

Federal Open Market Committee

Conference Call

August 5, 1991

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Black
Mr. Forrestal
Mr. Keehn
Mr. Kelley
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. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Beebe, R. Davis, Promisel, Siegman,
Simpson, Slifman, Associate Economists

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

Mr. Wiles, Secretary of the Board, Office of the
Secretary, Board of Governors
Mr. Ettin, Deputy Director, Division of Research
and Statistics, Board of Governors
Mr. Stockton, Associate Director, Division of
Research and Statistics, Board of Governors
Mr. Madigan, Assistant Director, Division of
Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant,
Division of Monetary Affairs, Board of
Governors

Messrs. Balbach, J. Davis, T. Davis, and Ms.
Lovett, Senior Vice Presidents, Federal
Reserve Banks of St. Louis, Cleveland,
Kansas City, and New York, respectively

Transcript of Conference Call of
August 5, 1991

CHAIRMAN GREENSPAN. I would ask Don Kohn to update us.

MR. KOHN. As you know, M2 was extremely weak in July; we are looking at about a 3-3/4 percent annual rate of decline. That compares to a 5 percent increase that we expected at the time of the Bluebook. June, as you know, also was weak, at only about a 1 percent rate of increase. Quite frankly, we're getting off on such a slow foot at the end of July that we've marked down our August growth to only about 1 percent, trying to take account of the fact that the last few weeks of July seemed so sluggish. So, we have several months here of very slow growth--much slower, obviously, than we were expecting but also than was projected by the models. We've looked at this in many different ways in terms of the various components relative to our expectations. We do have liquid deposits still strong but their rate of growth has come down a bit, and I'm including in this M1. M1 is up at a rate of only 1-3/4 percent in July, down from 9-1/2 percent in June. But also savings and money market deposit accounts, while still growing at double-digit rates, are growing less rapidly than they did in June. Eurodollars and overnight RPs have fallen short of what we were expecting. And the runoff in retail time deposits, which we thought might begin to [moderate] a little as balance sheets were restructured, continues unabated. We have about an 11-1/2 percent decline in retail time deposits in July; that's about what it was in May and June, so there's no letup there. And as the liquid deposits grow less rapidly that's showing through into overall M2. We've looked at this by region and we can find nothing unusual. We've looked at it by size of bank with the same result. We've looked at it by personal versus nonpersonal deposits where we have some data. We can't slice up M2 into personal versus nonpersonal [components] but we do have money market deposits accounts and a few other pieces of M2 that we can look at in that way. And there doesn't seem to be unusual behavior there, although we're still looking at all these things.

Part of the weakness, of course, could be in the scale variables; that is, income and growth are probably a little weaker than we had expected when we were putting the Bluebook together. But it doesn't come close to explaining an 8 or 9 percentage point shortfall in July M2 growth relative to our expectations. So, obviously, most of it is in a portfolio shift of some sort. Primarily, this looks like a portfolio shift [that involves a move] out on the yield curve--out of [retail] time deposits into longer-term assets and particularly into bond and stock mutual funds, especially bond mutual funds. But also we're seeing some pickup in noncompetitive tenders in Treasury auctions. So, we think people are investing directly in longer-term assets as well. Another aspect of the portfolio shift we are in the process of looking at is whether people are re-balancing their assets and liabilities. That is, credit growth has been very slow, and it could be that to the extent people are spending, they're doing it by holding down the growth of, or even drawing down, M2 assets rather than accessing consumer credit. The Mortgage and Consumer Finance Section in our R&S Division has been looking at models of consumer credit and looking at those in different ways trying to see whether consumer credit growth has been slower than one might have expected. So far, unfortunately, the results are ambiguous.

Any shifts either out on the yield curve or away from M2 in terms of spending and away from credit would be encouraged by low and declining [retail] time deposit rates. These rates actually are not that low relative to what our models are predicting, given the decline in market rates we've had. But they have been dropping very rapidly, and we think there are some aspects of the returns people get on deposits that aren't captured by these rates--that is, fees seem to be higher. Many banks are beginning not to pay interest, for example, on the 12 percent of NOW account balances that they say they're putting [aside to meet] reserve requirements. So, there are ways that banks have of reducing the return to depositors that may not be captured entirely in these rates. We don't know of anything that has happened suddenly in the last two months or three months. I think these are trends that have been occurring over time. Of course, banks don't need the deposits; bank credit growth continues to be quite sluggish. We have preliminary estimates for July, and these estimates I'm reading you abstract from some distortions to the data caused by the sale to Fleet Norstar of Bank of New England, as a result of which the FDIC ended up with an awful lot of assets. Abstracting from the FDIC's [acquisition] of these assets, we're looking at essentially flat bank credit in July. We have loans declining 2-1/2 percent; business loans declining 4 percent; and even a drop in real estate loans at banks, and that's extremely unusual. It's very rare that that number goes down. So, bank credit remains quite weak and banks are not looking for deposits. Looking at deposit growth by bank capital and bank loan-to-asset ratios, it does look as if the weakest deposit growth is in the least well capitalized banks with the lowest loan-to-asset ratios. So, there is some correlation between not making loans and declining retail deposits.

What is the meaning of this portfolio shift? It's somewhat ambiguous. This is obviously the difficult question. I don't think one can dismiss it out of hand. A lot of weakness in M2, an aggregate that leads income developments, occurs because of portfolio shifts. For example, if the Fed tightens up, in the first instance rising market interest rates cause shifts out of M2 into market securities and then later on that affects spending. So, just because [the initial effect] is a portfolio shift doesn't necessarily mean that it can be ignored for policy purposes. On the other hand, if it's a portfolio shift in which preferences of asset holders have changed for some reason, then it would be misleading to pay a lot of attention to it. So, the meaning is ambiguous. Clearly, people are reaching for yield. One question would be: Are long rates so high that they would damp the expansion? On the other hand, an explanation for that is that they got high because the economy was expected to expand--that that's how the yield curve got so steep. If M2 is damped because time deposit rates are dropping, that might indicate continuing credit restraint, which we couldn't ignore.

Another aspect of the staff's [analytical effort] is some more work being done with semireduced-form VAR type models, lead-lag models, trying to refit those things to see, after a few years in which we haven't paid much attention to them, whether M1 and M2 lead nominal income or real income--even when you include interest rates and other variables in them. We do see some power in the non-M1 part of M2 even when you include interest rates in these equations, which also suggests that one might treat continuing weakness of M2 with a little caution here in that it perhaps may have some effect. An issue

that has arisen recently is the question of whether stronger M1 growth should be a comfort to the Committee. As you all know, we dropped M1 targeting because the aggregate had become so interest sensitive that its velocity swung over a very wide range very rapidly. So, M1 is not far off of its demand curve, although it appears to be coming in weak in the third quarter relative to expectations. But it has not proven to be a good policy indicator since the early '80s when deposit rates were decontrolled.

CHAIRMAN GREENSPAN. Thanks very much, Don. Questions for Don?

MR. CORRIGAN. Alan, is Mike Prell there [to comment on] how he's looking at the real economy?

CHAIRMAN GREENSPAN. Yes, he is.

MR. PRELL. Well, at this stage, we're just beginning to put together a forecast for the next FOMC meeting. The data of late have been mixed. On the whole we don't feel they have been as robust as we would have expected if we are to get the almost 5 percent GNP growth we had for the third quarter in the last Greenbook. Thus, I would anticipate very tentatively that we will be marking that down significantly to probably something more in the neighborhood of 3 percent. But we're having to sift through some data that don't fit together very neatly. And there has just been such great volatility in the labor market data in particular, which are usually one of our most important guides, that it's very hard to read at this stage.

CHAIRMAN GREENSPAN. Any other questions for Don or other staff?

MR. HOSKINS. Don, this is Lee Hoskins. Maybe I missed it, but did you give a third-quarter projection and where would that leave us year-to-date in terms of the target ranges?

MR. KOHN. For the third quarter we have M2 on a quarterly average basis barely growing; that is, it's essentially flat. For Q4 to July we're estimating 2-3/4 percent growth; Q4 to August, given that 1 percent growth projected for August, is at about 2-1/2 percent, which is the lower end of the range.

MR. MCTEER. Bob McTeer in Dallas for Don.

CHAIRMAN GREENSPAN. Go ahead, Bob.

MR. MCTEER. What about bank reserve growth?

MR. KOHN. Well, bank reserve growth has been somewhat stronger because M1, particularly in June, was stronger. But total reserve growth also has tailed off in July. We have it expanding 1 percent in July following very rapid second-quarter growth. But that follows M1, obviously, which is the only aggregate that has any reserves against it anymore. So, it comes back to the issue of how much weight to give M1 which, in fact, has been strong partly because of currency, but partly because demand deposits and NOW accounts have been strong. However, M1 is tailing off a bit in July.

MR. PARRY. This is Bob Parry. You talked about bank credit growth. Some numbers I've seen with regard to insurance companies suggest that they're providing credit at a weak rate as well. Do you have any information on other sectors and what is happening in them?

MR. KOHN. Not really. Once again, that's something we would do for the FOMC meeting; we will go through the whole credit picture. We haven't really updated that since the last meeting. You'll remember that credit growth was projected to be very sluggish in the second quarter. We have very, very little information even about the second quarter. So, we haven't seen a pickup there yet.

MR. PARRY. Thank you.

MR. ANGELL. Mike, do you have a preliminary view on how you see the rate of inflation in the second half of 1991 as compared to before? Does this reassessed picture also give you a view of some improvement?

MR. PRELL. Again, it's a mixed picture in the recent data. In the most recent figures on the wage side, for example, we got a nice figure on average hourly earnings in July after a string of very bad numbers. That was some comfort but the employment cost indexes for the second quarter were not favorable. On balance, they were higher than we anticipated. So, the labor cost picture doesn't appear to be evolving in a more favorable way. In the other price data, for food and energy prices there are likely to be some adjustments. I don't think we see a materially different picture at this point for the second half than we had before. It's still a relatively moderate rate of inflation, something in the 3 to 4 percent range, for the second half.

MR. KOHN. If I may return for a second to Bob Parry's question: I'm now looking at a table on long-term debt issuance and it does look as if that has tailed off; both debt and equity issuance by nonfinancial corporations tailed off in July. Actually, it peaked around April or May and has gone down since then. It's down fairly robustly, particularly on the equity side relative to recent years, but it is also off [on the debt side]. So, it's not supplementing bank credit the way it was, say, in April or May.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. Other questions for Don? If not, I think it would be helpful to all of us to exchange views specifically on insights into the causes of these developments. The floor is open for comments from anybody who wishes to add to our state of knowledge.

MR. BOEHNE. This is Ed Boehne, Mr. Chairman. I don't think I can add any more insight to Don's comments in terms of technical aspects of what might be going on. But I'd like to suggest that at least part of what we're seeing in M2 is a reflection of the state of the economy. Increasingly, this recovery just doesn't have a good feel to it. The reports that I'm getting from the business community across a broad front suggest that the recovery isn't going anywhere. I had a board meeting last Thursday and I must say that the sentiment there was more apprehensive than it was some weeks ago. I think we're seeing some of the inventory impact here, where we're moving from

inventory liquidation to perhaps a bit of accumulation, and that's helping some in manufacturing. But when you get beyond manufacturing into retailing, into construction, and you talk to bankers who deal a lot with the middle market where much of the employment is in the economy, it just isn't ringing the way it ought to as far as having a healthy economy. If you look at the labor numbers that we got on Friday, I think they are telling us something that is contributing to this story of a recovery that doesn't have a good feel to it. And in the context of what is going on in the real sector, even though there is ambiguity and we can't reach definitive conclusions about what is going on in money, I think the money supply is telling us something. I, for one, think that the cost of additional insurance in terms of a modest easing is very low; and I think the risks are growing on the side of a much weaker economy than any of us anticipated. We ought not to overlook that in our technical analysis of the money supply.

MR. FORRESTAL. Mr. Chairman, this is Bob Forrestal. I want to pick up on what Ed said. We certainly don't see anything in this part of the country that can help explain the causation of the weakness in the money supply. However, I would say that over the past three to four weeks I've had many telephone calls from business people around the District--and these are people who for the most part have business not only here in the Southeast but around the country. And the question they're asking me basically is: Where are these numbers coming from that they're seeing? They are reporting that they just don't see any real recovery in their own businesses and in the businesses of their colleagues. True, they say there is not a continuing deterioration, but things are very, very flat. Businesses, particularly small businesses, are reporting that credit continues to be very difficult to obtain. Manufacturers are saying that orders are not really increasing at the rate that they had expected. Really, I'm repeating what Ed's contacts have been telling him: that the recovery seems to be much slower than expected--or at least than I expected. Bankers are reporting that loan demand is virtually flat; and that, of course, has some bearing on the performance of the money supply as well. So, I'm not sure that an easing of monetary policy at this time would help very much in terms of the money supply because it seems to me there is an awful lot of liquidity out there anyway. But the psychology, at least from the people that I've talked to, is not good.

MR. PARRY. Mr. Chairman, this is Bob Parry. I'd like to admit that what I've been hearing from business people throughout the Twelfth District has taken on a somewhat more gloomy tone. The one thing that I'm not sure I fully understand is whether this is an unusual reaction, if indeed we are at the trough of the cycle. I'm not sure that in the past business people really have been very good forecasters of a turnaround. The other point I'd make is that as far as the banks in our District are concerned, particularly the large ones, the thing that continually is cited is that, as I'm sure you know, they had some very disappointing results as far as their profits are concerned in the last quarter. And many of them are talking about the pressures they've received from the regulatory side; and they appear to be sitting on their hands in terms of what they think is likely to happen with regard to business over the next three to six months. I don't know to what extent that translates into their decreased appetite for attracting liabilities. I know Don indicated that there's no explanation by region or size of banks, but I've not seen them quite this pessimistic throughout this entire cycle.

MR. SYRON. Mr. Chairman, this is Dick Syron in Boston. I just want to support what Bob Parry said. It's critical with respect to the banking sector. I think as one might expect, at least in this part of the country--

MR. KOHN. Dick, could you speak up, please?

MR. SYRON. I said that at least in this part of the country among the bankers there is still a very strong fear factor, both in terms of growing pessimism about the robustness of the recovery and also of concern about the regulatory side. We have seen in several cases differences in how our regulators would approach individual credits compared with the Comptroller, for example. All of this is contributing to a sort of bunker mentality on the part of lenders, who hope that they can ride it out with enough capital until things return to normal. I would just add that in talking to a number of insurance companies in New England, they are also being very cautious on new commitments and are taking steps to assure that they have absolute liquidity. Now, that may be something that has more [unintelligible] as an explanation of what is happening to [money growth].

MR. ANGELL. Wayne Angell. I think most of you know that my view of the commodity prices has been that they've been pretty well flat. But it seems to me that that really hasn't changed, and particularly it hasn't changed in regard to our experimental index on commodity prices ex food, fiber, and energy. And I think taking out food, fiber, and energy helps if what you're trying to do is assess the impact of the money growth that you're getting on an auction bid process. In recent weeks this experimental index has really taken a nose dive. In fact, Alan, you remember last week I said I didn't understand why the price of gold wasn't falling and I guess lo and behold gold prices did catch on.

CHAIRMAN GREENSPAN. They did.

MR. ANGELL. I think that is important for two reasons. One, as most of you know, I've had the lowest real growth rate projection for the economy in '91 and '92 of any member among the presidents or the Board. So, it's not that I thought we had a strong recovery anyway, because ordinarily we get faster money growth and we also get some upward movement in commodity prices as recoveries take place. But the problem, as I see it, is that our conventional ability to alter the opportunity cost of holding M2--that power--has slipped away from us a little and the whole yield curve in some ways is competing. Then too, all the legislative talk and the swaying in regard to regulatory issues as well as lender willingness to lend really has placed us in a position where simply lowering the fed funds rate may not be effective in some circumstances. But if we get into an environment in which the rate of inflation does seem to come down-- and, Mike Prell, even though you don't see it at this point I guess I do see very sharply lower commodity or PPI numbers coming in the future--it seems to me that looking at it in that context we ought to be somewhat open to making certain that we do not let real rates increase in this environment. So, I'm in a position of somewhat more openness for some possible action in the period ahead.

VICE CHAIRMAN CORRIGAN. This is Jerry Corrigan. Let me just make a couple of comments. First of all, I don't think we have

anything at all to add in terms of what Don Kohn said about the diagnostics of money supply. But I do think the point that Bob Parry, Ed Boehne, and Bob Forrestal made in terms of the real economy is relevant. We had a directors' discussion last Thursday in which there, too, the comments bearing on the recovery reflected extremely sour attitudes on the part of some, if not most, of our directors, although I don't think that is likely to provide a full explanation. I just wanted to make a suggestion, which may not be very workable, but let me try it anyway. The suggestion is this: Would it be possible for Don, working with a handful of people around the Reserve Banks, to try to design a quick and dirty little survey that would be directed mainly at a sample of mid-size and large banks and would be targeted at the chief financial officer of a cross section of banks around the country over the next few days? The survey would press pretty hard in terms of questions like: What is motivating their pricing strategy on deposits? What do they have to say about loan demand? What do they have to say about credit standards? In other words, in what would still be anecdotal rather than perhaps a statistically perfect [way staff would] try to mount a special effort, literally over the next few days, to get some additional insights of what is going on there. I don't know whether anybody has anything that they--

MR. KOHN. President Corrigan, we do have outstanding right now [authority for] one of those quarterly loan [officer] surveys that we had timed so that we would have the information for the [next] FOMC meeting. The survey will be asking about credit standards and loan demand and that sort of thing. What it is not asking about is the deposits side. So, I think I could take your suggestion and twist it a little to say that maybe we ought to give some serious thought to going to some of the same banks and some different banks and ask them whether they're doing something special on the deposit side, with their [retail] time deposits in particular. [We could ask] what is happening there, whether they have any insights into the behavior, and what they're doing in terms of their marketing and pricing. That might be helpful. We could put it together with the loan survey information.

VICE CHAIRMAN CORRIGAN. One of the things that I'm not certain about--maybe you know the answer--is whether we really are sure that that regular survey is being responded to by senior enough people in the organization that we're getting enough of the strategic view of what is going on as opposed to a [unintelligible] view.

MR. KOHN. Well, we can double check that. It has been reasonably consistent with the anecdotal evidence that we've gotten over time. Let me look into that a little further in terms of who is filling it out and whom they check with and that sort of thing. That's a good point.

VICE CHAIRMAN CORRIGAN. Well, it's a complicated issue and it's hard to do much on short notice, but I have a suspicion, [given] the way these things seem to be unfolding, that it's worth whatever special efforts it may take to get further insights here.

MR. KOHN. Okay.

MR. HOSKINS. Mr. Chairman? Lee Hoskins.

CHAIRMAN GREENSPAN. Yes, Lee.

MR. HOSKINS. I think concern over the real economy is somewhat misplaced in the sense that our policy driver in terms of the monetary growth has been relatively slow and we'd expect a relatively modest recovery. I can't forecast next quarter's growth or even this quarter's very well. The real concern that I have is that we [not] allow money growth now to slip very close to the bottom of the range or perhaps outside of it. Coming off a four-year trend [of M2 growth] of around 4-1/4 percent, I would regard it as somewhat of a monetary shock if it came in at 2-1/2 percent or less. I think we ought to be concerned about where the economy is going to bulge in the future, and related to that we ought to be continuing to produce a monetary growth rate in the 3 to 3-1/2 percent range if we want to get an adequate response in the real economy and maintain our control over inflation. So, I would lean strongly toward looking for a way to get monetary growth moving again and that obviously would require us to give a little operating room to the federal funds [unintelligible]. We don't have to do it today; but certainly if these numbers look like this going into the meeting, I would recommend that we consider lowering the funds rate at that time. My last point is simply that I think it would not be politically acceptable to be outside the target range, particularly in this environment.

MR. BLACK. Mr. Chairman, Bob Black. I would be very near where Lee is if it were not that I think Don's explanation of these portfolio shifts has a lot to do with the kind of behavior we've had in M2. For example, over the last six months, if you exclude small time deposits, M2 has grown at a rate of 9.8 percent; in the last three months it has grown at a rate of 7.2 percent. Now, if it continues as weak as it looks for July and August, then I think we're going to have to do something to try to get it moving again. I do think one could raise a legitimate question as to whether lowering the federal funds rate really would do that, because of the tendency to force more funds from small time deposits into the mutual bond funds. But, anyway, I will be very concerned if [the weakness] continues much longer. I'm almost concerned at this point that it has gone too far.

As far as the real economy is concerned, I agree with the others that [the recovery] is sort of lagging, although it never looks very good near the bottom of a recession. But this one, it seems to me, is showing a little more weakness than I can remember having seen in similar upturns in the past.

MR. KEEHN. Mr. Chairman, this is Si Keehn. I don't have anything to add to the analysis that Don Kohn has given us on M2. But I think conditions in the Midwest in general are a bit more favorable than we see in some of the national numbers. But I very much agree with Ed Boehne's analysis. Our [regional] economy, at least in tone, quite closely parallels his. At our June board meeting the economists were really quite positive; at the July board meeting there was a decided shift in tone; it was much more modest, particularly as it related to some of the middle market companies here in the Midwest. Also of concern is the agricultural situation, which started out as being a marvelous growing season in March, April, and May. It has turned around on us; we now have quite a serious problem on our hands, given the very dry conditions we had in June and in July as well. That is really having a negative impact on the farm industry.

Having said all that, we expected the recovery to be much more modest than other previous recoveries, and we seem to be getting that. But I do think at this point that the risks are on the down side. We ought to be following developments very carefully and it may be appropriate to make another move.

MR. ANGELL. Si, are there states other than Iowa that are being hit [by dry conditions]? Does that go farther east and north in your District?

MR. KEEHN. No, in fact, Iowa is not as bad. Indiana is very serious and Illinois is serious, though not quite as bad as Indiana. I don't know, frankly; it's a bit mixed; some parts are dry and other parts had pretty good rain. But to give you a number: For June and July we had less rainfall in those two months than in any year since 1936. So, it's quite a low level.

MR. KELLEY. Mr. Chairman, this is Mike Kelley. I'm thinking down two tracks that are very closely interrelated, of course. First of all, if we tried to make a move that would force the Ms to get going again, it seems to me that in the light of all that Don has found so far we might have to make a very large move indeed in order to accomplish that directly and overtly--one that might make us all pretty nervous about its long-term consequences. If we're going to get the Ms moving, I think it has to happen in reverse at this point; it's going to have to come up through the real economy, maybe largely through the inventory cycle and other things. I have been heretofore fairly comfortable with waiting to see how the real economy came along but I have to say that, in light of the reports from the presidents on this call this morning, I have a lot more concern about that than I did before.

MR. STERN. This is Gary Stern in Minneapolis. I like your suggestion--I guess Don was heading down this path anyway--to try to put some extra effort into understanding what is going on with M2 between now and the meeting because, as some of the members said very early on, I don't think we can dismiss that altogether. With regard to the real economy, I am not as gloomy as many of my colleagues mainly because it seems to me we were expecting a moderate recovery and, as I interpret the statistics that we've seen, that's pretty much what is underway. Out here I don't detect any new signs of apprehension or nervousness. I think the economy is doing reasonably well, all things considered, and people seem to be fairly comfortable with the situation--not that it couldn't be better. But I sense that people are reasonably comfortable with the path we are on.

MR. GUFFEY. Mr. Chairman, Roger Guffey. If I may, I will follow up on Gary's comments. They fairly well characterize what we find here, with the exception of some drought conditions in eastern Kansas through Missouri that I think is a part of what Si Keehn has already detailed. Otherwise, we don't see any lack of optimism here. The District continues to go along not at a rapid clip, but nonetheless in a positive growth pattern. With respect to the money numbers, I think it's obvious to everybody--at least it is to me--that up until the month of July we were fairly well on track. But we've had one month's experience and a projection that nobody knows how [accurate] it may or may not be. I would just like to ask Don if the staff has done any work on lending by other than banks in the sense

that banks have become less important in the credit extension process. Is there something going on beyond the numbers that we look at and that, given the monthly measures, could change the view a bit?

MR. KOHN. Well, there isn't a whole heck of a lot. Commercial paper did pick up a bit in July, but commercial paper and bank loans combined were still pretty weak. As I noted, long-term debt market issuance was off and as I think someone mentioned: Who knows what is going to happen with private placements in life insurance companies? On business loans at finance companies, we don't have anything for June or July there, so it's not clear whether something new is going on. They have been on a slower growth track this year than they were in the previous couple of years. We've looked for other pieces of M2-type assets that might not be there. One thing we looked at, for example, were these quasi-mutual funds offered by IBM and GM and AT&T. And although AT&T started its fund within the last few months, it has very little money in it and those funds don't look as if they're absorbing a lot of M2. So, I don't think I can identify some source of credit or of assets other than the ones we've talked about that is filling the gap more than we think.

MR. MULLINS. This is David Mullins. We've now had a pretty extended period of slow growth in M2. About a month ago I was still pretty comfortable with the story. It is true that M2 tends to jump around a bit; indeed, February and March are the only months we've had in the past 9 or 10 in which M2 growth has been above the midpoint [of our target range] and it was above the upper [limit in both months]. But as of the last time we met it had averaged out to 3.7 percent, which was below the midpoint. I was pretty happy then with the story that the liquid components were growing so in some sense there was the raw material of monetary growth there. The less liquid components were not growing because loan demand was weak, and time deposits and M3 wholesale liabilities are issued to support loan growth and that would come later. Also, the yield curve had steepened in the spring and one would expect some shift out along the yield curve for a while. After that ran its course and after the recovery took off, we should see M2 growth fill out. What concerns me most is the rapid deceleration over the past month or so, and it doesn't seem to me that we have a good story on this. Loan demand is still weak but it's not a lot weaker than it was over the past couple of months to explain the deceleration. The yield curve hasn't changed much. It certainly hasn't steepened much over the last few months, although it is true that, if we put deposit rates--maybe M2's own rate--at the short end of the yield curve, with the lagged fall in deposit rates there may have been some steepening. And it's clear that there has been some acceleration in the move out of M2 to bond funds, although it's difficult to suggest that that could explain it all. So, I am concerned with allowing M2 [unintelligible]; I was more comfortable with it being 1 percent below the midpoint and expecting the recovery. But it's more troubling [now].

On the real economy, when we have a recovery which is not fueled by final demand but rather by this inventory process, I don't know how much growth we can expect. We are four months into the recovery though, if we assume that April was the trough, so we should be seeing some [money growth]. I would be concerned about ignoring the intermediate targeting of money and moving to targeting the real economy and waiting until it showed definitive signs. We know with

the lags involved that if we go back to trying to respond only to the real economy we run a great risk of being late and chasing the tail of the economy and creating instability. When you look around, [none of the aggregates] is growing: not money, not credit, not debt, not L. On the availability of credit side, I think we will find the insurance company credit extension to be particularly weak. Finance companies, because their holdings of business loans grew so rapidly last year, seem likely to me to have run out of steam as has the bond and stock issuance volume that we saw earlier on. Much of this deceleration has coincided with a flare-up again of concerns within the financial system. It seems to me that it started a month or so ago with some of the West Coast banks' concerns about the performance of the money center banks and even some recent concerns [raised by] some comments of chairmen on the Hill and the like about [financial] institutions. I wonder what effect the growing concern about insurance companies is having not only on credit extension but on consumer confidence. It seems to me that, as happened last fall, the financial system itself becomes a bit more sluggish as a transmitter of monetary impetus; and the relationship between interest rates and growth in money and credit may have changed. The other thing I would note is that we made easing moves in every month from October through April and that put a pretty steady stream of stimulus in the pipeline, which is pretty well exhausted by now. So, I think it's worth assessing. It really runs to the conceptual integrity of what we're doing here: whether we're trying to keep a stable environment of money and credit growth or trying to do something else. It is true that if the long end moved down again, as Bob Black mentioned, that might steepen the yield curve. Although it seems to me that the recent response of rates at the long end to a number of events has suggested that the long end might be well behaved and we might not see such a steepening.

MR. ANGELL. Well, in fact, I think if we're going to get the recovery to behave the way it needs to behave, it's essential that whatever moves we make are constructive in the sense of being associated with declining long rates. And now that we have the rates down from the 8.48-8.50 percent level, I think our patience has contributed to that. If it is then seen that what we are targeting is really price level stability and we think we are somewhat farther along in that, then it seems to me that with patience we have some chance of getting long bond rates down below 8 percent, which would undoubtedly prove to be very beneficial in the housing industry and provide a very desirable and steady underlying strength for a recovery, which puts more units of goods out there.

CHAIRMAN GREENSPAN. Any further comments by anybody?

MR. ANGELL. Well, it does seem to me, Mr. Chairman, that sometimes we might want the moves we make to be somewhat subtle but at some stage in the game it seems to me we might want to make a move that has more of an announcement effect.

CHAIRMAN GREENSPAN. That sounds like a euphemism for the discount rate! If there are no further comments, let's bring this meeting to a close and we will convene again on August 20th at the FOMC meeting here. Good morning, gentlemen.

END OF SESSION