Federal Open Market Committee

Conference Call

December 2, 1991

PRESENT: Mr. Greenspan, Chairman
Mr. Angell
Mr. Black
Mr. Forrestal
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Mullins
Mr. Parry
Ms. Phillips

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

Messrs. Boehne, and McTeer, Presidents of the Federal Reserve Banks of Philadelphia, and Dallas, 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. Lindsey, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Mr. Sternlight, Manager for Domestic 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
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Gainor, Hendricks, and Oltman, First Vice Presidents, Federal Reserve Banks of Minneapolis, Cleveland, and New York, respectively

Mses. Greene and Lovett, Senior Vice Presidents, Federal Reserve Bank of New York

Transcript of Telephone Conference Call of
December 2, 1991

CHAIRMAN GREENSPAN. Governor Lindsey had a previous engagement and I indicated to him that it was more important to keep that than to join us. That way we will have a full complement of the Board at the next FOMC meeting. This meeting, as you may recall, was scheduled during our November 5th discussion, and it is an information meeting to bring us up to date on events since November 5. I'd like to start off by asking Gretchen Greene if she would bring us up to date on the foreign exchange markets.

MS. GREENE. Thank you, Mr. Chairman. The attitude toward the dollar and toward the outlook for the U.S. economy is now pretty much in line with what we described at the November 5 meeting. What has changed principally in the exchange markets has been a reawakening of the perception of exchange rate risks and with that a renewed strengthening of the German mark. The dollar, looking across a variety of currencies, is mixed relative to where it was trading on November 5. It's unchanged on average. While [higher] against the yen, it's lower against the mark by about 2 percent or so. But between November 5 and now it has been even lower still. We are benefitting at the moment from uncertainties about developments in the Soviet Union. And, of course, we do not know how long and in what form these uncertainties will be, looking ahead. The dollar has now given up more than half of the gain that it [had achieved] early in the year after the war in the Persian Gulf. And we have seen a number of occasions in the intermeeting period when the dollar seemed to be moving closely in tandem with developments in our domestic capital markets. So far, the movements have been relatively [unintelligible]; but this could be a troublesome dynamic in a different form, accentuating the anxiety in the financial markets if the dollar were again to fall to a substantial extent. That's pretty much all I have, Mr. Chairman.

CHAIRMAN GREENSPAN. Are there any questions for Ms. Greene? If not, if Joan Lovett is available, would she bring us up to date on the domestic markets?

MS. LOVETT. Thank you, Mr. Chairman. Since the cut in the discount rate on the 6th of November, we've had some rate declines in the domestic market. They have ranged from about 25 to 30 basis points or so in the short end of the market where they have been supported by expectations from daily releases over the interval suggesting that there will be some further monetary accommodation coming along. The periodic unrest in the stock market shored up the short end, and from time to time some of the news coming out of the Soviet Union also has been a factor in that direction. The rate declines have been more grudging in the long end of the market where rates in the longest maturities [unintelligible] since November 6. In the long end of the market, some actual selling has been taking place throughout this period without the kind of demand that we had in the short and intermediate areas. And there is also a sense that the long end of the market is somewhat hostage to the various rumors that have come out from time to time about different fiscal stimulus packages that might be coming along. So, the gains are more pronounced at the short end of the market.

In terms of reserve management activities, the federal funds rate over the period has tended to hold fairly close to 4-3/4 percent; it has been a shade firmer than that over recent days. Reserve management operations have been supplemented throughout the period by outright purchases as we look toward the seasonal need to put in reserves that is typical at this time of the year. So, our outright activity has been of some magnitude over this period, and we used a big chunk of the leeway that Mr. Sternlight had requested from you at the last meeting. In terms of the stock market, which has been a focus of attention, I should take the opportunity to bring you up to date on that. This morning at the outset people were calling for a decline of something in the one percent range following on the heels of what had happened in some of the overseas markets this morning. And as the stock markets have managed to hold above the 2850 level today, it seems to have backed up from that. As we were coming in to this conference call, stocks were actually higher on the day at a shade above the 2900 level. Thank you.

CHAIRMAN GREENSPAN. Questions for Ms. Lovett?

MR. LAWARE. Joan, this is John LaWare. The press reported that there was some evidence that the Japanese were withdrawing very significant amounts from the Treasury markets. There was an indication that one Japanese investor was trying to withdraw as much as $4 or $5 billion from the market. Do you see any signs of that?

MS. LOVETT. We heard such reports over this period. I think people are trying to come up with a variety of [explanations] as to what is underlying this market. I have heard that in the past year a number of [times] in the long end of the Treasury market. These were securities that had been borrowed by the Japanese prior to the end of the last fiscal year and there are a variety of scenarios out there as to just why they have been lightening up their holdings. The magnitudes that you mentioned are estimates that have been around the market waiting for such a volume of Treasury zeros [unintelligible] that might come in for sale in that market from the Japanese. There are some reports, of course, that the Japanese are taking profits in this market and in fact [there is] a view about their placing money or keeping money home. Some of it has to do with periodic rumors of a [unintelligible] and no one has been able to come up with any change that will fit this bill. I think they're pretty hard to come up with specifically. But there's also a sense that the problem has to do with the IRS taking a closer look at Japanese practices in the wake of the stock market scandals and that people are cleaning up their books basically for that reason.

MR. LAWARE. Thank you.

CHAIRMAN GREENSPAN. Any other questions? If not, let's move on to Mike Prell on the nonfinancial outlook.

MR. PRELL. Well, Mr. Chairman, I think the news since the Committee meeting has been, on balance, decidedly negative. Just to note the one outlier: The housing starts numbers were certainly a more favorable reading than we had seen in the September data. We're a bit skeptical about the level of starts indicated by the latest figures in light of all the other anecdotal information, and the sales figures that we have in hand will be firming up that impression tomorrow when we get figures on new home sales. Otherwise, we've had a string of negative surprises. Right after the Greenbook was completed, as you know, we had the hours figures for October, which indicated very weak labor income. Subsequent to that period, initial claims have ticked up a bit, suggesting to us that in all likelihood payroll employment will be down a bit when reported this Friday. Consumer sentiment has soured further and the spending numbers through the latest month show some further erosion of consumer demand for autos and other goods and services. We found in the September inventory figures a buildup that went well beyond the Commerce Department's expectations, or ours, and that suggested to us that our expectations with respect to inventory investment in the fourth quarter had been perhaps too optimistic. Now, it appears that there may have been some influx of imported goods that showed up in those inventory figures and, thus, that we might hope for imports to absorb some of whatever inventory corrections we're looking at. From the orders figures and other information, we suspect that domestic manufacturing activity will suffer some in the next few months. The motor vehicle production schedules have been revised down to below even our discounting of the earlier assembly schedules. We think we're going to exit this year probably with some decline in total industrial production. Our sense is that the current quarter is likely to be on the negative side of zero--not deeply so but negative for real gross domestic product. And at this point, looking at the trajectory and the lack of an obvious spur for an immediate turnaround, the likelihood is that perhaps some additional inventory adjustment might be sought in the first quarter of the year. In an environment in which layoff announcements will still be widespread and consumer sentiment probably still very depressed, we may remain in modestly negative territory in the first quarter. It's obviously early relative to our schedule for preparing the Greenbook, but that's our general sense at the moment. Thank you.

CHAIRMAN GREENSPAN. Questions for Mike? If not, Don Kohn on the financial outlook.

MR. KOHN. Thank you, Mr. Chairman. Money and debt growth rates have strengthened just a little over the last few months and, although they remain quite weak, they are about in line with what was expected at the time of the FOMC meeting. We're looking at M1 growth in November at a 12 percent annual rate and we'd project the rate for the three months from September to December at about 10-3/4 percent, which is more than a percentage point higher than we were thinking at the November 5 FOMC meeting. A lot of this reflects demand deposits and undoubtedly the drop in interest rates that occurred earlier in November. For M2 growth, we're looking at 4 percent for November and a little over 3 percent for the September-to-December period, which is just about in line with the FOMC's 3 percent expectation; and that would leave M2 right at the bottom of its 2-1/2 percent to 6-1/2 percent cone. M3 growth looks to be about 2-3/4 percent in November relative to the 1 percent expected by the FOMC and about 2 percent over the three months from September to December. This also would leave M3 right at the bottom of its 1 to 5 percent growth cone. Debt seems to have picked up a little, according to mostly projected numbers. Insofar as bank credit is concerned, we had about a 6-3/4 percent growth in October and we're looking for something in the 6 to 7 percent range in November based on very preliminary numbers. Business loans have weakened a bit from October to November, but there's a small pickup in real estate and less weakness in consumer loans within [the loans] category.

CHAIRMAN GREENSPAN. Questions for Don? If not, I'd like to open up the floor for comments from governors and presidents on developments in the economy or in the [Reserve Bank] Districts and any views on the outlook and policy you wish to bring forward.

MR. BOEHNE. This is Ed Boehne, Mr. Chairman. I don't think there's been a major change in business sentiment since we met about a month ago. Most of the reports from around the District--and most of these people have businesses in the District as well as national businesses--suggest that [activity] is either flat or down. Most of those reporting "flat" note that they're already at fairly low levels and they don't see any encouraging signs of a pickup. And there are clearly deteriorating reports. I sense in the manufacturing area that we have had a couple or three months perhaps of negative growth there. We're seeing that mostly from the point of view of what manufacturers are telling us and also from cars from the Conrail people here. The retailers are somewhat mixed but they have very damped expectations for the next several weeks. I would think that would be on the down side. The lending area, except for the refinancing of mortgages, also points to the negative side. If there has been any really material change, it has been attitudinal. I have had a number of groups of people in the Bank in recent weeks--a number of credit union people--and I found them to be fairly close to rank and file people when it comes to pulse-taking. They were really quite negative, quite sour. I was surprised at the number of times I heard the word "fear" used to describe members of their credit unions and employees or companies that they represent. Where I come out is that we're still heading into negative territory for this quarter. I suspect it will spill over into next year.

MR. SYRON. Mr. Chairman, Dick Syron. If I could continue on just where Ed Boehne left off: I was talking to some retailers yesterday and this morning in anticipation of this call. The retailers here have had very, very negative expectations. Whether it's because of that [I'm not sure, but] their sales generally are a bit better than their expectations, although Sunday they were up [unintelligible]. Overall, it's slightly better than they expected, but one has to recall that they expected a negative trend and are coming out at closer to flat year-over-year. It is interesting trying to learn about their inventories. Some of them were in a backed-up situation or in re-organization. Actually on this issue of fear, they're finding it interesting where
[unintelligible] and it's now an off-price discounter through the Northeast and some of the Midwest. Actually, they did reasonably well over the weekend. One of the two fellows who owns it had a call from "Night Line" Friday; they said they wanted him to go on [the show] and they would ask him what his experience had been. His experience at that point had been positive and he told them he was going to paint his experience as relatively positive. He may be overstating it, but he said he got the feeling that this didn't fit with the tone they wanted to present and for that reason he was told he wouldn't go on. They said it didn't really fit in with the rest of the program and went on to something else. So, I think we do have a little self-feeding issue here.

As far as the economy as a whole goes, it's hard to differ very much from what Mike said. I would say it's most likely that we will see some further negative developments in the early part of next year. And that's something we have to bear in mind very carefully in thinking about what we're going to do.

MR. PARRY. Mr. Chairman, this is Bob Parry. Statistics in the Twelfth District would indicate that things are basically [moving] sideways. But in discussions with the Beigebook participants, it is very negative. As a matter of fact, the Beigebook for our District is probably as negative as we've ever seen it. I don't know if this is [unintelligible] here or what it is, but there's no question that you can't find them. And confidence [has deteriorated] in almost any of the states that encompass the Twelfth District.

MR. FORRESTAL. Mr. Chairman, this is Bob Forrestal in Atlanta. I don't think things have changed very much in this District since we met in November. In fact, I would characterize economic activity as being fairly sluggish. But I must say that some of the anecdotal information that I've picked up just over the last two days is perhaps marginally more optimistic in terms of sentiment than it was at the time of our FOMC meeting. Looking at some of the individual areas, retail sales about a month ago were fairly good or relatively good but the concern among retailers is the shorter-than-usual shopping season. I'll come back to some more recent information on retail sales in just a minute. Auto sales were unchanged from year-ago levels. Manufacturing continues to be slow, particularly in the construction-related industries. But we have seen some positive signs in the food processing and the packaging and paperboard businesses. My credit side banking contacts tell us that there has only been a slight increase in loan demand over the last month and all are reporting that their credit [standards] have remained unchanged. The only area in residential real estate activity that is doing anything at all is houses in the lower price ranges.

I picked up two somewhat optimistic reports--optimistic in the sense that they were so bad before that anything sounds better than what I had been hearing--over the last two weeks. This morning I talked to a couple of people in the paper packaging and the paperboard business and they both said that they are seeing some small pickup in business. They're seeing some increases in their orders, some inventory rebuilding, and the customers that they've been talking to seem more confident than they were three or four weeks ago. Now, these people are not doing business just in the Sixth District but around the country, so that view about their customers' confidence I think is interesting. We did some surveying over the weekend on recent retail activity and it seems that weekend sales were better than expected. Again, of course, the expectations were not very high so it failed to measure what the real gains might be year-over-year. Discount stores and people who are selling moderately priced goods are outperforming the traditional retailers such as the large department stores. And there is some concern--someone else mentioned this, I believe--that low inventories may restrain sales as we get closer to the Christmas holiday. And picking up on what Dick Syron said, several retailers reported to us that the negative press is affecting attitudes and making consumers quite afraid to move into the market. So, while this is not a terribly bright and optimistic outlook, it is marginally better than at the time of the FOMC meeting, as I said earlier. Mike came out with the view that we still have a very sluggish economy throughout the country and I think that's going to spill over into the next quarter.

MR. KEEHN. Mr. Chairman, this is Si Keehn. In a District context, the economy continues to slow; it is still on a negative trend but [unintelligible] the last meeting I think are continuing in moderation. Other than that, I would say that conditions in the District are a little worse than they were at the time of the meeting. As always, the auto industry is the key to activity in the District. I talked to one manufacturer this morning; they're still finishing up the numbers but their guess is that November probably came in at about 12-1/2 million units and that is a little lower than their estimates of two weeks ago. The order rates from dealers to manufacturers are still lower than production levels. One manufacturer had order rates that were coming in at about two-thirds of their production level and they're continuing to do that. The risk is that manufacturers' inventories [will rise] in addition to dealers' inventories, and that has some implications for the first quarter of next year. So far they have not backed up as much as expected. Indeed, one steel supplier told me this morning that they've had some deferrals of shipments in the first quarter but not as much as they would have guessed. They do anticipate both for the end of the year. Otherwise, the Chicago purchasing managers report 62.7 [compared with] 56.2 in October. On the down side, new orders with backlogs are down. You'll soon get [the Beigebook report] on retailers here but we did have a chance to talk to a number of our retailers, and they felt they had a good weekend. Their sales level was about 10 percent higher this year than in the same weekend last year. However, they do point out forgotten [unintelligible] because of the length of [the selling season].

I must say I find this a very difficult environment, and the outlook is especially murky. But I certainly have no reason to disagree with the forecast Mike has given. While I recognize that this is an [unintelligible] to me, nevertheless, it does seem to me that the risks at this point continue to be on the down side. And in light of that, I'd continue to ease.

MR. HOENIG. Mr. Chairman, this is Tom Hoenig. Activity in our District is moving mostly sideways. Agriculture is showing some weakness and energy continues to be quite weak. There is some activity still in the residential construction area and some non-building contracts for infrastructure [projects] in the western part of the District. Manufacturing is pretty mixed. The auto industry has still been producing; [they] suggested when we talked to them that they will be cutting back shortly. In the food processing industry and in nondurable goods some jobs are still being added in our area and that is balancing things out. In the retail sales area, I would really prefer to say that it's a little too early to tell. We've had mixed reports; some are indicating that while [dollar sales] are down the volume seems to be a little better. But generally they are pretty pessimistic in that area. I think that is in part due to the press as well. Overall, our District continues just to hold its own; it's not showing any significant improvement. At this point there's no sense of a terrible downturn or of [conditions] being great either.

MR. BLACK. Mr. Chairman, Bob Black. As you will see when you get our section of the Beigebook, things here in the Fifth

District look about like everybody else has described. But there is a thread of optimism about what lies ahead six months or so down the road, and this is something we have not seen until recently. We were extremely pessimistic--the most pessimistic I can remember in the postwar period. But there does seem to be a bit of a change that was a surprise. It was a welcome change.

MR. MCTEER. Mr. Chairman, Bob McTeer from Dallas. My sense is that our economy is about the same; I don't think it has changed noticeably over the past month. We did do a retailer survey this morning to try to get a feel for what happened over the long weekend. Given the diminished expectations, that was fairly positive. Most areas reported sales a little better than they had anticipated. If we had to put a figure on that, we would estimate [an increase] somewhere in the area of 3 to 4 percent over the comparable period last year. The real estate situation down here seems to be fairly quiet and stable. There is some residential activity that tends to offset a continued weak nonresidential situation. Things have been very much the same.

MR. MELZER. Alan, this is Tom Melzer. I've been on [this call] since the beginning but I didn't interrupt you at that time. I would say that conditions in the District have not changed much since the last meeting either, as others have said. We touched base with a number of our major companies here. Major retail department store chains ended up, with what happened on Friday, with a better November than planned but a somewhat disappointing start for [December]. The pattern of sales over the weekend [was] very good on Friday, not quite so good on Saturday, and worse on Sunday. But in general they're more optimistic about the Christmas season certainly than what is reported in the press. And I did hear the same comment that someone else mentioned: That the press was really affecting consumer confidence and their performance. In three other industries--chemicals, electrical equipment, and consumer nondurables--the reading I got was that business is about the same as it has been. They don't see any dramatic deterioration and don't see any dramatic improvement. In the chemical area there is really no sign of a double-dip there. The order pattern and shipment pattern are holding up [among] major customers of the auto industry. And that generally confirms what someone said about suppliers not seeing a major downturn in their business. Even if they did, I think they feel that they are geared to handle that without a major change in their business. In the electrical equipment area, there has been an improvement in consumer-related orders, primarily for tools. One area where I did pick up some sense of a downturn is in the paper industry. There was a very strong pull-out in September and October and some decline in November --perhaps somewhat more than the expected seasonal decline.

One final comment: It is interesting that among people I've talked to in this context and other contexts, I don't find anybody asking for monetary policy to do more. If anything, a concern is evolving among business people that monetary policy is going to be asked [to do] too much and that in the process it will lose sight of longer-term goals. There was no pressure for further ease in any of these conversations.

MR. HENDRICKS. Mr. Chairman, this is Bill Hendricks in Cleveland. We don't see much change in the past 30 days. What we see is an economy moving sideways. A couple of our directors reported to us: One of them reported some layoffs in the apparel industry; and one who talked about construction indicated that it was flat but not hurting in the Fourth District. Overall, we find that people are marking down slightly their expectations for the first quarter.

MR. OLTMAN. Mr. Chairman, this is Jim Oltman in New York. Things here also seem not much changed. We continue to see [activity] as flat, at best, for the foreseeable future--in the short run at any rate. Our observation here, though, is that our directors and others have heard that projection for a while now and their patience for that explanation seems to be wearing a little thin. It's not that there seems to be much around in terms of anecdotes about very pronounced declines, but it's perhaps more of a generalized sense of discouragement. Indeed, I think our directors' response to our own presentations on the economy have changed from skepticism to discouragement. And I'd like to echo what President Melzer said: There seems to be a generalized feeling here that not too much at this stage can be expected of monetary policy.

CHAIRMAN GREENSPAN. Is President Stern out there?

MR. GAINOR. Mr. Chairman, this is Tom Gainor in Minneapolis.

CHAIRMAN GREENSPAN. Yes, Tom.

MR. GAINOR. There's no substantive change here either. At our Advisory Council meeting last week, about half reported flat activity and the other half were more optimistic than that. Retail sales over the Thanksgiving weekend were affected by a record snowfall, which didn't do much for the retail sales. It did do a whole lot for the sales of snow removal equipment! That's the one hot spot in our District. One other positive note was that the

did report some pretty good activity in residential building going on in this area.

CHAIRMAN GREENSPAN. I was thinking about how I would summarize this discussion and it comes out as follows: The anecdotal [reports] from most of the participants are negative and increasingly so; the analytical material coming from the Districts seems a bit better than expected; and the macroeconomic evaluation at the Board seems negative. So, I guess we have a choice of any of a remarkably broad range of views. I have a suspicion that we're going to learn a great deal more in the next several weeks; certainly in the next few days we're going to be getting a lot of data. But there's a sense that we're near a [stage] of some form or another where the economy sort of sits still for a while and it might pick up some momentum. But if it starts to deteriorate, there's a lot of downside [risk]. While my [feeling] basically is that the future is always unknowable, there is something about the most immediate period in that it seems to have outdone itself in that respect. In any event, I think we ought to be watching the markets fairly closely and, short of an unexpected conference call, we look forward to seeing everybody on December the 17th. Does anyone have any further comments, questions, or reactions before we close? If not, the meeting is adjourned and we will see you all on the 17th.

MR. ANGELL. There was a bit of restraint here on the part of the Board members. Maybe we wore ourselves out in this morning's briefing!

CHAIRMAN GREENSPAN. Quietude amongst the Board members was such as to set a precedent! I thought it was quite interesting in the sense that things were a tad more optimistic.

END OF SESSION