

Meeting of the Federal Open Market Committee

February 6-7, 1990

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, February 6, 1990, at 2:30 p.m. and was continued on Wednesday, February 7, 1990, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman  
Mr. Corrigan, Vice Chairman  
Mr. Angell  
Mr. Boehne  
Mr. Boykin  
Mr. Hoskins  
Mr. Johnson  
Mr. Kelley  
Mr. LaWare  
Ms. Seger  
Mr. Stern

Messrs. Black, Forrestal, Keehn, and Parry, Alternate Members of the Federal Open Market Committee

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

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Assistant Secretary  
Mr. Gillum, Deputy Assistant Secretary  
Mr. Mattingly, General Counsel  
Mr. Patrikis<sup>1</sup>, Deputy General Counsel  
Mr. Prell, Economist  
Mr. Truman, Economist

Messrs. J. Davis, R. Davis, Lang, Lindsey, Promisel, Rolnick, Rosenblum, Siegman, Simpson, and Stockton, Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account  
Mr. Cross, Manager for Foreign Operations, System Open Market Account

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1. Attended Wednesday session only.

Mr. Coyne, Assistant to the Board, Board of Governors  
Mr. Keleher, Assistant to Governor Johnson, Office of  
Board Members, Board of Governors

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

Mr. Slifman, Associate Director, Division of Research  
and Statistics, Board of Governors

Messrs. Reinhart<sup>2</sup> and Wilcox,<sup>2</sup> 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

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

Mr. McNees, Vice President, Federal Reserve Bank  
of Boston

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

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2. Attended portion of meeting relating to the Committee's discussion of the economic outlook and its longer-run objectives for monetary and debt aggregates.

Transcript of Federal Open Market Committee Meeting of  
February 6-7, 1990

February 6, 1990--Afternoon Session

[Secretary's note: There is no transcript of the first part of this meeting, which included the Committee's action to approve the minutes of the previous meeting, the election of the Chairman and Vice Chairman of the Committee for the year ahead, the selection of staff officers of the Committee, a review of the various Committee authorizations, directives, and other policy instruments, and the members' questions following the reports by the Managers for domestic and foreign currency operations. The texts of the Managers' reports are attached. The Committee's decisions on the various matters listed above, including its vote to ratify the Managers' transactions during the intermeeting period, were reported in the minutes for this meeting.]

MESSRS. CROSS & STERNLIGHT. [Statements--see Appendix.]

MESSRS. PRELL & TRUMAN. [Statements--see Appendix.]

CHAIRMAN GREENSPAN. Questions for the gentlemen?

MR. JOHNSON. First to Mike: Given the fact that the inflation picture remains stable in spite of slower growth, I was looking at the profits trend and it's down. There is quite a profit squeeze going on. If we hold nominal demand pretty much in check, given the profits picture, doesn't something have to give? Wouldn't you expect labor costs to come down, maybe through layoffs or something? How can those weak profits persist when there's no avenue for changing them in terms of nominal demand? Shouldn't there be a cutback in costs or at least a recession or something?

MR. PRELL. Well, there are a couple of pieces to that and they are both areas in which researchers have argued a great deal and have not reached definitive conclusions. One is the influence of profits per se on business spending. I don't think [the outlook for] that is favorable, and I indicated that profits and the cash flow picture are considerations in our weak investment forecast. Whether that influence should be stronger and we should have an even weaker investment picture is an arguable proposition. As it stands our forecast is considerably weaker than the Commerce Department's P&E survey would suggest and weaker than some other forecasts. But that crunch in profits, I think, does raise some questions. I would note that corporations are paying out a lot of their revenue to debt holders. And if you look at the return to capital in forms of both debt and equity, this doesn't look as low in historical terms as profit share alone. But it's a factor that one needs to keep in mind.

Now, on the price side and the wage side, I think wages have a considerable momentum. What one picks up looking historically at decelerations in wages that come with higher unemployment is that those are times when typically there is weaker profitability too. Whether there's an independent influence here is the question. But I would think that this certainly would steel many managers in their negotiations with labor. They want to try to do something about improving their profit margins and one way to go about that is to be

tougher on the wage side. That may lend itself to some contentious negotiations in the unionized sector. But in general I think that whole complex of weak demand and low profits is going to be putting some squeeze on wages. We have a gradual deceleration. It's obscured in 1990 by the big payroll tax and minimum wage effects; it's less so in 1991. But we tried to take those factors into account.

MR. JOHNSON. Okay, thanks. A question for Ted on the dollar, and this is something I raised yesterday too [at the Board briefing]: I realize the dollar has depreciated from the peak in 1989, but I don't think it really has depreciated over the whole year. There have been a lot of wiggles since the dollar sort of settled down in 1987. I just have a little trouble with the secular depreciation in the staff forecast. I realize that the external claims issue is a theoretical issue that may support the dollar depreciation, but of course monetary policy may have something to do with that. In looking at these international trends, even though you're projecting slightly lower inflation for the foreign countries, based on this recent dollar depreciation, than for the United States, what we see right now is almost complete convergence in price trends. It's prospective, I think--going forward to what the inflation trends will be. What I'm struck by is the lower left panel on Chart 17, which shows that right now we have almost complete convergence in prices. I agree that expectations play a part in that, but with convergence in inflation rates we still have a slight interest differential advantage. It has narrowed quite a bit and I guess you have to look at the changes as one factor. But if prices converge rather than break apart like this, given where interest rate levels are now--we're still slightly higher than Germany in terms of nominal interest rate levels and we're still considerably higher than the Japanese even though that has narrowed--I'm not sure that dollar depreciation is in the cards. I would say that, obviously, if inflation diverges again, maybe to the degree you have [in the forecast], there is some modest [depreciation] in the works. But what do you say to that?

MR. TRUMAN. Well, several things. One point is that inflation in Germany and Japan, of course, is lower than the average that is shown there, so that--

MR. JOHNSON. But we're talking about the trade-weighted dollar.

MR. TRUMAN. But the relevant interest rates adjusted for inflation, at least the way we've done it, are the ones in Chart 15 where real interest rates in the United States are below those abroad. And that is, I think, the question. As we've calculated those real interest rates, there is some weight given to the forecast going forward and, equally I might add, to what has happened over the past year and a half. To the extent that we have overestimated the decline of inflation abroad, we have overestimated the level of real interest rates in those countries. Now, a lot of the decline comes from Canada and the United Kingdom, two economies that have moved into a fairly weak aggregate demand condition. Our projection is that, much as in the United States but sooner, that will begin to have an impact on the inflation situation. The other part of the decline is more of a statistical artifact and has to do with the fact that a couple of these countries--Germany and Japan are two in particular--had a somewhat artificial boosting of CPI numbers last year, which is going

to be wiped out this year. So, you have had either an understatement of real interest rates this year or an overstatement of real interest rates next year depending on what you want to say about that. As I said in my presentation of the forecast, the decline of the dollar in this period is hardly precipitous and does not have a dramatic impact on the forecast on balance. It has some impact on the 1991 level of activity and prices and so forth. But in and of itself, given the level of the dollar where it is today, it has relatively little impact on the forecast for 1990.

MR. JOHNSON. Okay. One last question, Mr. Chairman, on this recent turnaround in bond rates: I noticed in reading some of the commentary that was submitted to the FOMC, and in Steve Axilrod's comments and some others' too recently, it has been argued that the turnaround in bond rates--since most of it is real and not nominal--represents an effective tightening of policy. I don't know what policy necessarily can do about it, but the fact is that some analysts are saying that it represents a relatively tighter situation, let's put it that way, in the economy. I just wonder what you think about that. To me that's almost the other side of the coin of the question I have been asking for a long time here: Given the fact that long-term real interest rates were coming down, was that stimulative? I'm a little skeptical about the notion that the [more recent] turnaround is an effective tightening--as much as I was skeptical about the downtrend in long rates [being an] easing--because the implication is almost that the funds rate should come down further if we want an effective tightening. What is your response to some of that commentary about the turnaround in the long rates? Suppose most of it is real.

MR. PRELL. Well, as we factor all that, there are three things that have happened on the financial front recently. The dollar has come down and, for the last few months, the dollar has tended to outpace our expectations on the down side. Short-term interest rates have come down and they clearly are a borrowing cost for a number of businesses and households. They probably have come down very considerably in real terms in the very short run. We view that rise in long rates as being at least partially a real increase; it is more than that long-term inflation expectations have risen. Governor Angell referred to one thing that may have some persistence here on the energy front beyond just the heating oil crunch in December. But, basically, we've viewed that as being at least in considerable part a real increase, and it has shown through in our forecast, particularly in the construction area. Mortgage rates, both nominal and real, are a factor in this forecast and, certainly, that was one element. So, these things have all sort of balanced out in the greater scheme of things with our dollar forecast. It has tended to buoy net exports as a contributor to GNP as we look out, but interest rate movements on net probably have tended to damp domestic demands somewhat. We've come out with essentially the same GNP forecast.

MR. PARRY. Isn't there some suggestion that the increase in long-term rates could be due to higher inflation expectations? I note that the surveys we have available now cover inflation over a shorter timeframe but are indicative perhaps of a change in thoughts about inflation. In addition, some people have been concluding that the probabilities of recession are somewhat less now than they were a month or so ago. All of that would be consistent with the idea that

we have upward pressure on interest rates in the long-term end of the market for domestic purposes as a reflection of changed inflationary expectations.

MR. PRELL. As I tried to suggest, without putting a fine point on this, we've assumed that the rise in nominal long rates is part inflation premium and part real. It has been a big move and I think that real part is not insignificant.

MR. JOHNSON. It's a difficult question. The move has been too sharp. The long-run inflationary expectations surveys have ticked up slightly, but not very much. At least the only one I've seen--Hoey--has hardly moved.

MR. PRELL. Well, actually, Hoey hasn't done a survey since this recent run-up of the curve. So, for what it's worth, we don't have that one to look at.

MR. JOHNSON. I guess so. Okay. But I think most people would say there's a significant real component to it even if you do worry a little about the upturn in inflation expectations. One plausible explanation is that some sort of positive real rate increase is not necessarily contractionary. There are the developments in Europe; export markets may be looking better.

MR. PRELL. That's one of the problems with looking at real rates as a gauge of monetary policy. It's an outcome of both monetary factors and expected returns on capital. And, yes, this is a world-wide phenomenon in the sense that you were addressing before because growth prospects and returns on capital may be higher owing to developments in Eastern Europe. It's hard to believe that's 70 basis points worth, but--

MR. JOHNSON. No, but a combination of some--

MR. PRELL. And with the stronger cyclical indicators--the orders figures and so on--maybe there is some element of elevation in people's expected returns on real investment.

MR. KOHN. Or [it may reflect] their expectations of what the equilibrium real rate is not only because of Eastern Europe but because the stronger data suggested to them that the economy could go along with sustained growth at higher rates than they previously had thought.

MR. JOHNSON. Right. What I'm thinking is that to the extent that is part of the story, that's not necessarily a contractionary phenomenon.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. This was a very complete presentation and I just had two technical questions. My first technical question has to do with the composition of auto sales as shown on Chart 5. As you know, we've been hearing for a long time a lot of anecdotal information from people in the auto dealership business and usually in the Big Three dealership business. I'm wondering if there's a possibility that we're giving that too much weight. Going back to 1987, say, if one

looks at the increase in the number of domestically produced foreign nameplate units--and from what I understand just from reading--in many cases the input [unintelligible], and in some cases engines, are produced domestically in the United States. It's possible that we made a little too much at some point of the anecdotal information on the decline in the auto industry because of our natural instinct to look at the auto industry as Ford, Chrysler, and General Motors.

MR. PRELL. Well, I'm inclined to think that that's true. There is quantitative evidence of the increasing role of foreign parts producers in providing inputs to the transplants. It has become a very complicated international market. The point I was making was that in terms of future employment prospects I don't think the Big Three are stripped down yet enough. They are carrying a substantial amount of excess capacity, particularly at GM. They're not operating as efficiently as they're going to have to. So, while the transplants are probably going to be expanding employment somewhat over the next couple of years, the net may be a negative from this decline in auto demand because the Big Three really need to shrink some.

MR. SYRON. I don't disagree with that, but given the demographics and the cycle of car financing and so forth, there is a question of just how responsive much of this is to interest rates.

MR. PRELL. Well, that's true. As I said, I think the stock out there has become relatively ample. There is that financing question and the fact that with long maturity automobile loans it takes a long time to build up any positive equity. So the automobile manufacturers think that as a short-run factor there isn't the opportunity in many people's minds to trade in as rapidly. That shouldn't be a big factor over time in affecting automobile demand. But that is something they worry about; there's no doubt about it.

MR. SYRON. Also, if you look at the technical issues on this, cars are lasting longer as well.

MR. PRELL. Average life has been increasing and it may be because of improved quality.

MR. SYRON. The second technical question, picking up on something Governor Angell said, has to do with the outlook on oil prices. On Chart 20, in looking at the price per barrel on oil, what is the general outlook that you've factored in here in terms of natural gas suppliers? I hear from a lot of people that the natural gas bubble is starting to peter out and that there are concerns about pipeline capacity. I thought maybe I should mention this, since we've had very substantial cutbacks in interruptible service in the Northeast.

MR. TRUMAN. Natural gas belongs on the other side of the table.

MR. PRELL. I was afraid he was going to say that! I must confess I have not developed great expertise on the natural gas bubble. Yes, it is certainly widely discussed that the situation is changing, and in our forecast we have natural gas prices rising 4 to 4-1/2 percent per year in 1990-91. There is some firmness there in the long-run forecast. Fortunately, there are people who provide

inputs to this process who are more knowledgeable than I. I suspect there are others around the table here who can speak with more knowledge on that.

MR. SYRON. Thank you.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, Governor Johnson's questioning about these real long-term interest rates prompted me to look at the footnotes on Chart 15 down in the lower left-hand corner where there are three asterisks. That says inflation is estimated by a 36-month centered moving average of actual inflation, forecast by staff [where needed]. Does that mean that the last figure has 18 months of forecasting in it?

MR. TRUMAN. Absolutely. That's what I meant when I said to Governor Johnson that to some extent the higher real interest rates today reflect our assumption that inflation will be lower tomorrow in the foreign countries. As Mike was saying, there is a certain circularity in that construction. The historical series gives you an actual centered forecast.

MR. PRELL. If you look at the survey-based expectations for the foreseeable future or at Hoey's last survey, for example, he's looking at 4-1/2 percent or something like that for 10 years. And that would not be grossly out of line with what is built into these numbers for the United States.

MR. JOHNSON. But I think you could argue that inflation expectations in those other industrial countries have gone up significantly.

MR. TRUMAN. Well, that's a possibility. As I said, we are assuming that inflation will be lower. Now, if you add another percentage point to foreign inflation relative to our forecast and keep oil unchanged, then that differential is going to drop from 150 basis points to 50 basis points. [Unintelligible] absolutely. And there may be an expectational element built into that.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Yes. Ordinarily, for many years, we've had a full employment Federal budget deficit. What is the change from 1989 fiscal year to 1991 fiscal year in the full employment deficit?

MR. PRELL. I can give it to you on a calendar-year basis.

MR. ANGELL. Okay, that's fine.

MR. PRELL. The change in the high employment budget was \$11 billion in 1989 and then we reverse sign to minus \$34 billion in 1990 and minus \$44 billion in 1991.

MR. ANGELL. Would the high employment deficit or the actual deficit be the best measure of fiscal restraint? Now, I ask that, even though I don't understand what fiscal restraint is.



MR. PRELL. Clearly, we'd opt for the high employment over the actual budget deficit as a measure. But even that number has its shortcomings--the treatment of interest, for example. There are a number of things that bother us about that and that's why we invested the effort in coming up with some new measures of fiscal impetus, which I didn't cite this time. Basically those numbers are headed in the direction of restraint in '89, '90, and '91 and especially in '90.

MR. HOSKINS. Where do you put Senator Moynihan?

MR. PRELL. Senator Moynihan?

MR. HOSKINS. The fact that you're using high employment--

MR. PRELL. I don't know what the net of Senator Moynihan would be.

MR. ANGELL. Do you think of the FSLIC bailout cost as being different in terms of traditional fiscal effects?

MR. PRELL. Well, either the high employment measure or our own fiscal impetus measures would be looking at national income and product accounts data that would abstract the purely financial transactions. So, that wouldn't be a factor in our thinking. Basically, the \$30 billion that I cited is roughly that in either unified budget accounting or national income accounting. And that's in a sense a discretionary budget action and a reasonable measure of what we think fiscal policy is doing independently.

MR. ANGELL. Well, these questions are designed to get to the bottom line question which is: With monetary policy and some tendencies toward real interest rates being maintained at a level consistent with path and with some fiscal restraint, why does the forecast assume that there's that much improvement in the level of economic activity in 1991?

MR. PRELL. Well, basically what we have is high rates and fiscal restraint holding growth below the long-run trend. We're opening up a gap over that period of time. But we do have the effects of the dollar working through here to provide some increased demand for U.S.-produced goods. And that tends to hold [activity] up while domestic demand is being more directly affected by the monetary and fiscal restraint.

MR. ANGELL. Thank you.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Mike, I'm not sure I understand your personal income forecast. If I look at the middle panel of Chart 10, your numbers for '90 and '91 are comparable with '80, '81, and '82. But at best it looks like it stays on the weak side even given your modest growth path.

MR. PRELL. Well, we looked at that and asked ourselves the same question and, obviously, we ended up with these numbers after all of that. There is a marked slowing of employment growth in this forecast; we have increases in employment in payrolls of about 1-1/4

percent in the two years. We have another negative effect on real disposable income coming through the terms of trade effect as the price of imported goods rises relatively rapidly. That tends to create some wedge between product prices and consumer prices. It's a small thing, but it's tending to work in that direction. This is an economy in which we have very slow growth. We have some productivity increase and we think this is internally consistent. But it is a very low growth and it raises some questions, I think, about how this kind of situation will be perceived by consumers. We have not assumed that there will be any extraordinary change in their behavior, despite this prolonged period of slow growth. One needs to keep in mind throughout this, as we look at the future, that to the extent the population is growing more slowly we're going to get [unintelligible] too.

CHAIRMAN GREENSPAN. Any further questions? If not, can we start our Committee discussion? Who would like to start off?

MR. BLACK. I think they all want to go home!

MR. KELLEY. No comment.

MR. KEEHN. Comparing our forecast versus the Board staff's, I must say ours is somewhat stronger. We are looking for an increase in GNP, fourth quarter over fourth quarter, of about 2 to 2-1/4 percent. Our differences are not all that large in any particular category. But going down the whole list there does seem to be a bit stronger growth in most of the categories. Personal consumption, for example, in our forecast is higher and I think durable goods are a part of that; I'm sure autos have some relationship there. Business fixed investment also is stronger in our forecast; our housing number is somewhat higher. There are no major differences but, as I say, we have a higher number in most of the categories. But with regard to this interest rate increase we have had, if that were to continue at its current level for any length of time and become more pervasive, it might raise some questions about the strength of our forecast.

Moving to the District economy, our District continues to have two economies, really: the auto and auto-related activities, and then everything else. On the auto side, despite the improvement in the sales level in January, the attitudes are awfully grim. Plants were basically shut down in the early part of January; some have reopened since but the schedules for the remainder of the first quarter are really very low. And the comments about the second-quarter production schedules are very cautionary. Everybody is saying that they certainly are going to be higher than the first quarter but lower than the second quarter of last year. But people are unwilling to be much more precise than that. January's sales level has reduced auto inventories to about 70 to 80 days' supply, down from about 100 days' supply at the end of the year. Despite that, and this is really a very difficult issue, the dealers just are not ordering more cars. About half of the dealers, as I understand it, are still losing money. They really do have a grim attitude and are just simply at the point of not buying more cars. Therefore, we see the risk on the production side as down and not up. Also, on the outlook for sales of heavy duty and medium size trucks, they had a bad year last year and the outlook for this year is pretty grim. Despite that, no one I talk to suggests a forecast in terms of cars and light trucks lower than, say, 14 to

14-1/2 million units. As I've commented before, yes, that's down from other years, but comparatively it's still not all that bad.

Other parts of the District, I think, are moving along at a reasonably good pace. The steel business is surprisingly good despite this slowdown in auto orders; demand for steel for appliances and structural items for other sectors of the economy is doing pretty well. The level of incoming orders after the turn of the year generally looks good for this year. And I'm told that in the steel industry the actual facts are better than the perceived facts. Construction activity in the District is reasonably strong; both commercial and residential numbers are higher, I think, than the national numbers. And we have a surprising number of new office projects, particularly in the Chicago area. Vacancy rates are moving up a little but are not yet out of line. In agricultural equipment, business looks good; the expectation is for an increase in unit sales of 4 to 5 percent this year over last year. And in agriculture itself, the outlook is positive. Crop prices are down and farm income probably is going to be down a bit, but if we have a reasonable break on moisture and some rains this spring and summer, the outlook there is pretty good. As for retail sales in the District, the results in December were good and so far in January they have held up. So, net, excluding autos, we think that the attitudes are reasonably positive. There is no growing concern yet about accelerating risks on the recession side. But having said that, the big caveat is the auto industry. I think the auto sales will pick up, particularly in the second half; if that's not true, of course, the outlook will be different.

Finally, on the inflation outlook, our numbers are a little more positive than the Board staff's. We're expecting moderation in inflation this year to 4 percent or perhaps even a little lower by the end of the year. The people I talk to say that raw materials prices in many cases seem to be down. Steel, aluminum, and copper prices, for example, are down. And I don't sense any strong upward pressure on the wage side. Therefore, our outlook for the inflation situation is a little better. That's not to say it's acceptable to have inflation of, say, 4 to 4-1/2 percent on a continued basis and, obviously, that has some monetary policy implications. But presumably we'll talk about that later.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, turning first to the national economy: At current levels of interest rates we would expect real GNP at slightly less than 2 percent for this year. However, we do expect the composition of growth to be quite different from that in the Greenbook. For example, we are forecasting stronger consumer spending as a result of past strength in disposable income. Also, we are projecting a much smaller correction of nonfarm inventory investment from its fourth-quarter high. However, due to a long lag in the dollar's influence on trade, we don't expect significant improvement in real net exports until 1991. With regard to inflation, we expect the GNP fixed-weight index to average between 4 and 4-1/2 percent this year. Mild upward pressure on inflation should come from the price of oil, previous increases in the value of the dollar, and tight labor markets. If economic growth is moderate, pressures from the labor market should begin to subside late this year. But I really don't

expect to see any downward pressures on inflation--certainly on the underlying rate of inflation--until late next year.

If I may turn to the District economy, the economy in the West continues to exhibit healthy growth. We took a look at the Twelfth District employment growth last year and I think the numbers are really extraordinary. From December 1988 until December 1989 we saw employment in the District grow 3.2 percent; this compared to 2.3 percent growth for the nation--an extremely wide difference. Concern has been expressed about a collapse of California's real estate market. Our admittedly not detailed analysis--but I think it has been fairly careful--indicates that those concerns probably are not warranted. The housing market does not appear to be overbuilt in California. From 1984 to 1988 the ratio of new residents to new home permits was about 2 in California. The ratio for the nation was 1.1; in New England it's 0.8. The point is that we have had a very large increase in in-migration into the state and that has increased the demand for housing rather substantially. In addition, we have not seen a significant fall-off, at least to date, in home sales. They are down a bit from 1988 but not nearly as low as the average for the five years that preceded 1988. Also, there has been some decline in the state's median home price but that appears to be a change in the composition of homes sold. We're seeing a lot of strength in the central valley of California and in the Riverside-San Bernardino area --where the price of housing is quite a bit less--and less strength in the more urban areas. Meanwhile, the market for single-family homes in the Pacific Northwest is really booming, particularly in the Puget Sound area. Bidding wars have become common and home values are increasing at a yearly rate of 20 to 25 percent in many parts of that area. Thank you.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, if I may start with the District, I would say that the Sixth District's economy is pretty much the same as that of the nation--as good or as bad, depending on how you want to put it. What continues to impress me is the very pessimistic attitude that people I talk to generally have about the economy. There's a very pronounced fear of recession and I would say a distressing lack of interest in reducing inflation. The concern about recession seems to center basically on the auto sector and its effect on the economy and the weak real estate market as well as the increasing loan delinquencies and the number of personal bankruptcies that are showing up. The manufacturing sector in the District continues to be quite soft, not only in autos but in related activities that are particularly affected by import competition. That's particularly true of the apparel and textile industries, where activity is slowing down and inventories are beginning to build. And in the [unintelligible] and that's for a period of time when imports are usually not high, the end of a year. The petrochemical industry, however, remains a very strong industry in the District, particularly in the Gulf Coast [area] of Louisiana.

The housing market is just saturated with high inventories of unsold houses. New construction is obviously quite sluggish as a result. We did get in the District generally an uptick in office construction toward the end of the year, but that was mostly due to activity in Atlanta. And that gives rise to some concern because even

though we'll get a temporary boost from that kind of construction and an increase in employment, it's definitely going to create problems down the line. We have something like 8 or 9 projects in the city of Atlanta of 650,000 or more square feet and pre-leasing is very, very low at this time. So I think that's going to be a problem. We've had some uptick in the energy sector. Two of the major oil companies are adding platforms and the independents are becoming a little more active in domestic exploration and the rig count is up somewhat. I mentioned natural gas before; natural gas production is emerging as a source of strength in the District and that will be a particular help to Louisiana.

The very cold weather that we had in December took its toll in Florida. There was a 30 percent loss in the citrus crop, although the price impacts are being partially offset by imports from Brazil. This is in juice basically. There were fears earlier that the trees had been badly damaged or killed but that turns out not to be the case; most of them were not. The winter vegetable situation is more serious because that sector was hit much more severely than the citrus crop. For tomatoes, for example, where Florida is the major source for the country as a whole, imports from Mexico are not going to be sufficient to offset price pressures. And fresh vegetable prices are up by about 30 to 40 percent. If past experience is borne out, this should add about .2 or .3 to the CPI on a year-over-year basis. But in general in the District, we're not seeing any real pressures on prices and we don't seem to have any labor pressures at the present time.

Turning to the national economy, our forecast in Atlanta is somewhat stronger than the Greenbook forecast. We have growth at around 2 percent in real terms for both 1990 and 1991. We're somewhat higher in consumer spending but not significantly. The major points of difference would be in business fixed investment and also in the inventory correction. We have a somewhat higher inventory formation rate than the Greenbook. Because of that somewhat faster growth our unemployment rate is obviously a little lower. Unfortunately, our inflation forecast is pretty much in line with the Greenbook forecast, and I just don't see very much hope on that side. We're seeing that trend of inflation right through 1991 and I think we continue to be very vulnerable on the price side. The incoming data for the first quarter will probably overstate the price pressures but I still think that we're looking--in the services sector particularly--at an inflation rate stuck at 5 percent. So, in terms of monetary policy, I think we have a tough road to walk.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, our projections for the Humphrey-Hawkins report are very similar to those of the Greenbook on both GNP and unemployment. We basically agree with what I think the Greenbook is saying: that the economy seems to be passing through an inventory correction that's largely centered in manufacturing and that the correction ought to be pretty well completed during the first quarter of this year. At the last meeting we felt that the risk of error was on the down side and this time we've shifted to the point that we now have a sense that the risks are about evenly divided on each side. We've been impressed by how quickly the domestic automobile industry has adjusted or moved to adjust its inventories downward, and we are

encouraged by the strength of orders for durables goods and also for nondefense capital goods. So this suggests to us that manufacturing may be stronger than we thought and also that business outlays for new equipment may be somewhat better than we thought earlier.

At the same time, I have to say that I'm really concerned about these projections for inflation that the staff has for 1991 as well as 1990. They show, in essence, no further progress in bringing inflation down from the present rate and, in fact, the CPI less food and energy is shown as actually increasing a notch in 1990 and again in 1991. The same is true of the fixed-weight GNP index. I think, like all of us of course, that that would be a very undesirable outcome--to put it gently--in view of our stated goal of getting prices down. I think it's essential that somehow or other we improve on this inflation performance shown in the Greenbook, and I'd like to suggest that we keep this in mind when we work on our long-term targets later on in this meeting. We're more optimistic on inflation, I should add, than the staff is.

MR. PARRY. What was your estimate?

MR. BLACK. We put in 4 percent.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mr. Chairman, if I could first turn to the District economy, there is somewhat of a dichotomy in the New England economy between what statistical measures indicate and the level of confidence. In fact, if you look at the confidence survey that the Conference Bureau does by census region, there was really a dramatic decline over the last year: The region went from being the highest in the nation with an expected outlook of 144 on the index to 72 now. So, we've had a 50 percent decline in confidence in the region in a year. But according to the recent data that we've actually seen, personal income on a per capita basis grew faster in New England than nationally.

As for other closely related regional data, employment actually increased in the last two months of 1989 after declining earlier in the year. The unemployment rate in the region now is about 4.2 percent and the per capita income is still 124 percent of the national average, so we were starting from quite a high base. Having said that, we think a softening is inevitable. We do expect that the unemployment rate in the region will go up and will exceed the national level and that there will be a concomitant decline in the relative rate of growth in personal income. Thus far, the deterioration has largely been in the manufacturing and real estate sectors, exacerbated somewhat by newly emerging problems of financial institutions. If the only problem were in manufacturing because of the high-tech adjustment problems, one could be relatively sanguine. But I don't think that's the case. Looking at recent experience, even though we haven't had any real reason for boom/bust, we are going through one now in the real estate and construction area. It's to the point now where if someone calls a financial institution that they haven't had a long-going relationship with to talk about a real estate loan, it's almost like one of these commercials where people on the other end of the line just laugh and say something like: "You must be kidding! We're not doing any more real estate loans unless we have a

well established relationship with you or unless you have extraordinarily good collateral."

So, there is a great deal of doom and gloom. This, of course, has been reflected in retail sales. Our retail sales around Christmas were not terribly good, particularly in the durables area. And we have an emerging inventory problem in that area and in autos and other areas. I touched on the banking situation. The increased risk premia are having a compounding effect outside of real estate. We're hearing more and more, particularly from small and mid-size businesses, about greater difficulty in obtaining C&I credit. I think that's consistent with what we've shown in the loan officers survey. If you combine all of this with the severe fiscal problems and the essential political paralysis we have--certainly in Massachusetts and you can see it starting to emerge in Connecticut to some extent--it just doesn't paint a picture that is consistent with people having expectations that are going to keep spending up. Actually, we found quite a contrast when we talked to our larger manufacturers in terms of their experience domestically, in the region, and internationally. First of all, I should say that from the point of view of a producer, the labor market situation has improved markedly in New England. Turnover rates are down dramatically. Even in our Bank, turnover on the graveyard shift in the check production area is falling just astronomically.

MR. LAWARE. Growth here is a wonderful thing.

MR. SYRON. If you're on the buy side.

CHAIRMAN GREENSPAN. You realize that the labor unions would say that was awful; you say it's wonderful.

MR. SYRON. That's right, but we are not in an AFL-CIO meeting. And they have a little different view than we do on what is considered wage inflation as well. In the case of our large manufacturers, we have an interesting phenomenon going on. Many of them are suppliers to both the aerospace and the auto industries, and they certainly have seen a softening in their supplies to the auto industry. But you may have noticed that firms like Textron are supplying more to the aerospace industry even though their auto business is off. Big gains in aircraft are helping us out a lot. In terms of forward-looking indicators, we do have a large paper industry, as you know, and actually that area is somewhat worrisome. Paper and packaging materials tend to lead national cycles somewhat, and the demand for that does seem to be down and capacity utilization is down. Interestingly, thus far, defense really has not been that much of a drag on the regional economy and that's of course because a lot of what we do is in the research and development area. But large producers like Raytheon are attempting rather feverishly to diversify.

Nationally, our forecast is not greatly different from the Greenbook. It's just about the same in terms of unemployment and inflation; we have slightly stronger growth. But we think the economy has softened. Where I would have said before that we thought the risks were somewhat symmetric, I think the risks now are on the down side for the economy. Obviously, we'll get into this when we talk about policy, but I think we're in a very difficult situation in that we're walking on this razor's edge. There's a real question of how

long we will be able to walk on the razor's edge before getting cut or falling off and getting bruised. Perhaps where we sit depends on where we stand, but I think this question of financial fragility is really something that can't be taken entirely lightly. Having said that, I think that the arguments about concerns for greater inflation as compared to the softening of the economy can work both ways against fragility, which puts us in an extremely difficult bind in policy.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Well, there's little new to report as far as the District economy is concerned. We've had a modest and sustainable expansion underway for a long time now. It seems to be continuing and it seems to be reasonably well balanced both by economic sector and by region of the District for the most part. There is some pessimism and concern around and that has been true for a while. But for the most part that doesn't seem to be reflected in the actual numbers on economic performance. In talking to some business people I too hear reports about a leveling off or declines in some input prices, especially materials. But where you don't hear that, of course--and I think where the problem is to some degree--is in compensation. Clearly, if anything--at least in our area--it is accelerating. Part of it is the medical cost problem, but I don't think it's tied exclusively to that. If you look at inflation from the wage and compensation cost side, that's a distinct problem.

As far as the national situation is concerned, as I suggested with that question I asked earlier, I think the economy will do a bit better in 1990 than the Greenbook suggests. I think the Greenbook is conservative in regard to real disposable income and growth in consumer spending. As a consequence, I think we'll see a little more strength there. It wouldn't alter the outlook radically in my view, but I think the economy will do a little better. As far as inflation is concerned nationally, I have been cautiously optimistic for some time that we were going to succeed in bringing inflation down sometime soon. I must admit my optimism is fading. I would simply note that if you look at consumer prices excluding food and energy, the rate of increase has been stuck on a fourth quarter-over-fourth quarter basis in the 4 to 4-1/2 percent range since 1983. Actually, I think there was one year that it was worse. But otherwise, it has been pretty well stuck there since 1983; we just haven't made any further progress over that whole timeframe.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Well, as far as the national economy goes, I would agree essentially with the Greenbook. We come out roughly the same in terms of inflation and real growth.

As for the region, the Mid-Atlantic states are about the same as the nation as a whole--somewhere in between New England and the Midwest--with New Jersey having a few characteristics of New England, but not anywhere to the same degree of severity, and with Pennsylvania and Delaware being closer to the Midwest. Attitudes vary depending on where in the District and in what industry the people you talk to are; but if there is a majority attitude, I think it can be characterized as somewhat more concern about economic prospects than, say, 6 months or a year ago. But there is a general expectation that the slowing



that we're going through and the economic problems that we have are really a brief interlude, just a pause. It's almost as if the expansion of 7 years that we've had is so ingrained that people just think it's going to carry through into the future. Looking beyond the numbers and these current attitudes, I must say, as I listened to the chart show and leafed through these charts, I got the sense that this is a forecast waiting for something to happen. Essentially, what we're doing in the real sector is keeping the inflation rate about steady with subpar growth. That's not terribly satisfying; maybe it's the best we can do. Then, there's the whole business of financial fragility. For those of us sitting around the table what is especially frustrating is that our room to maneuver is really very, very small. In that context I think this kind of muddling through is probably about the best we can do, but it's not terribly satisfying intellectually or otherwise.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. In our forecast we have inflation about the same as the Board staff's forecast and somewhat less real growth-- actually relatively weak real growth--and somewhat higher unemployment as a result. I would characterize it, just because of the approach used in our shop, as the lagged effects of prior monetary restraint. In that connection, last July and then a year ago when we did the forecast and had to make an assumption about what we considered to be an appropriate monetary policy, it was rather a stretch in the sense that money growth was so weak. We were trying to assume something reasonable in terms of 4 to 6 percent growth in narrow aggregates so that it was difficult to see then how that would actually be realized. In contrast, this time around--for what it's worth--I think it's a little easier to make the assumption, with which I agree, that monetary policy looking forward is on a more or less reasonable course from the St. Louis perspective.

As far as the District goes, again looking back, our regional economy was considerably weaker in the first part of last year than the national economy. But in the most recent quarters, and particularly in the latest three-month period, our employment is right in line with national averages in the nonagricultural area and reflects almost identical weakness in the manufacturing area. We've had gains in medical and business services, finance, insurance and real estate, and in construction. And the declines--and this has been the same pattern we have been seeing--are in electrical equipment, fabricated metal products, and transportation. Maybe the addition to that list would be the fabricated metals as the weakness in autos has filtered back.

You all know in the consumer durables area I asked him not long ago whether he thought easier monetary policy would really help the problems in that industry and the answer was "no". He perceived the problems as demographic, which is the same thing that's affecting housing. In the auto area we've all read that Chrysler has announced the shutdown of the No. 1 plant in Fenton. That will affect 4,000 workers, 2,000 more than had already been laid off; the second shift had been laid off indefinitely. That closing will occur in September. And I think I mentioned in the past that at the No. 2 plant that produces mini-vans, where they're running just two shifts now, there had been a proposal

to add a third shift. But there are different [union] locals at these two plants and the local at the No. 2 plant didn't want to hear anything about integrating some of these other workers to put on a third shift. So, I don't know where Chrysler will pick up that capacity. There also is an expectation that Ford is going to repatriate some truck production from Brazil to a plant in Louisville later this year.

In terms of the residential [construction] area, activity in our District has been essentially flat most recently compared to declines nationally. There have been reports in the press of what people characterize as very heavy traffic in January and some better-than-expected sales. In reports I've read, Si, we don't pick up quite the same negativism in terms of auto dealers; they were more positive about what went on in January and the prospects there. That's just another perspective. Nonresidential construction has been especially strong, largely because of the large paper mill in Arkansas; it's a \$300 million facility where the contract was let in December. Finally, just a comment on the defense area: McDonnell Douglas is our largest employer and two defense programs are scheduled for cancellation; the Defense Department has put out the F15 and the AV8. But generally the expectation is that McDonnell Douglas will make this up with some aerospace contracts that they have and in addition--and I guess you can afford this, Bob--with moves in production from California to the St. Louis facility. So right now in terms of McDonnell Douglas there is not a lot of negativism about how the cutbacks in defense will affect the local economy, although there is indeed some uncertainty.

The last comment I would make is that I've read some reports and I heard some comments the other day that lending standards clearly are being tightened as a result of developments in the S&L industry and elsewhere. One person who is in the business of arranging financing for smaller companies mentioned to me that there's a view that the regulators are overreacting. Now, I suspect the regulators are being used as scapegoats by lenders who may not want to make the loans, but that tap dance is beginning to develop a little out there.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I'm running the risk here of being labeled the gloomy Gus of this organization, but my outlook is a bit gloomy. I see manufacturing employment declining almost on a secular trend; the construction industry is hurting in a lot of regions; the automobile industry is a hospital case--they're almost on a life support system--with incentives being pushed to try to push automobiles out of inventory; retailing is rather soft and I think deeply troubled by the problem of some of the bellwether companies in the industry being in bankruptcy and all the uncertainties that ride with that; corporate profits are selectively dismal; and consumer attitudes and consumer wherewithal are certainly not expansive at this stage of the game. And while the trend is more positive, the level of both corporate and household debt remains very high and I think that injects an element of ominous fragility into this system. The capital markets are certainly somewhat demoralized on an individual firm basis as well as in general terms. In the face of all that, I wonder if we aren't a little overconfident in not expecting some further stagnation in the economy. Add to all those factors a troubled banking system and a

real estate market that is laboring under the overhang of the RTC inventory, and I guess I'm just worried that we're sliding toward a recession. And because of the external factors we may have our hands tied and not be able to do anything very substantial about it.

CHAIRMAN GREENSPAN President Hoskins.

MR. HOSKINS. We have a forecast that's slightly stronger than the staff's forecast, particularly if the current monetary growth rate of M2 remains near the upper end of the range for the rest of the year. Around the District the slowdown in automobile production obviously has hit us fairly hard, but it has not spilled over into anything that we can find. We're also fortunate to have some transplants that do quite well in the area. Capital goods and capital spending are on a solid growth path according to our contacts-- companies like Timken, Eaton, and Inland Steel. Our stainless steel measure that is drawn from the orders for stainless steel strip which goes on all consumer products is below last year but higher than the company expected. So that has turned up even though it's still at lower levels than it was last year at this time. And steel producers say that first-quarter orders have picked up even from the auto industry. I'll mention another set of forecasts, for what it's worth. We have a Fourth District round table meeting quarterly, which involves economists from the financial as well as the manufacturing sectors, and their outlook for real growth is 2.1 percent with essentially the same monetary policy as in the Greenbook.

For all these reasons, we think the risks remain on the high side of the outlook for 1990. Having said that, and taking account of Governor LaWare's and others' concerns, I remind myself that the forecast error of plus or minus 2 percentage points is certainly enough to result in a recession, given the Greenbook forecast. So, I share the concerns. I also share Bob Black's concern that we have made no progress with respect to inflation. And I think we should keep that in mind when we set the targets tomorrow.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Mr. Chairman, I'm in a bit of an unusual position of being more optimistic than the Greenbook concerning developments on the real side of the economy. I see real growth this year coming in at 2.1 percent--I don't know what that means--and considerably more inflationary pressures. I am very pessimistic about the inflation outlook.

Our District economy has been improving recently--actually to a greater extent than I had anticipated. We thought that the weakness in the national economy would depress growth in our District more than it has. To our surprise this has not happened, which seems to show that there may be some underlying strength down our way. Our employment gains have exceeded the national rate during the last few months for which data are available. That may not be sustainable, although we do have some anecdotal evidence that suggests that the attitude in this regard has shown improvement. In agriculture, we're still reeling from the freeze. The lower Rio Grande Valley really has been devastated. The citrus damage I think was greater than in Florida, although we do have some insurance that will help tide growers over and cover some of that damage. The retail sector is not

robust but it has had a reasonably good year; there are year-over-year gains. Our national retailers show much better gains in the District than in the rest of the nation. Manufacturing is not doing very much. We have a little concern about the anticipated layoffs in the defense-related areas. Construction seems to be stabilizing and there is talk of the first signs of liquidity coming in. We were told that some of the Houston improvements, certainly in real estate, probably have moved up our way. We've been told that raw land is actually selling in the Dallas-Fort Worth area primarily for residential development. The energy situation is pretty stable, with possibly some improvement there. I'll sum it up by saying that in our District, at least, the overall outlook is improving. I can't resist saying, in listening to my friend Dick Syron--

CHAIRMAN GREENSPAN. Try!

MR. BOYKIN. I remember several years ago I gave a very comparable report and my good friend Ed Boehne leaned across the table and said "Boykin, that's a Texas problem." So, maybe that's just a Northeast problem.

MR. SYRON. Now people in the rest of the country, instead of saying we're not another Texas, are saying we're not another New England!

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. With regard to the forecast over the upcoming forecast period, for 1990 we're very close to the Greenbook forecast--a tick stronger in real growth and very close to the projection for prices. There is very little difference in the CPI less food and energy.

Turning now to the District economy, as I think all of you know, agriculture has been on a recovery path now for a year and a half except in those areas where there have been dry conditions. The concern was that we would start a third year of drought there. Much of that has been relieved with snow and rain across much of the Wheat Belt, although the sub-soil moisture reserves are still very low. They will need more moisture to produce this wheat crop, apparently. But, given the moisture that has already fallen, there are some brighter prospects there. Grain prices have slumped because of the moisture that has fallen but also because of improved soybean conditions in South America and a backlog of corn-laden ships in Russia, all of which have begun to dampen commodity prices. On the other hand, cattle prices are virtually at an all-time high and, given the selloff, there's a good outlook for the agricultural sector in the period ahead.

Energy prices, as everybody is aware, picked up in both December and January because of the cold weather. Most of the operators in our area believe that's only temporary and it has not encouraged them to expand their projections for additional drilling exploration or pumping from existing resources. As a matter of fact, the District rig count fell about 10 percent in December from 337 to 303, if those numbers are to be believed. The manufacturing story is the same in the Tenth District as it is elsewhere, particularly with respect to the auto assembly problems. We are heavily involved with

auto assemblies in the District. There had been temporary layoffs and I'm told that a relatively new, about a 3-year old, General Motors plant in Kansas City will lay off an additional 700 at the end of February. One plant has been closed, though not this year; nonetheless it has taken its toll in that community. Unit sales of general aviation aircraft increased about 45 percent nationwide in 1989 over 1988, but most of that increase--and we're fairly heavily involved with general aviation aircraft manufacturing in the Wichita area--has been single-engine piston driven aircraft and fewer large jets. As a result, the value of shipments is down from 1988. The construction industry, both non-residential and residential, is depressed in each of the major cities in the area. There isn't a great expectation for that to come back in the period ahead, particularly in the residential sector, as evidenced by the fact that a third fewer housing permits actually have been granted for residential construction. As a result that sector is kind of on its ear. On the other hand, in each of the major metropolitan areas in the District we have an unemployment figure that is less than the national average. That does say that there is some income being generated; [unintelligible] we probably will drag well behind the continued recovery on the national level.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Mr. Chairman, in terms of the outlook, our staff forecast is virtually identical with Mike's and Ted's both for this year and next. The only difference is that we have domestic demand in 1990 a shade stronger. The wage/productivity/price components are for all intents and purposes identical to the second digit. As a matter of fact, in looking at the two forecasts they're so close I'm inclined to think it raises the probability that they are both wrong!

On the more anecdotal side, in talking to business people in both small and large businesses, the impression I walk away with is that if you nudge them a little or maybe twist their arm a little they'll buy into that kind of forecast. But I think the nagging, if not growing, sense of unease is that things might not turn out quite that way. There has been a lot of talk about autos and real estate. I get the impression, reinforced by the earlier conversation about transplants, that there are a number of people who are beginning to wonder if the auto situation is simply an inventory adjustment or if there might not be something more permanent there. The real estate side--and the Second District is small geographically, but there are still a lot of people and a lot of buildings there--I would say is not by any stretch of the imagination in a calamitous state. As Ed said, New Jersey and I think especially maybe northern New Jersey--

MR. BOEHNE. Central and northern.

VICE CHAIRMAN CORRIGAN. --is bordering on New England-type conditions. But as far as New York is concerned, including Long Island and upstate, that would not be the case at all. The general impression I have is that the residential market, including the upstate market which in people terms is big, is holding up okay with the exception of the very high-end segment of the market--the \$2 million condos and the \$1-1/2 million houses in Rye. And as far as commercial real estate is concerned, again, we have not had even in

New York City anything like the extent of the overbuilding problem that characterizes many other major cities around the country. So, while there's some overhang of office space in New York City, it is modest in comparison to many other cities around the country. While it's not going to be a source of strength by any stretch of the imagination, I think the real estate market, with the exception of northern New Jersey, is probably not going to be any significant drag in terms of the overall national picture of the real estate sector.

I did want to mention a point that Tom Melzer mentioned. There clearly is a pervasive tightening in credit standards in depository institutions of all sizes. And, Tommy, whether it's valid or not, there is absolutely no question that lenders are alleging that they are being pounded upon by examiners. Some of what we're seeing here may reflect that. Again, I can't tell whether it's giving them a convenient excuse to say "no" when they were looking for an excuse or whether there's something to it. But certainly that is what one hears more and more from institutions, large and small.

There's another development that is somewhat noteworthy and that is in the retail sector, which I think has been brought more to the fore by the Campeau situation. It is very clear to me from comments by both suppliers and major retailers, including that have some debt service problems of their own but are clearly not in the camp of the Campeau group, that supplier problems and even trade finance arrangements for these major retailers are now becoming a problem. While they kind of "snuck through" the Christmas season, we are beginning to hear a lot of commentary from both sides, including at the very big chains, that they're terribly worried about their ability to get inventories into the stores for the Easter buying season. Easter, of course, is nowhere near as big as Christmas but it is not trivial in relation to the total amount of retail sales from soft goods stores for the entire year. Now, whether that problem will begin to straighten itself out remains to be seen. But the commentary that I get, in the context of the Campeau situation, is that it's going to take a long, long, long time for that to get unscrambled. And as long as it is not unscrambled, notwithstanding the theoretical protections to suppliers that grow out of the bankruptcy proceeding, getting a steady flow of merchandise into these stores except [by paying] cash may not be the easiest thing over the period ahead and possibly for an extended period of time.

That, of course, bears a bit on the other situation that I think accounts for some of this sense of discomfort I referred to earlier, and that is the very obvious and continued shrinkage on Wall Street. Again, in one sense it's a relatively small sector of the economy, but I think it does have some psychological overhang in other sectors as well. Now, if any of you have read, as I have recently, Barbarians at the Gate you might be inclined to say that that adjustment is overblown. Be that as it may, I think that too contributes a bit to this sense of uneasiness I mentioned before.

Having cited those factors that I think do account for that sense of unease, I myself still think that the likely outcome is something like the staff forecast. One thing consistent with that is that we are getting reports that exports, especially of high value specialized goods, are holding up quite well. Indeed, I draw at least a small sense of comfort in that regard from the most recent set of

business statistics. So, I guess the bottom line is that I think we're okay, but it's going to be a close call.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. I also think that the Greenbook forecast is a reasonable forecast. It's closer to my view of the world than it has been in a long time. I am a little more hopeful on the inflation front, although I think the Greenbook scenario is plausible. Among the reasons why I'm a little more hopeful are some of the concerns that people--Jerry and Governor LaWare and others--are sharing about the real estate problems and debt problems and the restraint that that is going to place on overall inflationary behavior. It bears watching. I think there is a sense of unease, but I don't see anything systemic to that, certainly not at this point. That's probably one reason I'm a little hopeful on inflation. I also think the problems are [unintelligible]. So far the dollar does appear to be stable to slightly weaker, but I think the weakness is more a special D-mark problem associated with the optimism in Germany and Europe than anything else. Commodity prices have been stable to slightly weak, although the oil situation is an uncertain issue. I actually think the turnaround in bond yields bears watching. I think that is to some extent a perception of a bottoming out of the economic conditions and some optimism about Europe and the Soviet Union. So, to some extent it could [reflect] an improvement in perceived real returns, which may not be a contractionary force but a positive one. It could also be, partially, some inflationary expectations surfacing; but that's not necessarily borne out in some of the other financial markets. Certainly, it's enough of a development for us to be very cautious and it certainly bears watching. I'm generally optimistic in that I can start to see the light at the other side of the slowdown. But I think this is a period to be cautious if we're going to consolidate what I hope are gains on inflation.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. My number for real GNP is right underneath the staff's at 1-1/2 percent real growth, but my nominal number is considerably less [than the staff's number]. I put nominal GNP just barely above 4 percent, so that gives you some indication of how I believe we can get a pretty narrow squeeze if we do not get better improvement than the staff has forecast on inflation. The price picture is really pretty mixed at this point. I do not see that we've really had much of a downward move in commodity prices other than for industrial metals prices. For the most part, commodity prices are pretty well holding steady at a relatively high plateau. If those commodity prices stay at that plateau, I think the chance for an immediate PPI and CPI movement downward, which would boost the bond market, is not going to come as early in 1990 as might be desirable for real output reasons.

But even though commodity prices don't show that much brightness, I do believe the whole price picture is in a position where it can move pretty fast. Several of you have mentioned some of these developments, but I want to refocus on them. Even though house prices nationwide are not in a deflationary mode, the fact of the matter is that the majority of homeowners do not have much expectation of appreciation. That has been a factor driving household wealth; and

it's a factor that I think has artificially depressed the household saving rate. Consequently, I tend to feel that the household saving rate may very well respond and, contrary to what we're seeing, may not be an interlude but may be somewhat longer-lasting. I believe that in this rolling adjustment that we've been in, a lot of people have experienced severe burdens of debt. It happened in the farm sector and they haven't forgotten; it happened also in the oil sector and they haven't forgotten. It has happened in nonresidential real estate and I don't think they've forgotten; and it has happened in LBOs. And households are not in a position to pick up this gap. The changes in the tax laws plus more restrictive lending standards can have quite an impact. I think households have just realized that that tax reduction feature is no longer there. And since home equity lines are not apt to be expanded in a flat real estate market, the home equity line doesn't provide as much opportunity for low cost or tax deductible lending. It seems to me that autos financed out of nondeductible interest payments would be a rather severe burden, so I just don't see any outlook for autos and perhaps other household durable goods to come back as fast as maybe the Greenbook implies.

However, I do believe that if we don't tip the economy over, there are some underlying positives. I agree with those who see the [outlook for] merchandise trade exports as being somewhat optimistic, as I think even the staff forecast shows. But I might expect slightly more optimism than that. The foreign tourism factor particularly is not a minor factor and I just can't but believe that that will continue. I think also that the undergirding factor in here is that we have had rolling recessions throughout the economy, so it's not as if we have been in a stage in which every sector has been in a boom. Consequently, I think we're not as vulnerable to downturn forces because, as Bob Boykin mentioned, in Texas energy is actually in a recovery mode and agriculture and agricultural machinery are in similar recovery modes. My forecast is for a much brighter picture except for the CPI; I only have the CPI down 1 percentage point from this year's level. So, I'm not expecting as much gain in the CPI because at this point in time I consider the greatest danger to this sustained expansion is through a financial problem for the dollar, and I'm not as optimistic about the dollar as I have been in previous years. Of course, my optimism about the dollar last year was that the dollar would be pretty stable and I think it behaved that way. I think that's our razor's edge; if something happens there, that could upset things. So, under the assumption that we're not going to cut the fed funds rate 25 basis points and drive long bonds up another 50 basis points, I think there's a reasonable chance that that will be okay.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Well, Mr. Chairman, let me put on the table something that I know everyone here is very aware of but that I don't think has been explicitly mentioned yet, and that is that we are living in a time right now of really incredible, momentous events in the world. I won't try to run the litany and I don't want to be too dramatic. But I think we may very well be in a time where there is a sea change going on that happens rarely in history. I think it's very, very important that we have a reasonably comfortable economy for the Administration to operate in, given this environment and this geopolitical era that we're in. And I think so far we have it. As I



listen to the reports and read the statistics and read the Beigebook, indeed, I think the forecast that we all seem to share quite closely is satisfactory and meets that criterion. But I also share a lot of the concerns that the two gentlemen on my left and right mentioned when they spoke. I don't know what has happened to this corner over here, Mr. Chairman. Maybe you should separate us! But I share the concerns about what could happen and I think it's very, very important that we keep a weather eye out, particularly in the kind of environment that we share right now in the world.

As far as monetary policy goes, I agree with everyone else here that it's essential first of all that we not allow [inflation] to increase, and indeed that we knock it down and make some progress toward stable prices over time. Hopefully, we're doing that right now and can do it this year. But I must say that, in economic terms, I don't think it's terribly shabby that we're holding [inflation] steady in the strong economy that we have had over the last couple of years, coming off of the kind of history that we've had over the course of the last ten years. In historical terms and in political terms--political in the big good sense of the word political--I think maybe we should be willing to accept some risk that this is the best we can do right here rather than be too terribly macho in the direction of trying to knock inflation down very rapidly at considerable risk to some other issues that may be larger.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. John LaWare stole my script. We're at the same end of the hall, so I'm a gloomy Gussie. I will add just a couple of items to his sad tale. One is that I really think the problems in the auto industry are more extensive and more permanent than a lot of people realize. I don't think we're going to have layoffs for a couple of weeks and then a pop back. If you look at even the transplant numbers carefully, I believe you'll see some adjustments. For example, Mazda has cut back on its pace of production--and that's acceptable Japanese, not American junk. So, I think one has to pay attention to that. Also, I don't believe that the weakness in durables manufacturing is limited to autos. Caterpillar Tractor, for one, is experiencing declines in orders from just about all categories of customers. They are below the peak levels. Also, appliances and [other durables], again these are not auto [unintelligible].

I'm getting more and more concerned about credit availability. I think I mentioned a couple of meetings ago that part of [the stringency is due to] the overreaction of examiners; they are scaring the heck out of bankers. But, in addition there's the problem in financing developers, and I mean the good developers not the scabby types. They are having problems getting financing from the S&Ls and their old sources because of these limits on loan size. [Regulators] have taken the national bank limitations and placed them on S&Ls and that's giving developers real problems. I think we're going to see this impacting the housing numbers more and more. Also, in certain parts of the country I think there is a problem simply in dealing with sick thrifts. I've been going back and forth to Arizona to check on my mother and out there 60 percent of the S&L assets in the state are now under conservatorship. When the grey panthers are talking about this kind of thing, you know it's a serious problem. And dealing with the overseers at these thrifts and conservatorships is different from

dealing with other kinds of managements. They have a different outlook. Just the decline in real estate values is something that's very significant, and I don't believe it's going to go away soon. Many of the gains in employment are in jobs like bankruptcy lawyers and "undertakers" hired by the RTC, etc. So, I don't find all that growth an optimistic story at all. I'm certainly not eager to see a recession but I really feel that over the next couple of quarters we're at risk. I hope I'm wrong. Thank you very much.

MR. ANGELL. Did you forecast a recession?

MS. SEGER. No.

VICE CHAIRMAN CORRIGAN. Hopefully without precipitating unnecessary debate, could I just make a quick comment on this recent rise in long-term interest rates? I may be missing something, but I don't find it all that hard to explain at all, and I think some of it is temporary. But abstracting from that, it seems to me that as long as we're in a situation where we have to attract \$100 billion or more a year from the rest of the world and we have been through a period in which our interest rates have been falling and interest rates in the two massive surplus countries, Germany and Japan, have risen sharply in recent weeks, either one or two things are going to happen. Either we're going to see upward pressure on domestic rates here or downward pressure on the exchange rate or both.

MR. ANGELL. Or we're going to see a decrease of the inflation rate in the United States to equal or below those of the other two countries.

VICE CHAIRMAN CORRIGAN. Well, that is another possibility, although I have a little trouble seeing that in the immediate term.

MR. ANGELL. But you would agree that that is a third option?

VICE CHAIRMAN CORRIGAN. But looking at it in that light, it seems to me that what we're seeing is a rather vivid illustration of the box we're in with respect to the interactions between domestic interest rates, foreign interest rates--in the surplus countries in particular--and the exchange rate. It really illustrates how difficult the policy environment is.

CHAIRMAN GREENSPAN. Well, I think that's a good way to end today's session.

MR. BOEHNE. Really end on an upbeat note!

CHAIRMAN GREENSPAN. We reconvene at 9:00 a.m.

[Meeting recessed]

February 7, 1990--Morning Session

CHAIRMAN GREENSPAN. Good morning, everyone. Mr. Kohn is on the agenda for the initial discussion on long-run ranges for the aggregates.

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

CHAIRMAN GREENSPAN. Questions for Mr. Kohn?

MR. SYRON. Don, you already mentioned it. I was going to ask on the M2 forecast which way you thought the risks were or whether they were symmetric. You said they were a bit on the down side?

MR. KOHN. I think they are. The forecast that we gave you is our best guess. As the Bluebook noted, it lies in the middle of the range of the model forecasts. But I think there's some chance that offering rates on deposits might be somewhat lower than the models would judge from past history. As I noted in the briefing, I base this on a couple of things. One is that we see bank credit as relatively moderate and we see banks acquiring a lot of core deposits from thrifts as they shrink and as the RTC shuts them down. In addition, if the RTC gets active again and starts putting out more funds for thrifts to pay off high cost liabilities, thrifts might start shrinking their core deposits a little more--reducing the rates they offer. And that would put downward pressure on offering rates. So I think the risks are weighted a little more toward 6 percent growth than 7 percent growth on M2.

MR. SYRON. That's good, too. A follow-up question on that: On balance, if commercial banks also were to decide to grow more slowly in this emerging caution that we see and decide not to fund [growth] in wholesale markets and people see some signs of less aggressiveness in the retail markets, would that work in the same direction?

MR. KOHN. That would obviously work in the same direction. We put in fairly restrained bank credit growth, given that we do have them taking over, in effect, a chunk of mortgages from the thrifts--not literally. In some cases they might do clean bank deals in which they would acquire these thrift mortgages. But we see them, as they have been in the last several months, a little more active in acquiring mortgages, secondary mortgages essentially. But even allowing for that we have fairly restrained bank credit growth. If it were even more restrained, then I think the first option [for banks] would be to reduce their managed liabilities and to rely a bit more on retail deposits, which have a more stable base. So, I'm not sure how aggressive they would be in reducing that. But if they really got their managed liabilities down very far then they could [unintelligible] into the core deposits.

MR. PRELL. President Syron, if you carry that general phenomenon far enough in terms of greater credit rationing effects and some contraction in credit availability, then you begin to affect the general interest rate level; presumably, that's consistent with the given growth path of the economy.

MR. SYRON. Sure.

MR. PRELL. And then that tends, presumably, to work in the other direction. We've built in only a modest amount of that sort of additional restraint in the forecast. That's probably consistent with what most of you, I would judge, think is likely to occur. So, there is a possibility of something more of a constraint.

MR. SYRON. Thank you.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Two questions referring to page 8 [in the Bluebook]: The tentative range for M2 is not only consistent with the baseline throughout the entire period but it also provides the flexibility that if one wanted to be somewhat more aggressive in trying to reduce inflation it is in some respects even more consistent with that outcome as well. Is that correct?

MR. KOHN. That's correct. Because we're expecting M2 growth at the top of its range there's nothing preventing you from being tighter than the expectations in that regard. I saw the tighter range as in some sense forcing the FOMC's hand and then signaling its intentions. But you're absolutely correct.

MR. PARRY. Well, the second point is that with regard to alternative III, which is the 2-1/2 to 6-1/2 percent range, you cite in your remarks the advantage of following the precedent of trying to reduce the [ranges for] growth of the aggregates 1/2 percentage point. It looks, based upon the record, that we ought to forget about that if reducing [the ranges] 1/2 percentage point in the future is something that we probably can't live up to. And perhaps we ought to recognize that as soon as possible.

MR. KOHN. I don't have any quarrel with that statement.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. That depends to a large extent on the accuracy of the Phillips curve type of model.

MR. PARRY. Oh, sure.

CHAIRMAN GREENSPAN. And to the extent that the process might accelerate, as indeed it has in the past, we might find that--you know, it says 1990 to 1994--they might not be full years. They may be 10-month years and the thing can actually accelerate. I think we could probably play it by ear, but what this does tell us is that our ability to play the game of just going down, down, down without making [others] fully aware of the consequences has to be rethought.

MR. PARRY. Even in 1990 I think we perhaps would get some advantage by publishing a 1/2 percentage point decrease. But it then runs the greater risk that we're going to tell the market at the end of the year that we have missed.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. I know that several times in the past we have taken into account how well we hit the targets in the previous year,

in terms of whether we should adjust for a miss. Now, on M2 we came in about 1/2 percentage point short of the midpoint of the range. Is that a close enough hit that it doesn't really enter into this consideration of what we set for '90?

MR. KOHN. By and large the Committee has not adopted a policy of explicitly taking account of where the end point is. I think implicitly, though, it does that. That is, presumably the economic and financial conditions you're facing as you make this decision are partly a function of, or at least involved with, where M2 ended up last year. So, I think the Committee's point always has been: Where are we right now? What are the conditions we wish to foster from here on out? Wherever we ended up in the range last year, we can assess the situation right now. So, the Committee generally hasn't chosen to worry explicitly about tying one year's range to where it came out in the previous year or intended to come out. Rather, it has said: Here's where we are; let's go on from here. The accusation has been made that, in effect, the Committee has allowed money to drift up more than down over time, although I'm not sure that we haven't corrected some of that upward drift over the last few years. The previous thought was that the Committee tended to allow it to go up, but I think in the last couple of years the ranges have been taken from the [actual fourth-quarter level in the previous year], which had come in at the lower part of the range. The point is that you look at where you are and see where you want to go forward from wherever you ended up last year.

MS. SEGER. I know we discussed this in the past without having an explicit policy for dealing with it. Thank you.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. I notice that even in your tighter scenario, the M2 growth rate for 1990 is still higher than the midpoint of the tentative ranges. You have 5-1/2 percent and I think the midpoint on the tentative range is 5 percent. So, as Bob Parry is saying, that scenario is fully accommodated within the tentative ranges. But a question that I have relates to your comment that real interest rates would have to be slightly higher over time to reach this 5-year path. Do you have any estimates for that or--

MR. KOHN. We have real interest rates rising about a point in the baseline and maybe 1-1/2 points in the tighter scenario. I would caution you that that's well within the margin--

CHAIRMAN GREENSPAN. So nominal stays constant?

MR. KOHN. Well, actually, nominal goes up. But to get the real interest rates up because of the momentum behind inflation--. Let's take the tighter scenario since it illustrates the point a little better. That has nominal interest rates, say, the nominal funds rate, going up this year and next but only to about 9-1/4 percent, something like that. So, it's only a matter of--

CHAIRMAN GREENSPAN. Is this the tighter or the baseline scenario?

MR. KOHN. The tighter one. Under the baseline we used the rates in the Greenbook forecast for this year and next, which only go up very marginally; and then we'd have another marginal increase in 1992. But you do have to have some increase in nominal rates because you can't get the increase in the real rates, given the momentum behind inflation, without some increase in nominal. But then they come down in the later years. As inflation comes down, nominal rates come down with it, leaving real rates a bit higher in the tighter scenario.

MR. JOHNSON. It is a problem. I agree that that's the way you have to look at it. But, as the Chairman said, if inflationary expectations are just a little better than you anticipate, that doesn't necessarily imply a rise, or at least a substantial rise, in nominal rates.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, Governor Seger raised an interesting question about base drift. I've been very much concerned about that problem over time. I had felt that the best way was some kind of point target, and I even thought of going with some range for missing above or below. But the way we do it, if we end up expecting a rate of growth for the next year from some point other than the one where we are at year-end, it's very difficult to explain to the public. I don't know exactly the way around that unless we move to some kind of point target. But it's very confusing. If we're way over, even those of us who are the most hawkish are reluctant to vote for something like a 2 percent rate of growth to counterbalance some of the overshoot, because that would seem rather extreme to the public who would just pick up the 2 percent and not realize that it came from a different base. I think it's a problem we ought to try to deal with somewhat differently from the way we're doing. But I don't really have the best answer as to how to do that. I do have a lot of sympathy for some kind of point target way out there, a multiyear target.

CHAIRMAN GREENSPAN. There's another thing that I suspect all of us have in the back of our minds and that is that somewhere in this timeframe there is [likely to be] a recession. And the ability to lock onto an appropriate money supply target in a recession improves very dramatically if you [unintelligible] right. So it's not as though we have to focus on calibrating literally to this type of environment outlined in the Bluebook strategies. We may be fortunate enough in fact to be looking at 5 years of continued growth on top of what we have already had and it would make the job a little easier. But I think the probability is that somewhere along the line we're going to get a shot at it. And that may in fact be the easiest way to bring price stability in the 1994-1995 period.

MR. BLACK. It would certainly be good if we could do that since our [Congressional] testimony--that of the four Reserve Bank Presidents and yours--of course suggested it. If we thought this were a real possibility within a 5-year period, the only scenario here that even comes somewhat close to that is strategy II.

CHAIRMAN GREENSPAN. Yes, but none of these is a likely scenario.

MR. BLACK. Probably not. I hope we have something better than anything that appears in any of them actually; but I think it would be rather optimistic to expect that.

CHAIRMAN GREENSPAN. Any other questions for Mr. Kohn?  
Governor Angell.

MR. ANGELL. Don, following along through strategy II, I get a [growth rate for] dollar GNP under strategy II of 5-1/4 percent. Is that right?

MR. KOHN. In 1994?

MR. ANGELL. In 1990.

MR. KOHN. Yes, you're right.

MR. ANGELL. I didn't have my calculator with me.

MR. KOHN. [Unintelligible.] But anyhow, you're right: it's something like that.

MR. ANGELL. Okay. Then that implies a V2 of zero.

MR. KOHN. Right.

MR. ANGELL. That doesn't seem to me to quite fit under that scenario.

MR. KOHN. In effect, what's happening in that scenario is that the decline in interest rates from the end of the last half of 1989 tends to push up M2 and push down V2; and then the rise in interest rates in the tighter scenario tends to exert the opposite force and they about offset. So, you get essentially no change in velocity for the year.

MR. ANGELL. The velocities that I calculated on strategy II were zero in 1990 and in 1991 and plus one in 1992. It seems to me that that tightening scenario somewhere in there is apt to have a declining velocity.

MR. KOHN. A declining velocity? Because of the drop in the inflation rate, you're saying?

MR. ANGELL. Yes.

MR. KOHN. It does in the out years. Once that inflation rate goes down and we start seeing that in nominal interest rates under that strategy--in 1993 actually and in 1994--then you get the velocities you're looking at. So, it's a question of how fast inflation comes down. Under the Chairman's thought that you might get faster 10-month years it would bring that forward. But you don't get it for a while because you have to get those real interest rates up and keep them up, in the conventional wisdom of the model, to induce a gap in resource utilization to get the inflation headed down.

MR. ANGELL. But those of us who believe that the Phillips curve model is not as accurate as the commodity price-V2 relationship

position would tend to see the timing of that as being a little different. That is, it seems to me that the strategy II scenario would be associated with declining commodity prices sometime in the second half of, say, 1990. I just can't help but believe that that would tend to take velocity down with it; and there's some risk, it seems to me, that velocity could be somewhat lower than anticipated.

MR. KOHN. If the declining commodity prices tend to take the price level and price expectations down with them so that nominal interest rates could fall, then I think you're right. That's the way I would think through your scenario-

MR. ANGELL. Yes, that will happen as gold prices decline!

CHAIRMAN GREENSPAN. Any further questions for Mr. Kohn? Can we start the general discussion? I'll start very quickly. I felt that this simulation out to 1994 was very useful. It gives us a real shot at the meaning of what it is we're voting on. And it pretty much says to me that the general recommendation of alternative II of 3 to 7 percent on M2 probably gives us about the flexibility we need. I guess on M3 it's just a mechanical adjustment and the same is true on debt. But on the impression that I originally had--which I think a number of us had--about the need to calibrate down, I think this has given us a somewhat different focus at this stage. I'd be curious to get anyone's impression of this. Bob.

MR. PARRY. I would be for alternative II; it not only provides an alternative that is consistent with our baseline but it also gives us the flexibility, if we wish to exercise it, to embark on a more aggressive policy to reduce the rate of inflation. I think it has a significant advantage over alternative III because I'm concerned that alternative III--though it has the advantage of maybe signaling our intentions--might set us up for failure in terms of not being able to adhere to it. So, I think this alternative is just what we need to accomplish not only our objectives for 1990, but potentially it sets us on the right path for subsequent years as well.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. Yes, I agree with that. For M2, alternative II makes perfect sense. It's consistent with this strategy II of getting inflation down over time. I wouldn't mind at all going with the alternative III ranges for M3 and debt. But for M2, certainly, alternative II makes more sense to me. And I would think that the strategy II scenario is consistent with the alternative II ranges--even though those may be the actual inflation trends--moving down toward 2 percent over time, assuming that that's the trend. What could accompany that downward trend is actual inflation expectations that really could achieve what the Chairman has described as price stability anyway. Obviously, there may be a lag in adjusting the actual inflation rate. But over the '80s we had a consistent downtrend in 10-year or long-term inflation expectations. And even more recently, those long-term increases have moved below the 12-month inflation rate. So, it's quite possible that inflation expectations would be lower than the actual inflation rate along that path and that we would be accomplishing a lot of what we are looking for.

CHAIRMAN GREENSPAN. Bob Forrestal.



MR. FORRESTAL. Thank you, Mr. Chairman. I too found this very, very helpful; the outlining of the strategies is great because it gives us a longer-term outlook. In looking at those strategies, I realize that this is a fairly long timeframe here and we probably will not be able to adhere to any particular strategy. But starting out I would hope that we would adopt the baseline strategy I and not be too aggressive in moving toward price stability because I think the risk of recession in the second alternative is too great. And if we do have a recession, we'll then have to ease until we get back into this sort of stop-and-go kind of policy stance. So, I think that strategy I is the one that we ought to pursue. That means logically then that we favor alternative II for M2--that 3 to 7 percent range--given where we are with M2 at the moment. I think that's the logical one. We could move the M3 range down; I wouldn't mind having that moved down. We'd get a little announcement effect, I suppose, from that. I don't feel very strongly about M3, though I do think the M2 range should be at 3 to 7 percent.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. For 1990 I'd just keep it simple: alternative II for the reasons that you and Mr. Parry have stated.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Well, I agree with those who support alternative II, and I also think it is helpful to have this longer-term view of what these strategies mean. But as important as that is, we still have to live through 1990. And I think the questions that we have to ask are: How much risk of a recession in 1990 are we willing to bear in order to keep inflation from accelerating? And how much flexibility do we need in 1990 in these long-run ranges to deal with the threat of recession, should it get more serious? I think alternative II also encompasses the right balance for 1990 as well as for the longer-run outlook. Alternative III simply doesn't give us much flexibility in that regard and alternative I takes us in the wrong direction on inflation. So, both for the immediate year, 1990, as well as for these longer-run considerations, alternative II makes sense.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I share your enthusiasm for the material contained on page 8 because I think strategy II clearly is the sort of thing that we really want to get, at a minimum. And even that strategy has inflation coming down only 2 percentage points over a 5-year period. In contrast to that, which seems to me to be the minimum progress that we ought to aim for, the baseline would have us coming down to an inflation rate that is still more than 3 percent in 1994. I part company a little with you by thinking that alternative III is probably a better way to go. But I realize that there are political problems. We did go with 3 to 7 percent tentatively as the range for M2 last time--although I argued forcibly, and I thought extremely persuasively, that it ought to be 2-1/2 to 6-1/2 percent but lost that battle--and it is very difficult to bring it down. But we also have to think about the risk of not doing something to lower the inflation over time. And that risk bothers me when I look at strategy II because it has the unemployment rate going up to 6 percent; I'm

sure that bothers everybody else in the room too. But, as Governor Angell said, this is a Phillips curve type model and the Bluebook points out, I think wisely, that a more restrictive policy might well change expectations and increase the credibility of our efforts and reduce the cost of getting there. So, the tradeoffs might not be as unfavorable. Finally, beyond that, I would say that we need to give some consideration to the risk associated with an outcome like the one in the baseline simulation. The inflation rate is still above 3 percent in 1994 and we've all said, as embodied in the Neal Resolution, that 5 years seems to be a reasonable length of time to work the inflation rate down gradually. If we had 3 percent that late, I think observers would pretty well conclude that we had thrown in the towel. We can certainly do what is compatible with strategy II with alternative II instead of III, and I certainly wouldn't dissent on it if I were voting. But I do have some preference for alternative III because I would like to send that little signal to the market that we still have the long-run objective of reducing inflation.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. It seems to me that we really should make up our minds to live within the ranges. I would be more inclined toward a range that we can live within than I would to get a little too macho and then find ourselves deviating from it. I could live with alternative II provided we take quite seriously that 7 percent is really a desirable top. When we look back to the last deflationary period, we let M2 get to more than 9-1/2 percent, so it would be considerable progress from 1986 when we had 9-1/2 percent if this time it were 7 percent. It does seem to me that V2 could well be as low as negative 2. And if nominal GNP were in the 5 percent range, I think that over a period of time would be effective restraint. I would also prefer to wait to cut the ranges until we can cut them a full percentage point. I think it would be nice to make the cut from 3 to 7 percent to 2 to 6 percent. I just don't feel that that's a very livable cut this time. So, I would prefer alternative II. But I would prefer, Mr. Chairman, that in your Humphrey-Hawkins testimony you make it very clear what our strategy is and why it is that we do not believe in a steady process of decreasing the ranges but that we think significant range decreases will come during the next period of interest rate increase. If we have that kind of strong statement I would like that better. I would share with Governor Johnson some preference for moving down at least the debt aggregate. It seems to me that 5 to 9 percent on debt could be a livable range within the future. Even though the thrift situation might bring back higher growth rates in M3 in 1991, I would expect debt to work in a 5 to 9 percent range.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Well, I'm concerned about all these choices and the circumstances we find ourselves in. I'm not worried at the moment about how we're going to get to price stability; I'm worried about how we're going to start to bring inflation down to what I think ought to be a somewhat more modest objective. And it seems to me to be one of the [unintelligible] in M2 growth. If you look at the recent history of M2, as Don pointed out, it has been running the last 3 years with increases of 4-1/4 to 5-1/4 percent per year. Even allowing for some slippage, that suggests to me an upper limit on the M2 range in 1990

of about 6 percent. I really am concerned that anything above that would represent, obviously, some significant acceleration over its recent trends and would not help us on the inflation side. In my view it would make it more difficult to bring inflation down in the future. I really think we're placing an awful lot of emphasis on the precision of these relationships in these alternatives and strategies; I find that very difficult to accept. So, I personally think that something like an M2 range of 3 to 6 percent is appropriate here. And I guess I'm not really concerned about M3 and debt.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. It seems to me that the critical question for this Committee at this juncture is whether or not we're really dedicated to bringing inflation down to zero or its equivalent--to achieve price stability, whatever its definition may be--or whether or not we're simply willing [to accept] and be happy with having inflation where we find it now. I look at the exercise--and I think it is helpful to go out to 5 years--but the fact of the matter is that if one considers the cost of taking action to bring inflation down from the current level, none of these strategies gives me very much comfort. That is to say, we're not making much progress against inflation or toward price stability, given any one of these three strategies. As a result, I would have to conclude that maybe our best efforts should be to cap inflation now with the thought that the only way we're going to get inflation down is with a recession and that quite likely a recession will occur within the next 5 years--particularly if we hold growth below the trend line for this long a period of time. I don't think there's a time in modern policy history in which we have gone for that length of time with growth below the trend line without falling into recession. So, I think recession is a real possibility in this timeframe. As a matter of fact, it may be something that gets us toward price stability. So, alternative II for the upcoming period is the most appropriate one, in my mind. And that says, really, that we're preparing in the near future to cap inflation and that the Committee hopes there's some exogenous event that causes a recession and we won't get blamed for it and yet we capture the progress toward price stability. The other thing about alternative II is that the reduction of M3 seems reasonable to me. It does show the flag a bit in the sense that we have taken a step in reducing the ranges of growth in M3 and debt. You can make whatever you want of that; it isn't much, I think. Nonetheless, for some people hearing your testimony it may be worthwhile.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Mr. Chairman, I lean a little toward alternative III. Governor Angell's comments appealed to me strictly in terms of the Humphrey-Hawkins testimony and a careful explanation that we really are not willing to settle for what we have and we're not losing sight of our objectives. With that kind of assurance, then I can accept alternative II. I also liked Governor Angell's point on debt: that probably a little further reduction on the debt figure would be possible. That had some appeal to me.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. In terms of the broader strategies, I don't have any trouble at all identifying with strategy II, the tighter option. As I look at the baseline, I think the progress toward price stability is really minimal over 5 years. If you accept the P\* model, it shows that when we get down to 3-1/4 percent or so we're stuck there. Under that type of program I just don't see how we can get any benefits of credibility, assuming there are some benefits of that in reducing the cost. I also think that we're unlikely to be able to sustain a program--and I know this is just a projection--of trying to keep the economy below potential for an extended period of time. So, I favor the tighter approach there. And, as the Bluebook observes, that logically leads one to alternative III in terms of the ranges. Obviously, we're in a very tricky period here. But, first of all, along the lines of what Gary was saying, I think the upper end of that range should be more than adequate to support positive real growth. And I think it signals our intentions in terms of really moving toward price stability relatively gradually. I think the 1/2 percentage point reduction in the M2 range conveys that. We moved the ranges a percentage point a year ago. I guess we're trying to trade off the perceptions of a number of different audiences here, but I think the most important audience--and the audience that is really going to determine what we're able to do or not do--is the market. What I think is important is the markets' perception more broadly, including the foreign exchange markets, along the lines of what Jerry was saying yesterday. If the perception is that we have thrown in the towel in terms of progress toward price stability, I think we're going to be dealing with much more difficult problems in the coming year than may be possible if we maintain that credibility. I still feel that if circumstances develop where we're forced to violate the ranges because of some very adverse developments on the real side, we can do that and maintain credibility. So, I would opt for alternative III.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I completely support all of the thinking that has been presented on alternative II and identify with that easily. But I'd like to suggest that we consider leaving the ranges at the tentative rates that we set last summer, which incidentally are the same rates that we had in 1989. The differences are in M3 and in debt. M2, importantly, is the same in the tentative ranges and in alternative II; the other measures have technical downward adjustments in alternative II. As we look at criteria for the selection of ranges, I think it's important to try to project forward as much stability as we can, as much continuity of policy as we can and, insofar as we're signaling the market, as much clarity as we can. I'm concerned that, if we make these small changes to two of the three tentative ranges and leave one the same, we may be projecting that there's some deep subtlety that really doesn't exist. The message would be clearer and the policy would be in substance essentially the same if we left the tentative ranges in place.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, I am very attracted by alternative III for the signal that it sends, and yet I am concerned that, if the staff forecast is correct, we don't have much room in the M2 associated with that range. Consequently, I'd like to split my ballot

here and cast a ballot for alternative II for M2 and alternative III for M3 and debt.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. A lot of what we're talking about here relates to perceptions, which are hard to know. And that always makes things very difficult. I'd like to associate myself with two things: Gary's comment about not being so worried about achieving zero [inflation] and holding where we are right now in the short run; and the consistency of that with your point that probably none of these things is going to happen over the next 5 years because of the intervening events. So, I think we have to look at the longer-run ranges in terms of their consistency with where we want to go in the short run. In terms of signal effects, like Governor LaWare, I had some sympathy for [unintelligible] going to 2-1/2 to 6-1/2 percent on M2. But then as I started to think about it, I viewed that as a balancing of risks--that the risk of not coming within the upper part of the range transcends the early benefits we get from having a signal. And if we're going to stay with M2 [of 3 to 7 percent], I would be inclined--this is a question of market perceptions and I think most of the market looks at M2--to leave all the ranges the same rather than have the market saying: If they came down on M3 and debt, why didn't they do something on M2? I'd also like to associate myself with Governor Angell's statement that this requires quite careful explanation--a fulsome explanation, perhaps is a better way to put it--in your testimony.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I would also be in favor of alternative II, which seems to me to be consistent with the baseline strategy, i.e. reasonable growth or at least not unreasonable growth with some progress on the inflation front at least over a longer period of time. My hunch is that if the growth rate, particularly in the early years, comes in as low as the strategy would suggest then it's low enough or far enough under the growth potential that in fact the inflation results may be better than suggested. In terms of M3 and debt, I don't have a particularly strong feeling, but I would be in favor of 3 to 7 percent and 6 to 10 percent as outlined in alternative II. Those seem to be reasonably technical adjustments for us if we were to go forward even more. Alternative III, I think, would perhaps be more of a message than we'd want to deliver.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. It was interesting to see these longer-term projections, but I'm extremely skeptical about our ability to get exact projections out that far. In looking at the more near term, whatever ranges we select, we have to make sure first of all that the monetary growth we achieve fits in those ranges. Secondly, I think it's very important to allow ourselves some maneuvering room in 1990 just in case the optimists here are wrong and the nervous Nellies are right about the strength of the economy in the next couple of quarters. I was impressed by something that Don Kohn wrote on page 16 of the Bluebook which suggests that a 1/2 percentage point shortfall in aggregate demand in the first half of the year would require 7-1/2 percent M2 growth for the year in order to achieve the fourth-quarter level of real GNP in the staff forecast. And it seems to me, if I'm

looking at these ranges correctly, that alternative II would not handle that. So, I would like to vote for an alternative that doesn't even exist, which is the alternative I version of M2 (3-1/2 to 7-1/2 percent) and then for M3 and debt I'd keep the tentative ranges that we adopted last July, just to give us running room through 1990. It doesn't mean anything in terms of my longer-term commitment to price stability.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. In terms of long-term strategies, I'd prefer strategy II or something better--or tighter, should I say.

MR. ANGELL. We knew what you meant!

MR. HOSKINS. Mike Prell might point out that in these long-term strategies that we're looking at, we're talking about a percentage point difference in the three strategies. And that probably is well within our ability to miss. I understand what the staff is doing: They are trying to be reasonable because we're all reasonable people around the table. But as the Chairman has indicated, probably none of these outcomes is what we're going to achieve. I might suggest that we be unreasonable once in a while and look at what could happen and take a tighter policy to get to where we say we're going to go, or we shouldn't be saying it's where we're going to go. And I don't mean zero inflation. There are many people who don't want to be nailed to that cross and I understand that. But I do think the statement that Gary Stern made is an appropriate one, at least the way I interpreted it. You may have to clarify this because I interpreted what you were saying as something different than Dick Syron said, and that is that you're not comfortable with the progress in this scenario--that you want lower inflation and we have not made any movement toward lower inflation.

MR. [STERN(?)] We don't have a difference in interpretation.

MR. HOSKINS. I might also point out in terms of long-term strategy that the only one that has 3 percent growth in 1994 for the real economy happens to be the tighter policy. And isn't that where we want to be? In some sense it seems to me that a tighter policy over that 4-year period or 5-year period is really what we ought to do. We averaged 4.6 percent monetary growth in the last three years. I don't see any reason why we should raise that in the next 3 years or 5 years, since that would be giving up some gains that we fought pretty hard to get. As I look at what has transpired in macro-economic theory in the last 20 years, it seems to me that the one thing that tends to come out is that policy ought to be predictable and it ought to be credible. I don't know what else we can say about policy than to make it predictable and credible. And it seems to me we're trying to do this backwards: We're trying to say let's get lucky and have the monetary growth rates fall out low and then we'll move our target ranges down to match it. That to me is not predictable and credible policy.

Just as a side note: As many of you know, I received a letter from the ABA group of economists that suggested we have a range for [M2] of about 2-1/2 to 6-1/2 percent. So, I don't think the markets will be unduly shocked if we come out with a range of 2 to 6 percent.

CHAIRMAN GREENSPAN. But they also talked about a lower funds rate.

MS. SEGER. They're also not going to be held accountable.

MR. HOSKINS. I understand. All I'm suggesting is that there are some people out there who happen to believe that a predictable and credible policy might be important. In terms of the alternatives, I would like to see a 2 to 6 percent growth rate for M2. I don't care about the other two, i.e., M3 and debt.

CHAIRMAN GREENSPAN. I think the best way to proceed is to have alternative II moved and seconded and then to open up the discussion to amendments on changes in both M3 and debt. So, if the Secretary will read-- I beg your pardon, I'm sorry. Are you okay?

MR. ANGELL. I'm ready. I move 3 to 7 percent for M2.

VICE CHAIRMAN CORRIGAN. I second.

CHAIRMAN GREENSPAN. Alternative II is moved and seconded. We're now open to amendments on altering the ranges for M3 and debt, sequentially. So, if anyone would like to--

MR. ANGELL. Yes, I would.

CHAIRMAN GREENSPAN. You can't move and--

MR. ANGELL. Oh yes you can.

CHAIRMAN GREENSPAN. You can't move to amend your own--

MR. ANGELL. You can move to amend, that's right. Mr. Chairman, the reason that I wanted to be earliest is because I really have another suggestion. And if my suggestion gets a second, we can [be done] with it. The suggestion is that we show our seriousness by getting down to one target, M2. So what I'm suggesting and I'm willing to move it if someone would second it, would be that we not have targets for M3 and debt--just as we abandoned M1. And that places us in a much more credible position. I believe that with a 400 basis point range for M2 that makes more sense. It is the one velocity we think we know more about. And so I would prefer and would move, Mr. Chairman, that we--

CHAIRMAN GREENSPAN. Let me just suggest to you that that is a major move which, frankly, I would just as soon not have discussed or voted on unless we had a paper on it. This has a lot of implications with respect to our relationships with the Hill and a variety of other things. Obviously, if you want to move forward, we can discuss it. I'm not saying I disagree with you; it's just that I hate to make that type of move without a significant amount of thought about it.

MR. ANGELL. Well, Mr. Chairman, under those circumstances I would be open to waiting to consider this issue.

CHAIRMAN GREENSPAN. Why don't we have Mr. Kohn provide some pros and cons on this and circulate that to the Committee? I don't

think we're equipped at this stage to think of the various secondary or peripheral implications. Nonetheless, it has something to be said for it.

MR. BLACK. Mr. Chairman, excuse me. I was just going to say that I'm very sympathetic to what Governor Angell has said, but I think the Humphrey-Hawkins Act says we have to report the rate of increase or diminution of the monetary and credit aggregates. And usually, I believe--

CHAIRMAN GREENSPAN. We would be required under those conditions to explain in some considerable detail why we dropped the two of them, and I--

MR. BLACK. It was just the plural on "aggregates" that made me hesitate, because I really support what he says if we could get away with it.

VICE CHAIRMAN CORRIGAN. Can I go back to a different issue in the context of M2 or M3 and debt?

CHAIRMAN GREENSPAN. Well, let's remember we're now in a position where alternative II has been moved and seconded.

VICE CHAIRMAN CORRIGAN. I want to make a comment about debt that actually goes back to something else Governor Angell said. As I think about it here, I must say that I have some sympathy with the idea of making the debt range, within the framework of the motion that's on the table, 5 to 9 percent. I think Don's observation is right that it's likely to come in somewhere around 7 percent. That range has some appeal to me for both the cosmetics and the substance of being able to say that we think the growth rate in debt has at last subsided--in a context in which in the minds of a lot of people the growth of debt has been symbolic of some of the excesses of the past--and of being able to point to an adjustment in the range of debt from 6-1/2 to 10-1/2 percent all the way down to 5 to 9 percent.

MR. ANGELL. I would second that.

CHAIRMAN GREENSPAN. Why don't you make that as an amendment and [Governor Angell can] second it. Why don't we vote on-- Well, first there has to be discussion. Does anyone want to discuss this particular amendment? Then, why don't we vote on it. All in favor of the Vice Chairman's amendment please raise your hand. Opposed? Can we do that again? There are a lot of people who have not [raised their hands!] [Laughter.]

MR. ANGELL. Well, we call the roll anyway for the record, don't we?

MR. HOSKINS. He wants a straw vote.

CHAIRMAN GREENSPAN. We can do this in a number of ways. We can vote. It is clear that we all have different views on M2, M3, and debt. I think the simplest way, from what I've heard, is to have what we now have on the table: alternative II, which has 3 to 7 percent for M2, 3 to 7 percent for M3, and 6 to 10 percent for debt. My impression, basically, is that there is a consensus for M2; and,



therefore, I've asked for amendments to see whether those ranges would pass for M3 and debt. Jerry has raised a specific amendment to alternative II which would strike 6 to 10 percent for debt and substitute 5 to 9 percent. And that will be voted either up or down.

MR. FORRESTAL. You're looking just to voting members?

CHAIRMAN GREENSPAN. Yes, voting members only. But I don't think we have enough. As I counted, not all voting members voted.

MR. ANGELL. Okay.

CHAIRMAN GREENSPAN. Let's call the roll on the Vice Chairman's amendment.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Boehne	Yes
President Boykin	Yes
President Hoskins	Yes
Governor Johnson	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Seger	No
President Stern	Yes

CHAIRMAN GREENSPAN. It clearly carries. Would anyone like to offer an amendment for other than 3 to 7 percent on M3?

MR. JOHNSON. Since I was the first one to say that even though I supported alternative II on M2 I thought the range in alternative III would be appropriate for M3--given what's happening in the broader aggregates and given the staff's forecast, which is even in the lower [part] of the alternative III range--I'll make the motion that we go to alternative III for M3, 2-1/2 to 6-1/2 percent.

MR. BLACK. Second.

CHAIRMAN GREENSPAN. May I just ask a question of where the forecast would show M3 in 1991?

MR. KOHN. We have 5 percent in 1991 because we have the runoff of thrift assets slowing down as more thrifts meet their capital requirements.

CHAIRMAN GREENSPAN. So, in effect, there is no evidence at this particular stage that were we to move in that direction we'd have to reverse and move it back up in 1991.

MR. KOHN. May I make another statement at this point, Mr. Chairman? There is some risk [on debt]. Although we have 7 percent debt growth for 1990, that is on the assumption that the RTC is off budget and not in the federal government sector. That would add a few--

CHAIRMAN GREENSPAN. I think the way to handle that is to make that assumption and be explicit in the Humphrey-Hawkins report; we will stipulate that.

MR. KOHN. The point I was going to make is that if growth came in a little low on M3 that would balance off by being a little high perhaps on debt, if that's the way that came out.

SPEAKER(?). I'm ready for lunch!

CHAIRMAN GREENSPAN. Well, I think we have to be very clear on what definition of debt we're using and not merely allow ourselves to be moved by an arbitrary bookkeeping arrangement.

MR. PRELL. Mr. Chairman, I might note on M3 that in our flow-of-funds forecast we're still assuming that there is some degree of restraint on thrift institution asset expansion and on that aggregate as a whole. If you look at the long-term trend, it is one of a velocity decline. So it does raise some question, if you have 6-1/2 percent as the top end, whether that would be sustainable over the longer run unless we did get nominal GNP moving down into the 4 to 5 percent range. So, that's a possible reason for a precaution in how aggressively you move the M3 range.

MR. JOHNSON. But it seems to me that this is not the time to worry about that. The time would be '91 to worry about stabilizing that range and maybe carrying it forward.

MR. PRELL. Well, I was addressing the concern that the Chairman was raising.

MR. JOHNSON. Yes.

MR. PRELL. Again, these things could be explained at each--

MR. JOHNSON. I agree that that may be the significant issue the next time we meet over this range.

CHAIRMAN GREENSPAN. Any comments?

MR. SYRON. May I ask a question? If we're going to move the debt target down a whole point and leave the M2 target the same--

CHAIRMAN GREENSPAN. Yes.

MR. SYRON. Given where the M3 target is about to come in, is there some value of parallelism in the sense of people not seeing too much fine tuning in it and also going to 2 to 6 percent for the M3 target? I'm coming back to [the question] of whether we're doing this just for this period, this year, and not looking out beyond it.

CHAIRMAN GREENSPAN. We're essentially doing one year. Any further questions on Governor Johnson's amendment? It has been seconded. Will you call the roll?

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes

Governor Angell	No
President Boehne	Yes
President Boykin	Yes
President Hoskins	Yes
Governor Johnson	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Seger	No
President Stern	Yes

MR. ANGELL. Mr. Chairman, this is something I've never done before but in view of the way this may be interpreted I would like to change my vote, if it's going to be recorded, because I don't want to explain this little bitty thing. I would prefer not to go with the halves but I don't want to explain that.

CHAIRMAN GREENSPAN. Consider your vote changed.

MR. BOEHNE. Mr. Chairman, I recognize the parliamentary procedure that you were using with these amendments but, in light of what Governor Angell just said, I wonder if we do want this kind of precision of votes recorded in the minutes. I would much prefer to have an overall vote that says whether we accept alternative II as amended and consider these largely straw votes and then let people vote up or down on something more substantive than these kinds of fractions.

CHAIRMAN GREENSPAN. I would agree with that. There's really no reason to use up all our paper in trying to do that.

MR. ANGELL. Well, but Mr. Chairman--

CHAIRMAN GREENSPAN. You can change your vote again if you want.

MR. ANGELL. Well, a procedural point: It seems to me that it may have been well for us just to have a consensus move on these; but once we took a vote, not to put it in the minutes offends my notion of accuracy of [minutes]. Is Virgil here?

CHAIRMAN GREENSPAN. Remember, we are in fact recording and voting on the total. In other words, we are reflecting our views overall.

MR. ANGELL. Yes, I know. I'm just saying it's a matter of procedure. Roll-call votes are ordinarily recorded. I think it would be well for us not to have roll-call votes on these kinds of--

CHAIRMAN GREENSPAN. Sometimes it is easier just to find out quickly what the view is rather than segregate voting from nonvoting members and worry about who is for what.

MR. ANGELL. Well, what's Virgil's view on this?

MR. MATTINGLY. Well, it seems to me that if the Committee has taken a vote that that should be recorded in the minutes. You can vote to rescind that vote.

MR. BLACK. That wouldn't be good.

MR. BOEHNE. Well, I just wonder if we're getting carried away here with this procedure.

CHAIRMAN GREENSPAN. Yes, we are.

MR. BOEHNE. My interpretation, Mr. Chairman, of what we did is that we took a straw vote and instead of doing it by raising hands we used our voices. And I view those two as largely equivalent.

VICE CHAIRMAN CORRIGAN. I agree with him.

CHAIRMAN GREENSPAN. Well, let me suggest that we complete this and then we'll put on the table a rule in which this Committee can make that judgment as to how we record this. I assume, Counsel, that we have that capability?

MR. MATTINGLY. Yes sir.

CHAIRMAN GREENSPAN. Alternative II has been moved, seconded, amended, and is now subject to a vote.

MR. BERNARD. Do you want me to read it, Mr. Chairman?

CHAIRMAN GREENSPAN. Yes, I think you better read it.

MR. KELLEY. You can't describe it as alternative II anymore.

MR. BLACK. I hope so.

MR. BERNARD. I'm reading from line 59 of the draft directive or from page 24 in the Bluebook: "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 3 to 7 percent and 2-1/2 to 6-1/2 percent respectively, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The monitoring range for growth of total domestic nonfinancial debt was set at 5 to 9 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability."

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Boehne	Yes
President Boykin	Yes
President Hoskins	No
Governor Johnson	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Seger	No
President Stern	No

CHAIRMAN GREENSPAN. The vote is complete. Now, would somebody like to move that the minutes not record the preliminary vote--rather, the vote on the amendment to alternative II?

MR. LAWARE. I'll move whatever you said.

VICE CHAIRMAN CORRIGAN. I'll second it.

CHAIRMAN GREENSPAN. All in favor please raise your hand. All opposed? The vote is--

MR. BOYKIN. I just wanted to ask about the wording in the directive. In the first sentence in that wording we had price stability first. In the last sentence in the directive we have price level stability last. I would suggest that we move the progress toward price level stability up to the first item in that last sentence, for reasons of substance as well as consistency.

MR. BLACK. What lines are you on, Bob?

MR. BOYKIN. I'm on page 24. This is on the 1990 ranges. The first sentence says: "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth" etc. The last sentence on that page says: "The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability." I'm suggesting that we say "The behavior of the monetary aggregates will be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets."

CHAIRMAN GREENSPAN. In other words, you're trying to--

MR. BOYKIN. Yes.

MR. ANGELL. I would agree with that.

VICE CHAIRMAN CORRIGAN. So would I.

CHAIRMAN GREENSPAN. I take it that you're moving that and you're seconding it. Yes?

MR. ANGELL. I suggest we might not want to record it, Mr. Chairman.

VICE CHAIRMAN CORRIGAN. I think the edge--

CHAIRMAN GREENSPAN. What were you about to say?

VICE CHAIRMAN CORRIGAN. I think Mr. Boykin's suggestion makes good sense.

MR. ANGELL. Yes.

CHAIRMAN GREENSPAN. Do I hear any objection? If not, I find that that is the consensus of the Committee.

MR. ANGELL. That's it.

CHAIRMAN GREENSPAN. Record the dissents. I think that brings us to Mr. Kohn. Why don't we have his comments and perhaps we can break for coffee at that point.

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

MR. JOHNSON. I think that's a very good explanation; at least that makes sense to me. May I ask one question that has popped up in my mind over the last couple of days? In the paper this morning there was talk of Germany going for a monetary [union] between East and West Germany. It appears that the Bundesbank is a little concerned about this. The political events are moving faster than the central bank in Germany would like. Now, I noticed that the dollar has depreciated a little more against the DM, possibly showing some anticipation of a big surge in demand for marks because of this monetary union. I've read some comments that the government is pressuring the Bundesbank to provide DM at a conversion rate for GDR marks that is well above the market exchange rate. That worries me, and I think the Bundesbank is worried about maybe having to convert GDR marks to DM at an exchange rate that is not appropriate to the market. If that were a big concern in the market, it seems to me that there would be a depreciation of the DM rather than an appreciation. What is going on there? Do you know any more than what is in the paper?

MR. TRUMAN. I don't know much more than what is in the paper. I think several things are going on here. One is that the political forces are seeking to do something--as political forces tend to do, if I may put it that way. I think the Bundesbank's resistance to that, which I gather is shared by financial people in Bonn as well, is that this is dealing with the symptoms rather than the cause. You can't automatically exchange--well, you can do it--but you can't exchange x number of East German marks for West German marks and then say that the world has changed and we'll all go on. The question is: What comes next? You haven't done anything just through the currency exchange.

MR. JOHNSON. I can see going to a DM standard, but I can't see exchanging--

MR. TRUMAN. Moreover, it may make things worse in terms of the workings of the economy. The resistance from the Bundesbank comes primarily from the view that--I'm repeating myself--doing this is dealing with the symptoms rather than the causes. On the other side, I would agree with your analysis that it is not so much the conversion in and of itself [that is a problem], because I've seen calculations that if all the [East German] currency were converted into West German marks, there would not be a big change in the level of the money supply.

MR. JOHNSON. I have seen some reports of 3 to 4 percent.

MR. TRUMAN. Well, it's something like 3 percent, which is trivial in the sense of what you're dealing with, because it makes some sense to have a new transactions currency. There may be concern, looking down the road, that there may be more to it than that. If you

think of what adjustments have to be made, initially it would be straightforward. Everybody's wages would be changed. If [the exchange ratio] were 3 to 1 and you were being paid x GDR marks per hour, you would now be paid a third of that per hour in West German marks. And that probably won't work. Moreover, the price levels presumably would adjust up to West German prices. And that's why it won't work. Then you might get the secondary impact on the Bundesbank [unintelligible] inflate. And I would argue that you are right--that one would be looking ahead, under those circumstances, to a more inflationary Bundesbank policy and would end up tending to think that the deutschmark ought to depreciate rather than appreciate. So, the deutschmark probably was responding to what is happening in Moscow, with all the fighting and discussion that has been going on between [unintelligible]. An interesting fact--and this is based really on one conversation--is that the East German financial people whom I met with yesterday agree on this point. They agree that this conversion, without doing anything else, is likely just to make things worse rather than better, even in this period running up--

MR. JOHNSON. [Unintelligible] calls from a lot of very important politicians wanting to do this.

MR. TRUMAN. Well, that does happen.

MR. CROSS. Well, I certainly agree with Ted. I think what is happening in the market reflects the view that Gorbachev is in charge and things are likely to move ahead in a stable rather than an unstable way. The market is reflecting the value of the mark in that sense. Beyond that, the market is probably thinking that the Bundesbank and the Germans are not going to do something totally stupid in moving into this "markization," or whatever it is, of the other part of the German economy. And I think they are further thinking that to the extent there may be genuine costs to the West Germans of making this move, which may mean higher interest rates and more borrowing by the Germans, that that may not be altogether bad from the point of view of the value of the D-mark--if the Bundesbank wins.

MR. JOHNSON. If they win, yes.

VICE CHAIRMAN CORRIGAN. Further questions for Mr. Kohn? President Parry.

MR. PARRY. Don, I have a question about the consistency of the short- and long-term [alternatives] with regard to M2. Alternative B seems to me quite consistent with the alternative that was chosen for the long term. Obviously, M2 [growth] ends up high well into the '90s. On the other hand, if one were in favor of alternative III for the long term, that seems to me consistent with alternative C, and alternative C really is not consistent with the alternative that was chosen for the long term. Is that correct?

MR. KOHN. I would agree with half of the statement but not necessarily the other half, partly based on what you said earlier today, President Parry. That is, alternative B is in a projection sense consistent with the 6-1/2 percent [staff forecast] for the year. We're assuming for the year essentially no change in interest rates under "B." We would expect [M2] growth in the first half of the year

to be stronger than in the second half of the year under those circumstances and to run along the top part of the range rather than the lower part. By the same token, if you had adopted a lower range--the alternative III range--which you didn't do, you would be hard pressed not to begin to lean a little toward "C." But to echo what you said earlier today, I think having adopted alternative II doesn't mean you can't lean toward alternative C and tighten because there's a lot of room on the down side. Alternative II does not get in the way of running a tighter policy than assumed by the staff. It might get in the way of running an easier policy.

MR. PARRY. Well, I agree with that. But someone who was strongly in favor of alternative III probably would be more inclined to follow "C."

MR. KOHN. I agree. If you were in favor of "III," you'd be more inclined to "C."

MR. PARRY. That's all I wanted to know. Thank you.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. Bob raised my question in part, but let me rephrase it. If we were centering our ranges for the year, that would imply a 5 percent monetary growth. What kind of interest rate increases would we have to have to generate that?

MR. KOHN. Relative to the staff forecast of 6-1/2 percent [for M2 growth] you'd have to have an increase of about 1-1/2 points in interest rates in the first half of the year to get [M2 growth] down to 5 percent for the year.

CHAIRMAN GREENSPAN. Further questions?

MR. BOEHNE. I have a question. What would a 1-1/2 percentage point increase of the interest rate mean for the real economy, Mike?

MR. KOHN. That's for Mr. Prell; he's in charge of the IS curve!

MR. PRELL. I think moving that rapidly would make a material difference. We can probably infer something from the simulations that were presented earlier--that a 1 percent slower M2 growth adds only 1/2 percentage point to the interest rate level. And you saw the consequences in terms of GNP growth. So you'd be enlarging that. It would make it a much closer call as to whether we had any significant [economic] growth this year.

MR. BOEHNE. In other words, it probably would bring on a recession, to be blunt about it.

MR. BLACK. No growth.

MR. PRELL. A no-growth scenario.

MR. ANGELL. But there are some unknowns here. If we were to tighten short-term rates, long-term rates might reverse



[unintelligible] take the last reductions. So it seems to me that one might make a case that long-term rates would be lower rather than higher.

VICE CHAIRMAN CORRIGAN. That would follow from the crash--

MR. JOHNSON. --in the stock market.

MR. PRELL. Well, that's all off the baseline in the model. Clearly, there are different views about underlying forces. You might have an entirely different conclusion about the ramifications of that type of move.

MR. ANGELL. Well, I would think an increase of 150 basis points in short-term rates probably would not be expected to be followed by future increases. Consequently, I'm sure long bond prices would rise and long-term interest rates would fall. But I don't know whether that mix will work very well or not.

CHAIRMAN GREENSPAN. Further questions for Mr. Kohn? If not, why don't we break for coffee at this stage and come back to this.

[Coffee break]

CHAIRMAN GREENSPAN. Let me start off by making some comments about what I think is going on and what I sense are the issues that we all are concerned about. For analytical purposes and policy purposes I think it's probably well worthwhile separating, to the extent that one can, the physical aspects of the economy--more specifically, the income and product accounts analysis--against the balance sheets of the financial system. If you look strictly at the movement of income, consumption, inventories, investment and the like, it is very easy to make the case that we may in fact already have seen the weakest point in [activity]. The very sharp reduction in motor vehicle assemblies in January coupled with an acceleration of motor vehicle sales [resulted in] a fairly sharp--close to 300,000 seasonally adjusted--decline in passenger car inventories, and there is evidence of some stability in the order pattern for capital goods, if no increase. In short, just going through the sort of simple evaluation and balance problem, it's probably likely that industrial production, after falling sharply in January--well over a percent--has rebounded in the early weeks of February. In a sense, with housing starts coming back--considering the permits backlog--one can very readily see a process of very modest acceleration going on. Initial claims, which will be published tomorrow, come down under our seasonals from their sharp peak of the week before, although insured unemployment for the week ended January 13 was up, clearly reflecting the layoffs that became fairly extensive early in the month, specifically in the motor vehicles area. So, if one were to look only at those data, the sense of having come through this deterioration and perhaps seeing it at an end seems somewhat positive.

Unfortunately, running simultaneously with this is what appears to be a general, continued financial balance sheet deterioration. It started perhaps with a related sort of half financial, half physical volume type of phenomenon--profit margins--which continue to erode. And it is very difficult to make the case that unless and until profit margins bottom out and turn back up that

we will have anything resembling a semblance of business expansion. But, with prices defined in terms equivalent to profit margins increasing at a relatively stable rate excluding the energy and food explosions, what we are looking at is stable price inflation with falling profit margins, which implies that underlying unit costs are going up at a rate that is higher than the underlying inflation rate. And that suggests that we still have not yet seen any evidence of a decline in the underlying rate of inflation. On the contrary, as profit margins stabilize and rise, we're more likely to see pressure working in the other direction before we get inflation moving down. But, just as important in that whole process is clearly the overall sense of fragility, which Jerry Corrigan and John LaWare were discussing yesterday. We are getting some evidence of credit rationing in some form within the banking system, although I think a recent study--I've forgotten who did it--suggested that there's less there than usually meets the eye when one looks at processes similar to the one we see at the moment. You didn't read the study, Mike?

MR. PRELL. I'm not sure what study you're referring to.

CHAIRMAN GREENSPAN. It was one of the things that slipped through my in-box and that I read as it was going to my out-box. The general thrust of the piece--. As I recall it was not contemporaneous but was basically a study of the extent to which credit rationing tends to go on and what its effect would be. I have trouble with this business of the extent to which banks are pulling in when that's not reflected in interest rates. There's usually more talk about people not being able to get loans; and if interest rates don't reflect it, I tend to be more dubious than not. Leaving that aside, there is no question that there has been some softening in real estate values, although on the basis of a report--which I'm sure you did see, Mike, because I know you were involved in writing it--the evidence of deterioration in real estate values, certainly in the residential area, is mixed. I think it's fairly heavily localized in a number of areas. And while it may be spreading, the anecdotal evidence probably is more negative than the real world. In a sense, that's what one often sees.

But, the crucial issue that we're dealing with here is that we have an international system that is creating significant problems for us. I think there is a severe threat to the Japanese stock market; there is a general threat to the level of our interest rates here. And as a consequence of that, one concludes that while on the one hand [economic conditions] seem to be improving on the side of the income and product accounts--pretty much in line with what the Greenbook in fact is saying--the underlying risks, which are very difficult to model, clearly if anything, are getting worse and not better. How important is that relative to the other? I don't think we can readily make clear judgments on it.

In my judgment, one thing that comes out of all of this is that clearly, at this particular stage, making any significant moves in monetary policy probably would be ill advised, because to the extent that we can contribute anything to the outlook, my suspicion at the moment is that the most important thing is a sense of stability. I'm not certain, using Wayne Angell's rule, that if we were to lower rates at this particular stage that we would not find that we were creating more problems rather than less. On the other hand, I'm not

certain that I agree with Wayne's view that if we were to move rates up we could get long-term rates down. If that were guaranteed I'd be the first in line--second behind you. In any event, I think that at this stage policy is partly blocked. I don't think that we can discuss, at least publicly, some of these problems because to the extent that we communicate to the markets that our ability to lever the outlook is becoming increasingly less forceful, I think we can set off some unfortunate instabilities.

In any event, I come out at this moment in favor of no change. I have no strong views about whether or not we should stay symmetric or go to asymmetric toward ease. If we were to change over the next intermeeting period, the odds are strongly likely that we will find reasons to move down rather than up. But frankly, my expectation and suspicion is that we probably will find that the least worse policy will call for more of the same--that is unchanged, alternative B. Governor Angell.

MR. ANGELL. Mr. Chairman, I agree with your analysis. I would favor "B" symmetric. That would be my preference even though I think that a large increase in the fed funds rate would cause long bond prices to rise. I believe there are many other factors that would make it unwise to do that, not the least of which would be the impact upon the yen. It seems to me that any tightening that we did at this point would be most apt to cause the Bank of Japan to make a move. Consequently, I would see it as somewhat frivolous in regard to its benefits and would believe, with you, that stability is the best path. Even though I wouldn't admit it outside this room and even though I like to talk about other factors like energy prices and oil prices, I think the fact of the matter is that the Federal Reserve is not in a "pushing on the string" era; we are instead in an era in which we're out of rope. And somehow or other, if we are going to get water out of the well and we don't have enough rope to reach it, we don't have as much power as we would like to have. I agree with your decision but I would very strongly favor symmetry because I would like a directive that would give the members of the Committee a chance to look at the impact of any intermeeting adjustment on the M2 growth path. It seems to me that it should be somewhat more of a major step than it might be otherwise.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. I also would support alternative "B" and symmetric language.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. Yes, I agree with your analysis of the problem. That problem is, if I read your analysis correctly, that we have a real economy that looks like it perhaps has been through the worst in terms of the numbers that we're reading, and that we will get the growth that Mike and the rest of the Committee essentially forecasted yesterday. I also agree that there's fragility out there. We hear the same stories that were repeated the other day about credit rationing, and people want me to express concerns in this meeting that something is going to happen in 60 days unless the banks start lending again. [That type of comment] comes in a lot. So, I agree that there is fragility. But I don't think we can deal with that concern as

directly as we might want--or at least that's my view. I think it depends on the measures of policy that one uses. If you argue that interest rates are the measure of policy, then I think your analysis is appropriate; that could upset the wagon. If you argue that the measure is stability in monetary growth rates over time, then I think we're running the risk of upsetting the apple cart or the wagon by allowing M2 to grow 6-1/2 percent for this year. It has been averaging 4.6 percent for three years. It seems to me the midpoint of the target range was about an appropriate place to be. Now, I don't think we can get there by raising rates 150 basis points now because I'm not willing to run that risk. But it seems to me we need to indicate to the public that we want to make progress toward reducing the rate of monetary growth closer to the midpoint. So I'd be comfortable if we could make some moves in the front half of this year, maybe 50 to 75 basis points, that would produce a slower growth rate in the second half of the year. And I think the strength in the economy, if I remember your forecast correctly, is in the second half.

MR. PRELL. Well, really, the first and second halves average about the same.

MR. HOSKINS. They average the same. So, we run the same risks in terms of weakness, I suppose. But we might have a better grip, certainly, by then on the fragility issue. So, I think it really boils down to what our measure of policy is here. What do we think is driving us in terms of economic activity? I tend to come down on the side of monetary growth rates, so I would be in favor of alternative C.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. I agree with you, Mr. Chairman. Your prescription of the situation is pretty much in accord with mine. I'm starting to see, I think, positive signs in the leading-type data that show the economy may have reached its weakest point. Going forward I think we are going to see some improvement, although I also agree that the situation is fragile and that there certainly is credit rationing going on. That may grow as a problem and affect attitudes and expectations as time goes on. So, we ought to be very careful about how we position ourselves. I'm also perhaps a little more optimistic about the future on inflation than some others. I noticed that last July our forecasts for 1989 indicated increases of 5 to 5-1/2 percent on the CPI and in fact the CPI came in at 4-1/2 percent. I don't think anybody was too confused about what special factors were at work on the inflation rate at that stage. Everybody knew in July that we were getting some benefits from the exchange rate and some other things, yet we still thought inflation was going to come in at about 5-1/2 percent for 1989 and it came in significantly below that. I notice the central tendency for 1990 is now running at least 1/2 point below what we estimated it to be for 1990 back in July. I think that's improvement. Our own expectations have improved whether we really think inflation has or not. The [forecasts] show that. So, I think what has happened is that our standards have gotten tougher as we've moved along. I don't think that's bad; it's probably good. It means when things work out a little better we can stay tough and get to our goals that much quicker. I agree that the news on inflation is going to get a little worse before it gets better because of some of the short-term pressures, especially the January numbers. But I

think, or at least I hope, that the year is going to be fairly good. From my perspective, the situation calls for alternative B; I also prefer symmetric language even though there are some potential risks associated with the credit situation spreading. I think that's balanced by the slightly more positive leading data on the economy. So, that leaves me somewhere in the symmetric category.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I agree with your analysis, Mr. Chairman. I think we ought to stay where we are. I would state the case for staying where we are somewhat more strongly, I think, than you did. I think it would be counterproductive for us to change policy at this point. The forward-looking indicators do suggest that the economy is bottoming out and we've prided ourselves in staying ahead of the curve over the last year or so. And I think this is a good time to pay attention to those forward-looking indicators. On the financial fragility, I think lower rates would not help the credit rationing. What will help the credit rationing is when confidence begins to grow again about the economy and the risk of recession fades into the background. I'd also put more emphasis on the international side. To lower rates now would be counterproductive in terms of international flows and I think it would be counterproductive in terms of long-term rates. So, I feel quite strongly that we ought to stay where we are and for that reason I would like a symmetrical directive. To try to move away from a "no change" policy is a very major decision and it ought to require a full discussion of the Committee before we do it.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Well, I also favor no change in policy at this juncture, largely for the reasons that you and Ed Boehne have expressed. I don't see much of a case for any change. As far as the real economy is concerned, even if it's starting to improve, it's likely to remain sluggish for another quarter or two anyway. I am sensitive to how rapidly the money supply, M2, grows this year, but I don't have any sense of urgency that we have to start doing something about it on the basis of the projection that has been presented so far. Experience, it seems to me, has taught us that these growth rates can wander around substantially over periods as long as six months or so. So, as I said, I don't have a lot of urgency about that at the moment. I also would favor symmetric language for the reasons expressed and also because it doesn't tie our hands.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I think your analysis is right on the mark. I perceive that the economy is doing somewhat better but I think what we really need at this point is stability, not only on the domestic side but, as Ed Boehne indicated, for international reasons as well. We have made some progress on inflation and from my point of view inflation is still too high. We need to keep our eye on the goal of price stability, but I think we need to recognize that in this kind of an environment it's going to take us a long time to get there. So I would not want us to move aggressively in the other direction. I think that staying where we are is the important thing right now for the markets. So, I would favor alternative B with symmetric language.

If I can just add a footnote to a comment that was made yesterday on credit rationing: I'm hearing from a number of bankers that the credit rationing situation is being exacerbated by the regulators. Now again, this may just be the defense on their part. The regulator is translated in my District as the Comptroller of the Currency. I'm hearing this view quite a lot, and I think there's a concern among national bankers about the aggressive stance that the regulator is taking.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. "B" symmetric. Looking at things overall, I agree with your analysis. I would like to make more progress against inflation, but in terms of moving now the international problem we talked about argues against that. I am concerned about the financial fragility and do agree that a little lowering in rates isn't going to deal with that. But a little lowering in rates could have some effect on the overall economy. So, balancing these two things out, I come out with the view that we should stay just where we are, particularly with the move that we're making on the long-term side and what the Chairman is going to be announcing in the Humphrey-Hawkins testimony. I think that's consistent with just being right down the middle of no change.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I believe that we cannot change basic policy and I would favor "B," symmetric. Instinctively, I would like to have made a case for asymmetric language toward ease, but I think that our hands are completely tied by the international situation and our long-rate situation. So, I feel that that would be inappropriate and would support "B," symmetric.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. "B," also symmetric. This has all been said, but in this intermeeting period I think the chances are at least 50/50 that we will see some further increases in interest rates abroad. There is some danger that that could result in a real watershed situation either for domestic interest rates or exchange rates or both. But that really does put me squarely in the symmetric camp.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I came to the meeting with the view in terms of policy moves that we've really done quite a bit in the last 6 to 8 months, that it will take a while for all this to work through and that, therefore, this would be a very appropriate opportunity to simply stay where we are. Therefore, I'd also be in favor of alternative B and symmetric language. My hunch is, given the length of time between this meeting and the next meeting, that there will be an appropriate opportunity to have a phone call.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. I would still prefer some modest degree of easing. From where I sit or stand, I don't see that the slowdown that

we've had in either autos or housing is completely wound up and I do believe that some drop in interest rates, even modest, would help. Looking at autos first, the dealers are very reluctant to add to their inventories. One of the reasons is the cost of floor planning them. One half of 1 percent may not sound like much to us here, but it's real money to those folks. So, I think that would be significant. I think that housing is very sensitive to the level of interest rates and that the credit availability issue is especially critical--not in financing Mrs. Jones who wants to buy a condo but in financing the builders themselves. That doesn't show up in these spreads between mortgage rates and T-bills or anything else because that's not what we're measuring. We're talking about loans to contractors. So, I think that somewhat easier conditions would help both of those industries.

If we should tip the economy into a recession, Congressman Neal may still be holding hearings on the need for zero inflation but 434 other people in Congress in the House and 100 people in the Senate are going to be dragging us down there to explain why in an election year they're facing rising amounts of unemployment back in their districts. And Congressman Neal--frankly, I don't know the characteristics of his district--may even get some calls. Who knows? But I don't think there's that much at risk for this kind of move and it could help in the immediate future. On the matter of inflation, I still maintain that we are not able through monetary policy to influence all of the sources of inflationary pressure and that we had better spread the responsibility for fighting inflation over more groups, including the folks under the dome down the street. They do a lot of things that contribute to inflation and I don't see how we can offset here all the bad policy moves that come out of the Congress. It may sound macho to beat our chest and pretend we can, but I think the cost to the economy of doing this is going to be very, very severe. So, I vote for "A."

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I favor "B," symmetric. There's no expectation of an easing of rates out there now and I don't see what we gain by creating one again.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. "B," symmetric, Mr. Chairman. I really have no new thoughts to add to those that have already been suggested.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Mr. Chairman, I come out somewhere between "B" and "C," as a matter of fact, recognizing all of the concerns that have been expressed: Financial fragility--we've experienced some of that; credit rationing--we've experienced some of that, and we're still there. Granted, the players sure have changed.

MR. BLACK. Some of you are still there!

MR. KELLEY. Some of you are still there!

CHAIRMAN GREENSPAN. That booming District of yours is turning your head!

MR. BOYKIN. If our view is right--and obviously we're an outlier on the up side--that there's probably a little more strength in the economy than the consensus feeling, and given that we're not quite as optimistic on inflation as the staff is, it does place me somewhat in a dilemma. If we wait until we get confirmation of which way it's going, obviously, it's always too late. In trying to figure out what I would do in this kind of situation, I guess alternative "B," [is appropriate]. But when we start talking about the directive--and this certainly would be somewhat of a nuance--I would be inclined to go asymmetric on the side of greater restraint.

CHAIRMAN GREENSPAN. Any further comments? President Black.

MR. BLACK. Mr. Chairman, I share fully Lee Hoskins' assessment of how we ought to measure the impact of monetary policy. And that puts someone who believes that in a very difficult position because what we have to do is to pick out of the air, as it were, some borrowed reserve target that will create some federal funds rate that will enable us to predict the demand for money. I'm very skeptical of our ability to do that in the short run, and I always have trouble with this particular part of the meetings for that reason. My guess is that the caveat Don Kohn threw out is probably right and that we're probably going to get a slower rate of monetary growth with existing money market conditions than shown in "B." That's a pure guess. But for that reason I would stick with "B" because I think the rate of growth we may get on M2 may be closer to that shown for "C."

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. "B," symmetric.

CHAIRMAN GREENSPAN. I think we have a significant majority for "B," symmetric. The Secretary will read an operational paragraph encompassing that and I will entertain a motion.

MR. BERNARD. "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from December through March at annual rates of about 7 and 3-1/2 percent respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rates persistently outside a range of 6 to 10 percent."

CHAIRMAN GREENSPAN. Would somebody like to move that?

MR. LAWARE. Move it.



CHAIRMAN GREENSPAN. Who seconds?

MR. JOHNSON. Second.

CHAIRMAN GREENSPAN. Would the Secretary call the roll?

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Boehne	Yes
President Boykin	No
President Hoskins	No
Governor Johnson	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Seger	No
President Stern	Yes

CHAIRMAN GREENSPAN. I think that completes our business for today.. Our next meeting is on March 27th.

SPEAKER(?). That's right.

MR. TRUMAN. Mr. Chairman, do you want to say a little, or maybe I can say it, about how we plan to run that meeting? The task force report on System foreign currency operations is--

CHAIRMAN GREENSPAN. You're talking about March?

MR. TRUMAN. March, right.

CHAIRMAN GREENSPAN. Why don't you talk.

MR. TRUMAN. The report is due at that time and we plan to get the associated papers to you, I hope, 10 days to 2 weeks in advance of that meeting. Given your conference afterwards, we decided the best way to try to handle this would be to start at 9:00 a.m. and, especially if we finish [the Committee's regular business] at 12:00 noon, then run through the last hour and into the lunch period to discuss the task force papers that are being presented to you in that order. We figured foreign exchange goes better over tuna fish than "A," "B," and "C."

CHAIRMAN GREENSPAN. Is that satisfactory?

MR. PARRY. When is the planning meeting?

MR. TRUMAN. My understanding from talking to Ted Allison is that they are a little flexible about whether the planning meeting starts at 2:30 or 3:00 p.m. It would be whenever the discussion--

MR. JOHNSON. We're free.

MR. HOSKINS. Will the papers be distributed before?

MR. TRUMAN. Oh, yes. Actually, drafts are already in the Reserve Banks.

MR. HOSKINS. Yes, I know.

MR. TRUMAN. We will polish them up and get them out to you. They are rather thick, I fear to say, but I think actually they're relatively accessible. We tried hard to make them accessible and we will try to get them out to you in an orderly manner and have a very brief summary--a reader's guide for them.

MR. BOEHNE. Mr. Chairman, do you view this as a general intellectual discussion or do you view it as more than that--as something leading up to an action of some kind?

CHAIRMAN GREENSPAN. Well, it depends very concretely on the nature of the discussion. I don't have any particular action in mind. I think that what we are doing is probably about the best we can do considering the nature of the circumstances. But I certainly think it requires a general review. If there are other alternatives that the Committee decides it might want to consider, they can be put on the table.

MR. HOSKINS. I think the answer to Ed's question depends on what is in or not in the papers.

CHAIRMAN GREENSPAN. Are there 11 or 12 papers, Ted?

MR. TRUMAN. If I'm not mistaken, there are 11.

MR. CROSS. Eleven papers so far.

MR. KEEHN. By doing it at lunch, is it clear that it's not a part of the Committee meeting?

CHAIRMAN GREENSPAN. No, it is part.

MR. TRUMAN. It is part of the Committee meeting.

MR. KEEHN. It is part of the Committee meeting but at lunch.

MR. TRUMAN. Well, from whenever you finish the main part of your meeting.

CHAIRMAN GREENSPAN. No, the meeting will stay in session through lunch.

MR. ANGELL. But it's not a recorded vote.

CHAIRMAN GREENSPAN. Not unless the Committee rules otherwise. Anything else? If not, let's adjourn. We are earlier than I expected and sandwiches will not be here for another 35 minutes, so we're all on our own.

END OF MEETING