Meeting of the Federal Open Market Committee

July 5-6, 1995

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 Wednesday, July 5, 1995, at 2:30 p.m., and continued on Thursday, July 6, 1995, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

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

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

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

Ms. Browne, Messrs. Davis, Dewald, Hunter, Lindsey, Mishkin, Promisel, Siegman, and Slifman, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Simpson, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Johnson, Assistant Director, Division of International Finance, Board of Governors
Messrs. Clouse 1/ and Roberts, 1/ Economists, Divisions of Monetary Affairs and Research and Statistics, respectively, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Connolly, First Vice President, Federal Reserve Bank of Boston

Messrs. Beebe, Goodfriend, Lang, Rosenblum, Sniderman, and Ms. Tschinkel, Senior Vice Presidents Federal Reserve Banks of San Francisco, Richmond, Philadelphia, Dallas, Cleveland, and Atlanta, respectively
Ms. Krieger and Mr. Miller, Vice Presidents, Federal Reserve Bank of New York and Minneapolis, respectively

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July 5, 1995--Afternoon Sesion

MR. BERNARD. The acoustics in this room leave much to be desired, so you are urged to speak as much as possible directly into the mikes. I have to say that I have an interest in this. I'd like to circulate later a transcript that does not have too many gaps in it.

CHAIRMAN GREENSPAN. If anyone heard that, it fundamentally disproves his proposition, there being no microphone sitting in front of Norm! [Laughter]

MR. BLINDER. Make sure none of them is an 18-1/2 minute gap!

CHAIRMAN GREENSPAN. Who would like to move the approval of the minutes?

SEVERAL. So move.

CHAIRMAN GREENSPAN. Without objection. Peter Fisher, you are on.

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

CHAIRMAN GREENSPAN. Questions for Peter? Governor Lindsey.

MR. LINDSEY. I have two, Peter. First, could you just quickly repeat the part about the Mexican transaction?

MR. FISHER. For value today, the Mexicans are drawing an additional $2.5 billion on the medium-term facility. That brings to $10.5 billion the amount that has been drawn on the facility the Mexicans have with the Treasury. For several months we and the Treasury each have had outstanding $1 billion drawings on our respective short-term swap lines with the Mexicans. Those remain outstanding; the drawings have three-month maturities. We have rolled them over once. I would expect, because I have heard nothing to the contrary, to be asked to roll them over again on August 1. That would be the second renewal. In our agreement with the Treasury, there could be a third rollover of the three-month swap in the fall.

MR. LINDSEY. Second question: There seems to be a decline in the amount of liquidity in the foreign exchange markets brought about particularly by redemptions by hedge funds and others. Do you think that has implications for the efficacy of intervention down the road? If the private sector has fewer poker chips, might we actually see intervention become more successful?

MR. FISHER. That's a very important and difficult question. I would put the emphasis slightly differently than you. I think the interbank community has been reducing its risk appetite and has been quite nervous not just in the last period but for the whole six months of this year. It's that reduction in the risk-taking appetite of the dealer community that makes it particularly difficult for hedge funds to operate in their traditional style. Now, the fact that there might be smaller positions in the market--and we have some confirmation of that--can cut either way on the efficacy of intervention. If people are closer to neutral, it's harder to catch them far off guard--leaning far the wrong way. On the other hand, if positions are smaller and people are slightly off guard, it may be easier to frighten them back to neutral. There is not much science to that assertion and a lot of feel. I think there is something to your point, but there could be occasions where it would be harder to intervene effectively because everyone is sitting happily at neutral in terms of their own risk appetite.

MR. LINDSEY. We only know about the individual withdrawals--I guess they are called redemptions. Do we have any sense at all of how big the market is and how much it has shrunk?

MR. FISHER. We have a survey on turnover in the foreign exchange market, based on April data. We still don't have all the data, but it will give us a three-year to three-year snapshot. The better comparison is to talk to the major interbank firms to get a sense of foreign exchange market liquidity and what is happening to their volume. In the last month it has certainly been thin. There is some variance among firms; different banks have had good months and bad months this year, and I don't feel confident that we can say something definitive about turnover in the foreign exchange markets this six months as contrasted with the first six months of 1994.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Peter, I want to follow up on what you said about Mexico, because something went by me awfully fast there. You said the Treasury has monetized SDRs to fund the Mexican drawing. Can you explain that a little?

MR. FISHER. One of the resources of the ESF is SDRs. The process of monetizing them and presenting them to us--let me say if I am explaining something wrong, Sandy, please bail me out--we take them in and they get dollars for them. And that is the major--

MR. TRUMAN. They sell us SDR certificates.

MR. FISHER. They sell us the SDR certificates; they get the dollars and we have the SDR certificates. That then is an injection of liquidity that we have to worry about and sterilize as we would any other form of intervention in that sense. So, that's the process of providing them dollars: monetizing the SDRs.

MR. JORDAN. But we, the twelve Federal Reserve Banks, own our respective shares of these SDR certificates based on the capital of our banks?

MR. TRUMAN. Right.

MR. JORDAN. How are we informed that we own them? How is my bank informed that we now have that in our portfolio?

MR. KOHN. It's published on the weekly H.4.1 statement; I don't know whether there is a separate internal notification. There already are $8 billion of special drawing rights outstanding in addition to the $11 billion of gold stock.

CHAIRMAN GREENSPAN. I think President Jordan is asking whether somebody is going to call him up and say "You have just become the proud possessor of an increased amount of SDR certificates." He is asking: "What's on my bank's liability side?"

MR. FISHER. Initially, it would--

CHAIRMAN GREENSPAN. Unless the New York Bank is holding them all and the increase is offset by deposits at the Fed wholly in New York--

MR. TRUMAN. The Treasury balance goes up.

MR. FISHER. The mathmatical way is that the Treasury balance goes up, as we are all saying. That's the narrow answer. But the Chairman is asking--

MR. KOHN. And then we sell government securities, as they draw down the balance.

CHAIRMAN GREENSPAN. That's not the question I am asking. If the liquification were wholly an issue of the Federal Reserve Bank of New York taking onto its books an SDR certificate and crediting the Treasury account for the $2 billion, then the transaction is complete and the Cleveland Bank goes its merry way and nothing happens. I think the question is: Are any of those certificates going to show up throughout the System and what are the transactions on the liability side and against whom--the New York Bank, the Treasury, or what?

MR. KOHN. The current SDRs are distributed throughout the System the way every other asset is.

MR. FISHER. I may be missing the point, but in terms of the System Open Market--

CHAIRMAN GREENSPAN. No, the point is that the liquification--

MR. TRUMAN. What's on the liability side?

CHAIRMAN GREENSPAN. The Treasury takes its SDR certificate, gives it to the Federal Reserve, which simultaneously places the SDR certificate on the asset side of our consolidated balance sheet and increases the Treasury deposit on the liability side. That's what happens to the consolidated system. President Jordan is asking what happens among Federal Reserve institutions? If you are going to allocate SDR certificates to the various Banks, then what appears on the liability side? Are we creating a deposit for the Treasury on all twelve Banks? Is it a transfer from the Federal Reserve Bank of New York? What actually is done?

MS. MINEHAN. It's done through the inter-District settlement account.

MR. KOHN. It could be the inter-District settlement account; Cathy says it is. But the other point, Mr. Chairman, is that that deposit never shows up. The Treasury knows in advance that it is going to get $2 billion. It doesn't call $2 billion of funds in from the commercial banks. So, the Treasury deposit is $5 billion or $7 billion or whatever it is the Treasury is targeting that day.

CHAIRMAN GREENSPAN. This has nothing to do with commercial banks. This is basically a Federal Reserve crediting of the Treasury account for the amount of the SDR certificates.

MR. KOHN. Right. Then the Treasury doesn't call in the funds. The Treasury's account--

CHAIRMAN GREENSPAN. No, the Treasury then disburses those funds to Mexico.

MR. KOHN. On the same day.

VICE CHAIRMAN MCDONOUGH. Wouldn't we just have a change of assets on the balance sheet?

CHAIRMAN GREENSPAN. Yes. In other words the check is then drawn on the Treasury account, if you want to put it that way, and will end up in the Fed account for foreign central banks, or whatever we do with it.

MR. KOHN. Maybe.

VICE CHAIRMAN MCDONOUGH. But on the Cleveland bank's account their share of SDRs goes up and another asset goes down, right?

MR. KOHN. That other asset is Treasury securities that Peter sells to offset the increase in SDRs.

VICE CHAIRMAN MCDONOUGH. That's what happens to Cleveland's balance sheet.

MR. KOHN. And it happens the same day. The Treasury's balance at the Federal Reserve never changes, whether the SDRs are issued or not. They target that at a given number; they know in advance what it is. They don't raise cash; they don't sell bills.

VICE CHAIRMAN MCDONOUGH. So <u>ceteris paribus</u>, the total on Cleveland's balance sheet stays the same? SDRs go up and Treasury securities go down.

MR. JORDAN. You sterilize immediately so that our share of the Treasury portfolio goes down by the same amount at the same moment?

MR. KOHN. Right.

MR. TRUMAN. If I could just add one other factor--

CHAIRMAN GREENSPAN. I'm still not sure I understand this transaction.

MR. FISHER. We will endeavor to have a simplified--

CHAIRMAN GREENSPAN. We still haven't discussed how the money gets to Mexico, where it is, and who draws the check. It's an interesting issue that I will reraise outside of this meeting, unless somebody needs to know. Maybe you already understand all this.

MR. TRUMAN. One more fact is that this is a case in which the Federal Reserve has no choice as to whether it accepts SDRs.

CHAIRMAN GREENSPAN. I understand that.

MR. TRUMAN. In a lot of other transactions with the Treasury, the Federal Reserve has some choice. But the law says, I think, that the Secretary of the Treasury may issue SDR certificates and the Federal Reserve shall accept them. Period.

CHAIRMAN GREENSPAN. Do we shift U.S. Treasury securites from our account to Mexico? Never mind!

MR. FISHER. We will endeavor to clarify it for all interested parties.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Actually, I had a related question. I was curious about the same thing Jerry raised. Do we end up with an earning asset? Is there a way to earn anything on the SDRs that we hold or is that, in effect, a nonearning asset?

SPEAKER(?). It's nonearning.

MR. JORDAN. We reduce our earnings. When you're clarifying this, another question is: This is a repurchase agreement, right?

MR. TRUMAN. No. It's outright.

SPEAKER(?). It's an outright purchase.

MR. TRUMAN. Like gold certificates, it's an outright purchase; there are no repurchase agreements on the gold certificates. They are required to redeem them under some circumstances.

MR. JORDAN. This differs from my understanding, then, because in February or March or whenever, my understanding when we were going to take yen or deutschemarks--

MR. FISHER. That would be warehousing.

MR. TRUMAN. That's warehousing.

MR. JORDAN. You are saying this is not warehousing, this is not a repurchase agreement? So, this is permanent.

MR. MCDONOUGH. Correct.

MR. TRUMAN. Permanent, yes.

MR. MCDONOUGH. It's an acquisition of an asset, not a swap.

MR. JORDAN. I didn't know that.

CHAIRMAN GREENSPAN. Any further questions for Peter? President Moskow.

MR. MOSKOW. This is on another subject.

MR. FISHER. I want to thank you!

MR. MOSKOW. Peter, I was on the "morning call" this morning and one of the subjects was the fed funds futures rate. My recollection from this morning was that the fed funds futures rate is now indicating a 60 or 65 percent probability of a 25 basis point cut in the fed funds rate this month. I was just wondering how that ties in with what you were saying here this morning.

MR. FISHER. I think we heard the same thing from the same sources at different times this morning. Looking through the pricing of the contract and the different time horizons one has to adjust for, there is a 60ish percent probability, if you read it literally, of a move early in the month--meaning now. And there is an implied probability closer to 100 percent of a 25 basis point easing by the end of the month. Without going too far into the gymnastics of it, that's how one interprets 14 basis points on a contract that settles near the end of the month, given the different probabilities and different time horizons.

MR. MOSKOW. But I thought I heard you saying that the majority of the opinion in the market was that there would not be a move.

MR. FISHER. Yes. I was trying to offer a note of caution about whether you should read that price literally as saying that everyone in the market has agreed that those are the probabilities attached to a move or whether it's a clearing price between some who have a much higher sense of confidence that there will be a move earlier in the month and others who don't think there will be a move this month at all. There is room for all sorts of interpretations as to whether a given basis point implication in the fed funds contract indicates a consensus view or a range of different views that find a clearing price.

CHAIRMAN GREENSPAN. I think I've got it! [Laughter] You are telling me that the SDR certificate comes out of the Treasury and we cancel the Treasury obligation and it is wholly an asset swap so that the debt to the public of the U.S. Treasury goes down by that amount. Is that what happens? That solves President Jordan's problem too! [Laughter]

MR. JORDAN. Can I follow up on that? The same thing happened when we changed the price of an ounce of gold from $35 to $38 and then to $42.22. The Treasury got a windfall of about $1 billion to $1.2 billion in both of those so-called devaluations. So an issue on this is: What was the dollar price of SDRs that we monetized? You say I have an asset on my balance sheet and I don't know what the value of it is.

CHAIRMAN GREENSPAN. It's about $42.

MR. TRUMAN. It's $42.22; it's equivalent to the official price of gold.

MR. JORDAN. We do this at the official U.S. Treasury price of gold?

CHAIRMAN GREENSPAN. Do you mean that we can lower the debt to the public by moving the price of gold up to the market price? That could cut the debt back by a not insignificant amount!

MR. JORDAN. I have been trying not to mention that publicly for fear that someone might want to do it.

CHAIRMAN GREENSPAN. It's probably too late; we just mentioned it.

MR. JORDAN. It will become known five years from now!

MR. LINDSEY. Five years from now, it will be read in the transcript for this meeting.

MR. BLINDER. By which time it already will have been done.

CHAIRMAN GREENSPAN. Any further questions for Peter? If not, would somebody like to move to ratify the foreign currency transactions during the intermeeting period?

SPEAKER(?). I so move.

CHAIRMAN GREENSPAN. Without objection. Similarly, would somebody like to move to ratify the domestic open market operations?

MR. MCDONOUGH. So move.

CHAIRMAN GREENSPAN. Then let's move on to the Chart Show with Messrs. Prell, Simpson, Slifman, and Ms. Johnson.

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

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

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

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

CHAIRMAN GREENSPAN. Thank you very much. That was a very interesting around-the-world evaluation. Questions for our colleagues?

MR. BROADDUS. Tom, could you briefly describe how that model that you mention on the bottom of Chart 8 is set up? I'm not sure I followed it.

MR. SIMPSON. This is an exercise using the quarterly macroeconometric model. What is assumed here is that you are willing to lock in inflation basically at current or recent levels and to hold output at potential. Then, in the case of the so-called baseline here, we are taking the CBO's current raw estimate of the fiscal deficit. So basically, the things I just mentioned are exogenous to the model: the fiscal deficit as well as the inflation rate and the output levels you are assumed to accept. Then we solve for the federal funds rate. Basically, it's the long bond rate that is driving spending and it's the funds rate or the bill rate and other short-term rates that have the biggest influence on the bond rate.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. I want to follow up on that same chart, Tom. If I'm reading this right, it says that if the bond market, looking forward, feels that lower future debt is going to lead to lower future real interest rates, the fed funds rate stays fixed for four or five years. Is that what it says literally?

MR. SIMPSON. Yes, right.

MR. BLINDER. That means that rates on instruments with maturities up to four or five years ought not to fall. Isn't that right?

MR. SIMPSON. Yes.

MR. BLINDER. But this doesn't look a lot like what has happened recently.

MR. SIMPSON. No. I might also point out that in this exercise the simulation starts in the second quarter. It doesn't start in the third quarter, so it doesn't acknowledge the large declines that we had in the second quarter.

MR. BLINDER. Right.

MR. SIMPSON. But you're right. In the model, the longer-term rates that relate to housing and capital spending are driving the economy. The decline in the shorter maturities would not have that much effect on spending in the model.

MR. BLINDER. Does it follow that expected future deficit reductions should not move rates on intermediate maturities--say, two-year, three-year, four-year maturities? What you just said is that if the ten-year rate stays fixed, those maturities won't have much effect on spending, right?

MR. SIMPSON. That's in the eyes of the model.

MR. BLINDER. Yes, absolutely, that's right. The other question I had was for Karen. In all of the G-7 economies--or rather the G-6, leaving out the United States--the forecast is for growth in the near term to accelerate by various amounts over what it recently has been. Presumably, in all the cases except Japan--and, heaven knows, maybe even in Japan--there will be fiscal consolidation over the next two years. You mentioned it in some cases. What does this imply about monetary policy and interest rates in those countries?

MS. JOHNSON. We actually have explicit interest rate paths built into what we have to say about these countries. I guess I would invert the question just a bit. I will deal with Europe first and return to Canada. These are countries that, as we perceive it, were exhibiting considerable momentum around the end of last year and even into early this year. So, the questions I ask myself are: What has slowed these economies in the first half of 1995 and will that persist? Will policy action be needed to stimulate those economies? In some cases that may be, but I think the answer that we get for some of these countries is "no." For example, in Germany the impact of the tax surcharge, which for reasons that I can't fully explain did not seem to have been anticipated, was not visible in the earlier data. But when the tax surcharge went into effect in early 1995, one does see it in the data; we expect to see that reversed in early 1996 when other taxes are reduced. Some effect of the exchange rate appreciation is certainly a piece of the story in Germany and maybe even in France, but there are flip sides of that in Italy and in the United Kingdom. We got GDP for Italy this morning, for example, and it was very strong in the first quarter. So, I guess what I am left with by way of describing our forecast is to say that a piece of this policy story is that the tightening that we thought would come on line early in 1995 has been postponed. And that, in a sense, is monetary easing relative to the baseline from which we were starting. And at least several of the factors that we see as explaining the slowdown in the first half of 1995 we view as having transitory characteristics. They are either already built in, as in the case of the German taxes, or are not seen as persistent enough to require a real policy response.

Canada is quite different. The drop in Canada was far stronger than I think I can rationalize in these terms. It was related in part to the U.S. economy, but it certainly was of an amplitude far greater than we experienced in the United States. I suspect that there will be a need for more monetary policy easing in Canada for recovery really to take hold again. We have seen actions by the Bank of Canada already, so I think some of that monetary easing will in fact be forthcoming.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mike, I have a question, not specifically about something that came up in the Chart Show but about a paragraph that jumped out at me in the Bluebook, and I thought you might want to comment on it. There is a reference to a change in the NAIRU; it is now 5.9 percent in terms of your analysis. My recollection is that the very thick study that was done several years ago came up with a number of 6.1 percent. Would you explain what elements have changed to produce this? Obviously, longer term, it does have policy significance. Secondly, there is a footnote indicating that there are no adjustments for demographics. I think Kansas City found out how interesting it is to talk publicly about such demographics estimates! They clearly are relevant in terms of estimating what the NAIRU is likely to be in the future. Are we going to get another thick study about this or a little more detail about how this change was made?

MR. PRELL. I guess it would be a fair request at some point for us to do another thick study.

MR. PARRY. A thin one would be even better! [Laughter]

MR. PRELL. One of the problems of comparing past studies with where we are now is the change in the current population survey. Even at this point we have some degree of uncertainty about how to translate today's unemployment rate into pre-1994 terms. So, that can be one ingredient in a comparison of old NAIRUs to new NAIRUs. As we have gone along, we have had to adjust our sights on what this is and now we also are trying to incorporate the experience over the past year and a half with respect to wages and prices and trying to surmise whether we might have been too high or too low. We have inched down a bit our working assumption about where the NAIRU is--the number around which our price forecast, in effect, pivots. At this point we are talking 5.9 percent; it is a little lower than it was previously. The allusion to demographic adjustments in the Bluebook was merely to recognize that, as we look out over the next five years, there will be compositional changes in the labor force and there could be movements in the NAIRU as a consequence. For this kind of schematic presentation, though, we thought such adjustments would greatly complicate matters and get us into areas of increasing uncertainty to try to maneuver them over the five-year span that we were portraying. But we wanted to alert you that there were a number of subtleties that we didn't address in this and that you shouldn't be thinking necessarily that the 5.9 percent unemployment rate would be the pivotal rate for each of the next five years.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I have a couple of questions. I'm not sure whether the first one is for Mike or for Tom. Going back to Chart 8 on real interest rates and fiscal scenarios and so on and comparing that with a statement in the Greenbook, I'd like a little further elaboration. You make references to what you call fiscal restraint. I understand what that is supposed to mean. But as you describe it in the Greenbook, fiscal restraint has the effect of lowering equilibrium real rates. Normally, most people would think that lower interest rates, real or nominal, mean easier monetary policy. So, a tighter fiscal policy causes an easier monetary policy.

MR. PRELL. Let me interrupt you there.

MR. JORDAN. Okay.

MR. PRELL. We wanted to make that as clear as we could--and I guess we failed--or maybe we did do it as clearly as we could but that wasn't clear enough! We didn't mean that adjustment in the nominal rate, which we took to be a reflection of a change in the natural rate, to be viewed as monetary stimulus. In effect, it keeps things neutral as the fiscal restraint tends to lower the natural rate--the rate that would prevail when the economy was in a steady state, operating at potential. I apologize if we confused you on that score. In fact, what we were doing was recognizing something that I think you raised at the last meeting about how high the real short-term rate should be expected to be over the longer run and whether we felt that 3 percent, or wherever the real rate is, was the sustainable rate. I noted then that if we looked out several years that would become a relevant consideration. I said that we felt it was higher than the longer-run equilibrium or natural rate and that in prior Bluebook simulations we had introduced a downward tilt. Since we were going out a bit further with the Bluebook simulations and we were building in a somewhat more substantial fiscal consolidation, we felt that it would be appropriate for us to introduce that into this forecast. So, that's how that should be interpreted.

MR. JORDAN. Okay, and I have absolutely no problems with that. I do still have a little problem with the references to bond markets being adaptive. It's like saying: If the bond market rallies enough, we don't have to lower the funds rate, and that gives me a little problem. But let me hold that for a second. The Greenbook says: "We have introduced a downward tilt in the funds rate. This decline in rates, though, should not be interpreted as implying any impetus to aggregate demand," meaning that this downward movement would equilibrate. I can read that statement to say also that because the natural Wicksellian rate or some equilibrium real rate has moved down, failure to move down the nominal rate would be a de facto more restrictive policy stance.

MR. PRELL. Assuming inflation expectations remain constant.

MR. JORDAN. So, whatever causes the equilibrium rate to move down--fiscal policy, or God, or something--you would say, even though the headlines may say a lower nominal rate is an easing, that failure to lower the nominal rate is in fact more restrictive.

MR. PRELL. That's right.

MR. JORDAN. Okay.

MR. PRELL. I should emphasize that, given our limited ability to predict these relationships, the calibration of this is clearly very uncertain. I think the point of Tom's presentation here, which is a schematic one in a sense, is simply that if there are large anticipatory reactions in the bond market, then you do not need to move the short rate as aggressively in order to give a greater stimulus to private investment spending. It's a simple point, and we don't want to suggest by the precision of these charts that we can calibrate that very neatly. Again, it's a broad conceptual issue and one that, obviously, I would think you folks would want to contemplate in thinking about where funds rates might be over time.

MR. JORDAN. I want to draw out this conceptual aspect. I do have a problem with this last point about the rally of the bond market, but that's because I translate it into supply and demand for reserves and what that might do in terms of quantities. And that's because I have a different framework. Let me hold that one, though, because I don't want to take too much time and I want to ask Karen to help me through thinking about something about Japan. You used the word "deflation" and I know a number of Japanese commentators have denied vigorously that they have deflation. I don't know what they mean by that, but the word deflation in the abstract means that the purchasing power of the yen is rising. I'm not sure whether that is really what people have in mind when they say those things.

If you go back to the beginning of this decade, commercial real estate prices were such that the Japanese would say such things as that the land under the Imperial Palace was worth more than the State of California. We would say "Yes and try to get it." All the stocks listed on the Nikkei, if aggregated, would have exceeded the present value of GDP for the world. We thought it probably wasn't true. Or at that time a cantaloupe cost 70 U.S. dollars. If you think during the course of the decade that you are going to remove the impediments to the workings of the market so that the law of one price starts to operate in tradeable goods and asset prices and things like that, then one of two things has to happen. The price of these things, converted into the equivalent of some other currency, has to fall either by a depreciation of the yen or by declines in absolute yen prices. Whether it is proper to think about that as deflation or not, I don't know. What else could happen? If the yen is not going to fall in value on the exchange market, then our economics would tell us that asset prices and goods prices had to move toward world levels. How else could this adjustment possibly be made?

MS. JOHNSON. I did not mean to suggest any pejorative notion by using the word "deflation." I meant it literally as just that the rate of change of certain prices was negative. Now, it is certainly true that it is happening in the goods sector because to some degree what you described has happened. That is, we have opened up--a little maybe--Japanese markets to world trade. For example, if you use Japanese national income account data in real terms, the share of imports to GDP has risen sharply. In that sense, imported goods and the competitive pressures that they can apply through market phenomena are having an effect of the sort you might want. I'm not so sure that I see that as much of an explanation for why land prices have been falling and are still falling. Nor do I see it really as an explanation for the stock market behavior. So, the asset price story, which had its own special factors on the up side in the late 1980s--a speculative bubble kind of story, fueled perhaps by what in retrospect seems like a too easy monetary policy--has a different story on the down side as well. I am not particularly alarmed that Japanese goods prices are responding to competitive pressures from the outside world. I would think that it might be easier on all concerned if it happened through an end to the upward pressures on the yen rather than through falling prices of Japanese goods. But I am not aware of any rigidity stories, for example, that suggest that because prices have some downward rigidity all sorts of problems are being created. I am merely suggesting that in that environment Japanese monetary policy looks to be a bit tight, given what we know about capacity utilization, the behavior of wages, and what is happening to asset prices. All the pieces fit together to suggest that the stance of monetary policy could be eased a bit in an effort to get that economy growing again.

MR. JORDAN. I didn't think you were being pejorative but I wondered about that policy conclusion. I don't see how what you called fiscal stimulus, which I assume is more resources flowing through the government or less taxes, or monetary stimulus is necessarily called for. If what is happening is a breakdown of the various types of impediments to the working of the marketplace in Japan, one should think of that as a wealth gain for the Japanese people. And other things the same, something that produces miraculously a wealth gain would not lead to the conclusion that you need an easier monetary policy.

MS. JOHNSON. True, but I am taking into account the other things we know about what is going on in Japan.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Mike, I have a question that relates to current activity. I have been struck by the fact that nonwithheld income tax payments this April were about $20 billion higher than in each of the two previous Aprils. I wondered what your assessment was as to the impact of that on personal consumption expenditures this spring. Is that a significant factor in your mind acting as a depressant?

MR. PRELL. It was one of the laundry list of factors that we mentioned in our discussion of consumption in the Greenbook. It works in the right direction. We certainly are not going to argue against that as a possible drag on consumer expenditures.

While we are on the subject of consumer expenditures--and I may get additional information later and I certainly would not want to interrupt your discussion at that point--but assuming you were interested in motor vehicle sales, Ford has released its data earlier than we anticipated, so we now have Ford and GM, the Japanese transplants, and a number of other manufacturers--that is, everyone but Chrysler. The ones we have are essentially unchanged from May. Chrysler has been indicating that they are fairly optimistic. They actually have seen their numbers, so I assume that their numbers will look fairly decent, and this would suggest that total light vehicle sales in June will be unchanged to slightly higher, which would be right in line with our forecast.

CHAIRMAN GREENSPAN. Any other questions for anybody? Would somebody like to start our roundtable?

VICE CHAIRMAN MCDONOUGH. I can, if you don't have another volunteer.

CHAIRMAN GREENSPAN. Go ahead.

VICE CHAIRMAN MCDONOUGH. Thank you, Mr. Chairman. The economy of the Second District remains weak, but earnings in the key financial sector appear to be on the rebound. That bodes well for the financial industry itself, for the service sectors which support it, and for needed tax revenues in New York City and the states of New York and New Jersey. Sales of existing homes are down from 1994 but are less weak recently than in the first quarter; they are now down about 5 percent as compared with 10 percent in earlier months. In the most recent month, permits fell 10 percent in New York and 14 percent in New Jersey, year over year. Payroll employment in May fell 1.2 percent in New York, reflecting cutbacks in local governments, and payroll employment was flat in New Jersey. Retail sales in May are up 2 to 11 percent over last year depending on the region, and they seem to be snapping back from disappointing sales in early spring.

On the national level, we see the economy working through the present weakness and growing stronger in the second half, entering

1996 at about a 2-1/2 percent annual growth rate and achieving a 2-3/4 percent growth rate in 1996, Q4 to Q4. We see CPI inflation somewhat more pessimistically than the Greenbook at 3-1/4 percent in 1995 and inching up to about 3-1/2 percent in 1996. You will recall that traditionally we are rather bearish in our view of price trends. Not surprisingly given the foregoing, we see the unemployment rate reaching 6 percent this year and dropping back to about 5-3/4 percent toward the end of 1996.

Looking only at the domestic economy, I believe that the risks to our forecast and the risks to the Greenbook forecast are rather well balanced. However, I am very concerned about the possible dangers from what may be at least somewhat greater than projected economic weakness abroad to considerably worse than that. I do not say that the international part of the Greenbook is lacking in its usual realism, but rather that the risks are mainly negative.

In the last several months I, like many of you, have had an unusual number of Japanese visitors including

They would be less optimistic than Karen Johnson on the growth of the Japanese economy in the next year and a half. Manufacturers must invest in capacity outside Japan to be competitive in world goods markets, leaving real and disguised unemployment behind in a country that is not accustomed to handling that problem. We believe the Japanese price data are distorted on the up side, and therefore there may be price deflation in the neighborhood of 2 to 4 percent. With few exceptions institutions in the financial services sector--banks, securities firms, and especially life insurance companies--have been severely weakened by operating losses and bad debts. Land prices fell 20 percent in 1994, and I agree with Karen that the land prices are likely to drop another 10 percent or so this year, at least that is how I interpreted the graph. The paper profits of many firms are largely gone at a Nikkei level of 14,000, which we are relatively near, and at 12,000 they disappear altogether. The Bank of Japan finds itself in the trap of low nominal and high real interest rates. Monetary policy is tight, A series of fiscal packages has been inadequate to provide needed stimulus. In the confused political situation, career bureaucrats have both more power and more fear of using it. A downward spiral of the real economy and the associated declines in financial--especially equity--markets are possible and could have a serious negative effect on world markets both directly and through generalized investor concerns.

In Europe a not very robust recovery suffers from two possible threats to European unity, which is the underpinning of recovery in many European countries. Those two threats, it seems to me, are the growing awareness of the difficulties of monetary union and the possibility that an even worse conflict in former Yugloslavia could separate the major European powers based on traditional and conflicting friendships with the various protagonists.

The jury clearly is still out and the verdict uncertain on the three major economies of Latin America--Mexico, Argentina, and Brazil. Positive verdicts are largely reflected in financial markets. I was in Brazil at the end of last week and met with the President, his economic team, and leaders of the private financial sector. Ongoing success of Brazil's Real Plan depends on superb financial management and near magic in working constitutional reforms in the fiscal area through a divided Congress. Among other things, the members of Congress from the various states have to agree to reduce the automatic division of tax revenues to those states, an act of considerable political courage. Any problem in Brazil would almost certainly mean further backsliding on their trade opening--particularly their Mercosur arrangements with their two small neighbors and, of special interest to us, with Argentina. And absolutely key to Argentina's ongoing success is market belief that Argentina will benefit from exports to the much larger Brazilian market. Private-sector investment, both domestic and foreign, is based on that assumption, and the future of Mr. Cavallo's convertibility plan in turn depends on private investment. Now, these foreign risks may remain risks and not realities, and let us fervently hope that is the case. However, the existence of these risks is of particular concern as our domestic economy passes through the present adjustment process when it is especially sensitive to shocks. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, most of the recent slowing in the Twelfth District economy has been in fast growing states, including Arizona, Idaho, Nevada, and Oregon. California has experienced less of a slowdown than other states and continues to expand at a moderate pace, but from depressed levels. Several large local governments within the state of California need to establish a path to longer-term solvency. Los Angeles County recently proposed to curtail expenditures severely.

Orange County is working to avert a short-term liquidity crisis, but it is having difficulty resolving its insolvency. Because Orange County voters rejected a proposed sales tax increase, additional measures such as cuts in county spending will be required. These recent developments have had surprisingly little impact on other municipal issuers in California. However, a persistent premium on California state debt suggests that the market expects the county's problems eventually to revert in part to the state.

Turning to the national economy, I am somewhat more pessimistic about the second quarter than the Greenbook. Our monthly indicators model suggests that real GDP declined at a rate between 1 and 2 percent in the second quarter. It appears that a good deal of this weakness reflects a small drop in final sales. While the economy is flirting with recession, it seems more likely that real GDP and final sales will increase somewhat in the third quarter and grow moderately over the next year and a half. Our staff has used our structural model to try to make sense of the unexpected surge in growth last year, which has been followed by surprising weakness recently. They found that in the latter half of 1994 household spending came in well above levels predicted by historical relationships with income, interest rates, and other variables.

Developments in the second quarter seem to bring these relationships back more into line so that the recent declines may have been in effect a payback for earlier strength in household spending. One partial explanation could be that consumers accelerated purchases to lock in interest rates in a period of rising rates. There certainly were anecdotal reports of this happening in the housing market in 1994.

Finally, I might note that we have raised our inflation forecast a bit for 1995, based on developments so far this year, but we have marked it down a little for 1996 in view of the excess capacity that is likely to develop later this year and the recent deceleration in unit labor costs. Overall, the longer-term inflation outlook seems to have improved in our view since we met in May. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. Mr. Chairman, the economic data for New England as for the nation indicate at least a pause in the recovery. The anecdotal evidence is more positive. In sum, total employment, housing activity, and confidence indexes have weakened in the region. However, the jobless rate continues to drop. Inflation on both the price and the wage side remains well in check. And many manufacturing contacts describe themselves as wavering between hopeful optimism and watchful concern as they contrast their own order books with media reports on the national situation.

Moving to a little bit of detail: Employment in the region fell in May with the weakness concentrated in construction and manufacturing. Services and trade, which have accounted for most of the job growth we have had in this recovery, also had a relatively weak May. Despite the lack of job growth, the regional unemployment rate was 5.2 percent in May. A decline in the regional labor force is one reason for the apparent inconsistency between the weak job figures and the low unemployment rate. Consumer confidence in New England has declined sharply, with the index dropping from over 80 in May to 60 in June--the sharpest decline in any region in the country. To contrast this a bit, business confidence in the region also deteriorated quite sharply in June according to a survey of Massachusetts companies, though it still remains above the level consistent with optimism on the part of more than half of those surveyed. So, consumer confidence has dropped quite a bit more sharply. Business confidence has declined but the way those indexes are figured it remains consistent with some optimism.

Our informal discussions with area manufacturers and retailers again have a somewhat more positive tone. Manufacturers in particular report good growth in shipments, and several high-tech companies in the electronics and medical areas are planning large hires. Nevertheless, there are some companies that see evidence of slowing and the performance of the auto industry in particular is being followed very closely. The retail situation is mixed. The weaker performers may be more representative of the general state of the regional economy. Our retail respondents who are doing well seem either to be gaining market share or sellers of specialty products.

Lastly, since the latest national data on new home sales were so strong and I reported the last time that there was a better picture in New England on home sales in general, I would note that our latest housing market data in New England have been quite sluggish, though again that is not without its bright side. Some contacts have noticed a pickup in sales in the past month.

On the national scene, we are largely in agreement with the Greenbook forecast this time around. Based on information to date, we see inflation, particularly for the last part of 1995, a little higher than the Greenbook is forecasting. All in all, we find the baseline Greenbook forecast appealing, but we are concerned about the risks to that forecast and, given those risks, how we should be looking at policy going forward. That is the subject for later on in the discussion.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Overall, the Philadelphia District economy is flat to down, probably down in the second quarter going into the third. Manufacturing has been the hardest hit, more so than in the nation as a whole. There is a tentative sense among District manufacturers that the bottom may be near and that an upturn is in the offing during the fourth quarter and into 1996. Most say a healthy export business to Europe and Southeast Asia is cushioning the downturn in domestic demand. Housing activity appears to be responding positively to lower mortgage rates, although the level of activity is still down from a year ago. Retailers say sales are up but below expectations. They are cautious about the rest of the year. They say that a period of pent-up demand has passed and customers are again more susceptible to postponing purchases. Retailers look to a continuation of discounting to keep sales growing. Loan demand at banks is soft and most bankers say their customers are more cautious than several months ago. The region has been hit with more major corporate downsizings, which make for headline news, and these downsizings greatly outdistance interest rates as a matter of general concern. There are still a lot of help-wanted signs in the region, at retail shops as an example, but they are mostly for lower-paying jobs. Wage and price pressures remain subdued. My sense is that expectations in the District about whether the economy is headed for a recession or a rebound are in a sensitive stage. Business people generally are cautiously predicting a bounceback, but these predictions are vulnerable to shocks or continued signs of weakness. Expectations could change quickly. Consumers seem more cautious than businesses, judging from comments from retailers.

Turning to the nation, I think the most likely outcome is a resumption of growth, although the risks of a self-feeding downturn clearly have increased significantly for all the reasons that we have discussed. There is little room at this point to absorb additional downside developments without causing a recession. These downside developments are easily imaginable. They may occur if we don't get a rebound in exports, say, because of less growth abroad as detailed by President McDonough. Consumer or business confidence may deteriorate much further as recession talk increases, and one can add to that list. We could conceivably get a much stronger rebound in the economy than expected for the opposite reasons, but this outcome seems to me to be much less likely at this point. As for inflation, there has been an uptick in cyclical inflationary pressures. However, with wage pressures subdued and price competition intense against a background of timely monetary restraint earlier, we still appear to be on track for achieving price stability over time.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Thank you, Mr. Chairman. I would like to take just a couple of extra minutes tomorrow when we talk about the longer-term strategy of policy, so I'll try to make these economic comments this afternoon as brief as I can.

As our Beigebook report indicated, our three latest monthly mail surveys of retail, service sector, and manufacturing activity all indicated somewhat slower growth in these key sectors in our region in May; again, these surveys were done in May. More recently, I found the tone of the anecdotal comments at our June board meeting, at which we invite not only the Richmond directors but also our Charlotte and Baltimore branch directors, somewhat more bullish and at least mildly encouraging. On the whole, I would say they suggested that business activity in our District may be bottoming out and getting poised for a bit of a revival going forward. Our regional anecdotal tidbit of the month is that the recent closing of Pennsylvania Avenue is going to cost the D.C. Government about $3/4 million in parking meter fees. I don't know what that implies for the fund rate, but that's a fact for whatever it's worth.

Regarding the national picture, as I think I have mentioned before, we use a VAR model in developing our Humphrey-Hawkins projections and this time our projections are very close to the Greenbook's except for inflation; we are on the high side there. We are showing about 1/2 percentage point more CPI inflation in both 1995 and 1996--to be specific, 3.5 percent for 1995, which I think is the upper limit of the estimates you received from the members, Mike, and 3.3 percent for 1996. Even allowing for the rising inflation in our forecast, I would say that both the Greenbook projections and our projections in a sense are pretty rosy, at least from here on out. They both say that real growth hit its low point and inflation hit its high point in the second quarter, and they both project rising output and employment and generally declining inflation going forward. Frankly, this gives me a little pause since, as we all know, rosy scenarios often don't play out. In general, along with my staff, I still think the risks are pretty well balanced, but I have to confess that I am still worried about the downside risks on the real side. I think the recent weakness in employment and income growth could feed back into spending. Moreover, a slowing economy is always more vulnerable to downside risks, and I think Bill McDonough's comments about the downside risks in the external sector are reasonably well taken. Against that background, I very much hope that the June employment report is a little brighter than the last two.

One final comment I would make on the financial side--I think the 15 basis point jump in the long bond rate in response to that new homes sales report in May was remarkable. It was, to be sure, a very large jump. But this is a series that everybody knows is unusually volatile and it usually does not get anything like that kind of reaction in bond markets. I think that reaction indicates how super sensitive even the longest-term inflation expectations are to relatively small bits of information. That suggests to me that we need to provide a firmer anchor for these longer-term expectations and I'd like to come back to that tomorrow if I may.

CHAIRMAN GREENSPAN. Well done! President Forrestal.

MR. FORRESTAL. Mr. Chairman, the recent indications of economic activity in the Atlanta District are fairly mixed, but the important housing and manufacturing sectors are beginning to show some signs of accelerating. Employment growth has pretty much leveled off in the District, although District unemployment rates generally remain below those for the nation as a whole. The retailers in the District have met most of their expectations, at least in most parts of the region, and merchants are fairly optimistic about the third quarter. Apparel sales, for example, have improved but sales of household goods have slowed down. Throughout the District auto sales remain weaker than they were a year ago. Tourism is strengthening in the District, with only central Florida remaining somewhat weak. Manufacturers' shipment and production activities have increased recently, but the number of contacts reporting that they have added to payrolls has declined since earlier in the year. The domestic market for paper producers is cooling, but export demands remain pretty good in that sector and are bolstering production, and chemical and plastic shipments also continue to be quite strong. Apparel production is steady for some products but demand has fallen off for other categories. This is resulting in slowing factory activity in that area. Building-related producers of such items as carpets and lumber are reporting some slowing. Residential building is also slowing in the region and builders are quite cautious, but realtors are optimistic; that is a change. I thought realtors were always pessimistic, but apparently they are not at the moment. Realtors are reporting that single-family home sales are up for May and early June, and they attribute much of this rebound to lower mortgage rates. Home inventory shortages are reported in very few of our markets. Multifamily construction continues to increase with rising rental rates and occupancies, although realtors anticipate that the rate of increase in rental rates should slow in most areas of the District. Nonresidential construction also continues to increase, with rising rental rates and occupancies now notably spreading into industrial space.

Lending activity throughout the District again is quite mixed. Demand for auto loans and most other types of consumer loans is generally soft, but commercial and industrial loan demand is strengthening. Wages remain essentially unchanged throughout the District, and we continue to get scattered reports of shortages of skilled workers, particularly construction workers in Tennessee. As was the case at the time of the last FOMC meeting, fewer manufacturers than before reported higher prices for both materials and finished products, although we are getting reports from industrial contacts that materials prices charged by paper, plastic, tire, and chemical producers continue to go up. Though I said at the outset that I think the picture is decidedly mixed, the anecdotal information that we are getting from our directors and other business people is definitely very, very cautious, a little bit on the pessimistic side.

With respect to the national economy, our outlook shows a pickup in growth toward the end of the year and we expect that growth to continue in 1996. For that reason we are somewhat more optimistic on the growth side than the Greenbook, and naturally with that kind of forecast our employment gains are a little better. On the other hand, we show very little improvement in inflation. Now, some of these differences might be accounted for by the fiscal policy assumptions in the Greenbook that we don't have in our forecast, and that would minimize the differences in the two forecasts. I think both forecasts are similar in that they view the current slowdown as a mid-cycle pause rather than the onset of a recession. I think that both of these forecasts are reasonable and within the usual range of forecast errors. But I must say that I continue to be disturbed by the incoming data, which are below the expectations that we had earlier. Clearly, as many people have indicated, the risk of recession has risen. It's not difficult to imagine, as Ed Boehne has suggested, that this decline in industrial production and weak employment could lead to a decided softening in demand. And built into at least some of our earlier forecasts was greater growth in our trading partners, particularly in western Europe. And as Bill McDonough and others have pointed out, that may be an optimistic view at this point since we are looking at a lower rate of growth in those countries. To sound like an economist, I would say on the other hand [Laughter] that underlying conditions are not unfavorable in the economy. The imbalances that we had during the last recession clearly are not present; household and corporate balance sheets are much better, the banking system is in relatively good shape. While we do have an inventory overhang, that seems to be in the process of being corrected. As I look at the entire picture, I think a recession is probably not the most likely outcome, but I think that the risks are definitely on the down side. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, the Tenth District economy remains moderately strong, but signs of slowing have emerged in recent months as I reported earlier. For example, District employment growth slowed in March and actually turned down slightly in April and May, and the decline was rather broad-based. However, total employment in May was still almost 3 percent higher than a year earlier, and our unemployment levels across the states are consistently below the national average. In addition to slow employment growth, activity in the energy industry remains weak in our region, and the farm economy has been hurt recently by unfavorable weather and weak prices. Other indicators, though, point to continued underlying strength in our District. In construction, we have had recent job losses, but an upturn in housing permits and other construction contracts suggests the decline will be reversed in the months ahead. In manufacturing, our survey of recent conditions indicates that this sector continues to expand, albeit at a somewhat slower pace. District manufacturers also indicate that they still are operating at relatively high rates of capacity use. Retail sales other than automobiles have been holding up quite well in recent months. Moreover, retailers are generally optimistic about their prospects, although some inventory trimming has occurred. Confirming some of this underlying strength in the District, loan growth at our banks remained relatively strong in May after moderating somewhat in earlier months this year. Against this backdrop, wage and price pressures are easing to some extent. We are seeing price increases in raw materials and manufacturing and we still have some shortages in labor in District markets. But price increases for finished goods have moderated and prices remain relatively stable on the retail side.

On the national front, our projections are relatively similar to those of the Greenbook. We believe the economy is going through a pause and an adjustment phase right now. We expect that there will be a couple of quarters of growth below trend, but at the current level of fed funds we would also expect the economy to return to growth near potential by the fourth quarter and into next year. This view is based on the fact that the fundamental determinants of consumer spending and business fixed investment are positive. The outlook for net exports, while less robust than earlier thought, remains generally sound. Inventory excesses do not appear large enough to require a prolonged correction. This outlook permits the labor market and the industrial sector to return gradually to levels of activity consistent with more stable inflation. We are looking for inflation to be capped at about 3-1/4 percent, which is not quite as optimistic as the Greenbook. Looking beyond that, we see continued growth near the economy's potential in 1996.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Mr. Chairman, reports from our District contacts have been more mixed lately. While economic conditions in certain sectors of the District continue to show signs of slowing, some pickup in activity was reported in other industries. Reports from our contacts in the automobile industry and, of course, today's announcements indicate that autos and light truck sales in June moved slightly above May's annual rate of 14-1/2 million units, but not up to the 15 million units that we were expecting just a few weeks ago. I think that's because of lower sales at one of the Big Three and lower expected sales at one of the foreign nameplates that has not yet announced its sales. I don't view this as a pervasive, industry-wide slowing in the last couple of weeks in June. I think the slowing is more focused in those two companies. And, as Mike mentioned, Chrysler has not yet announced, but we are expecting its sales to be up 11 to 12 percent; of course, that number is confidential until it is announced.

CHAIRMAN GREENSPAN. I think Chrysler has announced its sales.

MR. PRELL. You have the numbers!

MR. MOSKOW. They announced today?

CHAIRMAN GREENSPAN. Yes. The Chrysler numbers, seasonally adjusted by the Fed, went from a rate of 2.22 million in May to 2.43 million in June. According to Dixon Tranum, our analyst, that puts a rough estimate of total sales in June up slightly from the seasonally adjusted May level.

MR. PARRY. Is this the first month that Chrysler had the new minivans?

MR. PRELL. I don't think they have the new minivans.

MR. PARRY. They are out.

MR. BLINDER. I hope this is not going to throw the seasonals off.

MR. MOSKOW. Of course, they are the one company that has widespread incentives for both their cars and their light trucks now. None of the other manufacturers has incentives across the board. Despite the production cuts so far, it is likely that inventories at the end of June remained near the 70-day supply that existed at the end of May. This year's weakness in light vehicle sales may reflect factors other than overall consumer demand because the total number of light vehicles sold, including both new and used vehicles, actually has risen slightly this year from last year. I think an important factor is the rise in the supply of used vehicles coming off lease, and this trend is going to continue to accelerate in future years as well. In addition, despite the incentives on new vehicles, relatively high prices and finance company auto loan rates may be shifting demand from new vehicles to used vehicles. Orders for heavy duty trucks are exhibiting signs of weakness. However, the back orders remain quite high and cancellations have not picked up. On a seasonally adjusted basis, heavy duty truck production in the third quarter is planned to be about even with the first and second quarters of 1995.

For other manufacturing firms, particularly in the consumer durables sector, inventory pruning has been a major factor constraining production, but we do not believe that operating rates are falling to recessionary levels. Industry reports have indicated noticeable reductions in order backlogs for heavy equipment, further slowing of durable goods production, and planned cuts in overtime and weekend operations and in temporary workers. One large producer of heavy equipment has seen a drop in the number of their models on allocation from 30 to 15 in the past few months but, of course, they still have 15 models on allocation at this point. Indeed, producers of construction equipment believe that orders and probably production peaked in the second quarter, and firms are now focusing on managing the expected economic slowdown. One District appliance maker reported cutting production and workers in May and June in an effort to trim factory inventories accumulated earlier when sales were softening. But this contact also noted that the inventory adjustment by appliance dealers appears to have been short-lived. For the industry as a whole, factory shipments of appliances strengthened in May and strengthened again in June. Purchasing managers' surveys in our District indicate slowing activity overall, with the latest Chicago survey dropping to its lowest level since June 1992. On the consumer side, although reports were mixed, most retailers in the District report that sales growth improved in May and again in June on a seasonally adjusted basis. Reports from several national retailers reflected less concern about inventory positions than in previous months, although some added that stocks were still above desired levels. Others indicated an inventory buildup at specialty and discount retailers as a result of deteriorating sales.

We have not yet seen a widespread revival in the housing sector, although realtors and homebuilders are optimistic and there are increasing signs that lower mortgage interest rates are beginning to have an impact on activity. In agriculture, weather-related delays during the spring planting season trimmed this year's crop acreage from initial intentions and increased the odds that per acre yields will be reduced by other problems during the growing season. Because of the increased chances of a significant tightening in supplies, grain prices have risen sharply and are likely to remain quite volatile for the rest of the summer.

Although the labor markets in the District remain relatively tight, slowing economic growth had tempered demand for workers and some easing of wage pressures was reported. Our average unemployment rate in the Seventh District is 5 percent now compared, of course, to the 5.7 percent rate nationally. On the price side, reports generally have indicated some abatement in upward pressures, mainly in input prices. Reports of renegotiations of earlier steel price hikes continue to surface. Of course, the planned July increase is widely expected not to go into effect. The auto parts producers are reporting renewed pressures from the Big Three to cut prices. Energy prices in the District have eased, partly due to soft demand. Freight haulers report competition for slower business is pushing down rates. One notable exception is paper and paper products, where prices continue to move up.

Overall, we agree with the Greenbook that the current outlook is for slower growth in 1995 rather than a recession. Even though the second quarter may be worse than the Greenbook forecast, as long as some key expenditure categories do not turn sour, especially business fixed investment, 1995 should not yield to recession. While the core CPI has increased at an average annual rate of 3.8 percent so far this year, we agree with the Greenbook that the inflation outlook is improving. There remains substantial uncertainty about the actual level of inflation, but the expected path is one of improvement.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Thanks, Alan. As has been noted, there has been a mix of positive and negative indicators of U.S. economic performance recently, and it is not easy to know what such indicators portend for the future. It's my opinion, however, that the economy has enjoyed a very balanced expansion since its cyclical trough in March 1991, weathering major changes in federal spending and corporate restructuring. Like the Board staff, I am inclined to think that the recent spate of negative indicators reflects a pause in the current cyclical expansion rather than the onset of a recession. We are forecasting real GDP growth in the range of 1-1/2 to 2 percent this year, with such growth returning to near its potential in 1996. With an appropriate monetary policy I also believe that inflation could drift down from current levels in 1996, although we would still be a good distance away from price stability. On the positive side, the financial indicators are generally looking good. The equities market is riding high, and long-term interest rates are down significantly from their peaks of last November. Indeed, there are indications that investment spending, including housing, and durable goods may be responding positively to lower long-term interest rates. Bank lending is strong, and in the Eighth District loan quality is very high. Over the economy as a whole, bank lending is being reflected in an extraordinary increase in the broad monetary aggregates, which on a longer-term basis are roughly linked to demand growth and inflation. There are few signs of structural imbalance. The ratio of inventories to final sales remains low; the consumer installment debt delinquency rate is near a 20-year low; and the ratio of debt service to disposable income is well below peak levels reached in the late 1980s.

Furthermore, the value of the dollar has declined significantly in real terms, so much so that U.S. goods and services must certainly look like bargains in the world market. I expect that this will stimulate domestic production later this year and into 1996.

Although growth in the Eighth District has slowed, the District economy remains strong. Unemployment in District states continues at well under the national average, and employment has continued to grow in both manufacturing and nonmanufacturing. District firms producing prefabricated metal buildings, mobile homes, and furniture are experiencing strong demand. Perhaps this says something about the durables sector. Currently, foreign markets are providing good outlets for the products of many District firms, but sharp increases in import prices are adding to costs. In the Eighth District, we see little letup in pressures to raise prices. We continue to receive anecdotal evidence that qualified workers are in short supply. Most contacts in our District report rising costs and some moderate wage pressures.

Given this outlook, I am more concerned about long-run inflation than the prospect of a sustained decline in output. CPI inflation accelerated to 3-1/2 percent during the first half of 1995. Such an enormous amount of liquidity was added to the economy in 1991 through 1993 that I remain concerned whether our restrictive policy stance since then has been sufficient to cap inflation and make further progress toward price stability. In my opinion, the declines in inflation and inflation expectations have contributed to the current expansion. Comparatively low inflation has kept U.S. output competitive in both foreign and domestic markets. Moreover, the decline in inflation expectations, which is critically linked to our credibility--the point Al Broaddus was talking about before--has reduced uncertainty, encouraged investment, and enhanced productivity. A continuation of the downward trend in long-run inflation is essential for achieving maximum sustainable economic growth.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Growth in the Dallas District has slowed considerably from the pace earlier in the year, but we are still seeing positive employment growth. With high levels of resource utilization still being the norm, the attitudes of our directors, Beigebook contacts, and others remain fairly good. I might say that while our directors read the same newspapers as everybody else and are aware of the weakening in the national economy, their anecdotal stories are more positive than what they are reading. The drop in mortgage rates is beginning to have a positive impact on building permits, single-family housing starts, and forecasts of real estate activity for later in the year in our District. The impact of the peso devaluation, while it has been serious for our District, has been mitigated by several special circumstances. One is a surge in petrochemical exports that has helped especially the Houston economy in recent months. Another is a pickup in foreign demand for computers and electronics components produced in our District. Also, the weaker peso has helped the Maquiladora industry along the Texas-Mexico border. El Paso is particularly a beneficiary and is having good overall employment growth despite the very weak retail markets in the area right along the border. So, while export growth has slowed from what it likely would have been had exports to Mexico continued to grow at their 1994 pace, our overall exports have continued to grow sufficiently to offset some of the weakening in domestic demand. Our directors continue to report exceptionally easy credit standards throughout the District, which probably have reduced the effective cost of bank credit and made the impact of current short-term rates somewhat less restrictive than we might normally expect.

On the national side we have no major arguments with the Greenbook. One anecdote is that J.C. Penney's sales in June were very disappointing and they described their inventory accumulation during June as being at recessionary levels.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Thank you, Mr. Chairman. As at the last few meetings, I wanted to give a fiscal policy update, and I have distributed a table to the members of the Committee. I think the table carries with it several messages. First, I would refer you to a comparison of the two columns labeled "1995 Enacted" and "1996 602B Allocation." The 602B allocations are given by the budget committees to the various appropriations committees, and this is the amount of money they can divide up for actual spending. I think the first thing that is instructive is that the basis for comparison on this table is nominal 1995 levels of spending. We are not cutting from some baseline that includes growth; we are cutting from 1995 nominals. The amount of the cut is just shy of $22 billion. This is not mandatory spending; in other words, Medicare is not in here; Medicaid is not in here; food stamps are not in here.

CHAIRMAN GREENSPAN. Social Security?

MR. LINDSEY. Oh yes, Social Security is not in here; interest payments are not in here. These are real-money-out-the-door types of programs. The $22 billion figure roughly contrasts with the discretionary number of $18 billion that is in the Greenbook. The fact that these cuts are from a nominal level leads me to make some adjustment to see just how much contraction is occuring. If we thought that real spending should be roughly constant next year, we would need to have an idea of GDP in 1996 and we would at least want to assume some kind of constancy in real spending and perhaps a little above that. If we add a 3 percent inflation factor, we really are cutting real spending by something on the order of $37 billion as opposed to $21 billion, and that is before we get to the Medicare adjustments.

The second observation I would make--we have a small sample of only five subcommittees on the table here--is that four of the five subcommittees have cut more than their 602B allocations. These are appropriations subcommittees that refer back to the Appropriations Committee. I can't remember this ever happening before.

CHAIRMAN GREENSPAN. The reason you don't remember is that it has not happened.

MR. LINDSEY. It hasn't happened, yes. The chairmen of these subcommittees often are called the 13 cardinals. If you have a problem, no matter what party you belong to, you go to one of the cardinals and their job is to take care of your post office or your road or something like that. Needless to say, when they are up against a 602B allocation they manage to spend all the money. Otherwise, they don't keep their robes very long or whatever, I don't know what the analogy would be. So, four of the five committees that have come in have cut below their 602B allocations. The only thing I can read into that is that there is perhaps more political seriousness than is usually the case.

The third thing to keep in mind here is that what is being balanced is that one has to successfully logroll to get a majority among two different groups of people. The Budget Committee allocations involve one group of people, but they don't really have responsibility here. These appropriations committee people are another group, and the fact that they are managing to get majorities in both is very, very instructive. Basically, these are going through on party-line votes. So, the amount of cohesion is quite high. This, of course, is very, very early in the process. We go from here to the Senate and then to a conference and then to the presidential veto, but so far I would say that the Appropriations Committee actions suggest that deficit reduction is at least on track. Perhaps we are seeing some reductions below 602B allocations to have as bargaining chips later on. You have to have something else you are willing to cut in order to get your program back. But I think it is very, very striking that we are truly in a new world, as the Chairman just noted.

CHAIRMAN GREENSPAN. Thank you, quite interesting. President Stern.

MR. STERN. Thank you, Mr. Chairman. The District economy continues to do reasonably well based on the available objective measures. There are some problems in agriculture related to weather, but otherwise things seem to be moving along reasonably well. A couple of bright reports have come in recently. One is a firm with a large mortgage banking operation that says business has been quite good recently and the improvement is only partially related to refinancing activity. And a large appliance and electronics retailer says that business has held up well. Having said that, I think there is a sense of disappointment in some parts of the District, and it is not because activity has contracted in an absolute sense. I think it has more to do with what people thought this year's business growth might turn out to be for their firms, what they took to be a trend as opposed to what economists might consider trend rates of growth and so forth. Actual developments just have not lived up to those more favorable expectations. I think there is some of that going on.

With regard to the national economy, I do have some concerns. First, I will talk briefly about some things that don't concern me. Our model is also a VAR model. We update it as new data become available and it is giving us a forecast not precisely equivalent to that of the Greenbook, but not very different--a continuation of modest growth and some slowing in inflation over time. What strikes me about the forecast is that the most recent run of the model does not differ very much, if at all, from the run we did prior to the May FOMC meeting. So, even though a lot of the data that have come in on the national economy in that intermeeting period were on the soft side, our model continues to generate the same forecast. That says that either those numbers are consistent with what the model in some sense was expecting or there have been offsets. The offsets, of course, could be on the financial side because of the continued improvement in the bond and stock markets. In some sense it is as if we almost have an automatic stabilizer working in the bond market, with interest rates declining as this has unfolded. That, as I suggested, doesn't concern me.

What does concern me are some other things. First of all, like the Greenbook, when we interpolate the second quarter we get a contraction in activity; and if we go back and look at the preliminary GDP data--not the data that are finely smoothed and reported several years later--it's rare, though not wholly impossible, to find a contraction in GDP that isn't ultimately associated with a recession. I just report that as a fact. I don't know what its implications may be this time around. What concerns me are a couple of things that have been mentioned. One, I share Bill McDonough's concerns about the foreign situation. I have a sense that we have looked at the sunny side of a lot of those economies for a time, and that things just are not panning out and have not for a while, and I am concerned about what that implies for domestic activity.

I am also a little suspicious that we may have underestimated the effects of the 1993 tax increase. It's not just that tax payments apparently were much higher than anticipated in April 1995, but I can see where the repercussions of that may be more important than I, at least, thought earlier.

Finally, I am uneasy about this so-called inventory adjustment. My experience is that those kinds of inventory adjustments never turn out to be as quick and as easy and as painless as we hope. It is a truism that if demand holds up they do turn out to be relatively easy and relatively painless, but that is a big "if." In listening to the explanations about why demand might be expected to hold up, I agree that it might well. But I don't know that I heard anything newly compelling about that, and so my concerns are not entirely assuaged as I listen to those explanations.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. The staff at Cleveland did a survey of various companies across the District on the subject of inventories. The main objective was to gauge business sentiment about current inventory levels. In line with what Gary was just remarking, given their comfort levels with their order books and projected sales, our business contacts simply had no complaints about their inventories. They might talk about problems relating to the mix of their inventories, sometimes referring to thin inventories in some lines that were balanced by too much of something else, but they did not have an overall concern. And that was just as true of manufacturing companies as it was of retail companies and distributorships.

What has changed in the last few months is that we have heard far fewer stories about overworked workers--workers complaining about too much overtime. So to the extent that there has been an adjustment, our anecdotal information would suggest a change from something that was perceived as being unsustainable to something that is much more comfortable all the way around. We recently had a joint meeting with all three of our boards and the reports were the most remarkably uniform that I have heard yet about how well things are going from the standpoint of real activity. The directors express puzzlement over what they read about the national economy, but I took that to mean that they don't understand the difference between first and second differences. They think in terms of the level of their firm's activity compared to a year ago and it is uniformly positive in every respect. They do not see things as we would in the sense of changes in the rate of change.

There was one new development that I thought was significant and that was their expectations about prices. Except for paper, which Bob Forrestal also mentioned--they say that paper is a serious problem--there was uniform agreement in line with their earlier views that prices are going to be less of a problem. Steel industry people said that the July 1st price increases anticipated earlier simply did not happen, would not happen, and in fact that there would probably be some rollbacks in steel prices. They reported that prices of carbon steel were already being rolled back. Specialty steel people said that they had finished with their price increases for this year and were not planning any price increases even for the first of next year. said that he had come back from an international trade convention of their association, and he said that in the last few months there had been a dramatic shift in thinking about prices of paints and resins and that sort of thing--from expectations that firms could get further price increases to expectations that prices would be flat for the balance of this year.

On the labor markets, sometimes when I think about all that is being said about the minimum number of people that are not working and how we have to maintain this reservoir of unemployed people, I feel I ought to come to these meetings and apologize because we have so few people who are not working in our District. There are ten counties in Kentucky and more than ten counties in Ohio that report unemployment rates of under 3 percent; some reports are down around 2 percent or even lower. If we have so few people who are merely consuming the product of other people instead of producing something themselves, one might conclude that maybe we are going to have an inflation problem. If I thought that this was going to lead to a problem of cost push, wage push, or rising prices I would be as concerned as anybody else, but I simply don't see it. In trying to find inflation out there, I mostly get an indication that the productivity increases that are being sustained are warranting the kinds of demand for labor that our firms are registering. It is not the kind of thing that I think people have looked at in previous cycles as a source of future inflationary pressures.

Turning to the national economy, when I was looking at the Greenbook I was pleased to see the slight downward tilt in the inflation number for 1996. But then Mike gave us Chart 18 showing the ranges and central tendencies of the FOMC members' forecasts, and that leaves me still puzzled about consistency. The Greenbook projects an upward tilt in intermediate- and long-term rates this year. It suggests that the absence of some downward adjustment in the funds rate that is assumed in the Greenbook will disappoint the markets, and so longer-term rates will go back up. But except for that kind of a linkage, when I look at the staff's nominal GDP forecast for this year and next year I don't understand why we should have higher intermediate- or long-term rates than currently--not with 4.1 percent nominal GDP growth this year and 4.5 percent next year. If anything, rates of 6-1/2 percent on 30-year bonds and 6-1/4 percent on 10-year issues are still a bit too high for any sort of sustainable equilibrium. But when I look at the members' forecasts of nominal GDP for 1996, the range goes as high as 6 percent, and if that kind of forecast for next year and its mix of output and inflation are correct, then the consistency problem is in the intermediate- and longer-term rates, not in the short-term rates. If the central tendencies of the members' projections--they are above the Board staff forecast--are the best guess as to what is going to happen, then I would think that the adjustment has to be in the shorter end. I certainly don't sense any urgency on anybody's part--the directors of our boards and other people that we talk to--that we move toward something that would be perceived as monetary stimulus, with or without an idea about needing to offset some fiscal restraint. Yet, I think that very few people would be arguing at this juncture that we ought to be moving to what would be a de facto more restrictive policy stance.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, when the economy is experiencing a slowdown, we can't be comfortable about its potential length or depth until it is over--and this slowdown is not over. I feel that particularly strongly in light of many of the reports that we have had around the table so far today. But that said, I still have to be on the more sanguine side as I watch the data that come through here. The consumer does not look as if he is scared to death. Retail sales have come back some already, not strongly, but nevertheless they are not falling any more. Credit is still flowing nicely, maybe in the view of some a little too strongly. With regard to the surveys of consumer confidence, the Michigan survey has now turned back up just a little. The Conference Board survey is still showing a little weakness, but both surveys are at fairly high absolute levels. Capital spending was certainly going to slow down from its earlier pace, and I guess it has, but it still looks good. Orders and backlogs are still up. Housing and autos appear to be stabilizing on the most recent numbers that we have received, and certainly the strong rally in long rates has helped that. The stock market must be helping sentiment and certainly the wealth effect that goes along with that. All those good things being said, however, it is hard to find where there is a strong growth engine anywhere that is really going to kick this economy into overdrive. One of them that could have done that, the outlook for net exports, seems to be increasingly cloudy. When one can't find real strength anywhere, that could, of course, presage further weakness. But it does seem to me that the odds are against a deepening of this slowdown and that the odds favor an economy that is coasting upward toward a sustainable growth rate. For my part, I would put that rate somewhat above that in the Greenbook.

Turning to inflation for just a minute, the battle for price level stability certainly has not been won yet, but I must say that I feel better about that prospect than I have at any time I can recall since I have been here. The evidence on inflation and its course is positive. Everybody here is familiar with that evidence so I won't recite it. But it does look now as if inflation may be peaking cyclically somewhere right in here. If so, we are entitled to take some satisfaction from that. It would represent considerable progress both in terms of a substantial reduction and also the fact that a secular downtrend has been going on for a long time and is continuing. To be sure, we are not at price level stability and we have to keep our sights on it.

A couple of observations if I may: Number one, I think this Committee has always envisioned attaining price level stability as a project to be accomplished over some period of time. If in fact the rate of inflation is peaking right in here for this cycle, that will occur at a pretty high level of economic activity. I think most of us anticipate that we are going to go back to a sustainable level of economic growth that should not kick off any new inflationary pressures. If this expectation is at all reasonable, then I think we are in a fairly comfortable position for the moment. Second, I think it is of key importance that we maintain the secular downward momentum toward price level stability. That has been in place for a number of years now, and I think it still is. I believe it is the number one duty of this Committee to make sure that the secular downward trend continues in place. But if all of this is in the ballpark, I do think it may imply that we have more flexibility for positive kinds of reasons than we have had since I have been involved in this whole business. We do have some flexibility to move responsibly if there should be a desire to do so. I'll stop right there.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Thank you. I think the preparation for this meeting has been for me the most difficult of my tenure, and that is because we are seeing so many conflicting economic signals. We seem to be at the classic fork in the road--whether or not this inventory correction will work itself into a downward spiral or will turn out to be an air pocket as we approach a soft landing. There has been a fair amount of discussion today about the conflicting real economic data signals. We have talked about auto sales, housing, the inventory buildup, and the consumer sector--these are areas where the signals are mixed. But if the real data signals are mixed, I would have to point out that the monetary aggregates are giving us even less consistent signals. The current frenzy of economic analysis and spinning of the econometric forecasting models probably are more than can be supported by the meager data to date. We are all struggling to look inside the models, questioning assumptions, questioning this, and questioning that. However, because we are on such a narrow path and the adjustment is likely to be so fine, it is difficult for the models to pick up some of these fine gradations.

Well, having been a bit frustrated by that process, like Bob Forrestal I went back to the question of whether some of the fundamental strengths that propelled the economy forward in 1994 were still present. They are not as strong they were, but they are still definitely present. Business investment, while not growing at a high double-digit rate, is still relatively strong. The financial markets are not pointing to an economic downturn. The banking system is strong. There is no credit crunch in sight. In the labor market, even if unemployment does notch up a bit, we are still relatively close to full employment. In the manufacturing and financial sectors, the productivity improvements are holding up. On the inflation front, the uptick that we have seen this year does appear to be related to cyclical pressures, as Mike Kelley observed. Since wage inflation appears to be in check, it is unlikely that the upward adjustment that we have seen in 1995 is going to be permanent. On balance, the fundamental strengths that brought us to where we are now in this cycle remain, but I think the economy is vulnerable to the inventory correction that is under way. And as Bill McDonough and others mentioned, there is a potential risk from international weakness or other shocks. When the economy is in a weakened situation, any kind of shock can have more of an impact. In short, while I think the fundamental strengths remain, I think the downside risks are stronger.

CHAIRMAN GREENSPAN. Governor Yellen.

MS. YELLEN. During the last six weeks my optimism has diminished that the inventory adjustment process is going to be behind us after two quarters and that thereafter the economy will return to trend growth with unemployment in the vicinity of the NAIRU. The inflation outlook, however, has correspondingly improved. Although the most recent employment report was a wake-up call, I think the news since our last meeting has been predominantly negative. Governor Blinder's prescient prediction at our last meeting that the Greenbook forecast for the second and third quarters of 1995 would once again be written down by an average of 1/2 percentage point per quarter has proven accurate, although he, too, underestimated the downward revision. Even so, I still consider the Greenbook's forecast a bit optimistic because I think the bulk of the risk with respect to real activity is on the down side. With even a modest further shortfall in final demand growth, it is easy to elaborate a scenario in which the inventory adjustment process is more protracted than previously foreseen, and the longer-term outlook, once inventory factors have turned to neutral, entails higher unemployment and a larger output gap than the Greenbook envisions. We could easily end up I think in an extended growth recession.

At our last meeting, I was somewhat sympathetic to the Greenbook's conclusion that the bond market rally might be overdone, and I was a bit concerned about the upside risk that interest-sensitive sectors might rebound too strongly. My concern on this score has faded. I now see the bond and stock market rallies functioning simply as automatic stabilizers that partially cushion the downside risks. I think the impetus of lower long-term interest rates and wealth effects that are working their way through the pipeline will buoy spending on housing and related consumer durables later in 1995 and in 1996. That impetus is needed to avoid a hard landing. If longer-term bond yields were to back up, which is an outcome anticipated by the Greenbook under the baseline fed funds assumption, the downside risks would be greater.

Let me just briefly enumerate what I see as the major sources of downside risk at this stage. They have all been mentioned in the discussion during the go-around. The first concerns inventory investment, which I think could easily turn out to be higher this quarter than the Greenbook forecast of $29 billion in real terms. This forecast is guesswork since, as Mike noted, a lot of crucial second-quarter data are missing. And if inventory investment is higher, more of the adjustment remains ahead than the Greenbook contemplates. I mentioned this last time and I just want to reiterate it because it is very important in my own thinking. There is always the downside risk that an inventory adjustment could trigger a snowballing process of cumulative decline through the multiplier-accelerator process with negative feedbacks on consumption as disposable income falls and on investment as business expectations are disappointed in line with what Gary Stern said had happened at firms in some parts of his District. As firms see their expectations for growth on which their investment plans are based being disappointed, that could trigger a decline in investment. Governor Lindsey voiced concern at our last meeting that credit terms may stop easing or may even tighten during a process of slow growth or conceivably recession if default rates, which are now showing some hints of picking up, were to rise further.

Another risk concerns consumption, which has been sluggish this quarter and could easily rebound less strongly toward year-end than the Greenbook assumes, particularly if a backup in long rates puts downward pressure on the stock market. The Bluebook's simulations reveal that a higher saving rate poses serious risks to the forecast. With a 1/2 percentage point increase in the saving rate, those simulations show unemployment rising to 6.8 percent by mid-1996.

A third risk that many of you mentioned and also concerns me has to do with export growth, which is a needed source of strength as we go forward. The depreciation of the dollar has left American goods very well priced in world markets but, like many of you, I am concerned about growth prospects in Canada and Japan and our other trading partners. Karen Johnson gave good reasons to believe that growth will rebound later this year in the rest of the world as in the United States, and I certainly hope that comes true. But it does seem to me that most of the risk is on the down side and the downside risk here is magnified through multiplier spillovers across countries. It comes through one country spending less and other countries seeing their exports fall and their growth prospects disappointed.

And then, of course, there is fiscal policy where since our last meeting I think the prospects for a contractionary fiscal package have improved considerably.

Now, to offset those sources of weakness, the Greenbook forecast relies on a strong rebound in housing demand and associated spending on furniture and other durables, including motor vehicles. But under the baseline fed funds assumption with some backup of long rates, I see a real risk of insufficient revival in these sectors. Moreover, as the Bluebook baseline simulation makes apparent, and Mike Prell reiterated this, by 1996 the tighter fiscal scenario alone clearly points to reduction in the natural, equilibrium, or whatever you want to call it, Wicksellian real rate of interest consistent with an economy operating at potential. In the Bluebook baseline, the real funds rate must decline to 2-1/2 percent by 1996 and 2 percent by 1997 to keep the economy operating at potential. So, I agree with the conclusion of both the Greenbook and the Bluebook that as we go forward the real funds rate will have to decline from its current level.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. I have five points to make. I tell you that because then when I get to point four you'll know I am almost finished.

CHAIRMAN GREENSPAN. Why don't you start at five? [Laughter]

MR. BLINDER. All right, I'll start with five. That was about inflation. I thought it was a good place to finish.

At the last two FOMC meetings I expressed two views--Governor Yellen has scooped me on this. I said that I thought the Greenbook was a shade too optimistic, and I said that history tells us that forecast errors are serially correlated. I say this not to gloat, because I am just as guilty of this as anybody else. I was below the Greenbook both times, but I was also too high both times. I am again a little below the Greenbook. In none of those cases was the discrepancy very large, although this time I see that I have the distinction of being just enough below the Greenbook to be outside the FOMC range. But that has to do with rounding to quarters, I hope. If not, there is a stronger message there! [Laughter] I should add, however, that since we have free rein in these forecasts regarding what we assume about monetary policy, I did not make the Greenbook's assumption about interest rates, but rather I embedded in my forecast the assumption that the fed funds rate would be 50 to 75 basis points lower by year-end than it is today, starting immediately.

I have several reasons for coming in with a forecast that is below the Greenbook, and I am just going to mention them very briefly because someone around the table has mentioned each of them by now. The one I want to emphasize is that while it is not unreasonable to have an expectation of a fairly smooth inventory adjustment the way the Greenbook has it, there is up to now something between scant and no evidence that things are working out that way so far--that is to say, that inventory accumulation is coming in substantially lower in Q2 than it did in Q1. The data on that are very scanty, and so the Greenbook may in fact turn out to be right; I don't rule that out. But I think we should keep in mind that, when it comes to inventory adjustments, the bigger they come the harder they fall. Second, for reasons many people have mentioned and as you probably guessed from the question I raised earlier, I think foreign GDP is likely to be weaker than our forecast, and so exports will be commensurately weaker. Thirdly, I am worried about the consumer, or really the right way to say it is that I am worried about the multiplier-accelerator mechanisms being more severe than those embodied in the Greenbook. As I look at this list, I figure that one of those three downside risks is bound to materialize--I don't know which one--which is the reason my point estimate is lower than the Greenbook's. So, take the Greenbook and subtract any one of those three, and you get outside the FOMC range.

Now, more important to me than that is the risk to the forecast. I must be almost the 18th person--17th, the Chairman hasn't spoken yet--to say that the risk to me looks lopsided on the down side. That says to me that I have this point estimate and, as I look and think about the probability distribution around what I guess is the mode--don't ask me how I come up with a point estimate, I think it's the mode--the risks are clearly on the down side. I mentioned the risk of the inventory adjustment being more severe than the

Greenbook forecast, and I put that high on my list. I can think of a risk on almost every component of spending. On consumption, I already said that there is a serious concern that, with lower employment and real wages, falling income will lead to weaker consumer spending than is in the Greenbook. There is also a risk, as somebody said--it was Bob Parry--that 1993 and 1994 were unusually buoyant years for household spending and we simply are not going to repeat that again. On business fixed investment, which has been holding up remarkably well, I am very worried about the accelerator taking hold as GDP growth turns from positive 5 percent in Q4 to negative. As in the Greenbook forecast, falling capacity utilization and weaker sales are going to bring falling profits, which I think companies have not really factored much into their thinking as yet. Lower sales imply less need to add to capacity. I hope business fixed investment will hold up in response to that, but it is a downside risk. Governor Lindsey mentioned the downside risk on the fiscal side. I am a little less anxious about that than I was at the time of the previous FOMC meeting, but I don't rule it out at all. And we have already mentioned the foreign demand risk. Frankly, none of those worries, as I look at them, is that huge. But they are all going in the same direction. The odds that we will dodge all those bullets are not very strong.

The third point I want to make has to do with the relevance of the latest tea leaves to surface to the top of the cup, which have been a bit better than the news of the previous several months. I think the news of the last six to eight days is better than the news of the last six to eight weeks. But I don't think we should get carried away by that, just as we should not have gotten carried away by the news of the last six to eight weeks. Had we taken that news literally, and if it was the only information that we had, we should all be forecasting a deep recession. That would have been a great overinterpretation of those numbers as they came in. All of us avoided that overinterpretation I am sure. Similarly, the mixed bag of numbers, including finally a few bright spots in the cloud, does not obviate the fact that we are in a cloud. Mainly, these reports look good in relation to the unremittingly bad news in the preceding weeks. When I look at these numbers, I don't look so much at the last six to eight days or even the last six to eight weeks, but the last six to eight months. If we look at the last six to eight months, we find that retail sales were up just 0.4 percent from November to May. That is 0.4 percent in nominal terms and not at an annual rate. If June is down, industrial production will be down for four straight months, and if industrial production comes in close to zero in June, that will leave it barely above its December level. Household employment--again, depending on the way it comes in, if the June report is close to market expectations for total payroll employment--will be unchanged from what it was in November. That is not about tea leaves; that is about what the economy actually has been doing in the near-term past.

All of this does not spell a disaster scenario, but it is negative news relative to what we thought six months ago. And it does, as many people have remarked, leave us with an economy that is highly vulnerable to an adverse shock. This is my fourth point. You could think of a whole variety of such shocks, and when you are sitting that close to the edge, it does not take very much. In line with that, I examined--with some help from staff here and also at the

New York Fed, which I thank--several statistical indicators of recession. I am not quite sure how many there were because some of them were variants--putting different things on the right-hand side to come out on the left-hand side with a probability of recession. There is a whole bunch of these, more than I realized. I have learned that it is now a small cottage industry. Almost all of them seem to be flashing a number in the 30 to 60 percent range right now as the probability of a recession, which, ironically, is almost exactly what you would get if you just did the most naive thing. The old rule says that if the leading indicators go negative three times in a row, that predicts 10 of the last 5 recessions. That is to say, it gives you about a 50 percent chance of a recession. That is what the leading indicators are saying now and what these statistical indicators also are saying. My personal probability is actually at the lower rather than the higher end of this range, more like a third than 60 percent, but it is enough of a risk to leave me uncomfortable.

The fifth and last point, which should have been the first point, has to do with inflation. On the Greenbook forecast, and certainly with a weaker forecast, the risk of rising inflation now looks to be minimal. In the Greenbook, the unemployment rate is rising from just a tad below the natural rate to just a bit above the natural rate. Capacity utilization is falling to and then below its historical average, which leads me to conclude, exactly as the staff does, that the pressure for rising inflation is either gone right now or is soon to be gone as the GDP gap changes sign from positive to negative, if one signs it that way. This is particularly clear if you look at the long-run Bluebook projection, which shows inflation falling ever so slightly for the next several years. This leads me to the final point, and it is echoing what Mike Kelley said a few moments ago. If this inflation outlook turns out to be right--and that seems to be a reasonable expectation--the peak rate of inflation in this cycle, because there are cycles as well as trends in inflation, will be 2-1/2 percentage points below the peak inflation rate in the last cycle. That is very substantial progress. We have been talking here about individual inflation forecasts that differ very little. People have said that their forecasts are higher or lower than the Greenbook forecast by .2 percentage point or so. Nobody can forecast inflation that accurately; nobody on earth. So, a likely reduction of 2-1/2 percentage points from the last cyclical peak is very significant progress. It suggests, furthermore, that one more cycle, hopefully not starting imminently on the down side, is going to bring inflation almost to zero. Thank you.

CHAIRMAN GREENSPAN. Thank you. On that beneficent note, we have come to a termination of today's agenda. I want to remind all of the FOMC members of our usual annual dinner at the British Embassy at 7:30 p.m. In the past we have been quite successful in being as obscure as we are usually. But we need to be a little careful because I think there probably is going to be some awareness outside that we are there, and I suspect that there is going to be some attempt by the press to approach some of the people who will be at that dinner. So, if we can create some constructive ambiguity, it will not be a great loss to the world at large and especially for ourselves.

MS. MINEHAN. It should be easy to keep them talking, shouldn't it, given everything that has happened?

CHAIRMAN GREENSPAN. That's a good point. I think there are a lot of questions about the future of the U.K. economy. We will reconvene at 9:00 a.m. tomorrow.

[Meeting recessed]

July 6, 1995--Morning Session

CHAIRMAN GREENSPAN. With respect to your projections, Mike Prell is keeping an open book and corrections may be submitted through Monday, July 10th. I would also like to call on Mike to bring us up to date on the data that just came out.

MR. PRELL. Thank you, Mr. Chairman. I will be very brief. Initial claims for the week of July 1 were published this morning and were unchanged at 369,000. You will recall that two weeks ago they showed a spike up to 396,000; they came off last week and were unchanged in the latest week. Insured unemployment was up to 2.7 million. That has been trending up recently, so the rise wasn't particularly surprising in light of the initial claims. The leading economic indicators were down 0.2 percent in May, as we and most other people had anticipated. The change in the prior month stood at minus 0.6 percent; there was a revision from minus 0.5 percent to minus 0.4 percent, I believe, in the preceding month. For what it's worth, we were speculating that the measure of the probability of recession that we presented in the Greenbook would be about 54 percent and, with the revision to the earlier month--this is a very sensitive measure--it is now at 48 percent. [Laughter] The Johnson Redbook came out yesterday afternoon--up 1.4 percent for June--and you have the auto sales figures before you. As I indicated yesterday, they were up slightly in June to 14.9 million units for light vehicles, which is in line with the Greenbook forecast. Thank you.

CHAIRMAN GREENSPAN. What is the translation of the Redbook into reality? What is your guess as to what that means?

MR. PRELL. We find it to be terribly unreliable, but a change that large might be a signal that we can look for a positive in the retail sales numbers.

CHAIRMAN GREENSPAN. Maybe up 0.1 percent!

MR. PRELL. It is hard to say. That is all the news--some of which probably is not fit to print.

MR. STERN. It will be in five years! [Laughter]

CHAIRMAN GREENSPAN. Any questions for Mike? If not, let us proceed with the agenda. I call on Don Kohn to bring us up to date on the long-run ranges for monetary policy.

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

CHAIRMAN GREENSPAN. Questions for Don?

MR. LINDSEY. Don, do we have evidence--I think there was some earlier--that the velocity of M2 is now back closer to zero.

MR. KOHN. The trend in velocity growth?

MR. LINDSEY. Yes.

MR. KOHN. The whole level of M2 velocity has shifted up by, I think, about 15 percent; M2 is about 15 percent lower than we would have thought using old standards. There is some evidence that the growth rate relationships among M2, nominal income, and opportunity costs have come back roughly on track in the last two years or so. If that were the case and if we had any confidence that it would persist, we might be able to imagine a situation in which the growth rate of M2 demand was back on track and velocity then would fluctuate around its current level rather than around the lower old level. That is a distinct possibility, but the point I was trying to make in my briefing is that, given our uncertainty about these relationships, I think it is a little early to pronounce M2 velocity back on track.

MR. LINDSEY. But it looks stable for the last two years?

MR. KOHN. Approximately, yes. Now, we have had more M2 growth in the second quarter--by several percentage points--than this model was predicting. In growth rate terms, the model was right on for 1994. I think what happened in the second quarter of this year was that M2 was reacting to the decline in intermediate- and long-term rates, whereas the model uses the bill rate to proxy for alternative investments. So, it didn't capture those declines. Going forward, whether this old standard model--it is now nearly ten years old--will capture the dynamics will depend in part, I think, on whether short- and long-term rates move together in their traditional cyclical relationship.

MR. LINDSEY. I will phrase this as a question, but it is really a statement: If in fact we are back to a more stable relationship, wouldn't a 1 to 5 percent growth range for M2 be a bit low?

MR. KOHN. That would give you a midpoint of 3 percent. The Committee has looked at that as providing some sort of benchmark for what it might expect from M2 when reasonable price stability had been reached.

MR. LINDSEY. That's the year 2000!

MR. KOHN. For next year the models actually see growth at the upper end of that range--perhaps consistent with what you are saying--in the 4 to 5 percent area, approximately.

MR. PRELL. Let me remind you again that we ran those models off our nominal GDP forecast, which is a pretty low number, and you would want to make a mental adjustment for your own forecasts.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Don, applying the same logic you described with respect to how the 1 to 5 percent range was set for M2, do we have enough confidence about M3--its stability over time and its relationship to M2--to say, if historical relationships obtained, what a comparable range for M3 would be?

MR. KOHN. No, I don't have enough confidence. In the past, M3 growth has tended to run approximately a percentage point above that of M2, so a 2 to 6 percent range for M3 would not seem to be a bad alignment. But the past experience applies to a period in which depositories were capturing an increasing share of credit extensions. If your best guess were that their share of credit flows would remain about constant, then perhaps the M3 range ought to be about equal to the M2 range, assuming that depositories rely on retail and wholesale deposits in roughly the same proportions. So, it is hard to know. It really depends on the role depositories will play in the financial system. To repeat the earlier point, an M3 range of 2 to 6 percent is roughly consistent with a range of 1 to 5 percent for M2 in terms of historical relationships. Whether it would be consistent going forward is a much harder question.

MS. YELLEN. In setting these M2 ranges, do we normally look for some consistency between the target range and the Committee's nominal GDP projections? We just did our nominal GDP projections for 1996. Their full range is 4-1/2 to 6 percent and the central tendency is 4-3/4 to 5-1/2 percent; we were asked to prepare our individual forecasts on the assumption of a desirable monetary policy. So, if we take those nominal GDP forecasts and assume that M2 velocity is constant, wouldn't that suggest that 5 percent M2 growth would be consistent with the forecasts we are providing to the public and Congress? And shouldn't 5 percent be the midpoint of the M2 range? If it is not--and it is not even under alternative II for 1996--it seems to me that adopting the alternative II range, and certainly the alternative I range, communicates a lower real growth target than our nominal GDP forecasts imply. A growth rate of 5 percent for M2 is probably consistent with, say, 1-1/2 or 2 percent real GDP growth. If our M2 target is taken as the middle of our range, a 1 to 5 percent M2 range implies lower target real growth than that. Even under alternative II, the midpoint of the M2 range is 4 percent and that could entail perhaps 1 or 1-1/2 percent real GDP growth for 1996.

MR. KOHN. I think you are right, Governor Yellen, because for a number of years the Committee really has not been taking these aggregates seriously as guides to policy, and as a result it has not been moving the ranges around to make them consistent with its outlook. Part of the problem is that it is very hard ex ante to know what those ranges ought to be. We may now have a little more confidence about that, but even relative to the staff's nominal GDP forecast, which is 4-1/2 percent for 1996, the 1 to 5 percent range for M2 is obviously low. And if I took the Committee's nominal GDP, which is higher than the staff forecast--and especially if I assumed that interest rates would have to be lower to get that nominal GDP--we might have a decline in velocity. That is, we might need even more M2 as market rates went down. I have not run the exercise, but I would guess that we would be talking about an M2 projection of 5 percent or even a little over 5 percent to be entirely consistent with the Committee's nominal GDP forecast. The other way to work this, which is more or less what the Committee has done over the last few years, is to say that we see this range as something that is out there to provide a benchmark in the future, and we are not paying much attention to this now--and let it go at that.

MS. YELLEN. But we were asked to communicate our goals for 1996 and not for 2000.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. I was going to comment a bit on what Governor Yellen was saying and also point out that I think we are really on the horns of a dilemma. Governor Yellen's point stands by itself in terms of the logical consistency of what the ranges ought to be relative to the central tendency of our nominal GDP forecasts. But it is hard to separate that from the message that changing the ranges for M2 and M3 would convey to Congress in terms of the way we have been reducing these ranges over the years and the consistency of that with the credibility of our inflation objective. Given that we don't yet have firm evidence as to whether these measures have trended back to a more reliable long-term relationship with other economic variables, if we take what might be the logical step and increase these ranges to levels that theoretically make sense vis-a-vis the members' nominal GDP forecasts, we would be increasing both ranges to a degree that might be considered inconsistent with the way that the Committee has been reducing them over time. That is the concern I would have on that.

I wanted to raise a question on another subject, although other people may want to jump in on the current subject. The question that I had has more to do with your longer-run trends. I had some trouble sorting out the distinction between the downward funds rate path that you talk about in the Greenbook as a function of the change in equilibrium real rates of interest--which is part of the baseline forecast--and what you mean when you talk about a demand shock as a result of fiscal tightening. Are we double counting there?

MR. KOHN. There is a demand shock built into the baseline, which is the fiscal restraint needed to balance the budget by the year 2002. That is already in there, so you would not add more fiscal restraint on top of that unless you thought even greater fiscal restraint would be forthcoming. One could also imagine a situation in which the path of fiscal policy is a little more front-loaded than the staff is assuming and therefore the restraint happens sooner rather than later. As Mike noted yesterday, the assumptions for 1995 and 1996 on fiscal policy lie somewhere between those of the President and the Republicans. So, if you thought about a situation where the Republicans somehow prevailed on the stance of fiscal policy, that also would be a demand shock--at least over the next few years.

MS. MINEHAN. But that is not the demand shock that you had in mind?

MR. KOHN. What we used was a saving rate shock, but I believe we noted that you could think of it also as a situation in which we had more fiscal restraint than we were expecting.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. I just want to ask a very brief question to follow up on what Governors Lindsey and Yellen were pursuing. If the M2 demand function works, what interest rate is assumed tacitly in a 3 percent M2 growth forecast? How much higher is it than current interest rates?

MR. KOHN. In terms of a trend interest rate?

MR. BLINDER. No, in terms of 1996. The point was made that what we would like any of these things to be doing over the longer-term horizon may be one question, and what we would like for 1995 and 1996 may be another question. I was trying to ask the easier question--from now until the end of 1996.

MR. KOHN. I'm not sure it is easier! Of course, the staff has 4-1/2 percent M2 growth projected for 1996 with the interest rates of the Greenbook, and that means a gentle decline in interest rates toward the middle of 1996. If I used the interest rates of the tighter scenario--that is, the 75 basis point increase--that gets the projection for M2 down to 3-1/2 percent.

MR. BLINDER. The question is what interest rates would we need to make the midpoint? The staff has M2 growth of 4-1/2 percent in the baseline and 5-1/2 percent in the easier alternative. But as was pointed out, those are funny numbers if you are aiming for 3 percent.

MR. KOHN. It would require slightly more tightening than the tighter forecast. The tighter forecast has M2 growth of 3-1/2 percent; to make the 3 percent you would need slightly higher interest rates, perhaps avoiding the drop in interest rates in the second half of 1996 or you might have to raise rates a bit and keep them up. I think the tighter scenario gives you a baseline to think about that.

MR. BLINDER. Thank you.

MR. PRELL. I would like to emphasize the point that there are many kinds of interest rate paths that one could imagine. If you moved rates down very sharply in the short run and they were to flatten out or even come back next year, that might have some implications for growth next year; in particular, M2 growth might not run appreciably higher than our forecast. There are lags here and we still don't know all of the behavioral relationships--what would happen to mutual funds flows and so on under some of these rate scenarios.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. I want to explore a little further Don's answer to Governor Yellen. I think in the past the Committee has lowered the ranges in part because we thought that the trend velocity of M2 had increased somewhat. It was not that we believed that the ranges should be consistent with 3 percent growth in nominal GDP. The latter was closer to 5 percent. I think the fair question to ask is whether we think the velocity trend has shifted back to something closer to zero, and if we believe that, then I think it would be consistent with the Committee's forecast to change the M2 target range. So, I think the rationale had more to do with our beliefs about the trend in velocity than it did with our trying to establish a range consistent with price stability in the year 2000.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. It seems to me that we are still in a position where we don't have a great deal of confidence about the relationship between the growth of the aggregates and the growth of the economy.

In the past, I think we have acted in a way, as Cathy indicated, where we have used the ranges to convey a message, and I think we probably are most comfortable in continuing to do that at the present time. We would be able in my view to increase, as Don explained, the range for M3 and still be consistent with our longer-term objectives.

One point I would make, Don, about your comment to Governor Yellen is that I don't think there is a consistent basis for the members' forecasts. That needs to be kept in mind. If we were to go around the table, I think people would give different responses about what their forecasts assume, and I am not sure that all make explicit policy assumptions. There also is a difference between what they think is going to happen and what they think should happen. We are not given consistent statements about what we are supposed to assume in doing this exercise. So, I think we have to be a little careful about what those forecasts in fact are.

CHAIRMAN GREENSPAN. Any further questions for Don? If not, let me just say something that I think is on the table, and I will start off the roundtable. If we presume that the velocity of M2 is finally going to return at some point to the stability experienced for a very long period of time, all the arguments that are being made with respect to the ranges are very appropriate and to the point. However, the prospect that we will take them seriously, in the sense that their behavior may alter policy, is still a very long way down the road. It just does not seem credible that we will develop enough confidence by next year, or maybe even in two years, to be able to say that M2 is back on track in a manner that will affect the way we conduct policy.

As a consequence, were it not for the Humphrey-Hawkins legislation at this point, we would not be having this discussion. We would not even have the aggregates, so far as I can judge, as a significant part of the Humphrey-Hawkins report. I am not saying that we would not discuss them; obviously, they are not an irrelevant issue. So, that really gets us down to the question as to what type of signal we want to put out there. In a sense, what are we trying to do if we make changes in the ranges? If we don't make any changes, our decision will get zero publicity; indeed, that is what we found out after our February meeting. No one cared; no one commented; my recollection of the Humphrey-Hawkins hearings is that no one raised the issue. I may be mistaken on that, but if they did it certainly did not make an impression on me.

If, as I hope and suspect, we may vote later to ease policy, superimposing on that a signal that we are changing the ranges would worry me in the sense that we could be conveying more policy implications than I think we want to convey. I am persuaded that the position staked out by Governors Yellen and Lindsey is a perfectly sensible one, especially a year from now if I may put it that way. I would doubt very much that it is useful to make any changes at this stage, and I think that there are more downside than upside risks because we are not in fact using these ranges for policy purposes. Unless I am mistaken, there are very few of you around this table who would consider that your views on policy will be affected to a significant extent by whether or not we move the M2 range today. That is a view which, I will grant to everyone, is disputable because we got to the 1 to 5 percent range to a large extent by accident. We got there because it was very embarrassing to have higher growth cones when the growth figures were falling through the floor, so we decided to adjust and we ended up at 1 to 5 percent. That range is not a rational position; it is an accidental one, but if we change it we will be giving a signal which in my view would probably be a mistake at this stage. President Boehne.

MR. BOEHNE. In my view, Mr. Chairman, that is both an accurate and a sensible statement. There is a dog over in the corner and he is asleep and his name is Aggregates and we ought to let him sleep for another year or two.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, I agree that it would be ill-advised to change the M2 range at this stage, especially in light of the possibility, as you postulated, that we might ease monetary policy. You would spend an hour and a half of your Humphrey-Hawkins testimony explaining the changes in something that we don't take seriously. The risk of the body politic thinking, thanks to the press, that the central bank had decided to undertake a major softening of monetary policy would be very high, and I think it would be very unwise to take that risk. So, I agree very much that we should keep M2 where it is, and that would be alternative 1 for both 1995 and 1996.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. I certainly agree with your recommendation regarding M2, Mr. Chairman. With respect to the other aggregates, I would favor alternative II for 1995 and alternative I for 1996. Having said that, let me make just a couple of additional comments, if you will indulge me. I think, as the discussion is showing, that we all acknowledge that the monetary targets no longer serve much of their original purpose, at least for now or the foreseeable future. Among other things, that purpose was to underline the System's commitment to price stability and to serve as a nominal anchor for monetary policy. I think many interested parties outside the Federal Reserve, including some key Congressmen, are well aware of that. Of course, the Humphrey-Hawkins law requires us to set monetary targets, and we will have to continue doing so in the foreseeable future to comply with the law. However, the current short-term policy situation gives us an unusual opportunity to argue for some changes in the Humphrey-Hawkins law that may put us in a position to develop a more effective and a more meaningful longer-term strategy for monetary policy.

Let me clarify what I mean by opportunity. As everybody knows, the recent fairly sustained deceleration in economic growth has a lot of people calling for the Fed to ease policy. A case can certainly be made for that today. I am not going to be the one to make it, but I am sure someone will; and should we not do anything today, the case will become even stronger as we go forward if the sluggishness persists. I think it is fair to say, though, that many of us would be concerned that reducing the funds rate target, even in these circumstances, could seriously damage the credibility of our longer-term and oft-stated commitment to price stability, because at this stage policy has no firm longer-term nominal anchor. Consequently, within a short period of time--it probably would not happen immediately--if the performance of the economy does not play out exactly as we anticipate, a drop in the funds rate could produce another inflation scare. If that happened, long-term interest rates would shoot up and greatly complicate policy going forward.

So, as I see it, we have a dilemma. The way out of the dilemma in my view is for the Committee to develop a new and more meaningful longer-term nominal anchor for monetary policy that would tie down longer-term inflation expectations and really make our commitment to price stability more credible than it is now. That would free us to take more flexibly the short-term policy actions that we need to take. Monetary aggregates may have played this anchoring role in the past, but clearly they can't do it now. Against that background, Mr. Chairman, I would respectfully urge you to try to point this dilemma out in your testimony.

CHAIRMAN GREENSPAN. I think you have raised some very interesting points. May I ask, if you are not going to use the monetary aggregates, will you just give us 20 seconds on what you would propose?

MR. BROADDUS. I was going to lay out a strategy as briefly as I could. A key point I want to make is that the current situation gives us an opportunity to recommend something in terms that are fairly concrete rather than in the abstract. In my view, we can develop a more operationally meaningful longer-term monetary policy strategy. It would have three components. First, as I said in February when Janet and I had our little exchange, we should commit ourselves publicly and firmly to the price stability objective put forward in the Neal amendment--both its definition of price stability, whose language I think was negotiated at the time, and also importantly its 5-year longer-term horizon. It is that specific time horizon that I think would make it meaningful.

CHAIRMAN GREENSPAN. Are you talking about a statute or unilateral action by the Federal Reserve?

MR. BROADDUS. It would be preferable to have a statute, but I think we can go a significant distance in the direction I am recommending even without a statutory change. I am not recommending explicit numerical targets. It seems to me that it is feasible to adopt something like the Neal language in the context of the current law. I would like to emphasize that the 5-year time horizon would represent a difference from what we have now. We have said a lot about our commitment to price stability, and if we had a specific time horizon for its accomplishment, that would make us more accountable and would make that goal operationally much more meaningful. If we adopted that, we should issue an accompanying statement that says that we expect to continue to take short-term policy actions that are aimed at stabilizing the economy in the short run. As we continue to take those short-run actions, we ought to emphasize that we would in each case evaluate them against our longer-term objectives.

Second, if we were to refocus our longer-term strategy that way, I think it would be very helpful to revamp our semi-annual Humphrey-Hawkins reports in a way that would conform to that. Under the refocused strategy that I am proposing, the main purpose of the report would be to explain how our policy actions over the preceding six months have been consistent with advancing us toward our longer-term objective and also to explain how any short-term actions that we might have taken to deal with short-term economic conditions are consistent with our longer-term goals. If we were to revamp the report in that way, I think we would be in a better position to communicate our policy to the public and the Congress and that would help to increase our credibility.

Third, at the operational level, if the Committee refocused its strategy this way, we would need to alter in a conforming way our short-term policy deliberations and refocus them in terms of the options that we consider for the short run. This would mean revamping the Bluebook to some extent--especially its discussion of short-term alternatives and options. In some ways that has already been done. In particular, the current attention that we give to the relationship between our alternative short-run actions on the one hand and the behavior of the monetary aggregates on the other should be reduced and replaced with more discussion of the relationship between alternative short-term policy actions and our longer-term inflation objectives. Again, some of this is already being done, as is evident in this meeting's Bluebook, but I think we need to give it more prominence. It needs to be done at every meeting, not just in July and February. Now, I recognize as well as anyone that developing an operationally meaningful linkage between short-term actions and longer-term inflation goals is extremely difficult because there are long lags between the time we take short-term actions and the time they have an effect on inflation. That is why the intermediate monetary targets, when it was feasible to use them, were so useful. It is a difficult issue, but I think there are some things we could do. For example, the Bluebook could routinely assess the inflation expectations embedded in bond rates and perhaps speculate on how alternative short-run actions might affect those expectations going forward. Again, some of that is done already, but the effort could be sharpened and given more emphasis. We might also want to experiment with some sort of nominal GDP feedback rule, not externally but internally, as a benchmark in considering short-run policy alternatives. Clearly, the short-term operating issues are tough problems and some experimentation is needed, but I think that would be appropriate.

If I may end up with one last comment, Mr. Chairman, I feel very strongly that we have made enormous progress in the Federal Reserve System over the last fifteen years in moving from a dangerous situation with very high rates of inflation to where we are now. We have gone a considerable distance in increasing our credibility as protectors of the value of our nation's money, and that achievement among other things has helped us to foster growth in employment and output over time. As I see it, the task now is to put in place institutional arrangements that would allow us to extend and solidify those gains. So, I would vote for something like that. I think the time to do it is now.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I want to start off with a couple of comments related to what Al Broaddus was just saying. This is the 20th anniversary of Concurrent Resolution 133. That resolution was adopted in the aftermath of the first oil shock as a device to put boundaries on inflation in keeping with the notion at that time that there was some stability in the demand function for some measure of money and that constraining the growth in that measure would put boundaries around the rate of inflation. I think that after twenty years we have learned a lot; we have unlearned a lot; and it is time to rethink the underlying premise of Concurrent Resolution 133, which was codified in legislation enacted during 1977 and 1978. We are still being hamstrung by something that simply does not fit our objective. That objective is to give definition to the dollar and to maintain that in the minds of the people. The Humphrey-Hawkins statute, as we call it, as was true of Concurrent Resolution 133, does not do that.

For about 30 years the mean level of M2 velocity was about 1.65, with significant cyclical movements around that mean, but still it was a mean in which we had some degree of confidence. The ranges were related to historical experience. There is some very tentative evidence that the mean level has moved up to about 1.9, but that evidence is very tentative; and even if the new level is true there are still significant cyclical variations around it. Right now, with the recent acceleration that is being observed, we basically have two choices of assumptions to make. Either the mean level has shifted up and we are getting a cyclical increase in velocity and the recent growth in the aggregates should be very worrisome, or we should expect a substantial deceleration in the rate of change in M2. If someone wants to make the assumption that the level of velocity is going to shift back down to what it once was, then they have a bigger problem.

As a device for communicating intentions to the public and Congress, I think the ranges can be useful if properly explained. I don't think they are useful as a way of indicating to anybody how the short-run decisions about changing the funds rate will be made. I look at a lot of indicators of all sort of things; I look at the price of gold; I look at exchange rates; I look at yield curves. I would not want people to think that decisions on changing the funds rate from one meeting to the next are influenced by any single measure. We would have what former Governor Wallich used to call the Goodhart's law problem if people started to attach our actions to a single measure. So, I agree with the Chairman's initial remarks that changing the announced ranges of M2 in this environment, especially if we also decide to take action in the near term on the funds rate, could miscommunicate what we are doing. A reduction in the fed funds rate or the discount rate at this point, whether we like it or not, is going to be interpreted as an easing in policy. Whether we think it is a more stimulative policy or not is something else again, but we know how it will be interpreted. Associating whatever explanation we give to that short-term action with our long-run objectives is what I think we should be doing and we should not associate it with where money growth is relative to some announced target range. They serve two different objectives.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I agree with where you are coming from. We have systematically deemphasized these ranges because they have not been reliable, and I think it would be presumptuous at this stage to conclude that we know where velocity is going to be. And so I would feel comfortable with alternative I for the 1995 ranges; I would leave them where they are for 1996, although alternative I, which includes a higher M3 range, is acceptable to me for next year.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I had the unfortunate pleasure of having my maiden interview with the American Banker quoting me as saying that I am an M2 kind of guy.

CHAIRMAN GREENSPAN. I really thought that was a small typographical error! [Laughter]

MR. LINDSEY. I understand exactly where you are coming from, but I will phrase it a little more cynically. If after a year M2 growth is above the top of the target range, you will suggest then that we once again shift the range up as we shifted it down because growth was coming out near or below the bottom of the range.

CHAIRMAN GREENSPAN. I was suggesting that when it is our judgment as a Committee that M2 is something that we should be discussing and focusing on with respect to policy, we really ought to be serious at that point as to where we want to set the M2 range. In that context I think the types of arguments that you and Governor Yellen are making will be the right ones. My own view is that it would be premature to reach that conclusion.

MR. LINDSEY. Given that you are the one who will be up on the Hill to testify on these issues, I am willing to go along with your suggestion. My preference would be to go back to a higher range. I would go for what I would call alternative III for 1995, which would mean raising M2, and alternative II for 1996. In fact, there is no alternative III listed in the Bluebook. Even alternative II for 1995 has an M2 range of 1 to 5 percent. I think a 2 to 6 percent range would be better and that is the range associated with alternative II for 1996.

I remember well our embarrassment when M2 growth fell below the range. I am a little concerned that we will have a similar embarrassment when M2 growth ends up above the range and folks who might want a tighter monetary policy will use that as evidence against us. But, again, you are the man who has to be up there, and so in the end I will support whatever recommendation you make.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. Along the lines of my comments earlier, I am in agreement with not making any changes in M2. You did not address M3 in your comments, Mr. Chairman, but I would be a little more comfortable making a change, particularly for 1996, basically because I think that range has gotten extraordinarily low. The arguments the staff makes that the changes in intermediation trends probably will affect M3 over a longer course of time seem to make sense. So, I would like to cast my vote for alternative II for 1995 and alternative I for 1996.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Mr. Chairman, with regard to the aggregates, I certainly take your comments to heart. In light of that, I would favor alternative II for 1995 and alternative I for 1996. I would not change the M2 range. After listening to Don, the explanation for changing the M3 range seems straightforward, and in that sense I would go ahead and do that. I don't think that would cause any problems with your testimony.

CHAIRMAN GREENSPAN. I agree with that. M2 is the crucial aggregate.

MR. STERN. With regard to some of the issues that Al Broaddus raised, I think his points are well taken. We ought to be looking at monetary policy as it relates to inflation. My reservations have to do with my impression that a couple of his points in some sense jump the gun. They have to do with two issues in particular. Don Kohn raised a question about the quantification of the benefits of price stability and indicated--or at least I took his comments to mean--that the evidence was mixed and uncertain. If we started doing present value calculations, depending on what estimates we believed, we might find significant benefits or we might find that the benefits are rather small relative to their cost. I happen to believe that there are benefits there and that they are sizable, but I think it is incumbent upon us to make that case more compellingly than we have to date. I don't see any way around the difficult research that probably involves.

Another related and important issue has to do with public support for any objective that we adopt, whether it is mandated by statute or we do it ourselves. To some extent, it falls on us to build the public support for a price stability objective. I don't think that support is totally lacking, but I don't believe there is any great conviction among the public at large that price stability ought to be the preeminent objective of monetary policy. Until we put together some of that evidence I was referring to earlier, I think moving way out ahead and trying to bring the public with us might be very difficult. So, for the reasons that I stated, I would be cautious at this juncture about going down that path. I do think there are issues there, and I suggested before that we ought to be discussing and looking at them and probably finding some research to do. I am concerned about moving too far too quickly.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I have a great deal of sympathy for what President Broaddus said, and I think we ought to give serious consideration to it. With regard to the upcoming Humphrey-Hawkins testimony, I favor setting monetary targets that are likely to be consistent with policy goals in the long run. The current range for M2 would be consistent with low inflation in the long run if growth in M2 velocity returns to its historical zero level. On the other hand, if growth in M3 velocity returns to its historical average of roughly minus 1 percent, the current M3 range would have to be revised upward. Since there is some evidence that M3 velocity is reverting toward its historical norm, I favor Bluebook alternative II for 1995, which in fact does raise the range for M3, and alternative I for 1996, which preserves those ranges into 1996.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Alan, I agree with your concerns about moving the M2 range now and how that might be interpreted. I would not change that range. With regard to M3, I am most comfortable with the rationale that Bob Parry just described with respect to taking a look at long-term trends and viewing M3 on a basis consistent with what we have been doing with M2 in recent years. That would lead me to favor alternative II for 1995 and alternative I for 1996. I would add that our discussion today points up to me that we are in an increasingly untenable position with respect to how we communicate to Congress our long-term intentions about monetary policy and the need for some sort of nominal anchor. I don't expect anything necessarily to come out of what Al has suggested today, but I think we ought to have that as an important topic of discussion well in advance of our February meeting next year. We might be thinking about the need to revise our approach for 1996 and perhaps begin to move our time horizon further out.

CHAIRMAN GREENSPAN. We probably will have to respond to a bill on the Hill at some point. Our response will have to capture the view of this Committee in its various aspects as they have been raised, largely pro and con, by you, Al Broaddus, and the rest of us. It is going to be our one shot at the legislation, and I am a little concerned that if we don't focus on this issue, we could suddenly find ourselves with significant mandated revisions in what we do. Those revisions may not involve what we wanted, and in retrospect we may find that we could have gotten a different and more favorable outcome.

MR. MELZER. I agree and I felt that way when we talked about this in February. The more leadership we exercise in this, the better off we are going to be in terms of the ultimate outcome. There are different points of view on this issue, but I think it would be very unfortunate if, for example, we got to a year from now and we were debating how we might adjust the M2 and M3 ranges and never got to this topic. Price stability is what a central bank is all about. We ought to be quite explicit about that commitment, and we ought to discuss how we might achieve it operationally. So, that is very consistent with the sorts of topics that Al is raising. Ultimately, I think it would improve our accountability, which would in turn improve our performance and lead to higher economic growth and employment than we otherwise would have achieved. Gary Stern made some good points about documenting that case. I think that is becoming increasingly urgent, as pointed up by this discussion today, and it is something we have to pursue.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, your initial remarks about the ranges for the monetary aggregates are quite appropriate and I agree with them entirely. We are confronting a number of issues in monetary policy at the moment, and some of those are going to come up as they usually do in the Humphrey-Hawkins testimony. Changing the ranges would just draw more attention to them and provide a real distraction to the essential conversations that I think we need to be having. With that in mind, I would favor alternative II for 1995 and alternative I for 1996. That encompasses M3.

Let me just add one other thought, since there has been some discussion of possible changes that Al Broaddus brought up. I will throw on the table the possibility that if we really do not believe that the aggregates are going to return to providing us with some nexus to the real economy, the time might be coming if it is not here already to think about a change in the statute. Not only is this setting of the ranges a distraction for the Congress in some sense, but it is occupying a lot of this Committee's time for no good reasons except, as you said, Mr. Chairman, that the law is there. If we remove the statutory provision, the focus of Committee discussions can be better directed to more important issues. I realize that there are risks in going forward with that kind of legislative request, but I think it is something that we ought to think about.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I favor alternative II for 1995 and alternative I for 1996. I find myself quite frustrated with this discussion. I think part of it has to do with our not really knowing whether the ranges are something we should be shooting for--whether they are long-term objectives, or whether they are in effect short-term monitoring ranges to be explained. So, I support the notion of having a more extended discussion of what our goals should be in terms of thinking about restructuring the Humphrey-Hawkins statute and the kinds of things we monitor. I don't think this is the time to do it, because I am not sure we know enough now about what range we should monitor, whether it should be M2 or M3 or something else. At this point, I certainly agree with the notion that if we change the M2 range now, we are going to draw more attention to it. But at some point I think we do need to address the kinds of issues that Al Broaddus has raised and decide whether or not we are going to support legislative changes that would get us off the horns of this dilemma.

CHAIRMAN GREENSPAN. My suspicion, incidentally, is that if we are confronted with a legislative initiative to which we have to respond, that might require us to have a special meeting to discuss it or an addition to the agenda at a regular meeting that extends the discussion. It is not going to be easy to respond. However, if we have specific language proposed in draft legislation, that will focus where this Committee wants to come out in the recommendation that we as a group will want to send up to the Hill. President Moskow.

MR. MOSCOW. Mr. Chairman, I favor alternative II for 1995 and alternative I for 1996. In terms of the last point that we were just discussing, assuming that we will have to respond to some type of legislative initiative, I think it would be desirable for us to try to get ahead of the curve, as you were anticipating in your earlier comments. Perhaps we could have staff work done to identify some options and some specific language that we could plan to consider at a special meeting or at an extended meeting as you suggested.

CHAIRMAN GREENSPAN. We have been doing that for the last several years in part to respond to and capture--not to an exact extent but to a large extent--what we have been hearing around this table. However, when we are confronted with specific legislative language we will have to try to tie down the issue and not just float interesting ideas across the table. It is going to become the law; the law is going to affect how we behave; it is something that we are going to have to deal with as we operate in an institutional context on a day-by-day basis.

MR. MOSKOW. I agree and the legislative proposal would be the action forcing the event. What I am suggesting is that in anticipation of that coming legislation--

CHAIRMAN GREENSPAN. I agree with that and I think we will start doing that as we begin to interact with the committees up on the Hill.

MR. MOSKOW. I was hoping that in the work that will be done, we could see some alternative specific language.

CHAIRMAN GREENSPAN. Why don't I suggest this: Don Kohn is doing a good deal of work on this sporadically; he is the staff's point person on this issue. If you have any ideas that you want to put forward, I think it would be very useful for you to communicate them, hopefully in writing, so that we can all see them. You might send them to Don so that he can coordinate getting the various ideas circulated and we can then decide where to go from there if the legislative issue arises. Governor Kelley.

MR. KELLEY. Mr. Chairman, I would prefer alternative I for 1996. In the case of 1995, I would also prefer alternative I because I have a problem with changing benchmarks in the middle of the stream. I think we lose a lot when we do that in terms of our ability to discuss and judge changes that have occurred intra-period. Certainly, we can conduct policy just as well without making this change. But I think we can also have a better and a cleaner discussion in this Committee, in the press, wherever, without the distraction of having made a change right in the middle of the year and having people trying to read into that something that was not meant to be there in the first place, however clearly we may explain it. So, I would prefer to stay with alternative I for 1995 and for 1996 as well.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Alternative II for 1995 and alternative I for 1996 seem okay to me. I would like to associate myself with remarks that Al Broaddus and Tom Melzer have made. On our discussion relating to possible legislation, has there been any further dialogue with Senator Mack and is his proposal still the most likely that we will need to respond to?

CHAIRMAN GREENSPAN. It seems to be the only operative proposal at the moment. We have been trying to persuade the Senator and his staff to take an approach similar to what has been sort of the generic thinking here. If we have not circulated a copy of my letter to Senator Mack, I think it would be quite useful to do so.

MR. KOHN. Your letter has not been sent yet, Mr. Chairman.

CHAIRMAN GREENSPAN. It has not been sent? I thought it would be going out.

MR. KOHN. I wanted to talk to them about it before sending the letter over.

CHAIRMAN GREENSPAN. A letter will be going out! [Laughter] I said in the letter that I was not speaking for the Board or the FOMC but was expressing my own views on certain issues. But I must say that I tried, as I formulated my letter, to take into consideration a number of the views that I have heard around this table. I said that my thinking was still in a very preliminary stage, but it might be useful, when we get that letter out, to circulate it to the Committee. The letter might be useful as a vehicle to start getting your responses.

MR. MCTEER. I think it would be important for us to give Senator Mack the impression that we are eager to work with him on this--not the impression that he is dragging us along kicking and screaming.

CHAIRMAN GREENSPAN. No, and we are trying specifically to do that. Where we think he has a view that would be very difficult to implement, we have been trying to communicate that opinion. Does anybody else want to comment? Governor Yellen.

MS. YELLEN. I would like to associate myself with Governor Lindsey's comments. I would favor alternative III for 1995 [Laughter] and alternative II for 1996. I certainly understand the sentiments that you expressed, Mr. Chairman. This is not the most important decision we are going to make this morning. I think we are dealing with an imperfect law that asks us to communicate our objectives in an imperfect way. I certainly understand why you don't want the ranges to be the focus of your Humphrey-Hawkins testimony, and I understand that they can be confusing. Nevertheless, at the end of the day it seems to me that this is the law of the land and we ought to do the best we can to live with it and to have the forecasts that we put forward be ones that are defensible. If you are asked why we have selected these monetary targets, I hope you would be prepared to answer. Then I ask myself how you would go about answering. If you were to say that we are assuming a continuing upward trend in M2 velocity and if that were a defensible assumption, that would be fine. That would imply, in turn, real objectives that I would find perfectly appropriate. But if you were pushed that far, as I imagine you won't be, and if you were not prepared to say that an upward trend in M2 velocity is our underlying assumption, then you in effect would be communicating on behalf of this Committee objectives which I would not regard as my objectives and I don't think they are the objectives of this Committee. After Bob Parry said that our nominal GDP forecasts don't represent our objectives, I reread the instructions. They said the projections for both 1995 and 1996 should be based on what in our judgment would be an appropriate monetary policy. So, I thought that was the instruction under which we were to be operating.

CHAIRMAN GREENSPAN. I don't think it said money supply.

SPEAKER(?). You have a point.

MS. YELLEN. It would be an appropriate monetary policy--

CHAIRMAN GREENSPAN. However defined.

MS. YELLEN. --consistent with our projections for nominal GDP.

CHAIRMAN GREENSPAN. Yes. There is no M2 or anything else specified in the instructions.

MS. YELLEN. But I think Bob Parry said that the nominal GDP projections, or their central tendency, should not be interpreted as our objectives. Did I misread that?

MR. PARRY. No, you didn't. I get the impression that people have at times forecast what is going to happen as opposed to what they would like to see happen. I could be very wrong on that.

MS. YELLEN. That is where I was coming from. I understand why you don't want this to be a central issue of the testimony. In the case of 1995 we have language for M3 that says that raising its range is a technical adjustment. You don't seem to feel that M3 is going to be the focus of the Humphrey-Hawkins testimony. It seems to me that we could adjust up the range for M2 for 1996 and make a very similar statement about a change in our views about the velocity trend for M2 and say the increase is a technical adjustment. At any rate, that is where I would come out.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. I am in the Lindsey-Yellen camp here, but I must say that I have a little trouble articulating a view on the Ms. I find myself mumbling with great incoherence in the extreme; these Ms are a problem. On your first point, I agree entirely. These are basically gibberish numbers; we don't take them seriously; the markets don't take them seriously; economists who pay attention to monetary policy don't take them seriously; and it is hard for me to get very exercised about them. Having said that, I think there is some argument for consistency with the nominal GDP target, and I also wonder why an M3 shift is a technical adjustment and an M2 shift is not.

CHAIRMAN GREENSPAN. The reason basically is that the M2 range is wholly an accident of history. M2 has become a crucial variable in discussions on the Hill.

SPEAKER(?). It used to be M1.

CHAIRMAN GREENSPAN. Yes. I am just saying that if you are asking for a rational reason for the current M2 range, I can't find one.

MR. BLINDER. Right, I don't think there is either, and it is hard for me get exercised about this issue one way or another. Now, unlike the mumbling with great incoherence, there were two things that were said around the table that I can relate to very strongly. First, the kind of plan that Al Broaddus outlined seems to me greatly superior to these M ranges. I don't mean that to be an endorsement word-for-word; I don't think Al wants to hold it word-for-word. But it surely has to be a much better route than the M2, M3 mumblings. I just don't have any doubt about that. I think that something along those lines ought to be explored. The other thing I can relate to is what Gary Stern said. Mike and Don may remember that my first FOMC meeting was the Humphrey-Hawkins one last July, and I came out of that meeting saying that we really ought to get the staff working and put together all the research there is on the costs of inflation versus the benefits of disinflation; we should put together some kind of compendium of research, which is just what Gary suggested. Those are two very coherent thoughts that I can relate to on these ranges.

VICE CHAIRMAN MCDONOUGH. Are we returning to the ranges and the vote on them?

CHAIRMAN GREENSPAN. Even though we are required to vote on 1995 and 1996 ranges, let me suggest--can we vote on M2 separately for 1995 and 1996?

MR. BERNARD. Yes.

CHAIRMAN GREENSPAN. As far as I can judge, there seems to be a broad willingness, if I may use that term, to do nothing on M2 for either 1995 or 1996, but I sense that there is a significant split with respect to M3; there may be a majority in favor of raising the M3 range. I am reasonably certain about the first proposition, and what I will do is put to a vote a range of 1 to 5 percent for M2 for both years, which is unchanged from the current range. I would like to put that to a vote.

MR. BERNARD. So the vote is whether people prefer 1 to 5 percent for M2 for both years?

CHAIRMAN GREENSPAN. Yes.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Blinder	No
President Hoenig	Yes
Governor Kelley	Yes
Governor Lindsey	Yes
President Melzer	Yes
President Minehan	Yes
President Moskow	Yes
Governor Phillips	Yes
Governor Yellen	No

CHAIRMAN GREENSPAN. On M3, the issue is whether to raise the range to 2 to 6 percent for both years or to stay where we are.

VICE CHAIRMAN MCDONOUGH. There was a big majority in favor of 2 to 6 percent.

CHAIMAN GREENSPAN. That was my impression. I think nearly everyone was more comfortable with that higher range. So, let us vote on 2 to 6 percent for both years.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Blinder	Yes
President Hoenig	Yes
Governor Kelley	Yes
Governor Lindsey	Yes

President Melzer	Yes
President Minehan	Yes
President Moskow	Yes
Governor Phillips	Yes
Governor Yellen	Yes

CHAIRMAN GREENSPAN. Short-term monetary policy--Don Kohn.

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

CHAIRMAN GREENSPAN. Thank you. Let's cover any questions for Don; then we'll take a break for coffee. Yes, President Minehan.

MS. MINEHAN. We have alternatives A, A-prime, and B?

MR. KOHN. Right, or A-minus. I don't know how you want to characterize that.

MS. MINEHAN. I just want to be sure that that is what we are considering.

MR. LINDSEY. You can do what I did.

MS. MINEHAN. What is that?

MR. LINDSEY. I gave him alternative C.

MS. MINEHAN. I think three alternatives are enough!

CHAIRMAN GREENSPAN. Any further questions for Don? If not, why don't we break for coffee.

[Coffee break]

CHAIRMAN GREENSPAN. Let me start off the discussion as usual. First, I might indicate that I was somewhat surprised yesterday by the degree of convergence on the outlook. As I saw it, virtually all of us were concerned about asymmetric risks on the down side, but no one thought the probability of a recession was better than 50/50. Indeed, all your forecasts imply that the economy will work its way through this period. There was clearly, in the discussion and in the evaluations, some uncertainty as to how the current adjustment process ultimately will unfold. In my judgment, the crucial issue is whether the inventory adjustment will reach a critical mass that will weaken incomes sufficiently to upend final demand. Such a development would in turn set in motion a typical recession driven by inventories in a vicious circle downward until it exhausts itself. At this stage that does not appear to be the likely outcome, and indeed time is on the side of emerging stability. All we really need is sluggish final demand that persists until the inventory adjustment finally dissipates.

Three or so weeks ago I must say that I interpreted the risks as still increasing, because all the evidence that I could see suggested that the economy was moving to the down side. The inventory adjustment process was under way, but not as rapidly as I thought was going to be needed to be easily successful in removing the adjustment in inventories as a retarding element overhanging the expansion; and there was an increasing danger that it could reach a critical mass. But the data of the last few weeks clearly are moving in the direction that, while the downside risks are still there, we at least seem to have reached the maximum risk potential and probably are now somewhat on the other side. But by no means have we reached the point where we can very readily presume that the major threat to the recovery is over at this stage.

The key variable that I think is crucial in this process is that durable goods tend to be the major adjustment vehicle. Usually, one can learn a great deal about that by looking at how the orders structure at the bottom of the durable goods pyramid is behaving--steel, aluminum, and other metals to a lesser extent. An initial evaluation, coming largely from contacts at U.S. Steel, was that the steel industry was extraordinarily weak. In fact, conditions in that industry looked very much like those I have seen in the past on the way to a major inventory liquidation. It is turning out not to be that big a problem, because when we surveyed operation, to get an idea of whether or not we are looking at competitive shifts or whether we are looking at real changes, our contacts while sensing that orders were weak, displayed nothing remotely close to some of the negative vibes we were getting from Indeed, the fact that ingot production and, as best we can judge, finished goods production are holding up raises questions about how weak these markets are, because history as I remember it for the steel business tells us that when the markets really start to evaporate, shipments fall very dramatically and before that the ingot level goes down very sharply. That has not happened. The price of steel scrap has held up, apparently bolstered to an extent by export demand. Mill product prices seem to have eased, but it is not terribly clear by how much. We had a significant decline in aluminum orders three or four weeks ago. As best we can judge, it reflected developments not dissimilar to what is going on in steel--the automobile backup, excessive inventories of steel and aluminum at service centers, and to a small extent weak forward orders. Aluminum orders have come back from the low point. They are still lethargic but are scarcely evidencing the type of underlying metals inventory liquidation that usually is at the forefront of some of the bigger declines that we invariably have seen in conjunction with a major inventory correction.

We are, as best I can judge from the purchasing managers' data, beginning to see some significant retrenchment in lead times on deliveries. This is probably also affecting the holdings of inventories of component parts and peripherals in the producer durables area because orders for nondefense capital goods weighted by the demand for final producer durables are holding up better than the total durable goods orders for nondefense capital goods. This implies that orders for peripheral parts and components of the nondefense capital goods are coming down, which would be consistent with the type of durable goods inventory correction that we would expect. We have seen significant inventory liquidation in both cars and trucks in May and June. If one looks at the data on inventories, the motor vehicle inventory accumulation in the first quarter was $14 billion out of the $49 billion NIPA inventory change. Preliminary data on motor vehicle sales and production for the second quarter suggest zero inventory change, which effectively means that most of the implied $20 billion reduction in inventory investment in the Greenbook stems from the motor vehicle area and is pretty much on schedule. The big surge, or apparent surge, in book value of manufacturing inventories excluding motor vehicle finished goods inventories in May evidently got marked down in constant dollars to a level which, combining April figures, is a shade--$1 or $2 billion--under the first-quarter level for that segment. Looking across the board, it strikes me that the estimate of inventory investment in the Greenbook for the second quarter seems a not unreasonable number especially when we also look at the shifts that have occurred in C&I loans and commercial paper. Those shifts suggest a fairly pronounced decline in June inventory investment and probably in May as well, but it is hard to say. While the adjustment in inventory investment is not moving at a pace that suggests it is going to be over fairly rapidly, it is moving at a pace that does not seem inconsistent with the view that final demand will hold up enough for it to work its way through. I suspect this is the reason why the general view around this table has been one of mild optimism even though the members recognize that the downside risks clearly have increased since the last meeting.

So far as final demand is concerned, we saw that the motor vehicle sales figures were a shade stronger in June, largely as a consequence of Chrysler and the Chrysler sales incentives. The important issue is probably not so much that sales were up over May but that they were up significantly over April. told me that the market disappeared in the second half of April. They didn't have a clue as to why. The market came back in early May, and they did not have clue as to why it came back. It wasn't a terribly useful insight [Laughter], but the market does not seem to be too bad at this point. The new home sales figure for May, at an annual rate of 722,000, is bizarre as most of those home sales figures are. But we have other evidence that suggests that the residential building sector is clearly turning. As you well know, mortgage applications for purchasing new and existing homes have been moving up in both the series put together by the Mortgage Bankers Association and that by Morgan Guaranty, which has a slightly broader sample. The home builders data clearly indicate that things are moving. This is important not only because of the importance of the residential construction sector, but also because history suggests that motor vehicle sales and some parts of the residential building industry move together. If there is firmness in the home building area it has to exert, if history is any guide, some upward movement in the motor vehicle area, which would be very useful.

With regard to the weakness in the rest of the world, I must say that I subscribe to the concerns that the Vice Chairman and others among you have indicated. There is something going on in the rest of the world that I find somewhat disturbing. One gets a sense that the pickup that seemed to be under way earlier is having great difficulty gathering strength in Europe. In Japan, the odds that something adverse of significance is going to happen seem high enough to make one quite uncomfortable, and the Canadian economy clearly is in something of a swoon. Nonetheless, our export orders, probably largely as a result of the improved competitive position of American producers, suggest that the foreign market is still moving.

The equipment markets, especially when we adjust the orders figures for the final PDE as distinct from all the components and parts, remain quite solid. Unfilled orders still seem to be rising at a modest pace, though some slowdown in the rate of increase is probably on the horizon as some around this table have argued, mainly with respect to the deceleration risks that Governor Blinder mentioned. Although we are not yet getting any material evidence that profits are weakening, there is some evidence that the underestimation by the analysts of a continued rise in earnings through the first quarter shifted in the second quarter. But it is largely a change in their views rather than any really significant decline in earnings. Indeed, one crude measure that I tend to look at because it is useful on occasion--manufacturing prices over manufacturing unit labor costs as a measure of margins--continued to move up through May. So, we are not yet seeing the underlying earnings deterioration that one would expect at this stage. I do think that it has to emerge because it is hard to visualize that earnings are going to hold up through the second and third quarters. But at least there is no evidence that they are pulling back to a degree that could undercut the capital goods markets, and certainly the nonresidential building area remains quite strong. As I said before, it looks as though, or at least there is a possibility, that we are passing through and maybe have passed through the period of maximum risk. But just remember that business cycles are not smooth even if large external shocks are missing.

In summary, I would say that we clearly have managed to contain a highly unstable and inflationary business cycle expansion that was taking on some fairly strong characteristics in the second half of last year. I think we have cut the top off this boom and thereby significantly reduced the probability of having to deal with what was going to be a heavy and very distasteful inventory correction and perhaps a capital goods correction late this year or next year. I don't think we have solved the problem of the business cycle. I don't think human nature has changed. All we can hope for perhaps is to limit the degree of fluctuation. But somewhere, somehow, by some means, we are going to get something that is going to be called a recession unless somebody finds that human nature has changed in a manner that it has not in eons.

So far as policy is concerned, we concluded in late 1993 that the appropriateness of a 3 percent federal funds rate was no longer as evident as it had been before the elimination of the balance sheet adjustment strains and the 50 mile an hour head winds to which that rate was addressed. We accordingly and appropriately moved the rate up as we confronted new circumstances in early 1994. Today, we have defused to a significant degree the inflationary pressures that were building through the early weeks of this year. At this point we have to ask ourselves whether a 6 percent nominal federal funds rate, or a 3 percent real federal funds rate, is the appropriate level we wish to be at in the next 6 to 12 months.

In this regard we have quite encouraging evidence that the cyclical peak in inflation may be close at hand. I think inflation is being held down by events in the rest of the world. The crucial question we must ask ourselves is whether we need a 3 percent real federal funds rate to continue the secular disinflation that we have been involved with for a number of years and specifically the points that were made by Governors Kelley and Blinder with respect to the downward moves of the cyclical peaks of inflation. Remember that the cyclical peaks were all moving up throughout the 1970s and into the

1980s--indeed, the cyclical lows were moving up as well--and these highs and lows are now moving down. If as Don Kohn says, and I think he is quite right in this regard, the current real short-term federal funds rate is above some notion of the equilibrium or natural rate, and hence that rate is consistent with a degree of restraint that is not appropriate to the disinflationary trend that we envisage is occurring, then the issue is whether we should bring the rate down. If the argument essentially is that the 3 percent real rate is indeed appropriate for the future, I would ask how do we know that 4 percent real or 6 percent real is not more appropriate?

The point I am trying to make is that we are not, as a Committee with a goal of price stability, saying that the rate of real interest consistent with that is infinity. We obviously are arguing that there is a certain path which is consistent with that. We have to come to a conclusion of where we think that path is, and this gets to the point that Al Broaddus was raising about how we are focusing on the appropriate longer-term path to price stability. As I read what it is that we know, the real federal funds rate consistent with achieving price stability is something under 3 percent--not for certain but with some degree of reasonableness. If that is our conclusion--and that is what I would conclude, though everyone has to make his or her own judgment on this--the question is what do we do about it. A month or so ago when a very rapid decline in inflationary pressures seemed to be building up, I would have been inclined to say that we probably were safe in moving the rate down 50 basis points as a mid-course correction. In retrospect, I think that was a wrong view because I don't think the markets would believe an announcement in which we tried to make clear that it was a mid-course correction and that it was as far as we would go, which is frankly as far as I think we ought to go. We tried to make that point last August going in the other direction and we failed. That is, the markets didn't believe us and responded pretty much against it.

I have concluded that, since the risks are beginning to ease slightly, there is no urgency here; but I do think we should move because I find it increasingly difficult to argue in favor of staying where we are right now unless one can argue that inflationary pressures are still building. I personally find very little, if any, evidence that that is the case. I have concluded that probably the best thing to do is to move the funds rate downward by 25 basis points, which I must say likely will be a big deal because we would be changing the direction of policy. I am concerned about going further than that in part because I am really concerned about spooking the markets, especially the foreign exchange markets in this context. And I don't think a larger reduction now is necessary. We could readily, if we so chose, add another 25 basis points in August or later. In that sense, I think what we would do is probably create an expectation in the marketplace that indeed we will move again since everyone says "well, the Fed never moves only once." I am not sure that is all bad because it probably would mean that we would support gradually declining long-term rates, including mortgage rates, which would create support within the economic system. I find it very difficult to envisage inflationary pressures emerging at any point in the near term. If we were to lower rates by 50 basis points, I am fearful the markets would ask "when is the next 50?" I would be uncomfortable with that because it is very difficult to dissuade the markets from that point of view, and I think we would drive the federal funds futures rate down to a considerable extent.

I come out with the view, which strikes me as consistent with the Committee's basic economic outlook, that an appropriate monetary policy at this stage would be to move 25 basis points. The choice of an asymmetric directive is implicit in the notion that we might want to move again before the August meeting, while a symmetric directive implies that we wouldn't choose to move until that meeting. I am marginally in favor of going asymmetric, but I must say I don't feel strongly about that one way or the other. That is because I think events will determine what we will do. We are going through a period when we will know within 6 weeks or 2 months at the latest whether the adjustment process that is going on will cumulate into significant recession pressures or whether it will end up as a pause in the expansion. I don't think we can make that judgment today, but we will know a very considerable amount more the next time we meet. So, that is my view. Who wishes to begin? President Forrestal.

MR. FORRESTAL. Mr. Chairman, as you have indicated, in February of 1994 we set in train a series of actions to stem the rather robust economy in pursuit of our goal of price stability. I think no one on this Committee should be surprised, and I am sure no one is surprised, that we have experienced some slowdown in the economic expansion. I guess the surprise for me and perhaps for others has been the extent of the downturn that we have had. Now, the question in my mind is whether or not this slowdown will result in a cumulative downturn and a recession. My view is that that probably will not be the case and, as their forecasts indicate, that view is shared by the other members. If I were to look at my forecast and indeed the forecast in the Greenbook and the other forecasts that I have seen, I probably would not want to move because I think the results of those forecasts are reasonably favorable. Some of the forecasts anticipate growth a little below potential but not seriously so. The further question I ask myself is whether I believe even my own forecast. There are enough uncertainties surrounding all these forecasts to make me a little cautious about the downside risks. Those risks clearly are there although, as you said, they probably have dissipated a little over the past couple of weeks. Also, I think that the market is telling us that the 3 percent real federal funds rate that you talked about is a little on the high side.

In terms of policy I think it is wise and prudent for us to take this action at this time--as an insurance policy in a sense. When I came into the meeting, I must say I was thinking more in terms of a 50 basis point drop because I thought that 25 basis points would only compel the market to keep asking when the next move is going to take place. But hearing your rationale for 25 basis points, I would be prepared to support that. While 25 basis points is a close call for me, I think it is highly desirable for us to move at this time, whether it be 25 or 50 basis points. I think an asymmetric directive is appropriate. The risks of easing at this point are fairly minimal in my view. The inflation rate is not that bad. As I have said before and other people have said today, we have made substantial progress, and I think that we are going to reach the cyclical peak of inflation. I am not at all concerned by the argument that I have heard outside of this room that we may have to move again on the other side and therefore we should not move now. That argument does not carry much weight with me because I think we are compelled to move when conditions so warrant. In summary, I would support your 25 basis point move at this time with an asymmetric directive.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. I strongly feel we should be easing today. Indeed, it seems to me that we are already somewhat behind the curve, which is something we rightly feared greatly on the up side. We never really did get behind the curve then, fortunately. But I think we now are behind the curve. We would be terribly behind the curve I might add, and staring into the mouth of a recession, were it not for what you said in your Humphrey-Hawkins testimony in February, Mr. Chairman. That statement, for which I think we should all thank you, in conjunction with the incoming data has created an interest rate easing that was not of our making. And that, indeed, is what all of us are expecting is going to support the economy in the second half of 1995, which is the crucial period for this episode. That is why I and, I think, most of us are not looking for a recession later this year and into next year.

I want to say for the record, Mr. Chairman, that I wrote these notes on the 4th of July, because what I am going to say about the reasons is so similar to what you just said. With that in mind, I am going to be extremely brief. The case for easing now starts with the presumption, or the guesstimate, that the 3 percent real funds rate is too high for the long or intermediate run. Were it not for that belief, I think we would have a much weaker case for easing now. But I certainly think that it is true. I think it is very, very likely true with the current fiscal stance, and just about as sure as one can be with the significant deficit reduction that appears to be in train. So, I feel pretty confident that a 3 percent real funds rate is not something that we want to live with for very long, or another way to put the same thing, that a 3 percent real funds rate is restrictive at a time when we should not be restrictive.

The second part of the case is exactly what you said also--that calling this a 3 percent real funds rate assumes that we have capped inflation at about 3 percent, which is the way it looks to me. That seems quite likely as well. If so, bringing down the nominal funds rate at this point is in no sense abandoning the long-run movement toward price stability. It is capping the cyclical peak, exactly as you said.

The third part of the argument--again you said it and everybody around the table said it in the go-around--is that the economy looks highly vulnerable to a negative shock right now. As Bob Forrestal just said, that means we ought to be taking out some insurance against recession. It would have been nice if we had taken this insurance out some months ago, but we didn't have that kind of foresight. We ought to take it out now.

The final nail in the coffin is something you did not mention, but something that I know you believe as well. It is that, given what the markets have done, if the Fed does not ratify it with some easing--and it doesn't have to be today, but soon--the bond market is likely to back up. I might add that I would expect the stock market to crack as well. So, the very things that we are expecting to support the economy and prevent a recession will evaporate right before our eyes, if we don't act. Now, having said that, as you know Mr. Chairman, I feel that a 50 basis point, symmetric move would be better than 25 basis points, asymmetric, which in turn would be better than 25 basis points, symmetric. Let me very briefly give you the reasons why I think doing 50 basis points would be preferable today.

It starts with the belief that the ultimate need is going to be more than 50 basis points. If you don't believe that, doing 50 basis points today would not be a smart action. There is definitely room for disagreement on that. I feel that with the fiscal contraction in train, more than 50 basis points is likely to be the end of this episode. That is to say, at the end of this episode the nominal funds rate will be below 5-1/2 percent. If I didn't feel that, I would not be arguing for 50 basis points now.

The second part of the argument is, as I said before, that I think we are already behind the curve and it is useful at this point to give a signal to bolster confidence that the Fed is watching and not asleep at the wheel.

In addition to that, doing 25 basis points will be read as a fairly timid action suggesting a very tentative Federal Reserve not quite sure about what should be done. Now, maybe that is in fact accurate, and we are certainly seeing a lot of newspaper reports suggesting that. But again, it is not the image that we would like to project, if we can help it. Related to that, I think that doing 25 basis points now would create more uncertainty about our near-term future intentions than doing 50 basis points. We will have the markets constantly looking for the other shoe to drop and envisioning that this is the start of another downward staircase. I think there is more credibility that minus 50 now would be a mid-course correction or whatever you want to call it--I would call it a temporary resting place--a movement that we would be comfortable to sit with for a while and observe developments.

Finally, no matter what we say, a downward move of 25 basis points is going to be read as evidence of a divided Committee that a very clever Chairman was able to hold together on an in-between compromise. That, again, is not a total disaster. The situation is somewhat equivocal and reasonable people could have different views. But I would say it is not the image that we should want.

So, for all these reasons I think doing 50 basis points now would be better than 25 basis points now and 25 basis points in August. But, for the sake of unity, I could go along with your recommendation.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I basically agree with many of the comments that Bob Forrestal made. If I were certain of our forecast and that in the Greenbook, I would probably favor leaving policy unchanged at present. However, as we all know, forecasts are often wrong and they often underpredict the size of cyclical swings in the economy. Therefore, I support a 25 or a 50 basis point cut in the funds rate. I would have some preference for the latter with symmetric language as insurance against a more prolonged decline in real GDP than I think is most likely. I want to emphasize, however, that we should be prepared to reverse course and raise rates if circumstances change and growth looks as though it will exceed the growth rate of potential output. In fact, I don't think we should cut rates now unless we are prepared to raise them again fairly soon, should that become necessary.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Thanks, Alan. In my judgment, and I expressed some of this yesterday, the current slowing in the expansion will be followed by a rebound of growth at a rate near the economy's long-term potential. In fact, I think the recent evidence suggests, and you mentioned this in your comments, that lower intermediate- and long-term interest rates have in effect put a floor under the housing and auto markets. So, at this time my principal concern is really with the long-run inflation trend. Trend CPI inflation of 3 percent or higher is reflected in the forecasts, including the Greenbook forecast, and in long-term interest rates. In my view trend inflation of 3 percent just isn't good enough. With CPI inflation during the first half of 1995 running about 3-1/2 percent at an annual rate and the economy expected to continue to expand at or near its potential, I don't believe the current economic outlook warrants a change in the stance of monetary policy. Easing policy at the first sign of economic weakness after a period of what I think we would all agree is unsustainable real growth undermines our credibility and could adversely affect the bond and foreign exchange markets. In effect, we would be engaging in short-run fine-tuning under conditions of great uncertainty with respect to the economic outlook. Accordingly, my preference would be to maintain the current restrictive policy to ensure that the acceleration in inflation that began last year is capped and to bring trend inflation to a level significantly below 3 percent.

Now, having said that, if it is the strong consensus of this group that a 25 basis point cut in the funds rate is warranted, I would not dissent on that even though that is not what I would favor. But I would say that if we did that we should make it clear that this action does not reflect a change in our commitment to reduce the trend rate of inflation. And, as Bob Parry suggested, we should be prepared to reverse course and allow the funds rate to rise should the evolving situation warrant it. Any change in the discount rate at this time or a larger change in the funds rate would be most inappropriate in my view.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Thank you, Mr. Chairman. Going back to February 1994 when we began the process of raising rates, I remind the Committee that at that time the unemployment rate was still above the natural rate and inflation was still coming down. We made the very wise and prudent decision to take a forward-looking stance on monetary policy and not react to current conditions. I am glad we did. I think it was the right thing to do, and I would suggest that we do the same thing today. When we look down the road 6 to 12 months, we are looking at the first half of 1996 when our action will have its impact. Therefore, I agree with the point that was just made that we cannot think of ourselves as reacting to the current slowdown because there is nothing we can do about the current slowdown. What we can do is affect what we think is going to be the economy in early 1996. In that regard, I think we are fortunate that we have had the slowdown in the second quarter of 1995. Had we had the slowdown in the fourth quarter of 1995 or the first quarter of 1996 when some other factors that I foresee are going to come into play, we would be in the proverbial soup.

I think the Greenbook, although I am glad to see they have made an assumption of fiscal policy contraction, understates the actual amount. What they did was to average the President's proposal and the Congressional proposal when, in fact, these proposals start from different baselines. The Medicare saving that the President proposed is from a rate of growth in Medicare spending that is the same as the Senate's, and on the appropriations side that is not where the differences really are. I think we may see something a lot closer to $40 billion followed by another $40 billion rather than the numbers in the Greenbook. In addition, in the first half of next year, we have to add to that the potential of three other downside risks. In the order of their likelihood I would call them Japan, Canada, and Europe. None of us can really bet on the state of the Japanese economy. The chances of something significant happening there are probably less than 50/50, but they are high enough when we add that to the probability of continued sluggishness in Canada and/or less expansion than the Greenbook forecast for Europe; the latter seems high to me given that they have to have both a fiscal and a monetary contraction to meet the Maastrich criteria. It all adds up to a slow first half of 1996.

I agree, therefore, with Governor Blinder that ultimately we are going to need more than a 50 basis point reduction. If I were betting I would say that a year from now we will be 100 basis points under where we are now, and we still may be chasing where we want to be. However, Mr. Chairman, I agree with your point on tactical grounds. I think that 25 basis points is the right move to make today largely because of those foreign exchange rate considerations. I would be very nervous, given the current state of the yen, about making a move that was considered bold and aggressive and might send the yen up, with all kinds of perverse implications for our bond market and for the Japanese economy. And so, I support your recommendation.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. I can be brief; I planned to say a lot about the debt aggregate! [Laughter] We probably have one negative quarter in the bag and we may have a second in the bag. If we do, that will be embarrassing. It will be called a recession; and if we have a recession in the second and third quarters, looking back on it in the future, we will be a lot happier if we had eased today. If we barely escape a negative third quarter and barely escape the recession label, the economy is still likely to be weak and an easing will still look to have been appropriate at this time. Only if we have a booming third quarter will we look back on a decision to cut the fed funds target now as something of an embarrassment. If the economy last February had looked like it does now, I don't believe we would have gone that last 50 basis points. It now looks like we may have gone

one bridge too far. I don't regard a 25 basis point reduction in the fed funds target as much of an easing of policy, but even if we call it an easing, it is consistent with our long-term goal of fighting inflation for much the same reason that a race car has brakes. The point is not to reduce the average speed of the race car but to keep it on the track for the maximum sustainable speed. A recession now is not in the best interest of the Federal Reserve in the future and our future will be to fight inflation. As for tactics and the probable reaction of the markets, I'll have to defer to your judgment. I must admit, though, that coming into the meeting my rationale was that a 50 basis point reduction would leave the markets more settled than a 25 basis point reduction. I think they are going to start clammering for the next 25 basis points immediately. So, I would have recommended a 50 basis point move, but I will defer to your judgment on that.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. This is a fairly difficult policy decision for me. When I reviewed all the materials for this meeting, I realized that any decision that I would make would really depend on the interplay of three different factors. The first relates to my own preference among the three longer-run policy alternatives that Don laid out, and I must confess to some preference for the baseline strategy among the three, recognizing that they are all forecast-based and so forth. Second, and probably more important, is my view of short-term risks to the baseline forecast as we see it in the Greenbook. And finally, even if the risks are skewed to one side or the other, what are the costs of being wrong? That is, are the costs of being wrong relatively high even if the risks are low?

I think I view the risks to the forecast pretty much the same as everybody else here sees them. I think those risks have changed over the last few months from being on the up side--that is, that growth would be faster and inflation more of a problem--to being fairly evenly balanced; and now they seem to be much more on the down side--that is, in the direction of slower growth than the forecast suggests. However, I think these risks are wholly in the context of a pause in economic growth and not a recession. Growth could be slower than the baseline forecast, particularly in the third quarter, given the uncertainties about near-term consumer demand, inventory buildup, auto sales, and other factors that people mentioned yesterday. But I do think there is a powerful offset to all of this in the drop in interest rates, the health of the banking system, and the health of financial markets in general. In my view, those financial factors will pull the economy out in fine measure by year-end.

I continue to believe that even though the risks of being wrong on the up side are small--that is, having much stronger growth by year-end than the Greenbook predicts right now--such a development would be pretty costly in terms of central bank credibility and in terms of what might have to be done in 1996 to rein in excessive growth should it materialize. In that regard, I think the boom/bust scenario that DRI plays out in some of its latest releases--even though it gives those results, as I do, a low probability--is interesting and instructive. Also, I should note that the data have been pretty mixed, especially recently, and that recent data tend to confirm my hypothesis that financial market conditions will spur growth by year-end. A lot more data will come in by the end of July.

Normally, I would not be sympathetic to a wait-and-see attitude, but I really have these concerns about what would happen if we are wrong on the up side by the end of the year and what we would have to do in 1996 to rein in that excess demand. So, I came into the meeting wanting to vote for a no-change, although asymmetric, directive. I am not going to dissent over 25 basis points, but I did want to convey these beliefs on my part. I can go with your recommendation, and I can certainly accept an asymmetric directive.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I think a quarter-point drop in the funds rate is the right amount at the right time, along with an asymmetric directive. The current level of monetary restraint has helped cause more of a correction and associated downside risks than we preferred. A cautious move toward less restraint, therefore, would help shore up demand and lessen downside risks. More importantly, it would demonstrate that the Fed is awake at the switch and wants to avoid a recession. I think we would be seen as forward-looking both when the economy is overheating and when it is underachieving. As the central bank our primary contribution to prosperity over time is price stability. Within the longer-run context of moving toward price stability, however, there is some room and indeed an obligation to take into account shorter-run fluctuations in demand. Now is one of those times to act promptly. To wait is to risk having to ease more and faster later on, with a greater probability of boom/bust in 1996 or 1997. A quarter-point drop in the funds rate would be a prudent magnitude for financial markets as well. It would in my judgment balance the need to try to avoid feeding another big run-up in asset values versus the risk of setting off a major correction.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, after listening to the Committee's discusion yesterday and today, one of the things that strikes me--it feeds a little bit off the Bluebook--is that if we take the outcome in the baseline forecast as reasonable and desirable, then we might go with a no-change policy. In our own Bank's view and in my view that outcome is reasonable, and in their comments around this table a lot of people said that they found such an outlook reasonable. This suggests to me that the real funds rate may be where it should be at this stage. There is no strong evidence that it is not. When we look at the risks, yes, there are downside risks. But as others have pointed out, the strong financial markets, the favorable banking conditions, and our own Bank's projection point to upside inflation risks, and that leaves me inclined to leave policy unchanged. There is a statement in the Bluebook to the effect that if we want to insure against a possible further slowdown, we might want to ease. But I am concerned that that insurance comes with its own price. When we vote for monetary stimulus, we are also increasing the risk of further inflation. In addition, some members want to ease in anticipation of prospective shocks that have not yet materialized. The odds of such occurrences are unknown and that, too, leaves me uneasy about moving at this time. So, I think it would be prudent for us to adopt an asymmetric directive and wait for information rather than to move at this juncture based on the projections and the evidence that we have about the real fed funds rate.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I think the appropriate criterion for choosing a stance of monetary policy is whether we feel it is a move toward the objective of stabilizing the purchasing power of the dollar. An inappropriate criterion would be either somebody's idea about what the impact of fiscal multipliers was going to be, assuming we knew how to measure fiscal policy appropriately, or some idea about a cumulative process of decline in the economy in the absence of some pump-priming to prop it up. I do know that people outside the Fed, who believe in some kind of stagnation thesis and think that the economy contracts in the absence of fiscal or monetary stimulus, are going to interpret our actions differently than I would. But I still think that there are appropriate and inappropriate reasons for our thinking about whether a policy adjustment is called for. In Don's characterization of our move last February, one of his interpretations was that it is possible for us to take out some insurance, and I think that was correct. The way I viewed it at the time was that if we enjoyed full credibility of our commitment to stabilize the value of the dollar over time and felt that we would achieve a stance of policy that in 1996 and 1997 would move us decisively in that direction, then I would not have thought that the action in February was necessary. That is quite different from what I thought about our November 1994 action. In my view that action was an adjustment that was necessary to move us toward price stability. I did not think that the February action in a vacuum would have been necessary. With the advantage of hindsight, I think the February action was necessary because of what has happened to the price numbers and the possibility of our objectives being misinterpreted had we not done that.

The way I think about policy now is in terms of how much insurance we need against future inflation. I would not want to be taking out insurance against a contraction because I think the economy tends to expand in the absence of adverse shocks or perverse policy. So, it is a question of whether we should cancel all the insurance now and whether that would be appropriately interpreted, or in the alternative that we have a growing confidence that we are back on track with regard to the future value of the dollar and so we are going to cancel half the insurance now. We can live with the "other shoe to drop" syndrome if it is interpreted that when we have further evidence that everybody agrees that we are moving toward stabilizing the value of our currency, we will then feel comfortable in canceling the other half of the insurance policy. At that point I would pause.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, policy changes should not be based on reaction to present data, but rather on our views of the economy and prices about 18 months from now. I say that because if we were dealing only with a response to recent data I would want to keep policy unchanged because I don't like the price numbers that we have seen thus far this year. But based on a view toward the future, I do think that the real federal funds rate is too high. It is higher than it either should be or needs to be and thus we should ease. The question therefore becomes when and how much. Especially because of my very great concern about possible shocks from weakness abroad, I think the time is now. From what we know now and not giving credit for fiscal restraint until the appropriations bills are passed and signed by the President, I believe that the likely total easing requirement is 50 basis points. I think a single 50 basis point move now would be very likely to destabilize financial markets and lead to a concern that we know much more than we really do, or fear more than we really should, about a likely recession. That would disturb markets greatly, and I agree with Governor Lindsey on the likelihood that it would disturb the dollar/yen relationship and disturb further the already weak Japanese economy that is a source of great worry to quite a number of us. So, I think the downside risks that many of us discussed could become downside realities as a result of a 50 basis point move now.

But I think we also have another reason to be concerned that our fears about downside risks could become downside realities, and that would be if leaks were to come from this meeting that would reveal our very considerable discussion of downside risks. We are in a particularly delicate period of the business cycle. We are also in a very delicate period for financial markets, and I think we have to show an unusual amount of discipline and restraint about what we have to say for ourselves. Ideally, it would be very nice if all of us were to maintain a stoic silence until the Chairman's Humphrey-Hawkins testimony when he could lay out a very balanced presentation of what the Committee really thinks. Therefore, I support the 25 basis point asymmetric proposal.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Mr. Chairman, I believe that we should be forward-looking in setting our monetary policy. While we had two or three months of bad numbers, there is still a lot of uncertainty about the economy's underlying strength. As you mentioned, some of the more recent data that we have seen on housing and orders for durable goods suggest that the economy is stabilizing at a sustainable level of real activity. I think it is important that we be careful not to give the perception that we are tying monetary policy too closely to the fluctuations in short-run output. That would damage the credibility of our commitment to reducing inflation. Clearly, if inflationary pressures are moderating, we should be prepared to reduce the federal funds rate gradually. I believe the real federal funds rate should be below 3 percent, especially given the fiscal policy assumptions. At this point our forecast has the economy slowing to a sustainable rate of growth with some reduction in inflationary pressures, though not as much as the Greenbook in 1995. This is based on both the forecast that we have from our model and my own personal contacts with people in our District and elsewhere. Our forecast also assumes that the Committee will be lowering the federal funds rate by at least 50 basis points by the end of 1995. The timing of this policy action would have little impact on the economy's performance this year. By our assessment the 25 basis point reduction in the fed funds rate now will have little quantitative impact, but it may serve as a signal that we are indeed forward-looking. However, I think it is important that we not give the impression that we are simply responding to short-run fluctuations in output. It must be clear that our action is consistent with the slowing expansion and moderation in the inflation outlook. As others have said, I think it is important that we indicate that this is not a change in our commitment to reduce inflation. So, I support the 25 basis point reduction and an asymmetric directive.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I will make only a couple of points. I think the decision does not hinge--some people have made this point already--on the current weakness in the economy or even prospective weakness, at least of the type we have been talking about. In part that is because of the well recognized lags in policy; there is not much we can do about the economy at this point. In part also, as people have commented, the reaction that has already occurred in the bond and stock markets and the anticipation that the inventory adjustment will be rather brief and rather shallow--those, of course, are not independent events--do not suggest to me that a decision today hinges on the immediate outlook. What I think is important at this juncture is that the markets have essentially priced in an easing of policy. We do not in my view want to peg the federal funds rate at any particular level. Interest rates typically fluctuate pro-cyclically. If we look at even the relatively optimistic path for real growth in the Greenbook or the model that we maintain, we get ceteris paribus a number of consecutive quarters of below-trend growth. That is an environment in which I would expect interest rates to be declining. It doesn't seem to me that we should stand in the way of that. So, I support your recommendation, Mr. Chairman. For what it is worth, though, I would prefer a symmetric directive.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. I am very much where Tom Melzer is. If I were a voting member, I would support your recommendation, Mr. Chairman, although I must say with a considerable degree of nervousness. That kind of nervousness has been underscored by Tom Hoenig and some others. There seems to be a feeling--calling it a consensus may be too strong a characterization--that we can be fairly confident that inflation has reached a cyclical peak. The probability of that is certainly higher than I would have expected a while back, but I think we need to keep a longer-term perspective here. It was less than a year and an half ago that we ended an extended period of substantial monetary ease. While the risk of further inflation in this cycle is smaller than it was, I don't think it is zero and we need to keep that in mind. I think a cautious approach involving a quarter-point reduction in the funds rate is the appropriate degree of easing now. I would oppose a half-point reduction. One other comment: As Mike Moskow and others have said, it is important in communicating this action to the public to make clear that it is done in the context of a continuing longer-term commitment to price stability. I would very much like to see the words "price stability" in the announcement that we will make this afternoon if we take this action. I think it would be highly desirable for you, as I am sure you will, to emphasize that objective in your testimony a couple of weeks down the road.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, as I said yesterday, I think that we have the flexibility here to move for positive and affirmative reasons as opposed to negative and defensive ones. Based on my reading of the likely outlook, I don't see us as driven primarily by the specter of a collapsing economy, although I would certainly concur that the downside risks are still there. Rather, I see the likelihood of a moderate and sustainable noninflationary growth period ahead of us coupled with a cyclically plateauing inflation rate that is still in a secular downward trend. I find all of that rather attractive. It gives the Committee room to move within the context of maintaining its posture relative to a steady focus on attaining price stability. The positive reasons to move have been articulated around this table, and I won't try to recite all of them again. I do think that 25 basis points is plenty for us to move today. The major significance will be the change in policy direction as opposed to the amount of the move, and I share the Vice Chairman's concern about the risk of roiling the financial markets in destabilizing ways. I believe that whatever we do, 25 or 50 basis points, there is going to be speculation about what comes next, either way. I also favor 25 basis points because it is not at all clear to me what our next move may be or when it may come. For that reason, Mr. Chairman, I also would prefer to see a symmetric directive, although I certainly can support asymmetric if that is the way we are going to go.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I also think that the baseline projection is probably the most reasonable, but I would support a 25 basis point move as insurance in the sense of not being 100 percent sure about how our forecast of the inventory correction is going to work out. I must say that I vacillate on this question of symmetry or asymmetry. I guess I don't have strong views, but I am marginally supportive of symmetry because I don't think that we would move before August without talking in any case. But I wouldn't vote against asymmetry because of my lack of conviction as to the use of asymmetric language.

CHAIRMAN GREENSPAN. Governor Yellen.

MS. YELLEN. Mr. Chairman, I support your recommendation to lower the funds rate today. As I already emphasized, I am concerned about downside risks and the possibility of destabilizing feedbacks that could weaken the economy more than the Greenbook envisions. On the inflation side, I think a funds rate cut is consistent with our longer-term objective of gradually attaining price stability, given the greater slack already in evidence in both product and labor markets. Moreover, all our forecasts, with or without a cut in the funds rate of the size we are envisioning here, show a decline in inflationary pressures as we go forward.

To me, one of the major rationales for such a cut, as Governor Blinder and others have emphasized, is that we need to cement in place the existing financial conditions that are already working to provide the critical cushion against the downside risks. So, I would like to see a cut to prevent a further backup in long-term interest rates, namely, to ratify the expectations implicit in the current structure of longer-term yields. I certainly am not arguing that we should be setting monetary policy by following the fed funds futures, but I think we should recognize situations when the market has gotten things right and act accordingly. I see the reduction in market interest rates that has occurred since our last meeting as a very natural reaction--Gary Stern mentioned this, too--to a softening economic outlook and as an automatic stabilizer mechanism that cushions the the economy when it is buffeted by spending shocks. Our task at this point is to be careful to avoid a pitfall that is well recognized in the literature on monetary policy. It is that interest rate targeting has the potential to thwart the operation of that natural adjustment mechanism, thereby exacerbating economic volatility. So, I see a cut in the funds rate now as essentially giving the green light for this market mechanism, which is already working, to continue its work. I certainly agree that the rationale is stronger for a cut now. As the Chairman emphasized, and the Greenbook and Bluebook acknowledge this, eventually we have to cut the funds rate because the equilibrium real funds rate is tending to fall as we go forward.

In my view this is a mid-course correction and it is designed to do a little sooner as an insurance policy what I would envision our having to do anyhow in the not-too-distant future. In a sense we put some extra restraint in place last February at a time when it seemed as though the momentum in demand was never going to subside. That situation has changed dramatically; it changed pretty quickly after the February meeting. Now I think of that as extra braking action that is no longer needed, and I see this as a move to a more neutral stance. I remember that Bill McDonough warned us at the February meeting that we needed to be forward-looking and that we would one day have to make a pre-emptive forward-looking move toward ease that would catch the market off guard, but nevertheless we should have the courage to behave in that forward-looking way even though it would be a surprise. My only regret at this stage is that we really are not as far ahead of the curve as Vice Chairman McDonough envisioned in his remarks then. So a 25 basis point cut in the funds rate is not going to be a surprise to the market. In fact, for much of the past month the odds of a 50 basis point cut at either this meeting or the next have been close to one.

What should we do today? I guess my inclination would be if I had my druthers to choose a 50 basis point move today because I think it is needed, if not now then in the near future, to move to a more neutral policy stance. In a way, it would be psychologically stabilizing for households and firms to be able to rest a bit more secure in the knowledge that the Federal Reserve wants to take actions to keep the economy growing. But I also recognize the arguments against such a move today that the Chairman and others among you have articulated on the basis of the possible impact on financial markets. So, I can certainly support the proposal for a 25 basis point cut today. I would have a strong preference for an asymmetric directive, although I don't mean by that a presumption that there would be an intermeeting move.

CHAIRMAN GREENSPAN. Thank you. A cut of 25 basis points with asymmetric language seems to be the general consensus. Would you give us wording on how that would read?

MR. BERNARD. I am reading from page 25 in the Bluebook: "In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint might or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months."

MR. LINDSEY. I hate to raise the "slightly" versus "somewhat" issue, but if we are moving only 25 basis points, then we should make it "slightly."

CHAIRMAN GREENSPAN. Yes, I think you are right.

MS. MINEHAN. Yes.

CHAIRMAN GREENSPAN. Let's go to "slightly."

MR. BERNARD. "Slightly" for both?

CHAIRMAN GREENSPAN. Yes. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Blinder	Yes
President Hoenig	No
Governor Kelley	Yes
Governor Lindsey	Yes
President Melzer	Yes
President Minehan	Yes
President Moskow	Yes
Governor Phillips	Yes
Governor Yellen	Yes

CHAIRMAN GREENSPAN. Our next meeting is August 22?

MR. BERNARD. Yes.

CHAIRMAN GREENSPAN. Contrary to the original plan, we are going to have lunch here since apparently the air conditioning is holding up reasonably well.

SPEAKER(?). Is there a press release?

CHAIRMAN GREENSPAN. I am sorry. The draft reads as follows:

"Chairman Alan Greenspan announced today that the Federal Open Market Committee decided to decrease slightly the degree of pressure on reserve positions.

As a result of the monetary tightening initiated in early 1994, inflationary pressures have receded enough to accommodate a modest adjustment in monetary conditions.

Today's action will be reflected in a 25 basis point decline in the federal funds rate from about 6 percent to about 5-3/4 percent."

We will try to capture all sides of the general discussion at this meeting in the Humphrey-Hawkins report.

MR. BROADDUS. Mr. Chairman, is it possible to add one final sentence there that says "This action is taken in the context of our longer-term commitment to price stability"?

CHAIRMAN GREENSPAN. I thought of doing that but I concluded that such an addition would make the statement too complex. I think the issue is that we are not responding to an expectation of a recession. We are responding to the fact that we have succeeded in reducing inflationary pressures enough so that the adjustment makes sense for the longer term. A reference to price stability is implicit in there. I originally had that in an earlier draft and I decided it was redundant and we wanted to keep the announcement short. We will have a longer explanation in the Humphrey-Hawkins report.

MR. LINDSEY. What time does this announcement come out?

CHAIRMAN GREENSPAN. 2:00 - 2:15 p.m. What do you want to do, Joe?

MR. COYNE. 2:15 p.m.

CHAIRMAN GREENSPAN. 2:15 p.m.

MR. MCTEER. Is there a good reason it can't be earlier?

CHAIRMAN GREENSPAN. Don, why don't you--

MR. KOHN. We have tried to establish a regular time so that people, not knowing exactly when it would come out, would not be hovering over the Telerate machines and reading great amounts of meaning into the timing of the release, how long you argued about policy, or whatever. So, we thought it was better to establish a routine time rather than making it 1:55 p.m. after one meeting and 2:35 p.m. after the next. That was the reason.

CHAIRMAN GREENSPAN. Why don't we adjourn and go to lunch?

END OF MEETING