Minutes of the Federal Open Market Committee
May 19, 1998

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, May 19, 1998, at 9:00 a.m.

Present:

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

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

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

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

Ms. Browne, Messrs. Cecchetti, Dewald, Hakkio, Lindsey, Simpson, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

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

Ms. Fox, Deputy Congressional Liaison, Office of Board Members, Board of Governors

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

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

Messrs. Alexander, Hooper, and Ms. Johnson, Associate Directors, Division of International Finance, Board of Governors

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

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

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

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

Messrs. Eisenbeis, Goodfriend, Hunter, Lang, Rolnick, and Rosenblum, Senior Vice Presidents, Federal Reserve Banks of Atlanta, Richmond, Chicago, Philadelphia, Minneapolis, and Dallas respectively

Messrs. Altig, Bentley, and Judd, Vice Presidents, Federal Reserve Banks of Cleveland, New York, and San Francisco respectively

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By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 31, 1998, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets during the period March 31, 1998, through May 18, 1998. There were no System open market transactions in foreign currencies during this period, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period March 31, 1998, through May 18, 1998. By unanimous vote, the Committee ratified these transactions.

The Manager informed the Committee of his intention to discuss with market participants proposed changes in the procedures for lending securities from the System Open Market Account. The changes would be intended to adapt the lending program to the evolving structure of the U.S. Treasury securities market. They are designed to make System securities lending more effective at helping to relieve occasional significant shortages of particular securities, which could cause disruptions to the market. In a brief discussion, Committee members sought clarification of some of the proposed details of the new program and how it would fit with the Federal Reserve's broader responsibilities. Action to amend paragraph 2 of the Authorization for Domestic Open Market Operations would be required at a later date when the details of the new program had been decided upon after discussions with market participants.

The Committee then turned to a discussion of the economic and financial outlook, and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that the economy continued to expand rapidly in 1998. Strength in consumption, business outlays for durable equipment, and homebuilding boosted growth in domestic final demand to a very rapid pace in the first quarter, and there had been indications of slower expansion since then. However, weakening net exports were exerting a considerable drag on economic growth. Moreover, the extraordinary pace of inventory investment thus far this year might foreshadow less robust expansion ahead. Payroll employment remained on a brisk uptrend, but industrial production decelerated sharply after surging in the second half of last year. Despite indications of persisting pressures on employment costs associated with tight labor markets, consumer price inflation remained subdued, importantly reflecting large declines in energy prices.

Nonfarm payroll employment registered another large increase in April after a small decline in March; these data, along with the still-low level of initial claims for unemployment insurance in recent weeks, suggested that labor demand had remained robust thus far in 1998. Hiring in the trade, finance and real estate, and services industries was brisk in April; employment in construction retraced part of an apparently weather-related drop in March. The number of manufacturing jobs declined in April for a second consecutive month. The civilian unemployment rate fell sharply, to 4.3 percent in April, after having averaged around 4-3/4 percent since last November.

Industrial production rose somewhat over March and April after weakening earlier in the year. Part of the slowdown this year, following rapid growth in the second half of last year, was attributable to weakness in utility output associated with unusually warm winter weather across much of the country. More importantly, though, manufacturing output had changed little on balance in recent months. In April, a pickup in the production of business equipment, particularly of information processing equipment, was largely offset by further declines in the output of construction supplies, basic metals, and nondurable materials. The production of consumer goods was unchanged. The factory operating rate eased further in April, reflecting the continuing brisk expansion in manufacturing facilities and slow growth in output.

Consumer spending had remained strong this year in the context of robust gains in income and household net worth and of very favorable consumer sentiment. Total retail sales rose appreciably in April, boosted by increases in purchases of automobiles and nondurable goods. Housing demand and residential construction activity also continued to increase at a rapid pace this year. Home sales were at very high levels, reflecting the continuing improvement in housing affordability as a result of declining mortgage rates. Although housing starts slipped in April, they remained at an elevated level.

Business fixed investment rebounded sharply in the first quarter from a small decline in the fourth quarter of 1997. A surge in expenditures on producers' durable equipment, notably on computers, communications equipment, and heavy trucks, more than offset continued weakness in outlays for nonresidential structures. While available indicators pointed to further substantial gains in equipment purchases over coming months, data on construction contracts offered little evidence of a pickup in nonresidential construction activity in the near term, even though vacancy rates were declining and office rents were rising.

Business inventories increased at a very rapid pace in the first quarter, but with sales strong, inventory-sales ratios remained within their ranges over the past year. In manufacturing, stock accumulation slowed in March after increasing fairly rapidly in January and February. At the wholesale level, inventories rose about in line with sales during the quarter, and in the retail sector inventories built up at a greatly accelerated pace in the first quarter.

The nominal deficit on U.S. trade in goods and services widened substantially in January and February from its average monthly rate in the fourth quarter. The value of exports declined considerably in the January-February period, with most of the drop attributable to reduced sales to Asian countries. The decrease in exports was concentrated in agricultural products, industrial supplies, and machinery. The value of imports rose slightly, largely reflecting higher amounts of imported automotive products and higher service payments. The available information suggested that economic growth in continental Europe strengthened in the first quarter, with strong domestic demand apparently offsetting the effects of Asian turmoil on foreign trade. Robust domestic demand also continued to buoy the Canadian economy. By contrast, economic activity in Japan contracted in the first quarter and decelerated sharply further in Asian countries that had experienced financial turmoil.

Consumer prices were unchanged in March and rose moderately in April. Energy prices were down slightly further in April after declining markedly in previous months, and food prices increased a little; excluding food and energy, consumer price inflation picked up in April as prices of services accelerated and prices of tobacco surged higher. Over the course of recent months, core consumer inflation had accelerated to rates that were somewhat above those registered earlier. Even so, on a year-over-year basis, the increases in total and core consumer prices were substantially smaller over the twelve months ended in April than they were in the year-earlier period; falling import prices apparently helped damp the goods component of the index. At the producer level, price inflation of finished goods other than food and energy picked up a bit in April, but it was considerably lower over the twelve months ended in April than over the year-earlier interval. Inflation at earlier stages of production also remained subdued. The rate of increase in hourly compensation of private industry workers slowed in the first quarter, reflecting smaller advances in both the wage and benefit components of the index; however, compensation costs accelerated appreciably on a year-over-year basis, primarily as a result of faster growth in wages and salaries.

At its meeting on March 31, 1998, the Committee adopted a directive that called for maintaining conditions in reserve markets that were consistent with an unchanged federal funds rate averaging around 5-1/2 percent. However, in light of increased concerns that growth in aggregate demand might outpace the expansion of the economy's potential for some time, possibly generating inflationary imbalances in labor markets, the Committee decided that the directive should include a bias toward the possible firming of reserve conditions and a higher federal funds rate. The reserve conditions associated with this directive were expected to be consistent with considerable moderation in the growth in M2 and M3 over the months ahead.

Open market operations throughout the intermeeting period were directed toward maintaining reserve conditions consistent with the intended average of around 5-1/2 percent for the federal funds rate. Though tax flows were heavy at times and reserves were drained from depository institutions as tax payments spilled into Treasury deposits at the Federal Reserve Banks, the federal funds rate averaged a little below its intended level over the period. Most other market interest rates declined slightly on balance over the intermeeting period; incoming data suggested that labor markets remained tight and that the economy retained considerable upward momentum, but market participants evidently gave greater weight to information indicating that wage and price inflation was well contained in the first quarter. Share prices in U.S. equity markets rose further despite some reports of soft corporate earnings, and equity prices in most other industrial countries also reached new highs.

In foreign exchange markets, the trade-weighted value of the dollar in terms of major currencies changed little on balance over the period. The dollar declined considerably against the German mark and other continental European countries amid signs of strong growth in the German economy and further progress in resolving the outstanding issues associated with next year's launch of the euro; French and German interest rates also rose slightly over the period. The dollar appreciated somewhat against the yen; the announcement of a large fiscal stimulus package and Japan's intervention in support of the yen did not offset indications of further weakening in the Japanese economy and related declines in Japanese interest rates. Other Asian financial markets came under renewed pressure after a brief period of relative calm. The currencies of several key Asian emerging market economies depreciated considerably against the dollar; and in sharp contrast to the performance of equity markets in most industrial countries, prices in Asian equity markets declined substantially on balance over the period to near their lows of late 1997 or early 1998.

M2 and M3 expanded briskly further in April, but data for late April and early May showed M2 declining and M3 leveling out; much of the fluctuation in M2 during the April-May period appeared to be related to movements of funds associated with unusually heavy nonwithheld tax payments and a surge in mortgage refinancings to take advantage of lower long-term rates. On balance, the underlying growth of these aggregates seemed to be slowing from the pace of the first quarter. The moderation in M3 partly reflected a reduced need for non-M2 sources of funds at a time when bank credit expansion seemed to be slowing. Growth of total domestic nonfinancial debt apparently had slipped somewhat after picking up earlier in the year.

The staff forecast prepared for this meeting indicated that the expansion of economic activity would slow considerably during the next few quarters and remain moderate in 1999. Reduced growth of foreign economic activity and the lagged effects of the sizable rise that had occurred in the foreign exchange value of the dollar were expected to place substantial restraint on the demand for U.S. exports and to add to the pressures on domestic producers to hold down prices to meet import competition. An anticipated sharp slowdown in the pace of inventory accumulation also would damp domestic production as the growth of stocks was brought into balance with the expected more moderate trajectory of final sales. The staff analysis suggested that further strong gains in income, along with the surge in household net worth over the past several years, would support brisk, though gradually diminishing, gains in consumer spending. Housing demand, fostered by the favorable cash flow affordability of home ownership, was expected to remain at a generally high level, though the anticipated slowing in income growth over the projection period would damp residential construction activity somewhat. Substantial increases in capital spending would continue, but slower growth in business sales and profits would produce a gradual deceleration. While pressures on production resources were likely to abate to a degree as output growth slowed, inflation was expected to increase somewhat from its recent pace in response to rising compensation costs associated with persisting tightness in labor markets, a limited rebound in energy prices, and a diminishing drag on non-oil import prices.

In the Committee's discussion of current and prospective economic developments, members noted the exceptional strength in domestic final demand and viewed robust further expansion in such demand as highly likely. Final purchases were being supported by accommodative financial conditions, especially a rising equity market, by ebullient consumer sentiment, and by business spending on productivity-enhancing equipment. While there were limited indications of weakness in some sectors of the economy--such as manufacturing, energy, and agriculture in some areas--the members did not see conclusive evidence of appreciable moderation in the pace of the overall economic expansion. Nonetheless, they generally believed that substantial moderation in the expansion was a likely prospect in coming quarters, largely as a consequence of a marked slowing in inventory investment from the clearly unsustainable pace of the first quarter and, to a lesser extent, from some further weakness in net exports. The outlook for the latter was especially uncertain, and the weakness could be greater than previously anticipated owing to renewed turmoil in emerging Asian economies and pronounced weakness in Japan. Whether the moderation in U.S. economic growth would be sufficient to forestall cost increases arising from tight labor markets that in turn would add to pressures on prices was open to question. To date, developments in business costs had been relatively benign, owing to an important extent to somewhat faster productivity growth. This circumstance and a number of one-time influences holding down costs and prices had contained inflation at rates that were lower than those seen in several decades, and probably would continue to do so for a while. But the members generally were concerned that inflation might begin to rise over the intermediate term, especially if labor markets tightened further.

In their assessment of the factors underlying the persisting strength of aggregate final demand, members took particular note of the effect of accommodative financial conditions. The rapid growth in consumer spending was being bolstered by large gains in stock market wealth; and the strength in housing and other interest-sensitive consumer expenditures also reflected declines in nominal, and perhaps in real, intermediate- and long-term interest rates and the ample availability of loans. Likewise, the ready availability of equity and debt financing on favorable terms was a key factor in the continuing robust growth of business investment. Indeed, some members expressed concern that the widespread perceptions of reduced risk or complacency that had bolstered equity prices beyond levels that seemed justified by fundamentals were beginning to be felt in a variety of other markets as well, including commercial and residential properties, business ventures, and land. In the view of a number of members, rapid growth of the monetary aggregates, though it had slowed very recently, was a further indication that financial conditions were not restraining economic activity.

Despite the failure of domestic demand to moderate in line with their earlier expectations, the members were persuaded that appreciable slowing in the growth of economic activity was a likely prospect over the course of coming quarters even though its exact timing and extent were unknown. Key elements in this assessment were the outlook for inventories and net exports. The surge in inventory accumulation in the first quarter did not appear to have resulted in overall stock imbalances as evidenced by stock-sales ratios or anecdotal reports. Even so, growth in inventory investment at a pace sharply exceeding the sustainable growth of final sales was unlikely to continue for an extended period. Given the ample availability of industrial capacity and the related absence of pressures on lead or delivery times, business firms did not need to build precautionary stocks. Thus, inventory investment was likely to respond to the expected deceleration in final sales over coming quarters. Some members expressed reservations about the probable extent of the deceleration in the period ahead, especially in the context of their expectations of a still relatively robust uptrend in final sales.

Developments in Asia clearly were having adverse effects on a number of U.S. industries, but the overall effects on the U.S. economy appeared to have been limited thus far. Indeed, the direct effects of the Asian financial and economic problems on U.S. trade over time needed to be weighed against their indirect but positive effects in the near term in helping to hold down U.S. interest rates and in reducing the prices of oil and other imported commodities. However, members were concerned that, as evidenced by the most recent developments, conditions in Asian financial markets and economies were deteriorating further, with potentially adverse consequences for net U.S. exports. Of particular concern in this regard was the possibility of worsening economic conditions in Japan and the negative implications not only for U.S. trade with Japan but for worldwide trade and financial markets. Some members also commented that unsettled financial and economic conditions in East Asia could tend to exacerbate the economic problems of several important emerging economies in other parts of the world, including major Latin American trading partners of the United States. On balance, forecasts of a limited further drag on U.S. net exports from developments in Asia were subject to substantial uncertainty, with the risks tilted toward a greater effect on the U.S. economy than had been anticipated earlier. Moreover, the lingering effects of the dollar's appreciation last year against a broad array of currencies would continue to depress the nation's foreign trade position for some time.

The decline in the unemployment rate to its lowest level in nearly three decades underscored anecdotal reports of further tightening in labor markets in recent months and added to concerns about the outlook for inflation. Though the first-quarter data had not suggested as steep an increase as a number of observers had anticipated, labor compensation clearly was trending higher. But as suggested by the rise until recently in profit margins, businesses had been able to realize productivity gains that tended to offset the faster increases in compensation costs. Indeed, while the most recent data were difficult to read, once likely revisions were taken into account productivity improvements could well be on a steeper uptrend than had been estimated earlier. Even so, the members remained concerned that if pressures on labor resources continued to intensify, the associated increases in labor compensation would at some point significantly exceed the gains in productivity. The resulting pressures on prices might be muted, but probably only for a time, by the inability of many business firms in highly competitive markets to raise their prices or to raise them sufficiently to offset rising costs. Some members emphasized that a number of developments that had held down prices, including the dollar's sizable appreciation last year, the drop in world oil prices, and the downtrend in employee benefit cost increases were unlikely to be repeated over the coming year and could even be reversed to a degree. Members acknowledged, however, that the nexus between labor market tightness, accelerating labor costs, and the effects on price inflation was very difficult to ascertain and analyses based on earlier patterns that pointed to rising inflation had proved consistently wrong in recent years.

In the Committee's discussion of monetary policy for the intermeeting period ahead, a majority of the members indicated that they preferred or could accept an unchanged policy. These members also expressed a preference for retaining the asymmetric instruction in the directive that the Committee had adopted at the previous meeting. In this view, the uncertainties in the outlook for economic expansion and inflation remained sufficiently great to warrant a continued wait-and-see policy stance. Considerations underlying this view included the possibility that financial and economic conditions in Asia might worsen further and exert a stronger retarding effect on the performance of the U.S. economy than presently seemed to be in train. A good deal of uncertainty also surrounded the potential extent to which developments in the domestic economy, notably the pace of inventory accumulation over coming months, might foster slower economic expansion and the related degree to which pressures in labor markets would be affected. Moreover, considerable questions remained about the relationship of labor market pressures to inflation. In these circumstances, it was possible that inflation would continue to be contained, though the risks clearly seemed to be tilted in the direction that action would become necessary at some point to keep inflation low.

While a delay in implementing a tighter policy that ultimately proved to be needed to curb rising inflation involved some risks, many of the members concurred in the view that the potential costs of postponing action for a limited time were small. By some measures, inflation had continued to drop in the first quarter, and the appreciation of the dollar, reduced commodity prices, and low--if not declining--inflation expectations would help to hold down nominal wage increases and price pressures for some time, even if, as a number of members suspected, the economy was now producing beyond its long- run potential. Forecasts of rising inflation had proved unreliable and needed to be viewed in light of the considerable uncertainties surrounding them. The members recognized, however, that the longer any needed action was delayed, the more important it would be to take prompt and perhaps vigorous action once the danger of rising inflation became clearer.

Another reason for not taking action at this meeting was the possibility that even a modest tightening action could have outsized effects on the already very sensitive financial markets in Asia. The resulting unsettlement could have substantial adverse repercussions on U.S. financial markets and, over time, on the U.S. economy. Many of the members emphasized, however, that market considerations could not be allowed to jeopardize the effective conduct of a U.S. monetary policy aimed at an optimal performance of the U.S. economy. Indeed, such a performance would best serve the interests of troubled financial markets and economies abroad.

A number of members indicated that the decision was a close call for them. In this regard, some emphasized that financial conditions were very accommodative in terms of the ample availability of financing to most borrowers on very attractive terms and increases in equity prices. Several expressed concern that the persistence of quite rapid monetary growth this year was symptomatic of a monetary policy that was not positioned to restrain ebullient domestic demand sufficiently, even if short-term real interest rates were quite high. Although some of these members could accept postponing action for the present to await further information on the balance of risks, two members, while acknowledging the uncertainties that surrounded the economic outlook, indicated a strong preference for tightening the stance of policy at this meeting. They believed that current policy was accommodating excessive strength in aggregate demand that very likely would be felt in higher inflation before long. Prompt tightening was needed to avert the necessity of stronger and potentially disruptive policy actions later to contain inflation.

All the members who intended to vote for an unchanged policy at this meeting supported the retention of a directive that was biased toward restraint. In their view, current developments did not call for any policy action, at least at this meeting, but because they felt the risks were tilted in the direction of rising inflation, a policy tightening move, possibly in the near future, was a likely though not an inevitable prospect.

At the conclusion of the Committee's discussion, all but two of the members supported a directive that called for maintaining conditions in reserve markets that were consistent with an unchanged federal funds rate of about 5-1/2 percent and that contained a bias toward the possible firming of reserve conditions and a higher federal funds rate. Accordingly, 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, the Committee decided that a somewhat higher federal funds rate would be acceptable or a slightly lower federal funds rate might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with considerable moderation in the growth of M2 and M3 over the months ahead.

The Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

> The information reviewed at this meeting suggests that economic activity has continued to grow rapidly in 1998. Nonfarm payroll employment registered another substantial increase in April after a slight decline in March, and the civilian unemployment rate fell to 4.3 percent in April. However, factory output has changed little on balance in recent months. Retail sales grew appreciably in April, and consumer spending as a whole has been very strong this year. Residential sales and construction also have strengthened this year. Business fixed investment rebounded sharply in the first quarter after having declined slightly in the fourth quarter, and available indicators point to continuing strength over coming months. Business inventories appear to have increased very rapidly in the first quarter. The nominal deficit on U.S. trade in goods and services widened substantially in January and February from its average monthly rate in the fourth quarter. Despite indications of persisting pressures on employment costs associated with tight labor markets, price inflation has remained subdued this year, primarily as a consequence of large declines in energy prices.
>
> Most market interest rates have declined slightly on balance over the intermeeting period. Share prices in U.S. equity markets have moved up a little further. In foreign exchange markets, the trade-weighted value of the dollar in terms of major currencies has changed little on net over the period. However, the dollar has risen on balance against the currencies of key emerging market economies, particularly those in Asia. Equity markets in Asia have fallen substantially over the period to near their lows of late 1997, while those in Europe have risen to new highs.
>
> M2 and M3 expanded briskly further in April, but data for late April and early May show M2 declining and M3 leveling out. The swing in these measures seemed to be related largely to movements of funds associated with tax payments. Expansion of total domestic nonfinancial debt appears to have moderated somewhat after a pickup earlier in the year.
>
> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in February established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1997 to the fourth quarter of

> 1998. The range for growth of total domestic non- financial debt was set at 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.
>
> In the implementation of policy for the immediate future, the Committee seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 5-1/2 percent. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, a somewhat higher federal funds rate would or a slightly lower federal funds rate might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with considerable moderation in the growth in M2 and M3 over coming months.
>
> **Votes for this action:** Messrs. Greenspan, McDonough, Ferguson, Gramlich, Hoenig, Kelley, Meyer, Mses. Minehan, Phillips, and Rivlin.
>
> **Votes against this action:** Messrs. Jordan and Poole.

Mr. Poole dissented because he believed that the sustained increase in money growth in recent quarters and associated accommodative conditions in the credit markets pointed to rising inflation. Although faster productivity growth suggested that trend output growth might be modestly higher than previously thought, the growth rate of aggregate demand over the past two years clearly had exceeded the economy's long-run growth potential. Without a reduction of aggregate demand growth, inflation would rise. In his view, the Federal Reserve should therefore take prompt action to reduce money growth to limit the rise in inflation and to avoid an increase in longer-term inflation expectations, which would tend to destabilize aggregate employment and financial markets.

Mr. Jordan also noted that the monetary and credit aggregates had accelerated further from already rapid growth rates in 1997. In his view, these high growth rates were fueling unsustainably rapid increases of real estate and other asset prices, and reports of "too much cash chasing too few deals" were becoming more frequent. Anticipated gains on both real and financial investments had risen relative to the cost of borrowed funds. In these circumstances, it was increasingly likely that the Committee would face a choice between smaller increases in interest rates sooner versus larger increases later. He added that maximum sustainable economic growth occurs when businesses and households act on the assumption that the dollar will maintain its value over time, and nothing he had heard from consumer groups, bankers, or other business people in his District led him to believe that decisions were being made in the expectation that the purchasing power of the dollar would be stable. Furthermore, expectations that market values of income-producing investments would continuously rise relative to underlying earning streams were not consistent with a stable purchasing power of money. He also believed that the view that real interest rates currently were high was not confirmed by observed behavior. Bankers told him that both consumers and businesses believed that credit was cheap and plentiful. These potentially inflationary conditions and imbalances in the economy were not conducive to sustained maximum growth.

It was agreed that the next meeting of the Committee would be held on Tuesday-Wednesday, June 30-July 1, 1998.

The meeting adjourned at 1:35 p.m.

Donald L. Kohn
Secretary

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