the situation and of the probability we are going to find it necessary to move in the intermeeting period. So, I agree that we should declare victory, at least temporarily.

I do see two problems. The first is this feeling that we are asymmetric medium term. But that's not what the [operational paragraph of the] directive is about. The second problem is that this could be viewed as a negative signal, as Governor LaWare noted. Indeed with a weak first half, the budget deal, and no inflation problem--officially now--some will choose to portray the move to symmetry as renewed concern about deterioration in the economy. I'll also make a wild prediction that before long there will be talk of the need to ease, to do our part as part of this process. I think it's a bit tricky. I agree that how we portray this is important; [it should be portrayed] as a response to a deceleration of inflation which has reduced the possibility that we're going to have to move in the intermeeting period. I would say that it's important [to do that] without backing away from the groundwork we've laid concerning the importance of continued disinflation. So, while I still have this viewpoint over the longer term, I do agree that the appropriate stance today is to return to symmetric.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Mr. Chairman, I think you're right that the shelf life of an asymmetric directive has been reached. It's clear that the previous bias has been beneficial to our credibility. The red alert served us well. We may have stared down inflation with that bias. But we've now had three consecutive months of favorable inflation news, and the information for two of those months has come in since our last meeting. It's time to restore a symmetrical stance. We have a large retroactive tax increase that has a lot of people scrambling. The thing that I disagree with Governor Lindsey on his



arithmetic is his view that people are going to wait until April 15th to act. I think they're out there doing it right now and it's going to weaken the economy, and it's going to do it before next April 15th. If we wait and keep our asymmetric directive, we're going to get more political pressure. And we won't want to appear to be caving in to it. We're better off to move back to a symmetric directive in this window of opportunity when, as you say, we come down on the basis of [unintelligible] as well as the tax hikes. That bites the economy hard.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Well, I preferred a symmetric directive even last time. As I said in my comments earlier, I think under ordinary circumstances conditions would dictate a symmetric directive at this point. I still am concerned that if we give the impression that we have abandoned our determination to seek stable prices, we either signal a weakening in the economy that is more than is perceived elsewhere or we set off inflationary expectations again because they think we're backing away from our position of pursuing [price stability]. On the other hand, the arguments that have been presented here for, as Bob McTeer calls it, the "shelf life" of the asymmetric directive I think are persuasive, so I'm prepared to back "B" symmetric.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mr. Chairman, the substance of this issue of what we're likely to do has been talked about. I think we've been very, very successful on this. But there's a real danger in any organization if we try to calibrate the cosmetics too closely. This is not a simple decision, but at the end of the day the thing that strikes me is that we spend a lot of time at this table talking about the role of the central bank and how we communicate to the public and to markets as a whole and about the importance of being honest in the way we communicate. And if the perception of the markets is that our directive does not refer to our longer-term strategy but to what we're doing in the relatively short term, I think it's plain that it's intentionally disingenuous and damaging to the institution to be out there saying that we're leaning toward doing something that we're not likely to do in the next four, six, or eight weeks.

MR. MELZER. So where do you come out? [Laughter]

CHAIRMAN GREENSPAN. President Broadus.

MR. BROADDUS. Well, I may have a minority view here, Mr. Chairman. I agreed with everything you said until you got to the last part. I would favor pretty strongly sticking with an asymmetric directive. The latest inflation data are encouraging--no doubt about it--but I think it's possible to overstate the progress. We always play a bit of the numbers game here with respect to [the base for] the calculation. But if I've calculated it right, the core CPI rate on an annualized basis over the first seven or eight months of this year is 3.3 percent compared to 3.4 percent last year. So, the progress has not been excessive, it seems to me, with respect to last year. Also, as you pointed out in your Humphrey-Hawkins testimony, there is at least some evidence from survey data that inflation expectations in

some quarters may actually have worsened. So, while I think we've made some gains on credibility, we still have some distance to go before we really convince the markets and the public generally that we are going to go all the way this time to price stability. Also, I would make this point: I think precisely because we have not moved the funds rate at all for a long period of time, the directive language is now a very big signal. If we shift back to symmetry at this stage of the game, it's going to get a lot of attention and involve some risk. So, from my own standpoint I'd rather stay with the asymmetric directive.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, back in 1965 George Aiken, the Senator from Vermont, recommended that we declare victory and get out of Vietnam. I always thought that was a wise judgment. It applies today. First of all, I think the reason we should get out of the asymmetric directive is to reload because we are going to have to fight another day. That goes without saying. But I think the other part of what Aiken recommended--that we declare victory--is also very important. I am somewhat concerned about what Governor Mullins indicated: that some will take our move as a signal on the budget vote. But actually what we're doing is that we had a very, very well planned--it's almost miraculous how well it worked--shift in the nuance of policy, which I thought conveyed very well to the markets what we believed. It led businessmen, instead of talking about inflation, to come back saying: "We tried to raise prices and we couldn't." I think it really has changed expectations out there. We should let the world know that we've done it right and that's why we're doing it. And by the way, declaring victory is part of making it easier for us to reload the next time when we have to. So, I'll go with what George Aiken said 20 or more years ago and vote to go symmetric.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, it seems to me that the most important thing is that our policy should promote price stability. So I think it's terribly important, whatever the conclusion, that the minutes of this meeting reflect that ongoing view and that public statements, especially by the Chairman but also by the rest of us when we make them, make quite clear our commitment to price stability. Between now and the next meeting I think it's highly unlikely that we will change the fed funds rate. So, then we come down to the purpose of the [symmetry in the] directive. And at the present time I think the market is quite well prepared to believe that we have not changed the directive from a tactical tool to a policy statement, and we are much better off to leave the market with that perception. Perhaps at an appropriate time in one of your speeches or in testimony you might include that remark. Since I think it's highly unlikely that we would in fact change the fed funds rate before the next meeting, I believe we should avoid shifting the signalling device of the directive to a policy statement. And since I don't think we should do that, to stay asymmetric would put us in the position of doing some empty posturing, which is always extremely injurious to the credibility of any institution and especially to one whose credibility is so important. Therefore, I agree with your recommendation that we go to "B" symmetric.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I agree with your formulation for policy, particularly the symmetric part, because I believe as do others that this is something that should be viewed as what likely will happen during the intermeeting period. So, I'm for alternative "B" symmetric.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I support "B" symmetric.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I also support "B" symmetric. I think the economy has been weaker than we previously thought. Inflation is better and we could declare victory. Staying with asymmetry toward tightening may in fact signal more fears about inflation than might be necessary. Doing it now would get us ahead of the curve so that we're not seen as switching under pressure. I would like to see messages either in your testimony or in the minutes continuing to point toward our emphasis on price stability.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I think the risks to the forecast in the intermeeting period are clearly balanced so, therefore, I would prefer a move toward symmetry. I do think it is important that that not be misinterpreted, and I would assume that we certainly can make that point clear in the minutes.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I completely agree with the position you've developed. The opening line of the operational paragraph does say "In the implementation of policy for the immediate future" and it does seem to me that in the immediate future the chances that we would we change our policy at all are very remote. Therefore, I think symmetric language is appropriate.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I'm concerned that the Committee is becoming a little over-attentive to symmetry versus asymmetry. Certainly, in May, as you know, the fact that we went to an asymmetric directive didn't convince me that [it was an appropriate alternative to] increased rates. And if we continue to battle over symmetry and asymmetry, then we're back in the day and age in which the Committee groaned and moaned over an eighth of a point change in the fed funds rate, a change that really didn't amount to much. So, the issue of symmetry and asymmetry is not very great, given the Chairman's statement that he does expect us to be in an asymmetric mode in the long run. That is certainly more appropriate than acting as if we're going to tighten immediately. I recognize that the price of gold has come down from \$400 to \$371 and that really is a factor that parallels the move that took place in the bond market; and that has worked very, very well. And even if the fed funds rate is wrong, it would not be appropriate at this time to increase the fed funds rate. I'm very

disappointed that we went past that window of opportunity and did not get it done, and I am very concerned that, with the Japanese yen/dollar exchange rate being where it is, we put ourselves in a position in which the rate of inflation actually is going to be higher than it would be if we had the fed funds rate at the level called for by alternative C. That is, if magically we could go to "C" right now --we can't get there but if we could get a 3-1/2 percent instead of a 3 percent fed funds rate--the exchange value of the dollar versus the yen would not be so precarious and we would not have the window that is going to be there for price action by the automobile companies. [They will raise] wholesale prices but that will show through [to consumer prices and], we're going to have a higher inflation rate at a 3 percent funds rate than we would have if we had 3-1/2 percent. I also am concerned that a 3 percent rate provides lots of liquidity in the financial markets and it provides an opportunity for certain bubble events because money is scurrying here and there. At a 3 percent rate, we're chasing people out of M2 accounts to elsewhere. And all of that chasing may not be in the interest of long-run stability. So, I'm very uneasy with the fed funds rate where it is. I recognize, Mr. Chairman, that this is not the time to increase it. But more important than going back to asymmetric toward tightness would be for us to look for windows to get the fed funds rate up whenever we can.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I think as a tactical matter this probably is the time to return to symmetry. It strikes me that it would take some very surprising events to lead toward a change in the funds rate in the five weeks before the next meeting. Having said that, I do have a couple of reservations about a return to symmetry, one of which already has been expressed. And that is that when it becomes public, it may be subject to over-interpretation--not necessarily misinterpretation but a "Now what are they up to or what do they see?" kind of thing. But also I'm a little troubled by the fact that we seem to be responding again to the latest price statistics. Now, it's certainly true that they are better, but I have not heard anybody express a much more positive view about longer-run inflation. The forecast for the balance of this year and for 1994 is pretty much what it has been for an extended period of time. It seems to me that we really ought to be looking and thinking about that as we do this. So, I would be careful about putting a lot of emphasis on the fact that the latest price data look better and that, therefore, we don't need the asymmetric directive.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I think a symmetric directive is appropriate and I don't think that changes our long-run strategy toward price stability, which is what we should have. This is an operating paragraph and it should communicate what the Committee is thinking. I don't see any inclination to change in the intermeeting period. Therefore, I think we build credibility making that change now as far as our future actions go. So, I'm for symmetry.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I have a general aversion to the idea behind asymmetric, discretionary directives. And after listening to Don Kohn's explanation of the meaning of switching back to symmetric, I felt it left me with no choice but to prefer asymmetric if that's what it means to move to symmetric. But when I think about leaving the funds rate at 3 percent in view of the Greenbook projection on inflation, it implies that the Committee says either that projection is wrong or it's acceptable. I didn't hear any comments about whether it was either wrong or acceptable to the Committee, which leaves me puzzled about the comments about declaring victory. Those comments are suggestions that the Greenbook projections on inflation are in fact wrong rather than acceptable, I think. So, I'm not sure where I come out.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. I very happily support a symmetric directive. I would like to underscore what has been implicit in many of the comments--Tom Hoenig just now was quite explicit about it--that what we're doing here is making a directive. It is a directive to the Open Market Desk and its purpose first and foremost is to instruct the Desk about what we expect over the intermeeting period. There is a secondary effect and a secondary purpose in the area of signalling. There is a large inevitability about that and it has to be considered; it probably occasionally has to be dominant, but I would say only very occasionally. The order of importance of these two is distinctly in the area of first and foremost to provide direction to the Desk. And that direction to the Desk at this time certainly is that there's unlikely to be a change over the next five weeks.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Alan, I agree with your analysis in terms of going back. I think the directive ought to be symmetric. And I think, as Wayne Angell said, that we ought not kid ourselves that debating the language is really making policy. I don't think we used it inappropriately. Because things didn't unfold to give us the opportunity to move in that direction, it's appropriate to go back. But we probably ought not overuse the tool because to some extent we see the down side right now in terms of possible misinterpretation in markets. And I agree with Bill McDonough that a statement could be helpful at some point to clarify exactly what we mean by it because I do think the press and others put much more weight on it than we may intend.

CHAIRMAN GREENSPAN. Since I assume we're going to vote in that direction I just want to raise the caution here to everyone to be very careful about the press because that could be quite damaging to how we wish to proceed on this--whether or not we let the minutes handle it or make an official statement or something of that sort. The one thing we certainly want to be very careful about is that an inadvertent remark by somebody in the System about policy strategy and a variety of related issues can create some real difficulties for us in this period. In any event, I do read that a majority is supportive of symmetry and I'll ask Norm to read the appropriate paragraph.

MR. BERNARD. It's on page 13 of the Bluebook: "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 of price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with modest growth in M2 and little net change in M3 over the balance of the third quarter."

CHAIRMAN GREENSPAN. Okay, would you call the roll.

MR. BERNARD

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

CHAIRMAN GREENSPAN. Okay, the Committee is adjourned for lunch and our next meeting is September 21st.

END OF MEETING