

Meeting of the Federal Open Market Committee

July 2-3, 1991

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, July 2, 1991, at 2:30 p.m. and was continued on Wednesday, July 3, 1991, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Black
Mr. Forrestal
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Mullins
Mr. Parry

Messrs. Guffey, Hoskins, Melzer, and Syron, Alternate
Members of the Federal Open Market Committee

Messrs. Boehne, McTeer, and Stern, Presidents of the
Federal Reserve Banks of Philadelphia, Dallas,
and Minneapolis, respectively

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

Messrs. Beebe, Broaddus, R. Davis, Lindsey,
Promisel, Scheld, Siegman, Slifman, and
Ms. Tschinkel, Associate Economists

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

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Ms. Danker¹ and Mr. Brady,¹ Section Chiefs, Division of Monetary Affairs, Board of Governors
Mr. Oliner,¹ Senior Economist, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. J. Davis, T. Davis, Ms. Lovett, Messrs. Lang, Rolnick, and Rosenblum, Senior Vice Presidents, Federal Reserve Banks of Cleveland, Kansas City, New York, Philadelphia, Minneapolis, and Dallas, respectively

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

Messrs. Guentner and Thornton, Assistant Vice Presidents, Federal Reserve Banks of New York and St. Louis

1. 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
July 2-3, 1991

July 2, 1991--Afternoon Session

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

CHAIRMAN GREENSPAN. Questions for Sam? Lee.

MR. HOSKINS. Sam, what is our outstanding foreign currency exposure now relative to the limit?

MR. CROSS. We hold \$20.9 billion against a limit of \$25 billion.

MR. PARRY. Sam, has the market become aware of that swap?

MR. CROSS. The market has not become aware of exactly what has taken place. The market did notice, as I mentioned in my comments, that the Bundesbank was selling Treasury securities, which they needed to do in order to position themselves for this. And the market has seen the Treasury's balance sheet, released yesterday, which shows the change in certain of the accounts. But unless something has happened in the course of the day, they are still a little uncertain as to exactly what that means. There are some who are interpreting these moves as positioning for large-scale intervention either by the Federal Reserve or the Treasury or in the sale of the Treasury securities by the Bundesbank. So, they've seen some of the data and I think they will get a clearer view of this when the Bundesbank announces its balance sheet figures, which are supposed to come out Thursday but may come out on Friday.

MR. TRUMAN. They told us this morning close of business tomorrow.

MR. CROSS. It may be Wednesday or Friday. They're now talking close of business Wednesday. So, there will be a statement, which will not mention the United States, but will talk about an exchange of these reserve assets for dollars. I imagine people will be able to put two and two together at that point.

MR. PARRY. And you think an interpretation would be that this is just something routine or--?

MR. CROSS. Well, I think when they see everything that has happened, they will begin to understand just what it was. Up until now they've been wondering whether it was a gathering war chest for [intervention].

MR. TRUMAN. Our understanding is that when the Bundesbank releases its statement at the close of business on Wednesday, they will say that their gross assets and liabilities have been reduced because of an exchange with a foreign monetary authority. When the statement of the System comes out, given that hint, the market will then presumably be able to put it together as to what monetary authority is involved. We and the Treasury have worked out--

MR. CROSS. We've given the Treasury a statement.

MR. TRUMAN. --a general statement just saying: "Yes, the U.S. and German authorities have agreed to reduce their holdings, have been working on this for some time, and have come to a mutually agreed off-market transaction."

MR. CROSS. So, by Friday when the Federal Reserve balance sheets come out, they will have all the information.

MR. TRUMAN. It's not intended to provide information on the whole [agreement involving] 10 billion [DM] but essentially what has at that point impacted on the balance sheet.

CHAIRMAN GREENSPAN. Sam, when do we release our monthly reserves consolidated?

MR. CROSS. That comes out--

MR. TRUMAN. Well, that would be much later. The System's monthly statement is only published in the Federal Reserve Bulletin.

CHAIRMAN GREENSPAN. No, I think it's released in the press release with the Bulletin.

MR. TRUMAN. U.S. reserves are released about two weeks after the end of each month. But that combines the valuation adjustments of all kinds of other things, so it's not--

CHAIRMAN GREENSPAN. These are big enough numbers.

MR. TRUMAN. Well, in mid-July that will show what is on the balance sheets as of the end of June.

CHAIRMAN GREENSPAN. It will show the Treasury [balance sheet] as well; that's the thing.

MR. CROSS. It shows both.

CHAIRMAN GREENSPAN. It shows the Treasury, the ESF--

MR. TRUMAN. The United States foreign exchange reserves, including Federal Reserve holdings, are shown valued at market.

CHAIRMAN GREENSPAN. Lee.

MR. HOSKINS. Sam, it seems to me that there might be some merit in having the Committee consider formally lowering the limit for a couple of reasons. One, it's symmetric; it shows that we can put a reference point back around this Committee discussion of when we want to take a look at the portfolio. That is, we have to move them down [given that] we move them up. Second, we can face some discussions in the market that we're simply reloading--that we did a swap and we're reloading to go after protecting [our] currency again--and I think that would dispel that. Lastly, I think it's the right thing for us to do both in terms of the currency holdings as well as the warehousing arrangement; since the warehousing arrangement is \$4-1/2 billion and the limit is \$10 billion, it's not a real limit. I don't think that cuts down our flexibility. It seems to me that it indicates to a lot of other players--Congress, other central banks,

and the markets--what our intentions are with respect to the currency. And if there is a reason that the Committee has to move, then we can take a look at the limit; and if we run up against it, then presumably we'll have a good reason for moving it. But it gives a point of reference and framework for discussing where we want these activities to take place and the magnitude and why we're doing them. But if we leave the limits where they are, we're working in an asymmetric way. We only bump the limit when we hit it and we never lower it.

MR. CROSS. Well, we do, of course, look at these limits every year. We can certainly examine it to see whether the present limits are appropriate. The fact that it has come down from \$24 to \$21 billion is certainly a decline, but we do have to leave room in these limits because we are earning interest regularly on our holdings and we always have to consider what kind of [leeway] we need in order to allow for the interest accruals as well as for the possibility of being able to operate in the market when it's appropriate to do so.

MR. TRUMAN. President Hoskins, I think there are two other considerations. One is that the arrangement, while it reduces our position by about \$3.3 billion, pertains to a forward transaction, and only the first chunk of that has been done. So, I think there's a risk that until the full operation is completed you will confuse the market by lowering the limit in anticipation of what is in the contract but has not been put out. Secondly, as far as the warehousing is concerned, the Committee did consider that in February and the amount that has been warehoused has not yet been changed since then. Sam and I both in our conversations with the Treasury have told them that we think it's important, as this unfolds and they get the actual dollars, to reduce the warehousing and to bring that down substantially by the end of the year. So, the beginning of next year, when we have completed this operation, would seem to me the reasonable time to consider whether the Committee wants to change the limits.

CHAIRMAN GREENSPAN. Other questions for Sam? If not, would somebody like to move [approval]?

VICE CHAIRMAN CORRIGAN. I'll move it.

CHAIRMAN GREENSPAN. Is there a second?

MR. KELLEY. Second.

CHAIRMAN GREENSPAN. Without objection. Shall we go on to the Domestic Desk [report]? Joan Lovett is here, I gather; her colleague is off at some unannounced place doing unannounced things.

MS. LOVETT. Presumably having a nice time! Thank you. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Ms. Lovett?

MR. KEEHN. Joan, what is likely to come out of a refunding study, and will they [implement any change from] the third quarter out?

MS. LOVETT. They are looking at an array of options. I believe their thinking at this point is not to try to change the whole

structure, because it's a process that has worked very well, but to make some adjustments around the margin. It's possible that if they do decide to make a change, they would probably want to make that change known before we get into the August refunding and conceivably even before the next round of two- and five-year note sales.

MR. PARRY. Even after taking into account the strength of economic statistics in the month of May, were you surprised by the amount of the increase in bond yields, especially since there were some indications that financial markets were feeling a little better-- or at least it seemed that way--about inflation?

MS. LOVETT. Yes, some people feel that the move up to 8-5/8 percent or toward that level--it didn't really stay there--was reflecting an awful lot all at once. And, therefore, the yield has come back to the 8-1/2 percent trading range and it is sort of being held in that range because the views on both sides in terms of the [likely] extent of this recovery seem to be somewhat offsetting. There is a concern that even if the rate of inflation does come down, as analysts say they think it will, there are going to be sufficient pressures elsewhere in the long run that may keep that particular part of the yield curve from moving down much more. In that connection they keep looking at the yield environment in Germany and other countries and feel that it just may be a factor inhibiting any possible downward move in long rates even if inflation comes in better, as they think it will.

MR. PARRY. Are they expecting strong real demands for credit?

MS. LOVETT. Well, there have been a lot of reports about demands for credit abroad. I think right now, as far as people can see, the major source of credit demand is in the U.S. government and perhaps the state and local entities. What the corporate issuers are doing isn't being seen as an important part of the demand for credit but as restructuring their own balance sheets.

CHAIRMAN GREENSPAN. Other questions for Joan? If not, would somebody like to move to ratify the actions of the Desk since the last meeting?

VICE CHAIRMAN CORRIGAN. I'll move it.

CHAIRMAN GREENSPAN. Without objection.

VICE CHAIRMAN CORRIGAN. Mr. Chairman, could I briefly bring up another matter related to Desk activities?

CHAIRMAN GREENSPAN. By all means.

VICE CHAIRMAN CORRIGAN. The matter is a little project that we've been thinking about up in New York and I've touched base with Don Kohn on it very generally. I affectionately call it "save a tree." The concept is basically this: I've asked the two Desks to pull together a little report that is intended to remind all the Committee members of all the routine reports that the two Desks put out, ranging from daily to yearly. What we'd like to do is to send to the Committee members a paper that outlines those reports and the

frequency with which they're prepared and to raise with Committee members the question of whether they all are needed or at least whether they all are needed with the same frequency that they are currently being produced, recognizing if nothing else that screens have changed the world. I am simply mentioning this for the Committee's benefit right now. What I would plan on doing is to make this package available to Don and his people. Who knows? They may want to add some things to it! But after they have looked at it, then we'd circulate it to the Committee. It's designed so that you can get through it probably in 20 minutes or a half hour at the most and [provide] us some indication as to whether all these reports are still needed at least with the frequency with which we now produce them. As I said, it's called "save a tree," but it's also fair to say that if we can whittle away at this a little, it would save a lot of time on the part of the people who prepare these reports.

CHAIRMAN GREENSPAN. You're saying that if the results come in in the other direction--that maybe if there were howls out there--

VICE CHAIRMAN CORRIGAN. That's right. Obviously, if the results come in in the other direction--that people really find the status quo valuable--we'll maintain the status quo. We also in this paper have solicited your suggestions as to whether there are some things we're not doing that we could do. But I do think, Mr. Chairman, that it's worthwhile at least every now and then to take a look at this and make sure that all the time and effort and money that goes into preparing these things is producing the desired results.

CHAIRMAN GREENSPAN. Mike Prell and Ted Truman.

MR. PRELL. Thank you, Mr. Chairman. We've distributed a packet of charts with red lettering on it entitled "Staff Presentation to the Federal Open Market Committee." Statement--see Appendix.

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

CHAIRMAN GREENSPAN. Thank you, gentlemen. Questions for either?

MR. PARRY. Mike, the chart that you had on state and local governments was a rather dramatic chart. We're beginning to see a lot of efforts on the part of state and local governments to deal with these problems, and the dollars that we're talking about are not insignificant. For example, California very recently passed a series of laws that are going to have an impact of \$15.7 billion; and New York has a sizable one as well. Typically, we don't spend much time taking these kinds of influences into account, but are we missing something here--especially when we have new developments like this? Is there something that we should be doing to look a little more deeply as to what the potential micro impacts might be?

MR. PRELL. Well, we've been attempting to monitor this. We raised the flag long ago that there was an emerging sizable imbalance. And we have built into our forecast, certainly since the beginning of this year, a picture quite similar to what we have now of historically quite weak state and local real purchases.

MR. PARRY. There is a tax side as well.

MR. PRELL. That's right, and we've built that in too. And we've been noting for some time that a small but not totally insignificant ingredient in our expectations for consumer prices would be repeated increments to indirect business taxes. That plays a role, and, of course, even the property tax increases tend indirectly to show up in the consumer price index through the rents and owner equivalent rent figures. So, we think those are built into our disposable income projection. But this is a sector that is very hard to monitor. The data sources are poor; the numbers upon which all these estimates are based are benchmarked to shaky data after long lags. We could be blind sided. But as a Wall Street Journal article, I think of yesterday, suggested, there's a very powerful momentum here as one looks back at history. There are very strong demands for services; there are various imperatives. The prisons have to be staffed; there is a backlog of infrastructure investment that has to be attended to. So, though I think the risks here are reasonably balanced, there is an upside potential beyond our forecast as well as the possibility of some shortfall.

MR. PARRY. One of the things that is most troubling about the California situation is that basically it isn't a cyclical problem; it clearly is a problem that is structural in nature. And that's why I think the limitations on the growth of spending and to some extent also the taxes are likely to be permanent as opposed to something to deal with the short-run problems.

CHAIRMAN GREENSPAN. Lee.

MR. HOSKINS. In the same vein, I guess: Have you looked back at the Greenbook to see if, at this point in the cycle, there's a systematic error? Do we tend to underestimate the expansion? My intuitive notion is that we underestimate money growth rates, we underestimate the expansion, and we underestimate the rate of increase in inflation. Do you have any feel for that?

MR. PRELL. We have on occasion studied that. Certainly, I've warned for some time now that most forecasters tend to underestimate the amplitude of expansions; maybe the same is true of recessions. But I've been conscious of the fact that by presenting these highlights of the forecast the way I have that I have focused somewhat on the negatives because I'm trying to explain why we're expecting something well short of the norm. But I think these do stand out--for example, the state and local sector--as something unusual in a cyclical context. The restraint on federal spending, given the budget laws that have been put in place, is an innovation that may suggest a departure from the past. It stood up through the recession period; now, we will be into a recovery period; presumably that won't even give them the option that they had so readily if they had wanted to set aside the constraints. And in the construction sector, as I've illustrated, the imbalances seem to be well beyond anything in recent experience. So, I think there are some real negatives. Now, we could get surprises. We might do better in international trade than we have in the forecast; businesses may feel a greater urgency to modernize their equipment and improve productivity thereby. Maybe we can get an impulse there. If everything went well, maybe consumers would find the wherewithal to increase their spending relative to income. But, as I illustrated, barring a radical revision to the personal saving rate, we're really

in very low territory. So, I think in each of these cases there are risks on the up side and the down side; but they add up to something that suggests to us that we're going to fall short of past norms.

MR. PARRY. Using the average for the past may be a little bit of a difficulty [unintelligible]. There are [recovery periods]--I think after the '80 and '69-'70 recessions--with increases in the first year that were actually smaller than what you're forecasting. So, there are some precedents; both [of those recoveries] were moderate.

MR. PRELL. Well, there has been only one since the Korean War, I think, that had less than 6 percent growth for the first year--ruling out the abortive '80 cyclical expansion because that ended so quickly.

MR. PARRY. '69-70?

MR. PRELL. Right. So, this is a distinct outlier, which gives me some hesitation. Indeed, one of the features of the recession thus far has been a quite healthy inventory liquidation. And that is probably part of the correlation one sees between the depth of the recession and the size of the rebound. In this case we're looking for a sizable inventory swing because of how strong the liquidation has been. Yet we're saying the final demands are going to hold down this overall upswing. Obviously, none of this is certain and we recognize the risks on both sides.

MR. HOSKINS. Just to follow up, though maybe it's more a question for Don later on: How do you get this--to me, troublesome--5-1/2 percent money growth [assumption] in the Greenbook? Do you view that as a monetary stimulus? Do you view it as a neutral [factor], even though it's an increase in money growth? I'm not sure how you get your forecast. Do you start with nominal [GNP] and back out money and velocity or--

MR. PRELL. Well, I think we back out money via a velocity or money demand relationship, having derived a forecast using some interest rate assumption--in this case stability of the federal funds rate. That is the assumption made.

MR. HOSKINS. Then you'll have a very unusual velocity behavior for this recovery, because there hasn't been a recovery that has had positive velocity--at least in the last four.

MR. PRELL. There hasn't been a recovery in which interest rates came in absolutely stable in the short end either.

MR. HOSKINS. Sure.

MR. PRELL. I recognize the artificiality of this but, as Don will be exploring, I'm sure, there are special factors in the environment that condition our expectations about velocity.

MR. PARRY. Do you see faster money growth?

MR. HOSKINS. We usually have money growth for eight quarters after recovery starts that is a couple of points faster than the trend rate prior to the recession.

MR. PARRY. Right.

MR. HOSKINS. And velocity is usually negative for eight quarters on average.

MR. PARRY. Right.

MR. PRELL. I did note that one of the things that suggests to us that possibly there's less of a monetary impulse to this recovery is the fact that thus far we haven't seen much of an acceleration in money stock. If you look at real M2 in past cycles, for example, it's very clear that around the troughs and early in recoveries there typically has been very marked acceleration.

MR. KOHN. I can address this now since the subject has been raised, and I'll skip it when I get to my briefing. We see a couple of things that are different this time than in past recoveries. First, we are still predicting some further downward shifts in money demand. We've had a history over the last year of money falling short of what we'd expect, given nominal income and interest rates. Based on historical experience, we're predicting that that will continue, although at diminishing rates. So, we have some downward shifts of money demand that we haven't had in previous expansions. Secondly, we came in, as Mike just said, with a less steeply sloped downward trajectory of interest rates. I believe that a lot of the extra money we got early in an expansion before was a lagged effect of the previous stimulus coming in. And we have considerably less stimulus coming into this trough, in terms of the trajectory of the federal funds rate, other interest rates, and certainly long-term interest rates, than we've had in other expansions. Third, this is the first expansion we've ever had without Reg Q or without Reg Q being removed. Look at 1983. A huge portion of the M2 growth in the first year of that expansion was the result of MMDAs and the removal of Reg Q ceilings. So, we don't believe that deposit rates have been held below equilibrium over the last couple of years as they probably were in a Reg Q environment. We are predicting that deposit rates could edge down even further in the first couple of quarters of this expansion. That will raise opportunity costs and damp M2 demands. So, those are the three factors that we think differentiate this from previous expansion periods.

MR. HOSKINS. My point was that there is a rationale; I anticipated it, and it's a sensible argument. The problem, as we look back over 30 years of M2, is that all kinds of special factors have occurred and yet if we ran M2 at 3 percent forever we seem to get to price stability. So it troubles me because we're moving away from a trend rate that we worked very hard for four years to bring down to 4 percent, and it's causing me some concerns. All I'm saying is that there is a lot of slippage in terms of forecasting these things, and I don't put a lot of confidence in these relationships.

MR. PRELL. I think we've emphasized that the kind of money stock growth that we're anticipating over the next year and a half could not be sustained over the subsequent years and [remain

consistent with a] move toward that significantly lower inflation you're seeking. So, yes, this would have to be a transitory phenomenon; if you want to move toward price stability, [M2 growth] has to move significantly lower and, obviously, there are alternatives in the Bluebook that describe such a path.

MR. HOSKINS. Well, I want to raise one last point and that's your sacrifice ratios that are involved here. If you ran a forward-looking model with forward-looking expectations, then I think you would get a different picture.

MR. PRELL. I think in essence we've really embodied in this forecast a bit more favorable sacrifice ratio than some of our models would predict. But, indeed, we have not assumed that within this time span we're going to get an improved tradeoff coming from enhanced credibility and so on. But if moderate policies are pursued and it's clear that we are pursuing that objective wholeheartedly, then one might expect that tradeoff to improve over time.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Lee Hoskins has almost asked my question, but not quite. These scenarios really have been very helpful and the presentation was helpful, but I suppose it's always natural that somebody wants something else. And the one item that I would like to have had, of course, would have been the one that we control. That is, I'd like to have seen an alternative scenario of keeping money growth at 4 percent. What happens over '91, '92, and '93 if, instead of keeping the fed funds rate constant, we keep M2 constant at 4 percent--which would be identical to the rate it has grown over the last three years and identical to its growth rate from Q4 1990 to the present time?

MR. PRELL. Governor Angell, the alternative II strategy on page 9 of the Bluebook is an approximation; it has 4-1/2 percent M2.

MR. HOSKINS. That's the disturbing page that has the baseline for three years at 5-1/2 percent money growth.

MR. ANGELL. Okay.

MR. PRELL. As you can see, we get into the vicinity of price stability by 1995, with allowances for measurement questions and so on. We're certainly close, if we're not there.

MR. ANGELL. Yes, it really does. Thank you; I'm sorry I missed that. And the real GNP sacrifice is how much? It's not very much in the out years.

MR. PRELL. Well, the model says that roughly 1 percentage point of extra unemployment for a year gives you a 1/2 percentage point reduction in inflation, and we have not built in additional credibility effects that could improve that tradeoff as time progresses. So, it might well be that one could achieve, with the same unemployment path or a better unemployment path, as good or better price performance by the mid-1990s.

MR. ANGELL. But that path shows unemployment rates actually accelerating through the period. Does that seem surprising to you?

MR. KOHN. Well, in the staff's estimation, in order to hold down money growth and nominal GNP, you have to have higher real interest rates. And in order to get this kind of price performance by '95 you have to hold [real rates] up there and the unemployment rate has to be high. Clearly, we could have fine-tuned this to some extent to get a little more unemployment now and a little less later. I was bothered also by this accelerating path of unemployment.

MR. ANGELL. Okay.

MR. KOHN. But I think the basic point there is that without credibility effects and the sacrifice ratio somewhere in the neighborhood of 2 or a little less, you're going to have to have quite a bit of unemployment to get price stability or something approaching price stability by 1995.

MR. ANGELL. But if you were fine-tuning it, Don, then you would probably take the 6-1/2 percent 1992 unemployment rate up a bit and maybe take down the 7-1/4 percent.

MR. KOHN. Yes.

MR. PRELL. Well, there's another option. I think Don considered getting into this--and he's discussed it in the past--that there is this entry problem as you approach price stability. In a sense you're going to overshoot unless you bring that unemployment rate down fairly rapidly by around 1996. So, what one would do presumably is accommodate some faster growth out in '94 and '95 and then you would have a smoother landing as you went toward price stability. This just goes mechanically throughout without the kind of fine-tuning that one could do here.

MR. ANGELL. Yes.

MR. PRELL. So, that maybe overstates the bleakness of the employment--

MR. ANGELL. Well, thank you for doing precisely what I wanted you to do!

MR. BLACK. Except they had it a point too high!

MR. HOSKINS. Just one question on the baseline. One way to do a baseline would be to take the past growth rates. You must have something else in mind.

MR. KOHN. Well, the baseline was the extension of the staff Greenbook forecast. So, we had the 5-1/2 percent we're projecting for the next 18 months. Then we extended that through '93 with the judgmental forecast and also through '94 and '95. We didn't set out with a 5-1/2 percent rule. What we did was to set out what we thought was a policy strategy: that is, to bring the unemployment rate down gradually but to bring the inflation rate down gradually at the same time. Recognize that if you're going to continue to bring the inflation rate down, you can't have the unemployment rate at or below

the natural rate. And these money growth rates fell out of that calculation. We didn't say: "Let's do 5-1/2 percent forever and see what happens." It was an accident of the relationship of nominal GNP and interest rates.

MR. HOSKINS. Some people will judge policy change as a change in the monetary growth rate.

MR. KOHN. Right.

MR. HOSKINS. And so for them a baseline would be just a consistent growth rate; and that's obviously my problem.

MR. PRELL. Well, we tried to describe what our baseline meant because, as Don described, it was an extension of the Greenbook forecast assuming that you are going to leave some small margin of slack to bring down the unemployment rate gradually.

MR. HOSKINS. I understand that.

MR. PARRY. My recollection of our discussion of the natural rate of unemployment in March was that it was about 5 percent.

MR. PRELL. We found a range of estimates from about 5-1/2 to 6 percent, and we've determined that we would bet on something closer to the 5-1/2 percent.

MR. PARRY. But then you said you used the MPS model for taking this out. And the MPS model has what--6.2 or 6 percent?

MR. PRELL. It has been adjusted to be consistent with the judgmental assessment.

MR. PARRY. Oh, I see. So you made a judgmental assessment. Okay.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Mike, you mentioned in passing your estimation of zero inflation as 1-1/4 percent, given the measurement bias?

MR. PRELL. I was speaking loosely, but I think one could make the case that something in the 1 percent vicinity might be consistent, when you allow for the possibilities of substitution, look at quality change measurement problems, and so on. But that's [likely] to be settled when we get closer--

MR. MULLINS. Yes, I know it may be premature to talk about that, but when the time comes--

MR. PRELL. We have a study already in process.

MR. MULLINS. When the time comes, if my term isn't up yet, which is in '96, we might have a little more background work on that, I agree.

MR. BLACK. My term will be up; I sure would like to know now.

SPEAKER(?). We'll send you a postcard!

MR. PRELL. In fact, we'd be happy to distribute a paper by some staff members that was presented at the AEA meetings last December, which addresses this very question as a first cut.

CHAIRMAN GREENSPAN. Any further questions for the gentlemen? If not, who would like to start the Committee discussion?

MR. MCTEER. Texas and the Eleventh District continue to lag the national economy. In the fall that was an advantage that we had; our employment kept growing while the downturn in the national economy was occurring. That came to an end in January and February and we're now lagging on the wrong end. We had a weak May. I could see that May was our first month with expansion nationally. When we went into the recession in the fall, rising oil prices helped cushion our economy in the Southwest and now falling natural gas prices have been a problem of considerable concern. They have been low and declining for quite a while. A lot of the factors that have been cited here today as being a possible drag on the recovery nationally are factors also in the Eleventh District. I don't believe it has been mentioned today, but the perceptions have not changed out there; the credit crunch is still with us and is real. The banks are healing; they are becoming profitable and their measures are improving. But they are not lending at the moment, as far as we can tell. The decline in bank credit continues and they're getting illiquid, but the lending to small businesses has not really accelerated. And that's the impression that most of the people I talk to have.

Fiscal drag is also a reality in the Eleventh District states, particularly in Texas; we hear more and more talk of service cutbacks and layoffs and/or higher taxes. And Texas is debating the question of whether to have an income tax for the first time in a long time. But it's certain that there's going to be some sort of fiscal constraint for some time to come. There's a good bit of concern about defense expenditures--defense cutbacks and base closings. We had five bases on the chopping block the last couple of days and three of them were axed. That, of course, is going to occur over time but it does affect current behavior as people anticipate the loss of about 7,000 jobs in the Fort Worth area and a bit less in--

CHAIRMAN GREENSPAN. The loss of Lyndon Johnson!

MR. ANGELL. And Jim Wright!

MR. KELLEY. And Sam Rayburn!

MR. MCTEER. That's all I wanted to say.

CHAIRMAN GREENSPAN. Bob Black.

MR. BLACK. Mr. Chairman, I hate to say this because it may be a source of worry and concern for the staff, but our projection for '91 is almost exactly what you all have. So, you may want to go back and check yours! As I read the Greenbook, adjusting for the swings in the overseas earnings of oil companies, it's pretty clear that the [recession] must have hit bottom in the second quarter. That's a reasonable conclusion based on what we know about the April and May

figures and the little we know about the June figures. Whatever the final record does show, I don't think the bottom will come any later than July in view of this evidence we have of increased consumer spending and strength in residential construction. In any case, I think that the staff's 1991 projections are very plausible and that the risks of error are about equal on both sides for both real GNP and inflation.

When we get to '92, however, we differ right much. We are much more optimistic on both the growth side and on the inflation side. We're projecting about 1/2 percentage point more growth in real GNP and we're forecasting only a 3 percent rise in the CPI, which is about 3/4 of a point lower than the Greenbook and well below most other forecasts that we've seen. Now, I need to emphasize something that we have already alluded to earlier, and that is that our staff's 1992 projections are based, in accordance with our instructions, on what we would regard as an appropriate monetary policy in the next six quarters. So, what we've done is to assume that M2 will come in slightly above the midpoint of its current range this year and that the FOMC will lower the range for 1992 to 2 to 6 percent and will hold the actual growth of money within that range. This assumption of a lower target range for 1992 has a direct bearing on our projection since we believe, given the background of very favorable behavior in the money supply over the last few years, that reducing the range further would increase significantly the credibility of our anti-inflationary strategy and, consequently, would result in a more favorable division of nominal GNP between real growth and inflation--because of [how we factor in] forward-looking expectations, Lee. And without that strategy [unintelligible]. If we achieve what we think are these highly plausible results, then we think the prospects of the subsequent years after 1992 will be very bright indeed. I think we have a real opportunity here to make significant progress--the best we've had since I've been around.

CHAIRMAN GREENSPAN. The coffee is here and I neglected to take the break; I notice everyone is running for coffee, so why don't we take a short break and come back in 5 minutes?

[Coffee break]

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman.

CHAIRMAN GREENSPAN. Begin, s'il vous plait!

MR. PARRY. After a relatively strong performance during much of the national recession, more recently the Twelfth District's economy has actually weakened. Total District employment fell on a month-to-month basis in February, March, April, and May. The February and March declines were due to weaknesses only in California; but employment losses elsewhere in the District account for the April and May declines. However, I should point out that total District employment still remains 0.4 of a percent above the May 1990 level, with California the only District state to lose employment over the year. District residential property sales picked up this spring; in May, we saw the fourth consecutive month of increased sales activity and increased median home prices in California. However, it appears

as though construction activity has not rebounded yet. Boeing recently announced a major expansion of its Puget Sound area facilities. Facilities will be built or expanded at about 25 sites in the area and the construction cost is estimated at almost \$3 billion over the next two years. Most of the facilities will support production of Boeing's commercial aircraft, including the 737, the 767, and the new 777.

Turning to the national outlook, our view is not really much different from that presented in the Greenbook. In the near term, we expect the main sources of recovery to be increases in personal consumption spending and also a short-lived inventory swing. Next year consumption will continue to support GNP in our forecast and there should be something of a turnaround in business equipment spending. Like the Greenbook, we expect a decline in inflation over the next year and a half. Indeed, it seems to us that there is a fair chance that CPI inflation could be brought down in 1992 to as low as the 3 percent that Bob Black mentioned. Much of this improvement clearly reflects the existence of considerable slack in the economy. However, a good part also stems from the recent appreciation of the dollar and, therefore, may not be of a permanent nature. Thank you.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Thank you, Mr. Chairman. While the economic data that we've been receiving in the Sixth District tend to confirm that the recovery is at a turning point, if it hasn't already turned, clearly we still have some soft spots to contend with. Our contacts are reporting that there is lots of traffic in the stores and in the shopping malls but that spending has been fairly restrained to date. Where we are getting sales, they are concentrated primarily in apparel and home furnishings. Our recovery in home sales that has been going on for a while continues, and permits are up in most states of the District. We continue to have the problem that is associated with other places around the country: namely, the empty office buildings and retail spaces as well as excess capacity in manufacturing. And all of these things are tending to diminish business fixed investment. Orders and sales of apparel, household products, textiles, and packaging are increasing, which is good news. On the other hand, orders for autos, auto parts, and other consumer durables are either declining or flat. Our exports are about as they were at the time of the last FOMC meeting; that is, we're not doing as well in exports as the rest of the country, although one producer of telecommunications equipment recently reported strong gains in exports, particularly to Japan, which I thought was interesting. On the state problem that we've all been talking about, the three most populous states in the Sixth District--Florida, Georgia, and Tennessee--have now increased their estimates of budget shortfalls and they're attempting to deal with these in a variety of ways. Florida has a freeze on state employment; Tennessee tried to push through a state income tax but failed; and in Georgia there are just tightening budget constraints. The credit crunch seems to be abating somewhat, although the demand for loans is still very, very soft. One banker told me that his loan demand has picked up considerably but unfortunately none of the applicants was creditworthy! [Laughter] I don't know whether we want to count that or not. The agricultural situation has been dampened--no pun intended--by very heavy rains, which are beginning to [moderate] a bit so the farmers are now getting out into the fields.

That's the picture in the Sixth District; it's a little better than the last time we reported, although there are some soft spots, as I've indicated.

With respect to the national economy, we have some differences from the Greenbook forecast with respect both to growth and inflation. And the differences are magnified by the fourth-quarter-over-fourth-quarter comparison; they're not quite as extreme if you look at the annual averages. We have less growth in the early stages of the recovery as well as higher inflation. Both of those tend to even out and come a little closer to the Greenbook as we get further out into the forecast. Without going through all of the sectors, it seems to me that the basic difference from the Greenbook is that we're showing a slower pace of growth in the labor force than does the Board staff over the forecast horizon. This gives us less growth and amounts to a more pessimistic view on our part. What it comes down to, it seems to me, is that we're simply getting less improvement on the wage front. On that score I also don't see in our forecast very much improvement in the services sector, and that's something that perhaps we ought to be looking at a little more carefully as time goes on. What I'm more concerned about than any of that, though, is the continued fragility in the financial system. I think that's a shock that could come and kick us one of these days. It's not only the actual condition of some of the banks around the country and in my District as well but the continued publicity and pessimistic reports that are coming from the various agencies in Washington. That is having a very, very negative effect on people's attitudes toward banking and their basic confidence in the economic system. I think that's unfortunate and I hope it doesn't deteriorate to the point where it has an effect on the recovery itself.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. The District's economic growth continues to improve, with agriculture being the dominant source of that strength, but manufacturing and construction continue to show some additional improvement. In the agricultural sector, the harvest of wheat--a major agricultural product in the District--has been virtually completed. They've gone through Oklahoma, Kansas, and are now in eastern Nebraska. That wheat crop is estimated to be something like 25 percent less than last year--last year being a bumper crop. But the more important aspect is that wheat prices are at very low levels. As a matter of fact, I think they're now at the level that Wayne Angell experienced when he got out of high school 10 years ago! [Laughter] The fact of the matter is that there will be a cash flow but it's just not an outstanding crop. Part of the diminishment in the actual grain production of about 25 percent comes from less planting acreage, but also there are fairly spotty areas across the District in terms of either wet or dry [conditions] or some infestation. Beyond that in the agricultural sector, cattle prices have declined from their record levels but still remain a principal source of cash flow for the farmers.

In manufacturing, the District automobile plants, with the exception of the one in Kansas City, have been operating on a full two-shift production schedule. And that plant in Kansas City, which is a new GM plant, will be putting its second shift back on in September, suggesting that those production schedules are gearing up

to meet what they hope to be sales. Construction activity in the District also continues to improve. The building contract awards in the District in April, for example, were nearly 25 percent above year-ago levels and that was principally a result of public works projects, or infrastructure kinds of projects. However, the residential and the nonresidential contracts have shown improvement over year-ago levels, so there is some hope that those will continue and we will not have another downturn in that area. The energy sector has been a dead issue in the sense that prices are such that it just does not encourage any new exploration; indeed, they've shut down some of the small producing, stripper-type wells as a result of the current oil prices and projections of prices in the future. On the other side, natural gas prices, which the Tenth District probably is better known for--it has a greater supply of natural gas certainly than of petroleum--continue to deteriorate and as a result there's not great euphoria in that area.

On the national level, we're not greatly different from the Greenbook forecast but, like Mr. Forrestal, we have a little different pattern. For example, we do not show in the last half of 1991 as much vigor in the economy as the staff does. As best as I can determine, looking at the relative figures, the staff has a fairly sharp comeback in inventories which we do not have. On the other hand, in 1992 we're a bit stronger than they are and the averages for the next six quarters together are right on the button at about 3-3/4 percent growth through that period and in 1993.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. As far as the First District goes, I'd say that there has not been much change. It's pretty clear at this point that the District has been through its most wrenching adjustment since World War II. A lot of that, obviously, is because of the bubble that we were coming out of. Much has to do with specific problems that are not sensitive to the U.S. economy. In manufacturing, we have almost weekly announcements of layoffs; a lot of them have to do with some specific problems in our high-tech industry. In the defense sector, we have announcements of shutdowns of plants; but that has to do with Tip O'Neill not being Speaker [of the House]; they're not sensitive to macro policy. Outside of the high-tech area, the encouraging sign that we get in talking to manufacturers is that the general trend seems to be that things aren't getting any worse and about half of them seem to see things getting somewhat better. They do have a very, very cautious approach to capital spending. Generally, we don't see any problems with inventories and I'm seeing a favorable price performance from their suppliers. As far as retail sales go, consistent with what has happened in other Districts, ex-autos we have seen some significant pickup in our District. But we've had very, very warm weather and that probably is part of it. In the real estate sector, as has been mentioned in several other cases, we have serious problems remaining. Probably the best estimates are that we have about 54 million square feet of vacant space. Even if we were to get a recovery fairly soon, optimistically we would be looking at an absorption rate of 4 or 5 million, tops, of that space. So, it just looks as if we have a way to go there. That, of course, has had very, very serious effects and we're a long way from being out of the woods. In terms of our financial sector, there is a lot of discussion on talk radio about

that. I suppose the favorable aspect of it is that it doesn't seem to affect--except in a broader consumer confidence sense--people's behavior. People are not running from one bank to another; they feel quite secure with there being federal insurance. And some people are saying they've been through three institutions and they expect they'll go through a couple more before they get to another situation. We do have some feeling that a credit crunch is still going on but, again consistent with what Bob Forrestal said, loan demand for projects or enterprises one would want to finance is quite weak. In the residential sector we are seeing some pickup in housing; that has continued. That is not reflected in production yet, though, because of the overhang that we still have.

As far as the national economy goes, I have very little to add to the Greenbook forecast. I am comfortable with the forecast both in terms of its likelihood and also in thinking that it's not a bad situation to have evolve. One can't help but be struck, as was pointed out by Mike in his presentation, by the unusual nature of this recovery--the importance of inventory swings and of exports in terms of what we're looking forward to. And I think all of this means that we almost certainly have reached the bottom; but there are significant uncertainties about the upswing. Although hopefully not gratuitously, I find myself comfortable with the staff's assumption of what the baseline is because on a somewhat [capriciously] velocity-adjusted M2 basis I consider that to be about what we had built into the baseline.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Thank you, Mr. Chairman. First, with regard to the national economy, our forecast is very similar to the staff's forecast. The differences are really very much at the margin. Maybe my memory is faulty, but it's interesting that the range of the members' forecasts this time, particularly for real GNP, seems a bit narrower than I ever remember in the past. Our outlook is a little more modest than the staff forecast for both this year and next. I think, like Roger Guffey, that the main difference is in the inventory area. Although the staff forecast would suggest a somewhat smaller inventory swing this time than in the past, nonetheless, our numbers are even a bit more modest than that. I think the other differences really are very modest and our numbers line up reasonably well.

With regard to the District, there are increasing signs that we have reached stabilization and I think the prospect for renewed growth has improved quite a good deal since the last meeting. District employment was essentially unchanged in May after declining significantly in April and, as we [survey] the hiring plans for the third quarter, the employment situation looks to be getting better. As always, the auto sector is absolutely key to the District and, of course, we are in the model changeover period and there is an awful lot of uncertainty out there. But I think on balance--maybe it's because people are looking to a new model--that the attitudes are a little more positive. And we would anticipate that production schedules in the third quarter would add a full percentage point to the GNP. Even though auto inventories at retail are in good balance, nonetheless, I think the production risks continue to be on the weak side. Given the results of the 1991 model year, any way you look at it there is an awful lot of nervousness about the 1992 models, and we aren't going to know the market reaction to all this until later this

month and really into August. But the dealer attitudes are better; fewer are operating in loss positions now than was the case before and in general, as I say, the auto industry attitude is a little more positive. This is working down into the supplier sector. The steel business is a bit better than was the case at the time of the last meeting. The forecast of shipments for the year has been moved up a bit to 77-78 million tons. And the initial outlook for next year--at this point it has to be very [preliminary]--is that shipments will come in at about 80 million tons. But still, it's important to remember that these numbers are significantly lower than the 85 million tons that were shipped in 1990. In the capital goods area, an awful lot of weakness continues. Construction orders still are well below last year; the machine tool business is soft. Heavy truck sales this year are about 15 percent lower than was the case last year, which was not a very good year.

In the agricultural sector, we have a couple of interesting dichotomies. First, starting with the weather: Parts of Iowa are very wet--much too wet in fact to get into the fields; but some parts of Indiana haven't had enough rain. Nonetheless, on balance, with any reasonable luck on growing conditions it should be a good production year. The planting is about completed in the District. For some, though, I would say it was the latest planting that they've experienced in a great many years. And the latest Agriculture Department survey on planting would suggest that District corn and soybean acreage is up just a bit this year, which brings the other dichotomy forward: namely, food prices. Because of the increased acreage and significantly lower export opportunities, the carryover stocks this year are likely to be heavy, and prices are under significant [downward] pressure. Corn and soybean prices particularly are under a lot of pressure. Therefore, farm income is going to be down, and I am beginning to hear some bad news out of some parts of the agricultural sector that are a little more highly leveraged than others. We could have some more problems there.

On the inflation front, the news continues to be good and the outlook is even better. Materials prices are under a lot of [downward] pressure and competitive conditions continue to be very heavy. For some of the large manufacturers whom I talk to, the increases in their purchase prices this year are lower than last year. One very large manufacturer that I talk to from time to time says that in fact they have a lot of leverage; they have been able to achieve a decrease in the overall cost of their raw materials and other purchased products this year. So, they've accomplished a good deal. Labor contracts continue to be favorable, with fairly long contracts and good terms. But I would caution that there are at least two major contracts in the District coming up this fall that could make a difference. But, net, District conditions seem to have stabilized, albeit at a fairly low level, and people's outlooks seem to be much more positive than at the time of the last meeting.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you. If you go through the District economy sector by sector, I think you conclude that conditions are mixed. That is, you can find some sectors that are doing reasonably well and others that are not. On the other hand, if you cut it differently and ask how the second quarter looks compared to the

first, almost universally I think people would report that the second quarter looks a good deal better than the first. Some of that is undoubtedly seasonal but, even discounting for that, it is pretty obvious from the reports we get from our directors and advisory council members and so forth that the economy in the District clearly did better in the second quarter.

With regard to the national outlook, I find myself quite comfortable with the Greenbook forecast, primarily for one important reason that I think some people were getting at earlier. Presumably, the path of the economy isn't independent of the policies pursued. Following the '81-'82 recession we had a massive tax cut and expansionary monetary policy for at least some time. If memory serves me correctly, we had some of the same kind of policy mix coming out of '73-'75, and it wasn't surprising that we had a very strong expansion. I think we will get a modest expansion this time, basically because I don't think we're going to see fiscal stimulus and I'm assuming we will not see much in the way of monetary stimulus. So those things go hand-in-hand, and I think they give us the kind of path for the economy that the Greenbook suggests.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Well, my story has largely been told. I think the Philadelphia District is much in line with what is going on in most of the country. We're in the process of bottoming out but there's no lift-off yet. I would say attitudes in the business and banking community are hopeful but still cautious. Business people don't read as much into a tenth or two increase from month-to-month as do analysts. I think they tend to look more at their absolute level of output in business and they still see that business is low even though it's stabilizing. One gets the sense that a little good news would go a long way toward substantially improving confidence. I think the other side is true, too: Bad news would have a magnified effect in the pessimistic direction. But I think things have stabilized and attitudes are lagging some and will probably catch up. I can ditto pretty much what Bob Forrestal said about credit conditions and banks. I'm getting more calls than I would like from bankers who basically are saying "I told my board that at the end of the year I was taking a big write-off and I ought to have most of it behind us; now I'm coming back and going to have to put in for some more." I think the worst is over but there's still bad news coming out. And that does feed into this vulnerability issue concerning the financial sector. People are just being bombarded with it; to me it's the largest vulnerability that we have. I think you would find that credit demand is still weak. Business people will say there is a credit crunch while the bankers will say there is no credit crunch but they just need to make good loans. I think that is still there.

As far as the forecast goes, I think the staff is broadly correct in forecasting a modest upturn for all the reasons that have been given. I would see perhaps less growth in the second half of this year and more next year, simply because there are these cautious attitudes out there. Lots of business people are largely writing off '90 and '91 and looking more toward '92. But that's certainly a subtle difference, and I think the broad contours are correct.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. My forecast for nominal GNP is a little lower than the staff's for the four quarters ending in the fourth quarter of '91. Frankly, I think I would be more comfortable if I were a disinterested party looking at the Board staff's forecast than I would with my own because mine seems somewhat extreme to me in some ways. Yet I think I'm looking at the very same things that Mike Prell has looked at in terms of modifying his forecast to a less-than-exuberant recovery. But Don is certainly correct when he suggests that Reg Q is not [a factor] this time, and I think that does mean some very different things for money growth. [Several] of you have mentioned the tax and fiscal policies, and I think that has to be noted as a difference this time around. That is, quite often we get either some more liberal or faster depreciation of capital rules or investment tax credit or a reduction of capital gains tax; there's always some deal out there, and this time there is no deal out there. We have to remember that this time we're also not getting any action in the long bond as we ordinarily do. If you take either the 12 months before the recession started or take a point halfway into the recession, which would be all of 1990, long bond rates in 1991 don't move [in a way that suggests] they're going to be any different than 1990 long bond rates. So, that's quite an adverse factor for the residential real estate sector that needs recovery. Ordinarily, we find that household expenditures do seem to relate to what happens to home starts--not just appliances but crazy things like automobiles seem also to be related. I think we have a consumer out there who is also more damaged in regard to his exuberance for the future than we've seen in all of the post-World War II recoveries. I just don't think there's a lot of enthusiasm for borrowing and spending. Finally, the realization by many consumers that there is no tax deductibility on their interest charges is a factor there. So, this seems to be a consumer who is behaving differently. I know, Mike, that you have it in your numbers, too; I'm just taking it down a step more than you did, which is probably too extreme to be worth much. But that tends also to get me a little better picture in regard to the imports; that is, I think the consumer is being a little less exuberant so I do not expect the rebound in imports that the staff has in its projection.

What really worries me is that we have not had the kind of price effect that it seems to me we should have had. That is, given the money growth rates, given the slack that's in the economy, and given this recession effect, it doesn't seem to be there. Why have commodity prices failed to decline as much as they ordinarily would during recession periods? Now, it also looks as if commodity prices are not spiking upward in a recovery like they ordinarily would. So, we have a different picture in commodity prices than I've seen in a recession and, frankly, I'm very puzzled by it. At the same time that commodity prices do not show the extent of the recovery, I think it's somewhat strange that gold prices failed to move down. Given central banks' reduced willingness to own gold, or given what I see as a reluctance in the foreign central banks and others to hold as large gold stocks, given countries in southeast Asia who have changed their attitudes [toward gold], and given the Soviet Union [sales], I don't understand why gold prices do not come down. It suggests to me that there may be some what we call "crazies" out there who believe that gold is a good [inflation hedge]. And I guess I think that [inflation concern] is in the long bond.

On money growth, I do not expect 5-1/2 percent money growth with interest rates staying where they are. With interest rates staying at current levels, I expect lower money growth--more like what we've seen. So, I do not see that it takes a dramatic run-up in short-term interest rates in order to keep money growth at 4 percent. Well, that's a contrary and rather rambling indication of my being perplexed by what is going on. So, I don't have much confidence in my forecast, Mr. Chairman.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, I think the direction of the economy, as indicated by the recent news, is obviously up. And I have a good deal of confidence that indeed we are in a recovery mode and that the staff projection is a reasonable one. My concern is that the recovery doesn't abort along the way. Without being able to identify possible external shocks that might stall out the recovery, I continue to think the downside risk is significant. And I believe that it is centered in the financial system. Although the stock market continues to surprise me by its strength, I'm concerned that continued weakness in corporate profits and another spate of bad news about the banks could cause the market to retreat and the confidence of both consumers and bankers to evaporate. Without more vigorous lending by banks and the concurrent demand from both consumers and businesses, the recovery could run out of gas. I don't see the banks exhibiting rosier cheeks much before the first quarter of next year, which makes the next six months critical. And in that kind of an environment, we need to remain flexible and tactically nimble in these months ahead. Given all that, I would favor keeping the range for M2 growth just where it is. It might be a serious mistake to signal our intent to slow the growth in the aggregates before we have confirmation of the strength of the recovery.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. The economic forecast that my associates in New York have put together is not now materially or systematically different from Mike's forecast; there are some differences around the edges. In listening to the talk around the table, Mr. Chairman, I'm inclined to the view that Mr. Prell and his colleagues perhaps should qualify for a gold star either for forecasting or for courage in standing pat against the skepticism of many of us around the table for the past six months.

CHAIRMAN GREENSPAN. With an oak leaf cluster!

VICE CHAIRMAN CORRIGAN. With an oak leaf cluster! You're not there yet, Mike, but you look a heck of a lot better than we thought. I do think it's a great tribute to Mike and his colleagues that they were willing to stand pat, essentially, with their forecast when a lot of people, including myself, weren't buying it. Now, it's not in the barn as Roger Guffey would say--or the bin, I guess. I never get those two things straight, bins and barns, but--

CHAIRMAN GREENSPAN. Barn is for hogs; bin is for corn.

VICE CHAIRMAN CORRIGAN. Okay. [I had] good training; I was out in the Ninth District, too!

MR. BLACK. You left too soon!

VICE CHAIRMAN CORRIGAN. I left too soon. In terms of the anecdotal [evidence], I can say that even among the industrial sector types that I talk to, if nothing else, the decibel count is down a bit. And if you try really hard, you can even find one or two here and there that acknowledge that something looks a little better. If that's not confirmation, Mike, I don't know what is! Having said that, there still is, of course, a not-so-silent minority who remain concerned about a double-dip. And something that surprised me a little is that we actually hear a little more these days about the credit crunch than maybe we did even six months ago. That may just be some people smelling the coffee for the first time; nevertheless, certainly that was the impression I had with the fall meeting of our Small Business Advisory Council as opposed to the last two meetings when they were in. I do agree with John LaWare, Bob Forrestal, Ed Boehne, and perhaps others, who have made the point that in terms of the near-term risks, the financial fragility factor probably looms as the largest. [The financial system] is still tender. I think John's comments about some of the events at the end of last week illustrate that point. On the other hand, and for what it's worth, we've just gotten through examinations of a couple of the big banks that we examine directly and I see some evidence, at least on the basis of that small sample, that the rise in problem loans is stabilizing at a high but, in these cases, not alarming level. I'm also hearing reports from my own examiners in connection with the shared-bank credit review, Mr. Chairman, in cases where they are working jointly with the Comptroller and the FDIC--for the first time certainly that they're willing to talk to me about it and I don't know whether others are picking this up as well--about rather sharp collisions between examiners working on the same credits. The suggestion is that the other two agencies are differing sharply in some cases with my people over classifications of the very same loans.

CHAIRMAN GREENSPAN. Which direction?

VICE CHAIRMAN CORRIGAN. [Down.] I don't know what to make of that, except that I do have a fairly high degree of confidence in my own examiners. I don't know if others have picked this up or not.

MR. HOSKINS. Only one.

MR. KEEHN. Did you say that the difference is that they're rating down versus your ratings?

VICE CHAIRMAN CORRIGAN. Yes.

MR. HOSKINS. And they want a whole write-off.

VICE CHAIRMAN CORRIGAN. Much lower.

MR. KEEHN. That's what I'm hearing.

MR. SYRON. That has definitely been our experience with our large institutions.

MR. KELLEY. Yes, it surely is.

VICE CHAIRMAN CORRIGAN. The worst case I know of involved a fairly large credit, though not huge, where they even had differences in algebraic signs. My guys were saying that they thought it should have been upgraded a notch and the dispute was to downgrade it a notch. That's a big difference.

CHAIRMAN GREENSPAN. That's a huge difference.

VICE CHAIRMAN CORRIGAN. As I said, I don't know whether other people have picked this up or not but I have been told this by my own guys.

CHAIRMAN GREENSPAN. I'm picking up the first part, but I have not yet picked up different signs.

VICE CHAIRMAN CORRIGAN. Well, that was one case; I don't want to make a big deal out of this isolated case. I mentioned that just to be dramatic.

CHAIRMAN GREENSPAN. You have been!

VICE CHAIRMAN CORRIGAN. But the point is that this is unusual; this is not something that happens with great frequency. It doesn't happen often that there are material differences in judgment among teams of examiners working on the same credit at the same time. I cannot verify how widespread it is, but it's widespread enough that it has been called to my attention in a couple of individual cases by my own examiners. That's an aside; the main point is that the financial tenderness, if I could put it that way, is still very much in evidence.

Having said that, let me just add one other general point. If what I hear to be the consensus around the table is correct in that the recession is over and that at least a moderate recovery seems to be taking hold, I think it's probably fair to say that in one sense we really may have very successfully dodged the bullet because not only are we looking at what historically would be a very modest recession in all respects but a recession combined with other factors that I think have produced some of the foundations that could really help us out over the intermediate term. Now, Ted mentioned earlier the improvement in the external sector. The numbers Ted is looking at now compared to what we were looking at not too long ago really are a good deal better. There has been a lot of talk about the prospective improvement on the inflation front; not only is that improvement absolute but it's also relative. If you look at the chart on page 12 of Ted's handout, you find a very pronounced convergence in the inflation rate in the United States versus those of Germany and Japan. They're not the same but the gap has narrowed very appreciably.

CHAIRMAN GREENSPAN. We could cross Germany next year.

VICE CHAIRMAN CORRIGAN. We could.

MR. ANGELL. Well, I think we will.

VICE CHAIRMAN CORRIGAN. It's really significant in terms not just of the absolute improvement but the relative improvement. The cost containment going on throughout the economy, including in the

banking sector. I think bodes very well for the future. And notwithstanding what Governor Angell said a moment ago, I think the balance-sheet rebuilding that we're seeing in the corporate sector and the household sector, while badly needed, is not an inconsequential factor looking out over the intermediate term as well. That is another way of saying that if we don't screw it up, the outlook over the next few years is a good deal better than we might have thought.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. We're at the low end of the central tendency for the inflation outlook in '92, so we're very constructive on that score. I might add that that assumes a tighter monetary policy than I think the baseline does. I'm not sure about all these velocities and so forth.

MR. HOSKINS. They wash out over time.

MR. MELZER. Picking up on Jerry's last point and a little on what Bob Black said earlier about the uniqueness of this opportunity we have: It took four years of good policy to get here and I hope we don't screw it up, because I do think it's a very unique opportunity.

As far as current District activity goes, we have the same pattern that I've described in recent months. We're getting slight employment growth and basic weakness in manufacturing--not as much weakness as nationally--being offset by growth in nonmanufacturing. And the particular weakness in manufacturing is in transportation--McDonnell Douglas and Chrysler, with the layoffs they've had in the St. Louis area. And in nonmanufacturing, we're seeing strength in services. Somebody said earlier that they are not seeing that yet; we're seeing that and we're also seeing a pickup in construction employment. In fact, both residential and nonresidential contracts are up in the most recent period, and residential is up very sharply. That's now beginning to spill through to some other sectors of the economy. GE in Louisville has called back 1,000 employees because of what they see going on in homebuilding.

As far as banking conditions go, if you compare the numbers in the first quarter to the first quarter a year ago, it's really hard to detect that there has been any change. There's a very slight deterioration in return on equity and in nonperforming loans, but it's almost indistinguishable. So, banking conditions in the District are still very good. Despite that, and even though the banks are in a position to lend, we're seeing very moderate credit growth, which I think probably reflects a weakness in demand.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. Mr. Chairman, I wanted to come here today also and congratulate Mike by confirming that the recovery started in the quarter in which he called it. However, I was not able to get hold of Mr. Smuckers to get my apple butter index and come down here and report. And that's unfortunate; that index is really reliable.

MR. TRUMAN. Mike had two quarters!

MR. HOSKINS. The District isn't showing anything much different from what anybody else's District seems to be showing, at least from what I've heard here. In the state of Ohio employment in May is up one percent over what it was a year ago; in Pennsylvania it is down a percent and a half or so. All the anecdotal information suggests that we've touched bottom and will be beginning to head up soon. The employment numbers in Ohio would tend to indicate that. The capital goods people are all nervous. The order books aren't dropping or anything like that, but they don't see any sign of a pickup in the third quarter, with the exception of large trucks; there has been a pretty good surge in that.

CHAIRMAN GREENSPAN. I'm sorry. There's what?

MR. HOSKINS. A surge in the last couple of months in the order books for large trucks. The one thing I hear uniformly from talking to people is their comfort with the inventory levels. There was not one person we talked to who thought they didn't have their hands right around inventory; inventories were very low and right where they wanted them. That's the only consistent [comment] I got across the District in talking to manufacturing people.

In terms of the outlook for the national economy, again, we're not too much different from the Greenbook. We just have different monetary assumptions than they do. I guess I'm a little troubled by our concerns over all the risks that are out there. We have to be cognizant of risk but I think everything we know about the empiricism of macroeconomics, as well as macroeconomic theory in the last 20 years or so, tells us that we probably can't control most of those things very well. And trying to offset them with monetary policy is not going to help us a lot, whether it's unemployment caused by defense changes or troubles in the real estate industry. So, it seems to me that we ought to keep our eye on what we can control over time. If we want to get long rates down and get some credibility, then we ought to take a tack that focuses on inflation. Now, if 4 percent money growth isn't going to get us there, then I think we ought to go lower. Governor Angell is concerned that we haven't gotten far enough; maybe that's because the relationship is disturbed. The objective is not money growth; the objective is price stability. So, I think that's where our focus ought to be.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I'm a good deal more comfortable than I was when we last met here in May. At that time we hoped that we had a recovery at hand and now it's virtually certain it is at hand and probably in hand. I find myself with a forecast for the remainder of '91 that's on the high end of the [members'] range. It's strong inventory that does that. But that having been said, I'm in the camp for '92 of still having some considerable concerns. My forecast produces what I consider to be a good [result]; it's a bit under those of some people, but I'm concerned that the economy could well be tender for a good while for several reasons. The first is the fragility in the banking system; that has been brought up by several people and I think everybody here is fully aware that it exists. I think that's going to be here and it presents continuing risks, as John LaWare points out consistently.

The second thing that concerns me is the heavy load of debt that has been built up over the '80s at all levels of the economy. I think that's going to be a drag for some time. In my view, we've crossed the watershed between the basic orientation to create debt and are changing over now to an era where it seems to me the orientation is more to service debt and try to bring it down. That's going to take an extended period of time to accomplish and that's going to be a certain underlying drag all the time that it's at work.

The third concern would be in the area of this inventory cycle. As I understand it, it seems to be a substantially heavier component of the overall recovery that we're looking for this time around. And after a little while--a couple of quarters or maybe three--that's going to run its course. Then there are going to have to be some other sectors to pick up that slack when that ceases to be an expansionary factor. And it's a little hard for me to see where that slack is going to get picked up. Net exports don't look as if they're going to be any help; real estate generally and commercial construction in particular are going to be very weak for an ongoing period; government certainly doesn't look as if it's going to provide any stimulation--and I certainly hope it doesn't. There may well be some help from consumers, but I have some question in my mind about that. Some of these other things may turn out to be just a little better. I'm well aware of Lee Hoskins' remark earlier today that things always seem to be a little better than we estimate, and I hope that that turns out to be the case here again. But I think we're in for a tender period, at least through the next year. So, that leaves me thinking that our policy challenges are, on the one hand, to do what we can do to sustain the economy--not hype it up but sustain it--and to try to see that it has a chance to broaden as it goes along. Clearly, at the same time, we have to get in hand and then maintain and hold this much improved inflation outlook that I think we all see. But for the time being this is a time to wait a while and see what sorts of things begin to unfold over the next quarter or two.

CHAIRMAN GREENSPAN. Finally, Governor Mullins.

MR. MULLINS. Most of my stuff has been stolen by now by other people! Some of my views are pretty consistent with Mike Kelley's. It's very difficult to predict the turning point, and there are plenty of moderating influences out there, which we have talked about many times. Some are starting to come to a resolution. In the state and local governments and pretty soon in most of these venues we will see the shape of the resolution. The dollar continues to be strong. The Greenbook now projects only a modest retreat and many people have referred to Joan Lovett's list of the new recent flare-ups on the financial fragility front. I would just mention, in reference to Jerry Corrigan's comment that some of these recent episodes in the examinations may raise again the specter of the credit crunch, that there was an article today on the screen, and it may have been in The Wall Street Journal, on the difficulty homebuilders are having getting credit. The National Association of Homebuilders was saying that it's going to be a terrible year. I might point out that their estimate for housing starts is only a little higher than the Greenbook estimate. So, actually, we're not being too optimistic. I think it's fair to say. The Greenbook story has slimmed down and now it's mostly inventories driving the process. I think the cessation of inventory liquidation should give us a healthy boost for a couple of quarters.

It's less clear to me how much accumulation we can project--whether businesses will really want to replace the \$80 billion they liquidated. Inventories have been a bit illusive, although it's good to hear that people think they have them under control; we should get some help there. After that, like Mike Kelley, I don't see a lot to propel the economy. The Greenbook simply falls back to moderate growth in consumer expenditures and acceleration in business-fixed investment in '92, and I wouldn't have a great argument with that. That should be enough to sustain the recovery. I do think there is some risk that after the inventory effects wear off in the next quarter or two we could return to the slow growth we had in '89 and the first part of '90, leaving us vulnerable to shocks and recession.

There is the question of the adequacy of money growth to sustain the recovery. For the last four years we have undershot the midpoint of the target range. And I feel confident we're on that track this year as well. It's not clear to me in which direction the next appropriate move will be. I think the dollar has already gotten a head start on the tightening, as Ted Truman alluded to--although perhaps not quite in that way. I do agree that we stand on the threshold, potentially, of very substantial progress in reducing the core inflation rate and it's a position that has taken this Committee quite a few years to achieve. The potential progress seems to be large by historical standards, so I think it is important that we do what is necessary to try to put that in the bank.

I think we're in pretty good shape overall. It is true that the long bond may not be convinced; again, to say it reflects concerns about inflation raises questions of why the dollar has responded [differently]. I need more lessons in chart reading because the CRB index looks like it did fall off some, although gold is another issue. And there may well have been an increase in the real rate due to the demands in eastern Europe. But my view is that it will take more than just a couple of months of this to convince those taking a 30-year risk. And if the inflation numbers behave as we've projected them as the recovery progresses, I think they will want to see what happens after it starts. And I think the long bond will come around.

CHAIRMAN GREENSPAN. Thank you, everybody. I think we've run pretty much to the end today. We will adjourn until 9:00 a.m. tomorrow morning. Are we going to lock up here?

MR. BERNARD. We usually do, yes.

CHAIRMAN GREENSPAN. Anyone who wants to leave his materials here may feel free to do so.

[Meeting recessed]

July 3, 1991--Morning Session

CHAIRMAN GREENSPAN. Mr. Kohn.

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

CHAIRMAN GREENSPAN. Questions for Don?

MR. HOSKINS. I sort of asked you all these questions yesterday, Don, so let me try it differently this time. The Bluebook and the alternatives that you present for the Committee give us the impression that we can shape the contours of output in the short run without giving up disinflationary efforts. What I want to know is: What is your comfort level with these kinds of projections based on the models that you use? They're not forward-looking particularly, and our experience with them leaves me uncomfortable.

MR. KOHN. Obviously, there's a wide band of error around any of these projections. Mike would be the first to admit that.

MR. PRELL. Or second! [Laughter]

MR. KOHN. We're obviously giving you our best guess based on experience, model results, etc. We are coming at this from the trough of a recession in which we do have some slack in resource utilization, which gives us some encouragement that we can both reduce that slack, keeping the unemployment rate above the natural rate of unemployment, and get some progress on inflation. It is a middle road. It's a new version of a soft landing in some sense and perhaps the ideal outcome. Obviously, there's a lot of room for slippage on either side. And the issue for you, I guess, is whether you want to aim at that or aim at something else. The other piece of slippage, of course, is between money and the objectives. Not only is there uncertainty about the underlying forces in the economy but there is a lot of uncertainty about what money growth paths one would choose in order to hit some agreed on set of objectives. So, that compounds it.

MR. PRELL. President Hoskins, if Don hadn't just made that remark, I think I would have myself. My sense is that we have as much confidence in predicting what inflation will be over the next couple of years looking at the real GNP and unemployment picture as we would looking at money and guessing at velocity and the links through all these channels to prices. So, there is a significant uncertainty here about what you should be focusing on to have the greatest confidence--

MR. HOSKINS. Let me just follow up. Would you make that same statement if we were talking about money growth over a 5- or 10-year period?

MR. PRELL. I might.

MR. HOSKINS. But you wouldn't be comfortable?

MR. PRELL. Obviously, this unemployment/inflation link is a short-run relationship, so it may not be relevant over the longer span. But with financial innovation, I'm not sure what the meaning of M2 will be five years from now. So, in today's world I'd be reluctant

to set out in advance a particular course and say "I want to stick to that and I can be highly confident what the price trend would be."

MR. KOHN. If I may take the liberty of retranslating your question: Our forecasts are based on a path for nominal interest rates and they relate that to spending and through that to output, employment, and inflation; and another way of putting your question is whether over 5 or 10 years I would have as much or a little more faith in a money/nominal GNP relation than I would in a nominal interest rate/GNP relation. I think as we practice policy we end up looking at both of those and at a number of collateral pieces of information to try to interpret the interest and exchange rates--with money being an important piece of collateral information. But we'd be hard pressed to put entire reliance on one or another set of these things.

MR. HOSKINS. I just had one other question, not on that subject. At one point we widened the bands on M2 and the [other] aggregates because we thought there was significant volatility. As I look at the numbers over the last four years, we've been within a 1/2 point or so of the midpoint of the range on a fourth-quarter-over-fourth-quarter basis. So, it seems to me that maybe we don't have the same degree of uncertainty about where we're going to come out. I guess I'm asking you: Would you be comfortable with a narrower range, given our experience of the past?

MR. KOHN. No, I guess I wouldn't. I think the widening of the ranges reflected two things. One is the increased interest elasticity of M2. So, working as we do with interest rates and nominal GNP, and feeding that back through M2, a mistake on the interest rate/nominal GNP spending side means that the Committee would tend to push interest rates higher or lower and, because M2 is more interest sensitive now than it used to be over short periods of time, we can get quite a substantial response in M2 to get the same nominal GNP with the same inflation outcome in the short run, cyclically. The other point would be that, if anything, I'm a little more uncertain about the relationship of M2 to nominal GNP now than I was two or three years ago when I thought we had a very good handle on it--at least it looked like--over four [to] six quarters. Now I'm less sure. So, the fact that we came out near the midpoint of the ranges the last few years is almost a coincidence, involving offsetting surprises to some extent. I know, for example, that last year, 1990, we expected money growth--and I think the Committee didn't disagree with this--near the upper part of the range by the end of the year. And it fell way off. So, I think there's at least as much uncertainty about those relationships now as there was when the Committee widened its ranges.

MR. PARRY. Don, a very key assumption in the alternatives is what happens to the shift in the demand for money. Clearly, we had a substantial shift in 1990 and we're making some assumptions about further shifts. If one were to see a return to more normal relationships, then clearly we'd have a much different outcome with regard to what the target ranges should be. Is there some additional information you could give us about the degree of confidence associated with those particular assumptions?

MR. KOHN. I think I just expressed my uncertainty to President Hoskins. I'm not sure I could emphasize it any more. We see that miss being related in part to the unusual developments in the

depository sector over the last year: the shrinkage of the thrift industry and the simultaneous problems of the banks and the effects they are having on both depositors and depositories. Since we're projecting an expansion in the economy and a slow abatement of the credit crunch--and that these pressures on the depositories and the thrift adjustment, while continuing, won't be accelerating anyhow--we're projecting that in growth rate terms M2 and GNP will come back closer into their historical alignment over time. But it is purely a projection that comes out of this notion of the abatement of some of these severe pressures with the economic expansion. But there is just a huge amount of uncertainty about that. It is the case that relative to the models the errors in the first half of this year were a little less than they were last year, and that by either extraordinary skill or pure dumb luck we actually projected the model error at the beginning of this year. The model error we got for the first half of the year is pretty close to what we expected.

MR. PARRY. I guess I'd make a comment. Those alternative strategies to me seem very useful, but in going to the alternatives that you then show it's useful also to think that one could justify perhaps following one strategy in the next year or so, given the uncertainty associated with that period, and still go to perhaps an even more aggressive strategy in subsequent years to achieve--

MR. KOHN. We tried to hint at that in strategy IV, in which we were sort of having fun fine-tuning this. We said: "Well, suppose the Committee put a little more money in now. How fast would they have to take it out so that at least they didn't get off the track of strategy I?" But, obviously, there are lots of permutations and combinations.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. My question is really along the same line. I'm trying to understand the process in these alternative strategies a little better than I do. Where does this 5-1/2 percent money growth in the baseline, especially in the out years, come from?

MR. KOHN. We start with the presumption of a strategy for policy involving slow deceleration of inflation, holding the unemployment rate around 6 percent. We ask what nominal GNP and interest rates would be consistent with that and the M2 fell out of that. We did not set out to design a rule for money growth. You couldn't hold--

MR. STERN. You specify the economic characteristics and then you back into the money path?

MR. KOHN. Exactly. And we recognize in the P* simulations--they are sort of footnotes here--the notion that you couldn't hold to 5-1/2 percent forever and get decelerating inflation. It's too fast.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Don, not to put too fine a point on it--and I think you probably already answered the question--but on this key issue of the relationship between the Ms and nominal GNP: In footnote 5, where you say you assume further downward shifts, would it be fair

to say that that's a separate assumption and that you could just as easily have less downward shift as more downward shift? That has some implication for how much room we'd need if the downward shifts were not [abating].

MR. KOHN. It's our best guess and I agree with you that we could have some more. If you thought that the shrinkage of the depository institutions system was just beginning, by asking for more capital, closing all these thrifts, we would really be rerouting credit away from these institutions. The new banking bill will put depositors, at least uninsured depositors, at risk if it passes and I think accelerate that process. If anything, one could easily make a case for asking what they are going to do with all those M2 [funds]. They won't need them; they won't have any loans to make and we will have greater downward shifts in the out years. I think one could also make a case, which is sort of embodied in the P* model, that we've had a constant velocity since World War II on average. Actually one can go back earlier, I guess--is that right, Mr. Chairman?--to World War I and we've had constant M2 velocities since then. And what the staff is assuming here is that V* is changing; that is in effect what we're doing here. We have permanent velocity shifts, which is fighting an awful lot of history. So, I can make arguments, as I just did, on both sides of that.

MR. PARRY. Well, one nice thing is that, given the preliminary nature of these deliberations, we will have six months more to observe what is happening to velocity relative to what one would expect before [we set the final ranges in] February.

MR. KOHN. Well, in fact, the 5 percent growth for the year 1991--5-1/2 percent over the two quarters of the second half of the year on average--really has very little further downward shift relative to our standard demand model. So, it will be interesting to see whether that happens.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Don, on page 9 [in the Bluebook] on the baseline you have real M2 growing from 1 percent in 1991 to 2, 2-1/4, 2-1/2, and 2-3/4 percent [in the subsequent years through 1995]. Why does real M2 grow--now, maybe real M2 is not something you think works--and yet under alternative II, the tighter [scenario], you have real M2 growing on a much slower course, from 1 percent to 1-1/4, 1-3/4, 2-1/2 and then to 3-1/4 percent? Why does real M2 behave so differently under those two scenarios?

MR. KOHN. Okay, I'm not sure I see the 3-1/4 percent; I see 2-1/2 percent.

MR. ANGELL. Well, in 1995 you have the price level at 1-1/4 percent.

MR. KOHN. Oh, I see. I'm sorry; you're right. I think the point is that you tighten up a lot earlier in strategy II and then in order to keep the unemployment rate from rising, at some point you have to ease off a bit and push in a little real M2 or you're going to have even faster increases in the unemployment rate out there. The other point is that with the slower growth--this probably accounts for

even more of it--and the lower inflation of strategy II, the tighter strategy, nominal interest rates are moving down pretty substantially by the end of the period, almost a percentage point below the baseline. Baseline nominal interest rates also begin to move down in '94 and '95 as inflation abates, to keep the real rates from rising too much. They move down even faster in the slower money growth strategy because inflation is coming off even more. As those nominal rates move down, you get increased demands for money in the usual velocity sense of lower velocity. And if you didn't push in more M2, you wouldn't get the decline in nominal rates; things would explode in a tightening way. So, you need more M2 in the out years in order to satisfy demands for money compelled by lower interest rates.

MR. ANGELL. Under both scenarios?

MR. KOHN. Right, but even more under the tight scenario in the late years because inflation is coming down more and nominal interest rates come down more. For nominal interest rates, although they go up in the tight scenario right away and stay higher, the decline is a full 2 percentage points from '92 through '95. In the baseline scenario, the decline is about 3/4 of a percentage point.

MR. ANGELL. But if that's the case--if you have real M2 under both alternative I and alternative II at 2-1/2 percent in 1994 and then in 1995 you have 3-1/4 percent [under alternative II]--I would think the unemployment rate would fall more rapidly in 1995 under alternative II than it would under alternative I.

MR. KOHN. Well, the answer is in this interest rate effect--that is, the effect of money once you take account of the demands for money associated with lower interest rates. It isn't that much; the growth doesn't accelerate that way under the tighter alternative; you get some additional [growth], but not as much as [under the easier one.]

MR. ANGELL. Okay, that's fine. I don't think you're disagreeing with what I'm saying: that there would tend to be toward the latter part of this period some possible gains from unemployment, depending upon credibility. That might actually bring the unemployment rate below alternative I.

MR. KOHN. Below alternative I? Below 6 percent? That would be a lot of credibility! But it's moving in that direction.

MR. ANGELL. With the same inflation rate?

MR. KOHN. Anything is possible, Governor Angell.

CHAIRMAN GREENSPAN. Any other questions for Don? If not, let me get started. I was looking over the data the last few days and the more I look at the data--despite all the flowers that we are getting and all the showering with praise that David Mullins has gotten recently up on the Hill--policy has really been quite successful, especially on the money supply side. That is, by whatever means, we have managed to bring money supply growth down in a gradualist, successive, cumulative way to a point where we are now back to growth rates of the 1950s. And we have done it by bringing down the targets slowly; actually, one time we left them unchanged,

but otherwise we continued to move them down in small increments. I think we especially ought to be quite pleased that we've come through a recession--hopefully, this is the end of it--without engendering double-digit money supply growth. And that is an accomplishment that I don't think is to be pushed aside very readily. When you look at the data in the context of the P* model, which is as good a reduced-form means of looking at money and inflation [as any], we still have a way to go on the down side with respect to [controlling] inflation--that is, under the existing regime. I don't think we can hold the last three months' figures, which are under 3 percent; but it may well be that we will be surprised at what is actually in the process of emerging at this stage because it's hard to make the case for anything above a 3-1/2 percent inflation rate with these types of data. In fact, assuming constant velocity, at the 4-1/2 percent midpoint or slightly less, actual [M2] growth is consistent--or pretty close--to price stability, if we believe that there is an upward drift [in the price measures]. Or I should say that the price [measures] do not fully capture the quality drift and, as a consequence, overestimate the inflationary pressures.

I do think the credibility question that we're looking at has to be a function of where both money and prices are. I cannot see how anyone could claim that we have been expansionary with money, even though we have not yet seen prices fall to the level that [is commensurate with what the decline in money growth] suggests. It's hard to know how to read the long-term bond rate, as to whether there really are inflation expectations in there, or the behavior of the exchange rates, which suggests that it's more real than we realize. I don't think there's any question that the 5-1/2 percent M2 growth rate that is implicit in the baseline model is too high over the long run. That [rate of growth] is not consistent with the level of price stability that the vast majority of us are looking at. And there's no question that at some point within the next year or two we're going to have to bring down our targets by a notch, maybe two. But we're not all that close from where we want to be over the long run if we believe that the long-term velocity [of M2] is stable. As a consequence of that, I raise the question: If over the long run we're going to be required to bring down the target rates, is this July 1991 meeting the time to do it for the year 1992? My answer to that at this particular stage is "no." We have a credit crunch; we have fragility; we have all sorts of problems that have not worked their way out. And I should think at this particular stage that we could do very well by staying where we are. I fully recognize, and I agree with Bob Parry on the point that the credit crunch may disappear. By next February, the outlook may be significantly different; the fragility may be behind us; and we'll have another shot at [the ranges for] '92 in February. In fact, I had Don put together for me a list of the times we've changed the July provisional targets in February, and one way or another we've done that more than half the time.

So, I would argue at this particular stage, with fiscal policy clearly shackled and likely to remain shackled for a while, that the spotlight is on us in a way that I don't think we've seen for a while. And I see, frankly, very little benefit to moving now on lowering the targets, although I think it's essential that we not stop here. I think we have made extraordinary progress in bringing inflationary pressures down. We have gone through the recession without blowing it. And with the current targets I think we have the

capability of continuing to cement a continued disinflationary process. I'm not sure there's anything to be gained in the short run in signaling a tightening for '92 this far in advance. I don't think we need it. All that will do is to galvanize some anti-Fed actions which, since the banking bill is still open and under negotiation, can create an inadvertent problem for us because amendments on the floor of the House and the Senate can be particularly ill-informed and still pass. I should think at this particular stage that we probably would be well advised to sit tight with '91 and '92, but plan to look at it again in our next review of the '92 targets. If things have improved measurably and we have a shot at it, we probably should think strongly about reducing the ranges a notch at that [time]. But if we wait a year or if we wait a year and a half, I don't think that does us any damage so long as money growth doesn't start to move outside the target ranges and we are perceived to be willing to accept a lot more in the way of monetary and credit growth than we have demonstrated these last several years. Bob.

MR. PARRY. Well, Mr. Chairman, according to our projections as well as those in the Bluebook, it is likely that M2 and M3 will end up well within the range this year unless the outcome for economic activity and inflation [differs markedly from our expectations]. Thus, maybe we should retain the ranges that we currently have for this year. For 1992, I can see compelling reasons in support of either retaining this year's ranges or lowering at least M2's range by 1/2 percentage point. In support of lowering the ranges, price stability over time does require further reductions in the range of M2, as you noted. Also, a reduction could send a clearer message to financial markets concerning our goal for reducing the ranges and it could have salutary effects on inflation expectations. On the other hand, a reasonable outcome for the economy next year, including further progress against inflation, seems to require an M2 growth above the midpoint of this year's range. Moreover, there is considerable uncertainty, as we've talked about this morning, about the trend of velocity over the next 18 months. It could return to slower growth rates more quickly than is being assumed in our forecast. Finally, staying with the same range for M2 for two years was agreed to in 1989 and also in 1990, without I believe sacrificing the pursuit of price [stability]. I believe in view of the preliminary nature of our July deliberations for 1992 I would favor alternative II, which basically repeats the same ranges for next year as we have for the current year.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. As you know, Mr. Chairman, we've had a few reporters around in recent months asking questions. One of the most interesting questions I was asked--my answer was not reported as far as I know--was: What have you learned in five years? And to that there was a clear-cut, easy answer. I've learned that getting inflation down is a lot harder than I thought it was five and a half years ago. It just is pretty hard to get it down. There have been times that I've argued with the staff, with Mike, in regard to inflation. I thought we were going to be more successful than we were. It's very clear to me now that it's not easy to get the rate of inflation down.

The second point I would make, Mr. Chairman, is that you pointed out to me a year and a half ago, when I was complaining about inflation not coming down, that inflation would come down in a bunch sometime, and I think you were right. If you look at the history of disinflation, it does tend to come in bunches. I had the view at one time that maybe inflation can come down during expansions, but our success in getting inflation down during the latter part of an expansion phase has proved not to be an event. So, we have an opportunity; and when you have opportunities, you act to make gains.

The third point I would make is that inflation never comes down too rapidly. Now, deflation could be too rapid. But inflation doesn't come down too rapidly because when inflation comes down rapidly the bond markets know it and you get some benefit from falling interest rates. So, gradualism sounds nice in theory, but it's just too easy if gradualism never begets progress. So, at some point in time we have to stake out an opportunity, and I believe this is an unusual opportunity to make tremendous gains. Now, Don, I know why it is that you have the 5-1/2 percent [assumption for M2 growth in 1992]. But it seems to me that by most measures we can look at the 4 percent growth rate from Q4 to June and the 4 percent average over three years --and it was very stable during the three years--and say that it really is quite adequate. It would have been very adequate if the rate of inflation had not bulged to 5 percent. We would have found the 4 percent to be just fine if that rate of inflation hadn't bulged. If M2 growing at 4 percent is sufficient to provide a recovery that all of us are agreed is in place, then I see no reason why 4 percent money growth won't work in the future.

I think you asked the question, Mr. Chairman: Why do it now rather than in February? And I think the answer to that is that we have a Chairman who is very, very good at persuading when he makes the Humphrey-Hawkins report. And if the Chairman explains why it is that we're [adopting] a lower target range, that can give us the credibility kick that all of us think would be very, very helpful. And in doing that I think we have a chance to have this recovery be better rather than weaker. That credibility could cause the long bond interest rate to fall from its [current] level, which is higher than it was last year, and that would be very, very good for the recovery. So, the reason that I would like to do it now is because we need the bond market improvement now. That would give us a credibility that we could not get in any other way. And, Mr. Chairman, even though you would prefer not to explain that now, I think you'd be very good at explaining it now. And I think that would make a considerable difference. If I'm wrong and the money relationship changes, I don't see any reason why we couldn't back off in February. The tentative step should be the step that we want to make and then if the money relationship turns out to be quite different, you'd be able to explain that next February.

CHAIRMAN GREENSPAN. [Explain] raising the targets in February? I appreciate your over-estimation [of my abilities]! President Black.

MR. BLACK. Mr. Chairman, I've never disagreed with you before, much to my pleasure, and I certainly agree with your comments that the baseline growth rate for M2 is much too high and that strategy II is near what we ought to be aiming for. I even went so

far as to say one time to a reporter, facetiously, that much to my dismay I was tempted to just give you my proxy and go play golf. And you, on another occasion, said you were going to hold me to that! I will try to cover my tracks by saying that I suppose at some point inevitably we're all going to differ.

So, I'm with you on the first two-thirds but [not] when we get down to the discussion of the ranges. I recognize that long-run alternative II, which means extending the '91 ranges to '92, could encompass strategy II--an idea that we both endorse. But as the Bluebook points out on the bottom of page 19, long-run alternative III, which lowers all the ranges 1/2 percentage point is "more consistent with the spirit and intent" of our anti-inflationary strategy. And that would provide fresh evidence of our commitment to the very things that Governor Angell has just described very well. I think that is a very important point, as he emphasized. As I said yesterday and as he said much better today, we are at a very crucial point; we've had remarkable success up to this point and many forecasters are now beginning to lower their projections of inflation in part because they think the economy is not really going to spurt as much as it has in past recoveries. But I think a large part of that is due to the growing credibility that we have gained because we have had this remarkable record over the last several years. I think leaving these ranges unchanged in '92 would raise some doubts and possibly slow, if not break, the momentum that we've gained thus far. But lowering them would reinforce our credibility and I think would reduce the transitional costs of achieving price stability. Consequently, I very strongly favor alternative III. I recognize that M2 growth may well be in the upper part of that range next year if we adopt that alternative, but that strikes me as a pretty manageable problem that we could afford to take on in view of the benefits that I think we would get from the credibility standpoint by lowering our ranges. And if, as Governor Angell postulated, we had to raise them, I share his confidence that you could explain that very well. We really have a golden opportunity here that we haven't had until now, and I think we have to seize it. Although there are many reasons why I could argue that we ought to temporize, I'm afraid that I just have to come out for alternative III.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. Our goal is price stability. I agree with you that we've made progress in terms of bringing money growth down. What we know about money--or at least what we think we know--tells us that we ought to get some progress. To date we haven't gotten the progress. I'm not wedded to a particular money growth; I'm wedded to price stability. And it seems to me that what we think we know about it is that we're about a percentage point away from a noninflationary economy in terms of money growth. And to look to raising the growth rate in money--. Even though I know it's a residual that falls out of your output, price, and interest rate model, I view it as a policy instrument. And I just can't see how we would want to tolerate a 5-1/2 percent rate of growth in money for any significant period of time when we've worked so hard to get where we are. If the 4 percent growth rate [over the past] four years doesn't get us anything, then I think we ought to move on down to 2 percent or whatever it takes to get us there in a reasonable time-frame. I just think that we shouldn't be considering anything in the upper end of this target

range. I would argue that we ought to lower the midpoint of this target range and center it on 3 percent because that's where we want to be. And if that doesn't work, then we should center it lower. But I don't think we ought to abandon our efforts to bring money growth down when we seem so close. We can stay with the current targets for the rest of this year but, for the reasons that both Bob Black and Wayne Angell have already given, I think we would do ourselves a great service by clarifying our commitment to price stability by lowering the target ranges. I'm not even comfortable with a 2 to 6 percent range; I'd like one centered on 3 percent or at least I'd collapse the top end of the range.

MR. ANGELL. Be patient, Lee; be patient.

MR. BLACK. Show the kind of restraint that Governor Angell and I showed!

MR. HOSKINS. Well, I'll compromise and opt for a lower target range of 2 to 6 percent. That's my recommendation.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, as I look back over our experience of the past 12 to 18 months, I think that policy has been about as good as we could have expected and certainly better than I had anticipated. And for all of the reasons that you gave, I would very strongly favor staying where we are. In saying that, I'd like to make it clear that I in no sense am abandoning the idea of price stability, but I think we have to bear two things in mind. We're trying to achieve price stability over time, not all of a sudden at a cost to the economy. We have other responsibilities besides price stability. Price stability may be the primary objective of a central bank, but I don't think it's the only one. Our credibility, it seems to me, is measured not only in terms of how we deal with inflation but also how we deal with the real economy. We have a recovery in train at the moment; I think that's pretty evident. But I do think the risks are still on the down side. You pointed to a number of other risks, none of which is trivial, I would say. So, I think it's important that we hold where we are at the moment. I think the risks to us as an institution as well as to the economy are really quite significant if we make a move at this time. So, I would strongly support your recommendation that we hold [the M2 range for] both '91 and '92 at 2-1/2 to 6-1/2 percent at this time.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, the position that you have presented to the Committee today and the conditions you described are almost identical with the one's I espoused yesterday, so I'm very happy to support alternative II as the strategy. It seems to me that there's room in that range to accommodate whatever we wish to do in terms of continuing to put pressure on inflation. And I am very concerned that at this point, when we don't have assurance of the strength of the recovery that we think is underway, the announcement effect of saying that we are going to slow down the growth in the money supply could run the risk of aborting the recovery. So, I very strongly support staying where we are, believing that we have enough room within that range to do whatever we wish.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. I think, as others have said, that policy has been quite effective, largely by drift of fortune as well as by skill. And I think there is general agreement that most of us often think about our objectives in terms of inflation and [view achieving price stability] as a vehicle for promoting real growth in the economy. A lot of the somewhat technical debate right now comes down to the issue of how much we want to take into consideration uncertainties associated with the relationship between money and output. And it seems to me that, not unusually, we're in a time of significant uncertainty. First of all, we're not absolutely sure where we are in terms of the real economy itself. Beyond that, there are all of these factors going on in the financial system to which some people have alluded. And coming back to the question I asked Don earlier, it's far from clear that we have a great deal of certainty about velocity's behavior in either direction. In terms of credibility, a concern I have--I think we'd be surprised by it--is that if we were to lower the ranges and then have to break through the top of the range, that could be as damaging to credibility as some other specs could be in the other direction. Additionally, I have a great deal of sympathy for your view, Mr. Chairman; I'm not quite sure what we get for changing [the ranges] now in July, halfway through the year. We'll have more information both on the real economy and on what is happening in the financial system as the year goes on. So, I think the opportunity for gaining credibility is greater, if we find it necessary to make a change, to do so after some of these things become less [uncertain]. So, for that reason, I support your suggestion.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I would prefer alternative II at this time as well. I think, as Governor LaWare says, it's unnecessary to change the ranges. The current [M2] range provides ample flexibility to respond to inflation risks. If we need 4 percent growth we have the ability to achieve it within this range. Indeed, we've experienced 4 percent growth over the last year and a half within the range. On the credibility question, there is some merit to the credibility argument. On the long bond, I'm not so convinced that there's much inflation built in. When I see our long bond rate at roughly the same rate as the German long bond, I wonder how much inflation premium is built into our bond. Moreover, it seems to me that our credibility is not threatened now. It has not been brought into question. And we might be better off saving this and using it when it's needed more, although I do think one could make an argument there. I have some concern about the appropriateness of the 2 to 6 percent range and the 4 percent midpoint, and I think that's something we should think about. It may be right, but I'm not convinced that setting the midpoint at a rate that is below realized core inflation for virtually every year for the past 20 years is something we should do right now. If we really think inflation is going to be 3 percent in '92, and if we're going to have 4 percent growth in money, and velocity stays constant, are we willing to say to the world--or to the people who will read it this way--that we're willing to accept 1 percent real growth and rising unemployment? If we are willing to accept that, perhaps now is not the time to announce it when the unemployment rate is still rising, the recession is not yet cold in its grave and inflation is

already receding, and the banking bill has opened up our statutes to meddling. This process of reviewing it has been quite successful and has been characterized by patience and persistence; and it's an impressive achievement. We are approaching a stage when we ought to think about where we're headed--toward a stable range and a more stable target and what price stability really means, given that we have the bias in estimation, as the Chairman mentioned and as we discussed a bit yesterday. I think there's a question about the range as well. It's not clear to me why Germany has a 4 to 8 percent range and many of these other countries are able to operate within relatively tight ranges. My view is that we're approaching a time in which we ought to confront those issues. But I would prefer to postpone that and talk about them perhaps with some background work by the staff and in an environment with the recession behind us and the recovery safely underway and when we know more about the shape and form of the recovery and the nature of the progress that we're making on reducing inflation. At that time the credibility of lowering the range might be worth much more. So, I would agree with your proposal, Mr. Chairman, the current ranges for '91 and tentatively for '92.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, it seems to me you phrased it very, very well, and I absolutely agree with both the strategy and the scenario as you outlined it. It seems to me at this point that the message effect of what we decide today is awfully important, perhaps a bit more important than the practical operating effect. As I think about it, I'm not sure I'd like the message effect of changing the ranges either way at this point. To reduce the ranges has some unfortunate consequences, which you talked about; it's the wrong time to send that particular message. And, obviously, raising the range would be inappropriate. I think the baseline alternative strategy as Don has outlined it is reasonably consistent with the economic forecast that we talked about yesterday. And I must say that as I think about that forecast for this year and next year, it's a pretty constructive outlook and, therefore, it seems to me that we ought to continue to leave the ranges as we have them. I very strongly favor the ranges of alternative II.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I strongly support alternative II and I think that case has been made pretty thoroughly by others. But I would like to go ahead and offer my summary of where my thinking lies. There are two concerns that have been mentioned. Number one is the actual operation of policy, which is of course the most important thing. But signals are also important. As far as the actual operation of policy goes, we always have a challenge on both sides. The primary challenge, of course, is to maintain the downward trend of inflation that we're all dedicated to, and that will be particularly important if this recovery flourishes. But alternatively, we have to be able to provide for a sustainable and broadening recovery if it tends to falter after a bit. Under alternative II, we would provide ourselves room to expand a bit if that turned out to be required and I think the probability of that is non-trivial. And we would still have plenty of room to apply more constraint if that were required. If, on the other hand, we tighten the ranges now, we'd be pretty much constraining our ability to respond if the economy did turn out to

falter after a time. As far as the signal effect goes, we clearly have tightened slowly for as much as a decade now and within the framework of today's economy I think it's fair to say that we continue to do that. And I believe that we're perceived as doing that. I think the market perceives us as dedicated to lowering inflation, but it also sees us as trying to be realistic about the state and the needs of the real economy. It also sees us as a bit frustrated as far as our inability so far to make visible progress on inflation. So, in those contexts, I really question the need for an aggressive signal at this point. I would even suggest that an aggressive signal might frighten the market in a way that would be counterproductive, if they come to see the Federal Reserve as tending to over-react to its frustration of not getting faster inflation progress. So, signal-wise a perception of an increased level of aggressiveness at this point may be (a) unnecessary, and (b) possibly a little counterproductive. As far as the actual conduct of policy goes, I think the present ranges give us plenty of room to provide more constraint if that's what time shows to be necessary and still provide us some head-room if trouble arises and we need to have some head-room.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Mr. Chairman, I favor alternative III essentially for two reasons. One has been discussed at some length and has to do with credibility. I'm not sure that a 1/2 point move in the range gets us a lot of additional credibility. In fact, in this environment and given our stated objectives, it might be kind of expected. On the other hand, anything we can do to enhance credibility is important because there are costs involved in bringing inflation down; and to the extent that we can get credibility working for us and contain those costs, I think that's an advantage. My judgment is that a reduction in the range at this point would help us at least a bit on that score. The second reason I'm in favor of lowering the ranges at this point is continuity. This has been commented on as well. The fact is that M2 over the past 4+ years has grown at 4 to 4-1/2 percent or so. It just seems to me that we shouldn't compromise that kind of performance. I think continuity is important here, and we ought to act in that fashion.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Well, long-range target setting is a mix of substance and symbolism. Given where we are as the only game in town and hopefully at the bottom of the business cycle with inflation coming down, I think the symbolism part is more important than the substance. It is important that we have credibility on the inflation side in terms of reducing it, but I think it's also important to have credibility in the sense that the central bank ought to be viewed as pro recovery and pro healing of the financial system. And I think keeping the ranges the same in this context is the right balance. I think it gives us the overall kind of credibility that we need in order to be an effective policymaker. On the more substantive side, the technical side, all of the options that we're talking about have us in the top end of the existing range. I think we need that maneuverability and the operating room, given the uncertainties about what kind of recovery we're going to have. We've talked a lot about velocity. It may turn out to be the way the staff says; it may not turn out to be the way the staff says. So, when I look both at

symbolism and substance, I come out fairly clearly on the side of keeping the ranges the same.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. I think perhaps everything has been said and there's nothing more new, particularly with respect to my view that your proposal is the correct one. That is, we've come to mid-July when you will testify and there are still such uncertainties about this recovery that to suggest that we can say the recovery is well underway and we can look forward 18 months ahead and say we're going to bring money growth down seems to me to be the wrong signal to be giving at this time. That does not say, however, that if I were here in February that I would not be going to the 2 to 6 percent range, because I think it is over the long run the appropriate way to go-- providing we do have the recovery that has been projected by the staff in the Greenbook.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. For 1991, I think everyone is in agreement that we ought to stay with the same ranges. For 1992, it's a fairly close decision, but the emphasis is that the ranges are tentative for 1992 and will be reviewed in seven months. I agree with Governor Angell that one can make the case, based on what we expect to happen between now and then and based on conditions that we expect to prevail in 1992, that our tentative judgment right now is that it will be appropriate to reduce those ranges by 1/2 of 1 percent, centering on 4 percent. I would recommend that we do that and explain it in a way that emphasizes that should developments not occur as we expect, it could always be reversed.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. I would reaffirm the '91 ranges and put in alternative II for '92. But I do take quite seriously this point you made, Mr. Chairman, about the need to take a hard look at those '92 ranges in February. I say that because, assuming there are no big surprises in the economy or financial system that would make me take away Mike Prell's gold star that I gave him yesterday, we are at the point in the cycle where we have to think about, or begin to think about, the need to tighten policy. Certainly, I'm not saying that's needed right now, but we should start thinking in those terms. And it seems to me that on this whole question of credibility, which probably gets a little overblown, the real test of our credibility is going to be whether, if it's needed, we will tighten soon enough and sufficiently enough to prevent the serious mistakes in policy that were made in the mid-1970s. If you look at the forecast and take it more or less at face value, it seems to me that that question could easily be on the table in spades six months from now or so. Since I see that as a possibility, and since I think our credibility really does come down to what we do and not what we say, I'd rather keep the ranges where they are just in case things do work that way. And then a cut in the ranges in February will be more than symbolic and the timing might be precisely what we need. So, I'm quite comfortable with reaffirming the ranges in alternative II but, as I said, I do take seriously your point about the need to look at that closely in February. Indeed, things could turn out such that both substantively

and symbolically a cut in the ranges then could be just what the doctor ordered when we need it most.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. In terms of the strategies laid out, I'd favor strategy II, the tighter one, and flowing from that alternative III in terms of the ranges. We're talking about a long-term approach to strategy here, and that underlines our commitment to price stability, which I think is the one thing we really can influence in the long run. The credibility point is the major argument in favor of it. It seems to me that we could get the most positive impact by making a move now. I agree with Jerry: Our actions are more important than the symbolism of this. But I think if we change it in February, it's going to be because we're perceived to be on the run; and I don't know whether we buy a lot at that point in time. Some of the arguments that I've heard I'm not particularly persuaded by--for example, gradualism. We've been at this for four years and I think we ought to keep down that path. I agree with what you said, Mr. Chairman, and with what Lee said: There's some distance to go here. And I think this is the time to try to consolidate some of the gains. In terms of this issue about a top end of 6 percent somehow constraining our ability to act if the economy is weaker than we expected--and this picks up on Jerry's point--we're already "acting" quite a bit now; we have projections in the Bluebook of M2 growth moving up to a 6 percent rate, which is 50 percent higher than what we've averaged over the last four years. So, we're doing our part in trying to assure a recovery. In fact, I would agree with Jerry that what we have to be thinking about is: When do we take some of that rope back in? On the final point that I've heard some arguments that I don't necessarily agree with, I'd add the financial fragility point. I don't think the conduct of monetary policy, so long as we're providing adequate liquidity to the economy, is really the appropriate tool. I think we can look ourselves in the mirror and say that we've been doing our part on that score. I don't disagree that there are problems out there, but I think there are other policy approaches that need to address those. If you step back and look at them, the problems that we're having with the financial system are really the products of a monetary policy that sowed the seeds for inflation, and a lot of the problems are inherent now as inflation is coming down.

CHAIRMAN GREENSPAN. Okay. We have to take two votes at this stage. One is on 1991. I inferred from the comments that there was a consensus for maintaining the 1991 ranges currently in place.

MR. ANGELL. I move that.

CHAIRMAN GREENSPAN. Is there a second?

MR. BLACK. I'll second that, Mr. Chairman.

MR. KOHN. Mr. Chairman, could I interrupt just a second? In the Bluebook we raised the issue of whether the Committee wished to delete the words "a resumption of sustainable growth" in the first sentence. We put that in when the economy was in recession.

CHAIRMAN GREENSPAN. I think it's appropriate to delete that.

MR. ANGELL. I would agree.

CHAIRMAN GREENSPAN. Does anyone object to the deletion of that phrase?

MR. PARRY. Are we talking about the language of the [directive] now?

MR. KOHN. Yes, the long-run part of the directive.

CHAIRMAN GREENSPAN. Page 26.

MR. PARRY. I was wondering what contribution this phrase "contribute to an improved pattern of international transactions" made. That seems to me a bit of fluff maybe. I think we took some of that out of the shorter-term language in the operational paragraph. It seems to me that we could excise that as well. The recommendation that Don made was to take out "a resumption of" and I suggest that we take out what follows--that is, "and contribute to an improved pattern of international transactions"--because I don't know what it means. It seems to me that it would be better if we said "will foster price stability and promote sustainable growth in output."

CHAIRMAN GREENSPAN. You know what it means but you can't provide it! [Laughter]

MR. TRUMAN. This phrase, if my memory is correct, has been in the directive since about the middle of the 1970s. And it was--

MR. PARRY. That's even more reason!

MR. TRUMAN. Well, I'm not so sure about that. There have been several rounds in which we tried either to define it or to refine it to a greater degree. My memory of listening to the Committee on this point is that they always ended up saying it's a way of suggesting that international dimensions of policy are not completely irrelevant to the Committee's deliberations. If you want to look for substance, that's what it is.

CHAIRMAN GREENSPAN. Bob, would you rephrase your revision?

MR. PARRY. Yes. "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output."

CHAIRMAN GREENSPAN. It strikes me as eminently sensible at this particular time because I had the same problem when I reread it. Does anybody have any objections?

MR. ANGELL. I agree.

CHAIRMAN GREENSPAN. Okay, let's assume that the bracketed phrase "a resumption of" gets deleted and that the sentence ends with a period after the word "output." Would the Secretary call the roll?

MR. BERNARD. This is for reaffirming the '91 ranges with the new wording in the leadoff paragraph:

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Black	Yes
President Forrestal	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Mullins	Yes
President Parry	Yes

CHAIRMAN GREENSPAN. For 1992, as I recorded the consensus, it comes out as alternative II. I infer that that referred not only to M2 but in general to M3 and the debt aggregate. Would somebody like to move that?

SPEAKER(?). I'll move it.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

MR. BERNARD. It would read: "For 1992 the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1991 to the fourth quarter of 1992, of 2-1/2 to 6-1/2 percent for M2 and 1 to 5 percent for M3. The Committee provisionally set the associated monitoring range for growth of total domestic nonfinancial debt at 4-1/2 to 8-1/2 percent. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress the growth of this aggregate relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	No
President Black	No
President Forrestal	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Mullins	Yes
President Parry	Yes

CHAIRMAN GREENSPAN. Okay. We now move to current monetary policy and I'll call on Don Kohn.

MR. KOHN. Thank you, Mr. Chairman. I will be much briefer this time. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Don?

MR. ANGELL. Don, if we look to the period ahead and, as Vice Chairman Corrigan indicated, we find it necessary to engage in a tightening, are there any explorations underway that will enable us to administer the open market window in such a way that we would not have every 1/4 point seen as an announcement arrangement? It just seems to me that it has always been very helpful when we had some reserve targeting arrangement that did not give an announcement effect to the fed funds rate. What can you tell me in regard to explorations of ways to administer the window which would enable restraint to take place and would cause interest rates to be seen as rising by market pressures rather than as an announcement of the Fed?

MR. KOHN. As you know, Governor Angell, we explored such possibilities a little while ago, partly at your urging. I think there is nothing actively underway now. If the Committee wished, obviously, we could do something. I think the key question the Committee would need to ask is whether you're going to have reserve targeting and have it tied in some way to M2; this would be a stretch, given the pattern of reserves, as Harvey Rosenblum pointed out [to me] yesterday, but you could do it. We played in the past with "shadow" reserve targets but not tied to M2. The premise there would be that movements in M2 would provoke some reaction. The Committee would have to have enough confidence in its reading of M2 that it would want money markets to be moved around by deviations of M2 of some size--the Committee could decide [what those should be]--from its projection. The underlying confidence needed is in the relationship of money to the outcome.

MR. ANGELL. Well, would having the discount rate above the fed funds rate and having some other supporting overnight arrangement below that tend to give an atmosphere in which you could do this without having the fed funds rate run too far?

MR. KOHN. Well, I think your plan would limit the movements in the funds rate, depending on where the penalty discount rate was in terms of a ceiling and where something else was in terms of the floor. But if you wanted a substantial band in there, then you would have to tolerate increased federal funds volatility within that band; that would go along with this. So, it would help in some sense. I don't think it would negate the need to make the fundamental decision about whether you wanted to tie federal funds rate movements even within a band to relatively short-run movements in M2. Now, if the Committee so desires, we can certainly work to see how we could do something along the lines of tying reserves to the funds rate and M2. But I think there are some decisions that need to be made by the Committee if we're going to go ahead with it.

MR. ANGELL. Mr. Chairman, the reason I ask this question is that this will be the first time that we might be in a tightening arrangement in which the market will misread every 25 basis points in the fed funds rate as having an announcement effect. And I think that's a frightening disadvantage for us.

CHAIRMAN GREENSPAN. I agree with that. If we can find a way to avoid that in time, I think it would help policy.

MR. BLACK. I would strongly support that suggestion. I've been urging my colleagues in Richmond to do just that, but they have

been resisting because they don't really think it can be done. And it is difficult, unless we're saying that the reserveable part of M2 is going to grow at the same rate as the nonreserveable part. If we paid interest on reserve balances, it would make that more likely. But having to reach up in the air and pick some federal funds rate that's going to give some predictable rate of growth in the money supply is just a crap shoot at best. I'd really like to move toward some kind of reserve targeting if it can be done. But it might necessitate a complete change in the reserve requirement regime to do it successfully.

CHAIRMAN GREENSPAN. Why don't you give it some thought, Don? Well, we've been thinking about this continuously now for quite a while. The question is: Are we at a point where there's any payoff in committing Committee resources to start to be somewhat more detailed? It's more a question and not so much an issue of whether we should do it because, obviously, if it looks as though it's going to work, it's something very valuable for us to have. The question is more an operational issue as to whether or not enough is out there to suggest that the commitment of research resources will come up with something other than "on the one hand and on the other hand."
[Laughter]

MR. KOHN. We will commit to bringing a memo to the FOMC by August, at least outlining the issues and the sorts of decisions that we think will need to be made. I would invite the research directors around the edge of the room to supply me or my colleagues with any of the work that you have already done on this, please.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Don, what would be your interpretation of the meaning of M2 if it continued into July-August at the subdued rate of growth that we've seen in the last months?

MR. KOHN. I don't know; it would worry me. And I would have to be honest with the Committee and say that the numbers handed to me this morning suggested weaker M2 than we built into the Bluebook for the latter part of June in terms of preliminary data. This wouldn't necessarily affect the July growth rate, but we'd probably be marking June M2 down by close to a percentage point relative to the Bluebook, based on the data for the last two weeks. As I tried to say in the briefing, one way of approaching it is to say: Well, everything is going fine; the economy is recovering; all the incoming data on the business cycle etc., seem very consistent, and we assume they will continue that way over the next few months, consistent with the outlook of the staff or of the Committee for a recovering second half of the year. I might also say that something odd is going on with peoples' portfolios, so just ignore it; it's a demand shift [unintelligible] missing money [unintelligible]. I guess I would have trouble if it persisted, particularly through August, and growth was edging down toward the lower part of the range. I would have trouble making a judgment to dismiss it out of hand. If people are moving out of M2, they're finding other assets more attractive. In the past when the Committee has eased or tightened, for example, the first effect on M2 is just a portfolio shift. You raise or lower the rates on other kinds of instruments; people shift their M2 portfolios and later change their spending. If we're seeing a situation in which interest

rates in bond markets, for example, are so high that they're attracting a flood of savings, it may be that those interest rates are so high that they're not going to support the kind of expansion [we envision]. If we're seeing a situation in which depositories simply don't want the retail deposits or depositors are still so scared and uncertain about what is happening at depositories that they don't want to give [funds] to them, the re-channeling of that credit may not be entirely effortless. So, I would hesitate to say that if it continued weak like this, I would definitely ease policy. But it would certainly make me think hard about where we were going three, six months from now and whether we really did have a satisfactory policy in place. It would be an extraordinary miss in the predictive power of M2, which isn't very great. There's a wide band around our expectations but it seems to me that when you get to one or another edge of the band you're probably getting a signal that you shouldn't ignore it unless it is overwhelmed by other signals. It would weigh on that side in my mind.

CHAIRMAN GREENSPAN. Other questions for Don?

MR. MELZER. Where is that weakness in M2? Is it across the board or in the non-M1 components?

MR. KOHN. It's in the non-M1 components. I started talking about the revisions that I just got handed me this morning.

CHAIRMAN GREENSPAN. Is that more than yesterday?

MR. KOHN. Slightly, I think. I can't remember exactly what it looked like yesterday. But it's widespread. Small time deposits, which had been consistently weakening, have continued to weaken; there are big minuses there. But the interesting thing in this is that the MMDAs have weakened as well.

MR. MELZER. Is M1 still growing?

MR. KOHN. Yes, in fact M1, if anything, was revised slightly upward.

MR. MELZER. Wouldn't that give you some comfort in connection with your response that--

MR. KOHN. Yes, particularly since the strength is in other checkable deposits. We will be publishing a drop in M1 on Friday, but the preliminary data for the latest week suggest that that comes back, with a \$2 billion increase on July 1.

MR. BLACK. Don, is there anything that suggests--other than what your material contains--that the small time and savings deposits might be moving into bond and stock funds?

MR. KOHN. We have actual data on the bond and stock funds through May, which show very large increases. We've talked to the managers of those funds and they say that it's not less for the stock but more for the bond funds and that those inflows have persisted in June. So, I think there is some of that there.

MR. BLACK. Would I be justified in being less concerned about the weakness in June because of where this money has gone?

MR. KOHN. Well, I don't know. I think that's an analytical issue. Whenever M2 is weak, it can be weak for one of two reasons: Income is weak or people are reallocating their portfolio. I do think it's not giving us a signal that the economy was somehow collapsing in June. Of that I'm quite confident. But as to whether the portfolio reallocations can be entirely ignored, I'm less confident.

MR. BLACK. I come out, I think, about where you do. It gives me some comfort knowing where they've gone; otherwise I'd be concerned that M2 has been too weak.

CHAIRMAN GREENSPAN. Any other questions for Don? Why don't I start, then, on the discussion. It's really interesting in a sense that we are getting so many positive signs that the economy is strengthening. We're picking it up pretty much across the board. In fact, with the exception of a somewhat disappointing new-home sales figure that came out this morning, I don't recall a figure that was under expectations in the last three or four weeks, which is really an extraordinary run on specific data. Very specifically, I think the progress that we had been discussing at the last meeting relative to how we foresaw inventory liquidation moving into increased orders and eventually increased production is pretty much on schedule and, if anything, is ahead of schedule. The order patterns are weak in increasingly fewer areas. There is still evidence that in June, even though it looks as though industrial production is clearly up for June, inventory liquidation was still going on. And when you look at all of the other elements of final demand, there's not much to see; it's not terrific, but it's clearly not caving. The crucial issue that concerned me--namely, the problem of capital goods weakness--seems to be fading. The order patterns are somewhat better. There seems to be at least now a mixed pattern in nonresidential building contract awards and permits, whereas before it was a free fall.

So, all of the data are coming together, with the exception of the financial balance sheet structure. The weekly data that we're turning out on bank loans look awful. They suggest that inventory liquidation is being financed out of declining bank loans. Bank credit, as Don has said, is pretty sluggish; we are getting a modest increase in residential real estate loans and a presumed continued decline in commercial mortgages. Since the individuals who are putting the orders in and obtaining the production materials are the same or at least in proxy form are those who are making the financial decisions, it's obvious that purchases of materials are getting financed. So, the question we have to ask ourselves is: Why is it that the flow-of-funds or the balance sheet structure don't seem to reflect the financing in physical volume? There are a number of potential answers to this. The first is that it's clear that this is not a forecast. This is actually what happened; it is merely looking at the recent past. Orders are moving up, production is moving up, and sales are moving up, and the balance sheets show nothing. So, whatever is happening, ex post it is being financed. I've been meaning to look at one thing and haven't had a chance to look at it closely; I have a suspicion that part of the answer is that an increasing part of the nominal GNP reflects non-asset accumulation categories. Electric power purchases, for example, in the GNP have no

balance-sheet effect. Purchases of residential structures do; inventories do and involve varying degrees as you go up and down the detail of the GNP, even though you can get a very big chunk of services with no balance sheet effect. And that clearly has an impact on how the system is financed. I suspect that is the case. I also suspect that the grossing effect in the flow-of-funds has probably come down, meaning the type of big grossing that we used to see in the state and local government sector, which borrowed to reinvest, or the very big element of borrowing on existing homes.

One of the interesting charts that Mike had yesterday was the one that showed net equities as a percent of GNP and net borrowings as a percent of GNP. In the last several quarters they were tending to converge, implying, if you just put them together, that the total-funds-raised ratio to GNP wasn't all that much out of line. But there is no question at this stage that we are getting a credit deflation. That is, not only are the monetary aggregates growing more slowly but all of the intermediary expansion is softening. And part of this is clearly offset by significant increases in direct borrowing in the bond markets and increased equity issuance. So, that curve that we used to look at about the proportion of financial intermediation on the one hand and commercial bank intermediation on the other as a percent of the GNP has been going down for quite a long time and still seems to be doing that. And it may well be that what we've got here is sort of a secular shift out of intermediating institutions; part of that may be that people are just scared of banks and thrifts and are trying to keep their money out. It doesn't require very much change to affect the net change figures and to give us peculiarities, which may well explain the money supply problem that Don is raising. I don't know what to make of it. I would say that the bottom line suggests to me that it's not a policy question at the moment.

Things seem to be pretty much on track and I don't think there's any real alternative to alternative B. There are [areas of uncertainty] that are more likely to affect Federal Reserve action later rather than [sooner]. And I think we have problems in both directions. Jerry raises the concern, which I think may well be the more appropriate concern, that problems are going to be coming at us in the direction that will require us to tighten, not ease. But there is the possibility that we may be looking at a financial system that is disintermediating and we're going to have to make a decision as to whether or not that has any significance for the economic output or the economy. But at the moment it doesn't strike me as an immediate issue that confronts us; I suspect it's one that may emerge sometime later in the year. So, for now I would recommend no change, alternative B. Bob Forrestal.

MR. FORRESTAL. I would agree completely, Mr. Chairman, alternative B. I assume you're talking about a symmetric directive?

CHAIRMAN GREENSPAN. Yes, I didn't say but obviously I--

VICE CHAIRMAN CORRIGAN. That's really symmetric when you don't even have to say it!

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I would agree with your recommendation of alternative B--that we stay with existing policy. However, based on the performance of the economy in the early stages of past recoveries, I really wouldn't be very surprised to see new information coming in that will indicate that perhaps the recovery is a bit more robust than we're currently anticipating. If that were the case, then I think promptly reacting to such information probably would have beneficial effects on long-term financial markets and, moreover, probably could avoid the need for a more vigorous policy action in the future. Therefore, I would prefer an asymmetrical policy directive to reflect the possible need to tighten over the intermeeting period.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I support the proposal of "B" symmetric.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I support "B" symmetric, although I understand what President Parry is concerned about. And I would emphasize that I think it's very, very important that we not be seen at all to be getting behind the curve. That is, if the market believes we're falling behind the curve in that kind of circumstance, it would be very, very unfortunate; I think the long-term bond rates would show that and when we tighten I think long-term interest rates would go in the wrong direction. But there isn't anything right now that suggests that that needs to be done. It seems to me that the money growth ought to be discounted; that is, we ought not to be thinking we're as tight as maybe we think we are looking at money growth. But looking at commodity prices and other things, I don't think there's any need to tighten at this point.

CHAIRMAN GREENSPAN. President Melzer.

Mr. MELZER. I favor "B" symmetric. I'm just reflecting on something you said, Alan, and on Don's comments before. I'm wondering whether we ought to be worried about weak M2 growth in the other direction. In other words, it may actually give us a false sense of comfort that we have a restrictive policy in place. I had our people look at what reserves are doing every two weeks when they're released. And if you just look back over the last year, total reserves--this isn't the St. Louis number this is the Board number--have grown 5.2 percent over the last year; since the end of the year they've grown 7.1 percent; since the end of the first quarter they've grown 8-1/2 percent. But over the last two months, it's 16.4 percent. So, if you look at that, it's hard to argue that monetary policy is not providing adequate liquidity to the economy. We've talked about it before in terms of the problem with the operating regime, but if market rates start to move up with a strengthening economy and we peg the funds rate too low, this is the result. I guess I'm a little worried, just listening to the comments that we have portfolio shifts in M2 but that the M1 component of M2 is growing very healthily, that we may be misled by a weak M2 number. I would not advocate any tightening now; I wouldn't even advocate an asymmetrical directive. But I think we have to be very attentive to this.

CHAIRMAN GREENSPAN. That's an important point. I think that's the reason why Wayne's view about trying to get off the funds rate is really an important issue. President Syron.

MR. SYRON. Mr. Chairman, I support what you suggest, "B" symmetric. I do think that the point that has been made--that it may be necessary for us to be willing to react quickly, if things do come back strongly on the real side--needs to be emphasized again. Also, I think what Governor Angell said is very, very true. But it's less clear to me how we resolve that in the short run. So, all of this argues in my mind for just staying where we are right now.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. I agree with "B" symmetric, Mr. Chairman. I would like to suggest that we consider moving the "monetary aggregates" phrase up to either first or second place, though. I'm a little concerned by the weakness we've had, but I think there's a good explanation for it. So, I think Governor Angell is right; we have not been too tight. But at some point the aggregates may give us a little more accurate information and I'd like to pay more attention to them.

CHAIRMAN GREENSPAN. May I suggest something? Actually, if we had more time, Governor Kelley was going to make the presentation on this whole question. If you wouldn't mind, I'd just as soon wait until the next meeting when we can discuss this in considerably more detail. I think you ought to be prepared at that time to re-raise the issue because--

MR. BLACK. That's fine.

CHAIRMAN GREENSPAN. That whole section [of the operational paragraph] does require us to take a look at it and I think it would be useful then to make some decisions. President Keehn.

MR. KEEHN. For the interim period it seems to me that the current policy is appropriate. There is a fairly short interval between now and the next meeting and, therefore, I'd be very supportive of alternative "B" with symmetric language.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. "B" symmetric, Mr. Chairman.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I support "B" symmetric

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I, too, support "B" symmetric. I don't see any case here for changing anything. I do have a little concern that things have worked out exceptionally neatly this time.

CHAIRMAN GREENSPAN. You don't trust it!

MR. STERN. I don't trust it. But unless we get some major data revision or something, I guess we ought to just--

SPEAKER(?). Enjoy it.

MR. STERN. Enjoy it, right.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. "B" symmetric. Let me just come back to this point that Ed Boehne raised first and others have commented on. In the period immediately ahead, partly for the reasons Tommy Melzer noted, I would worry more about slower real money supply growth than I would about fast money supply growth. Part of what this dilemma about the money supply is telling me at least right now is that the money supply really isn't worth a damn either in terms of a policy indicator in the short run. Wayne wants to get off the funds rate and so do I; but if you're going to get off that, you have to get on something else. And it isn't clear to me what else we can get on.

CHAIRMAN GREENSPAN. That's what Don Kohn keeps telling us.

VICE CHAIRMAN CORRIGAN. But this point you're raising, this intermediation phenomenon, really could make the policy process in the period ahead very, very tricky no matter what horse we're riding. It is a worry.

CHAIRMAN GREENSPAN. I think it's so dramatic that a lot of our old guidelines have to be rethought. President McTeer.

MR. MCTEER. "B" symmetric, Mr. Chairman.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. With our hard peg on the funds rate, as everybody has said, money is the residual; and we don't much know what that residual is telling us. If you want a suggestion for what we ought to be targeting, it's probably the CPI. And if it moves up, we ought to raise rates.

MR. ANGELL. Commodity prices?

MR. HOSKINS. "B" symmetric! [Laughter]

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. "B" symmetric.

CHAIRMAN GREENSPAN. I guess that leaves President Boehne.

MR. BOEHNE. "B" symmetric.

CHAIRMAN GREENSPAN. We have a consensus for "B" symmetric and I would like to have the language read with the appropriate [wording].

MR. BERNARD. "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic

financial markets, somewhat greater reserve restraint or somewhat lesser reserve restraint might 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 June through September at annual rates of about 5-1/2 and 3 percent, respectively."

CHAIRMAN GREENSPAN. Would somebody like to move that?

VICE CHAIRMAN CORRIGAN. I'll move it.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Black	Yes
President Forrestal	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Mullins	Yes
President Parry	Yes

CHAIRMAN GREENSPAN. The FOMC meeting will adjourn after I indicate that the next meeting is Tuesday, August the 20th.

END OF MEETING