

Meeting of the Federal Open Market Committee
March 31, 1992

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, March 31, 1992, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Hoenig
Mr. Jordan
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. Melzer
Mr. Mullins
Ms. Phillips
Mr. Syron

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

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

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

Messrs. Balbach, J. Davis, R. Davis, T. Davis,
Promisel, Siegman, Simpson, and Stockton,
Associate Economists

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

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

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

Mr. Slifman, 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. Broadus, Lang, Rosenblum, Scheld, and
Ms. Tschinkel, Senior Vice Presidents,
Federal Reserve Banks of Richmond, Philadelphia,
Dallas, Chicago, and Atlanta, respectively

Messrs. Fieleke, Judd, and Miller, Vice Presidents,
Federal Reserve Banks of Boston, San Francisco,
and Minneapolis, respectively

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

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CHAIRMAN GREENSPAN. I wanted to welcome Jerry Jordan to his first meeting of the FOMC, but I understand that he attended his first meeting in August 1969. So, I have decided we'd just say: "Hello, welcome back" and leave it at that! The first item on the agenda is always, of course, the approval of the minutes, and I would seek a motion.

SPEAKER(?). So move.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. The next item on the agenda is the report on foreign currency operations, and I'll call on Bill McDonough.

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

CHAIRMAN GREENSPAN. Are there any questions for Mr. McDonough?

MR. JORDAN. May I ask one clarification?

CHAIRMAN GREENSPAN. Go ahead.

MR. JORDAN. Something out of my past struck me here about the BIS. Twenty-odd years ago, in an environment of a weak dollar, the Germans were intervening and acquiring more dollars than they wanted to put into U.S. Treasuries, especially special certificates of indebtedness, at very low yields. So, they were making deposits at the BIS for a period and that gave rise to a phenomenon that later was labeled "rabbits out of hats." When the Bundesbank realized what was going on, they drastically cut their deposits at the BIS, forcing a contraction of dollar credits by the BIS. I would want to be assured on this that we're not making the same mistake in reverse by putting DM on deposit there and having them extend the DM credits. They are not a central bank. I don't know what the full set of transactions is that they are doing, and it struck me as interesting that we're sort of reaching for yield on our foreign portfolio but not on the domestic portfolio. Every dollar's worth of DM we hold in CDs at the BIS is that much less U.S. Treasuries that we hold.

MR. MCDONOUGH. I suppose, Mr. Chairman, the answer partially [relates to whether] we should reduce further our overall DM holdings. The reduction of DM10 billion this year and the sale of our interest earnings, which I mentioned in my note to the Committee last week, is about the maximum amount that would lead the Bundesbank to feel that we were operating in a friendly manner between central banks. That was about the maximum, in conversations that President Corrigan and I had with Mr. Tietmeyer, that the Germans could really go along with. So, that's a partial answer to the question. The shift of the DM6 billion was partially to get some additional yield

With regard to our arrangement with the BIS, just in terms of our own liquidity, we do have an early liquidation agreement with them. Therefore, from the standpoint of managing our own affairs, I think the move to the BIS is something with which we can be comfortable.

MR. TRUMAN. I think the other distinction, President Jordan, between the period 20 years ago and today is that 20 years ago the operations took place without the concurrence or even the knowledge of the U. S. monetary authorities. In this case we're moving to the BIS with the Bundesbank's knowledge

So, it's folded into their monetary policy and they have the capacity to offset the temporary effects

The other side of it is that

MR. JORDAN. But in lieu of other sources funds to the BIS will not [unintelligible] their balance sheets?

MR. TRUMAN. The balances moved to the BIS

CHAIRMAN GREENSPAN. Any other questions for Mr. McDonough?

MR. MCTEER. Yes. I don't have a question on these specific transactions but as another sort of newcomer here I've been listening to these reports and I'm never quite sure exactly what the role of the FOMC is in exchange market intervention and what our goal really is in a world of flexible exchange rates. That's not necessarily a question for now, but sometime I'd like to hear a discussion of precisely what we are trying to accomplish in these kinds of transactions.

CHAIRMAN GREENSPAN. I think we ought to have that topic for a luncheon discussion at some point. We have periodically done precisely what you're suggesting, but it's probably worthwhile to redo it every once in a while to make certain that we're all still in the same boat.

MR. MCTEER. Well, we have three new presidents and two new governors this year, so I think it might be helpful. I know it would be to me.

MR. TRUMAN. President McTeer, as the Chairman said, two years ago we did have an investigation, if I can put it that way, of this matter. Maybe I've been derelict, but I have provided the new governors with a copy of that study and, if the new presidents would like a copy of that document, they can get it if it's not already in their Banks. I think it will be useful as background to this matter. The simple point is that the System has independent legal authority to operate and we have set procedures that have been in place and reviewed periodically over the last thirty years. We have the ability to make our own choices about whether we operate with the Treasury or not. In fact, as Bill has described, this last period very clearly

illustrates the usefulness both of having our independent authority and of using it from time to time because it serves in my opinion to improve the overall character of the policy decision.

MR. MCTEER. I don't really question our authority. I'm just not sure what we're trying to use that authority in pursuit of. I'm just not really clear on that.

MR. TRUMAN. There is a directive that is approved by this Committee at least once a year.

CHAIRMAN GREENSPAN. No, I think the president is requesting the answer to the age-old question: Does it work? And this is still a dubious proposition about which studies go back and forth. I think the great value of the presentation a couple of years ago that Ted was mentioning was that it really went through the literature and the various studies which we have been engaged in and endeavored to conclude in what areas such intervention could be productive and have beneficial effects and in what areas it seemed unlikely to do so.

MR. ANGELL. Mr. Chairman, it seems to me that it might be somewhat worthwhile at this point to reassure the new members that in [our review of] this issue two years ago most of us who were on the side of not having as heavy a hand and not building up our foreign currency balances have been very appreciative of the fact that the Federal Reserve's position under the Chairman's leadership has been in the direction that we prefer. I have a great deal of appreciation for the fact that there's a political question involved here. And it seems to me that our being absent from a significant portion of that [intervention] speaks a lot louder than the \$25 million participation that we did. So, I feel in accord with the direction we're going in and I'm satisfied, but I'm not suggesting that we ought not to have the review. Mr. Chairman, I'd be very happy to move to ratify the transactions, if that's appropriate.

CHAIRMAN GREENSPAN. Well, let's first double check on whether there were any other questions.

MR. MELZER. Just a quick question.

MR. MCDONOUGH.

MR. MELZER. Fundamentally and technically.

CHAIRMAN GREENSPAN. Any further questions? If not, is there any objection to Mr. McDonough's request for advance clearance for the DM sale? Finally, would you like to make that motion [again], Wayne?

MR. ANGELL. Yes, I would. Anything you say, Mr. Chairman!
[Laughter]

CHAIRMAN GREENSPAN. I won't tell you what motion you made!

MR. KELLEY. He was carrying out the vital function of educating his fellow member here on a particular point.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. As a somewhat related issue, we have an exchange of letters with the Treasury Department. I call upon Ted Truman to elaborate on the subject matter.

MR. TRUMAN. The Committee will remember--those of you who were here--that at the last meeting the Committee voted to reduce the size of the Treasury warehousing facility from \$10 billion to \$5 billion, a level at which it had been for most of the last 15 years. As the Chairman said, in the aftermath of that decision there was an exchange of letters between Treasury Secretary Brady and the Chairman. As I noted at the last meeting, this reduction from \$10 billion to \$5 billion caused a certain amount of anxiety at the Treasury. There was concern or nervousness about whether the Exchange Stabilization Fund, which remained pretty [fully invested] on the foreign exchange side relative to the dollar side, would be available to carry out other vital functions. Secretary Brady wrote to the Chairman expressing his concerns to this effect. The Chairman replied making three basic points. One was that he could contemplate a wide variety of circumstances in which he would strongly support an increase [in the size of the warehousing facility]. Secondly, he expressed his confidence that the Committee would give full, careful, and expeditious consideration to any reasonable proposal in that regard. [Lastly,] he said he could not guarantee in advance what the Committee might do with such a proposal. On the second point, just to clear everything up, we mentioned to the Committee last time that it was our hope and expectation that the Treasury would unwind the remaining \$2 billion of DM that they had warehoused with the System. And they are planning to do that; they are ready to do that effective on Thursday. So, the facility will be wound down to zero effective as of that date. [Secretary's note: Copies of the letters referred to by Mr. Truman are appended to this transcript.]

CHAIRMAN GREENSPAN. Any questions for Ted? If not, let's move on to the Domestic Desk, Mr. Sternlight.

MR. STERNLIGHT. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Mr. Sternlight?

MR. PARRY. Peter, you made reference to the strong demands for credit as playing a role in terms of what has happened to interest rates. But the debt aggregates seem to suggest, when you look at what actually has been new debt, that there really hasn't [been much]; it has been quite weak. I guess most of it is mainly [unintelligible]. Is that really much of a factor?

MR. STERNLIGHT. Well, I'm commenting on it as I see it from the market's perspective of enormous Treasury issuance and still pretty heavy corporate issuance. I realize that if you fold in everything, including the bank loan demand and so forth, that it's weak or not all that substantial. But just from the standpoint of what the trading markets are coping with it has been substantial.

MR. PRELL. There's probably also some greater volume of net mortgage financing and it's clearly at the long end.

MR. PARRY. But when it comes to the debt aggregate it just doesn't show up as being very strong; it's very weak.

MR. PRELL. There's a very modest pickup from the fourth quarter.

CHAIRMAN GREENSPAN. Further questions?

MR. SYRON. Peter alluded to this. Is there any more to tell about these stories of a squeeze in the 5- and 7-year note areas?

MR. STERNLIGHT. Well, as I said, we are following up on those stories. On the 7-year note we had a rather formal, organized roundup of additional information and have contacted a number of the dealers to talk specifically about how they are conducting their operations in that issue. We've also had several conversations with respect to the December 5-year issue, which has been a kind of on and off special. It went off and then in the last couple of days came back on special. There, too, it has seemed to us that these were the results of understandable investment decisions by market participants. We don't get any sense of market manipulation activity that, at least at this point, makes us feel that we have to proceed further in that vein.

CHAIRMAN GREENSPAN. Further questions? If not, would somebody like to move to ratify the transactions since the February meeting?

MR. SYRON. So moved.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Mr. Sternlight still has the floor with respect to the memorandum that he sent out a couple of weeks ago.

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

CHAIRMAN GREENSPAN. Questions or comments?

MR. SYRON. Peter, I completely agree with the conclusions in your paper. I have a question on one of the statements in it about the decision that was made some time ago to maintain the liquidity of the System's portfolio.

MR. STERNLIGHT. Yes.

MR. SYRON. In looking at the reasons to maintain the liquidity of the portfolio, what are the relative weights? Is it [primarily] a concern that if we own [securities] at the longer end of the market there are risks for gains and losses as we go in and out or is [the dominant concern] the risk of impacting the longer market more than we might impact the short market? I was trying to understand.

MR. STERNLIGHT. It's more a question, President Syron, of having ample holdings in the very short areas so that if on short notice we had to lighten our portfolio by substantial amounts within a matter of months or even weeks we could do that by either running off bill holdings or selling very short-term securities.

MR. SYRON. That has to do with the depth of the short market as compared to the depth of the long market?

MR. STERNLIGHT. Yes.

MR. SYRON. Okay. So, it's the disruption in the market you would have to deal with. Theoretically, you could still do it on the long market but you might have a greater impact.

MR. STERNLIGHT. There would be a disruptive effect if we sold large amounts in the longer end.

MR. SYRON. Okay.

MR. KOHN. This first arose when Continental borrowed billions and billions of dollars in a very short period of time and we had to offset the reserve effects of that. I think there was a concern that at a time of financial crisis there is definitely a flight toward Treasury bills and that would be a market that we could easily sell into. But we weren't sure what would be happening in the coupon market. And selling into a market that might already be--

MR. SYRON. Tumultuous.

MR. KOHN. --treacherous or tender would not be a good idea.

CHAIRMAN GREENSPAN. Hold on a second. President Black was first.

MR. BLACK. Mr. Chairman, I think Peter has done an excellent job of outlining the history of this for us and he has made an excellent case for a high degree of liquidity. That has been needed in part because we have had to offset reserves supplied through the discount window and also through foreign exchange operations. The only point I would make is that a lot of us have reservations about how much we ought to deal in the foreign exchange market. The changes in the discount mechanism and the law that was passed last year suggested that we lessen our emergency lending through the discount

window. So, I think this gives us a little more opportunity after we've sopped up the reserves released by the reduction in reserve requirements and through the "encouragement at the margin"--I believe that's the term you used, Peter--toward getting longer-term securities. If there is some premium on those rates, this could help to reduce that premium to some extent, although I don't really buy that argument to any great degree. I think we have a little better case now for intervening than we did before but it's only a marginal case, and I don't feel very strongly about it. We also would earn a little more from the Treasury if we did more, but who can tell? Maybe, we'd need more liquidity and a further reduction in the reserve requirements. It was a good paper; I thought it was very, very good.

MR. STERNLIGHT. Thank you.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Peter, let's say we did tilt toward doing more operations in longer coupons. I don't know what your reaction would be, but it seems to me that a cynical market observer could question what that implies in terms of the System's long-term commitment toward price stability. I don't want to carry this too far, but to the extent we are seen trying to jawbone long rates down or conducting operations that substantively are not going to have a lot of impact, if someone looked at that cynically they could view that as window-dressing to try to hold long rates down while perhaps we were trying to pursue basic policies that weren't consistent with price stability. Do you see the opportunities for that kind of cynical interpretation?

MR. STERNLIGHT. I do, President Melzer. That makes me very leery of doing anything, as I say, very noticeable in that direction. That's why I would suggest holding any greater effort in that vein very much at the margin.

CHAIRMAN GREENSPAN. I think the question, however, is: Do we slow the rate of decline in the average maturity of the portfolio, do we stabilize it, or do we defend against a rise? And despite the \$11 billion in Treasury coupon absorption last year, the average maturity continued to fall. The question is: Do we want to let it continue to fall or to stabilize it? I would be surprised if the markets reacted negatively to our taking actions that tended to stabilize or just slow the rate of decline toward ever shorter maturities in our portfolio. I think the argument is that if we switch from [slowing the] decline to a rise, that could very easily turn out to be a counterproductive activity on our part. But I gather from what Peter's memorandum is suggesting that the issue is essentially [whether] to slow the decline.

MR. STERNLIGHT. And I think it would have that effect. That particular statistic on the average maturity is very dependent on how we handle not so much our market purchases but our rollovers and quarterly refundings. We've tilted those quite strongly toward the short options. That was what we had outlined as a plan to the Committee in the mid-1980s, following the discussions that Don alluded to. And by virtue of steering our holdings very strongly toward the three-year option each time, that has tended to work, just as a factor in itself, to bring down that average maturity.

CHAIRMAN GREENSPAN. The purpose then was to increase the liquidity of the portfolio for fear that it might not have been adequate in the event of some really significant problems with some of the larger banks?

MR. STERNLIGHT. Right.

MR. KOHN. That refunding action itself has no effect on the maturity of the debt held by the public because our allotment is just an "add on" to Treasury auctions.

MR. MELZER. My point, Alan, was that there's probably no problem doing what [Peter is] suggesting, but it's probably better for us if it's just done quietly than if for some reason what we do attracts publicity. That's my point.

CHAIRMAN GREENSPAN. I don't think Peter is recommending that we--

MR. MELZER. No, I know.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Well, I agree with President Melzer and Chairman Greenspan on this issue. The pattern has been one of [average] Treasury maturities increasing since the '70s and System holdings decreasing in maturity. And that means the public holdings have increased substantially [in maturity]. Now, I don't think it's an especially good idea to wander around in maturity issues, whether it's our holdings or Treasury issues. So, I think there's a strong argument to figure out where we want to be. I'm not very comfortable with discretionary action or anything that could be perceived as discretionary action to move along the maturity structure to affect rates, especially in this environment. One only has to look at the way the markets responded to this innocent little reserve requirement cut we did a few weeks ago to document Tom Melzer's assertion of cynicism in the market. So, I think it would be a bit difficult to pull off here, and we ought to be very careful. It's hard to communicate what we're doing. But I think it would be useful to stop the wandering and determine what makes sense as a maturity structure and implement that. And I think that's what Peter's memo does.

CHAIRMAN GREENSPAN. Vice Chairman.

MR. CORRIGAN. I think there really are two issues here. One is this question of what should be our strategy as a whole with regard to demands on the portfolio itself. I think that's fundamentally what Peter's memorandum addresses. For the reasons that a couple of people have already cited, including Don Kohn, it seems to me that the premium should in fact be on liquidity even though we may need it only once in ten or twenty years. When we need it we better damn well have it! I think what Peter is suggesting is quite consistent with that. I don't have a great deal of allergy to the average maturity going down a little more or slowing down. What Peter suggested seems to me to make a lot of sense.

Of course, the other question that looms in the background, which I think is different than a coherent longer-term strategy to

portfolio management, is this question of whether the System, by becoming more active in the long end of the market, could or should do something of a one-time nature to help somehow or other to tilt the yield curve down. I don't think that issue [unintelligible]. On that point, I have to say that I am increasingly skeptical. I think Peter captured it right: That the great danger here is that this holds out more than it could possibly deliver. I ask myself again the question of why the long rate is so high and so sticky. Peter gave the usual menu of explanations. Now, I think they're all relevant, but I am coming more and more to the view that maybe it's not all that complicated. The Treasury is selling \$100 billion, give or take, of new debt into the market per quarter. It doesn't matter whether some of it is cyclical deficit or RTC financing; it's still \$100 billion a quarter. And it's in a context in which for the past year to 18 months--this is Bob Parry's point--private credit demands have been virtually nonexistent, net. I think part of what we're seeing now is [the realization that] if the economy starts to pick up and if the credit crunch is about to have run its course and private credit demands begin to increase even a little when we still have the \$100 billion a quarter hanging over our heads--and in a context in which the appetite of the Japanese for American securities and Treasury securities in particular has changed very significantly and is not likely to reverse itself in the near term--the deck is stacked against us. In those circumstances, I'd have to say that any overt effort to use our own portfolio management tactics and strategies to wiggle around the long-term rate would run a very sizable risk of backfiring. I would be most reluctant in these circumstances to get ourselves back into that kind of position.

CHAIRMAN GREENSPAN. Any further comment or questions? I gather from that that there is a general acceptance of the philosophy and thrust of Mr. Sternlight's memorandum with respect to this issue. If that is the case, I think we can move on to the economic situation and call on Messrs. Prell and Truman.

MR. PRELL. Thank you, Mr. Chairman. [Statement--see Appendix.]

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

CHAIRMAN GREENSPAN. Questions for either gentleman?

MR. FORRESTAL. Mike, I'm curious to know why exactly you think that long-term rates are going to come down over the next year? Is it basically inflationary expectations?

MR. PRELL. Well, we do think that the outside world is perhaps overestimating the inflationary effects of this moderate growth and underestimating the effects of what is generally perceived to be a continuing fairly sizable amount of slack in the economy. So, I think the possibility of diminution in the markets' inflation fears is a significant one. Also, as people perceive that only moderate growth--if we are right--is ahead, that will ease some people's fears that we might be opting to do something that could close the margin of slack more rapidly. I have the sense that perhaps long-term rates have moved up into the range in which they have been fluctuating for a while without a particularly sound basis and that we can simply have some reversal. But I think the fundamental factors are the moderate

course in the expansion we see and the continuing slack that should be bringing the inflation rate down, not stabilizing it or pushing it up as most outside forecasts have it.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Ted, two characteristics of the usual forecast are what was mentioned: the downward trajectory for long-term rates and also a flat dollar. What are the interest rate developments internationally that are assisting in bringing this about? For example, in our model we almost have to constrain it from pushing the value of the dollar down in that kind of environment.

MR. TRUMAN. I'm not sure what you assume about rates abroad, but on the interest rate side we have essentially the same [amount] of decline in long rates. We're assuming that ultimately the Germans will get things under control and bond rates will drift down as well, though maybe not quite with the same timing as U.S. rates, by about 50 basis points over the projection period.

MR. PARRY. Japan?

MR. TRUMAN. And that includes Japan, though the timing might be a little different for German and Japanese rates.

MR. PARRY. Would more conventional linkages among rates produce a decline in the value of the dollar when one uses the model?

MR. TRUMAN. Well, it all depends on the model. Exchange rate models that use longer real interest rates essentially produce an unchanged dollar using these rates.

MR. PARRY. They produce an unchanged dollar?

MR. TRUMAN. Yes, an unchanged dollar, given our inflation forecast and given our interest rate forecast. We mentioned in the Greenbook that there is one qualification that one might introduce here and that is the issue of what is expected either here or abroad. One can tease out of some of this yield curve information and certainly out of T-bill futures a view of U.S. interest rates that is different than Mr. Prell's, if I can put it that way. And to the extent that Mr. Prell's true view becomes clear to the markets, one might argue that that would put downward pressure on the dollar. I think the only question is whether there is an analogous error of judgment about interest rates abroad. So, there is some downward risk coming from that disconnected light at the end of the tunnel that he referred to.

MR. PARRY. The Prell factor! Thank you.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mike, I have a lot of sympathy for your view of the importance of inventories and trying to understand this whole area of inventories and the risks on either side. There's no definitive answer to this, but I was wondering: What is the central tendency of opinion on how close we've come to the end of this process of [firms]

changing their optimal, if there is such a thing, inventory/sales ratios? Do you see that as a process that is still going on?

MR. PRELL. I feel reasonably confident that it is a process that is ongoing. Certainly, to the extent that there is any evidence, formal or informal, companies indicate that they would like to have lower inventory/sales ratios. In manufacturing, while there has been some considerable progress, firms still are redesigning their production processes, their relationships with suppliers, and their overall inventory management, to trim inventories. And as we noted before, we've yet to see the benefits of inventory management techniques and utilization and so on in the retail and some wholesale sectors that we might have hoped for, and we think there's potential there as well. But, certainly, the consolidation of the retail sector, if that continues, ought to work a bit in that direction. So, there's still likely to be a trend movement and it's inherent in our forecast. We have a very modest rate of inventory accumulation; late in 1992 and in 1993 the inventory/sales ratio is drifting down [in our forecast]. We're drawing our lesson much more from the trends of the last long expansion than from what one might have seen in earlier cyclical upturns. So, in a sense it's either a cushion or we've captured a trend that's probably continuing.

MR. SYRON. Thank you.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Mike, would you elaborate a bit on this issue of pent-up demand that you mentioned in passing with regard to the consumer spending situation?

MR. PRELL. That is obviously hard to assess. It's to some extent a matter of gauging what people's desires are and those could change over time. A simple examination of what happened, particularly in the motor vehicles area, is that we look for trends in motor vehicles per household. The trend in the stock of motor vehicles has varied in constant dollars. We look at the equations that we have for automobile demand, such as they are, which estimate a desired stock given operating costs, interest rates, and those sorts of things. All of these seem to point toward some shortfall. We're not sure how much it is. Drawing some trend lines we get something like 1-1/2 to 2 million units at present. We are aware of the forecasts within the industry, which are based on the notion that there may be a 3 million unit shortfall--pent-up demand as it were. Basically, our forecast is one that, given the basic replacement needs, doesn't really make any substantial progress in overcoming that. Again, one might view this as possibly a small upside risk: That as this expansion proceeds people will want to replace some of those cars which are now, in terms of median age, considerably older than people used to live with. Maybe the cars are better; maybe we don't need to return [to trend]; but there does seem to be some possible backlog of demand there.

Other areas we don't see so clearly. There has been a very sharp downturn in expenditures on other durables and on some nondurable items that one might think of as lasting some span of time. Conceivably, there's some backlog of desired spending there. We haven't built it in; it isn't readily visible in other data on stocks for durable goods, for example. The past year or so has been a period

of extraordinarily weak consumer spending and we think there's some backlog and buildup.

CHAIRMAN GREENSPAN. Further questions? If not, would somebody like to start our Committee discussion? [Does the silence mean the answer to] that is a no?

MR. FORRESTAL. The last couple of--

CHAIRMAN GREENSPAN. I think Bob Parry signaled me first.

MR. FORRESTAL. I yield to my colleague.

MR. PARRY. Thank you. Mr. Chairman, the Western economy appears to us to be moving sideways, although I must admit there are a few encouraging signs that have emerged since the last meeting. We do a survey of business leaders and ask them their views about future developments. One of the questions that we ask them is whether they expect any declines in output in the next two to four quarters. In January, more than 30 percent indicated that they did. In the most recent survey, that number was a little over 10 percent. We also have seen a bit of a change in the residential real estate market. In California, for example, the number of existing homes sold has risen in each of the last four months, and the gain that we saw in February was the sharpest month-to-month gain in five years. Moreover, retail sales don't seem to be deteriorating the way they were. One major retailer on the West Coast indicated that in the month of February his sales were up 8 percent from the year-ago period and another major California retailer indicated that sales were about 10 percent above year-earlier levels. One recognizes that there were some special factors, including the extra day in February and also the war-related weakness that occurred the year before.

I'm sure you've heard about or are familiar with the benchmark revisions going on with regard to employment data. On a negative note, the California benchmark revisions for employment are expected to show a falloff of 4 percent since July of 1990, which is more than double the decline that we've been working with in the preliminary data.

If I can turn briefly to the national outlook, it certainly seems clear to everyone that final sales have picked up rather significantly in the first quarter. As a result of these developments, it would seem to me that the risks to the outlook are more symmetrical than they were at the time of our last meeting when the downside risks seemed to dominate. Our forecast is very similar to that of the Greenbook. Both forecasts include a downward path for long-term interest rates, which to me seems consistent with the fundamentals of a moderate expansion. Such an outcome for rates, however, as we've mentioned a couple of times, does not accord with market expectations. My own view is that if we do get those kinds of rates, it's conceivable at least that we'll see the dollar decline rather than remain flat. Finally, it would seem to me, given the current low level of economic activity and also the prospect of a modest expansion, that the Greenbook's basic outlook for a gradual downward trend in underlying inflation certainly makes a lot of sense. Thank you.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I'm happy to say that economic conditions in the Sixth District have definitely improved since the last meeting. The information that we have for the six states in our District suggests that activity is improving in all those areas with the exception of Louisiana. And more importantly, the forecast seems to be that this improvement is going to continue. This general improvement has been confirmed by our directors and other business contacts that I've talked to over the past several weeks. They're expressing guarded optimism, but the tone is certainly a lot better and there seems to be an uptick in consumer confidence. On the other hand, bankers are continuing to report very soft loan demand. If there's any strength at all in loan demand, and it's very marginal, it's on the consumer side, not in business lending. We've recently seen modest expansion in orders, production, and shipments by producers of apparel, household goods, and construction materials. And there is a parallel development of improvement in the retail sector as well, although durable goods retailers are reporting rather weak sales. But the nondurables and services are doing better. Auto dealers, on the other hand, are talking about increased traffic but not increased sales.

Housing, as in other parts of the country, has improved, although realtors are becoming more and more concerned about increases in mortgage rates. We've had increased permits for single-family homes, and I guess associated with that lumber prices have moved up a little and builders are [now] anticipating price increases for other construction materials as well later on this spring. On the commercial side, leasing rates for commercial properties have stabilized and this market seems to be in the very early stages of a recovery. Another positive factor in our District is that we're not hearing of any new projects coming on stream, which is certainly a plus. Tourism and business travel continue to be a bright spot for our District. Convention bookings are up in several cities and Florida is seeing a quite significant increase in visitors from abroad. The improved health of many of the Latin American countries is reflected in increased export sales to many of those countries. Those are the positive aspects of the ledger.

Obviously, we have some weak spots as well. State and local governments throughout the District are still wrestling with their budget problems, and I don't really see any light at the end of that tunnel. The energy sector has also been very hard hit by the mild winter, which has added further downward pressure on natural gas and oil prices. And in February the rig count was down 41 percent in Louisiana from a year earlier; that compares to a decline of about 32 percent in the nation as a whole. And, of course, layoffs are continuing apace in that sector in Louisiana.

In addition to those price pressures for construction materials that I noted earlier, many manufacturers are anticipating some higher input prices in the second half of this year. Labor markets on the other hand are still quite soft and wage pressures are quite steady; in effect, there are no wage pressures.

With respect to the national economy, our forecast for real GDP is quite similar to the one in the Greenbook. We're not quite as

strong in the first quarter, but after that we virtually converge with the Greenbook. We do have unemployment coming down a little faster than the Greenbook, but our biggest difference is on the inflation side, where we see inflation moving up more rapidly than in the Greenbook. Our forecast in 1993 is for inflation, as measured by the CPI, of about 4 percent. In general, it seems to me that the risks are much more symmetrical than they were when we last met; they're much more balanced. Obviously, as Mike indicated, we could have another false start as we did before. But I personally feel much more confident that we're on a path of a more sustainable but modest recovery. All of this suggests to me, Mr. Chairman, that we don't need any policy adjustments at the moment. Thank you.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Thank you, Mr. Chairman. With regard to the national economy, our forecast is very similar to the staff forecast at least in contour. We also show an improving quarterly trend but our growth rates, particularly in the first and second quarters, are a bit lower. Our outlook for personal consumption, particularly durables, is just a little lower than the staff forecast. Correspondingly, our outlook for inflation this year is a bit more positive. We would think the CPI, for example, by the end of the year could be at 3 percent or a bit lower. But these overall differences are really just differences at the margin.

In the District, the modest improvement that I commented on at the time of the last meeting and also on the telephone call continues. Certainly, residential housing in the Midwest has been a strong point. Homebuilding has increased significantly and home sales have also been very active. But I do think weather has been a decided factor. We've had the warmest winter in 97 years and I have a hunch that the seasonal adjustment factors have had an effect on the numbers. At the distant horizon--and I would emphasize distant--I am hearing a little better tone in the commercial real estate sector. Some investors are beginning to express at least a possible interest in commercial real estate. That's the first time I've heard that in quite a while. Not in any way should this suggest that there's any interest in new projects; that's a long way out. In fact, in Chicago we have a number of fairly sizable projects that are still being finished. As a consequence the rental overhang is pretty high and the rental terms are very, very tough. Nonetheless, this possible interest on the part of investors to come back may be indicative that we could be reaching toward stabilization in this very tough sector.

The automobile business is a bit better, at least for the one manufacturer that I talked to. Their first-quarter production, for example, was 32 percent over last year; last year, of course, was very low as a comparative period. The second-quarter production will be up about 8 percent. Encouraging also is the dealer order rate, which has shown a significant improvement on a week-by-week basis as we've gone through this year. Sales have been a little under forecast but there is a better tone out there. There is a better mix: Fleet sales are down; retail sales are up. Also, retail pricing for autos has been a little firmer. In the truck industry, medium truck demand is flat to down a bit, reflecting very tight control on capital expenditures by businesses. But the demand for big trucks, the class A rigs, is up a bit, and one manufacturer is forecasting a 10 percent increase in

sales this year for the class A group. Still, in a comparative sense, that is a very modest number.

The steel business continues to be pretty reasonable. First-quarter sales will come in at an 82 million ton annual rate. The industry is now operating at about 85 percent capacity but the pricing in the steel business is very, very tough. On the retail side, sales continue to show an improvement. It looks to us as if retail sales in the Midwest are running about 5 percent ahead of last year on a comparable store basis but the pricing continues to be [very competitive]; we see no inflation on the retail side. In the agricultural sector, the outlook for the crop year looks favorable, at least at this point, despite a fairly warm and a dry winter. Ground moisture is regarded as being excellent in most of our ag areas. Planting is going to start in two to three weeks and the outlook is pretty positive. There is some concern out there about the [weather] effect; nonetheless, we are forecasting normal crop production this year.

With regard to inflation, I do think the outlook continues to improve. Pricing conditions in the marketplace are awfully tough. The big increases just don't stick and in some industries--paper, for example--prices are continuing to come down. And energy prices just don't represent anything by way of an inflation issue. On the labor side, the contracts are being settled on very favorable bases. In the paper [industry], for example, one of our directors reported that a company has recently gotten a six-year contract, with annual increases of 3 percent a year plus a one-time premium shift buyout of 3 percent. Two other paper companies got five-year contracts at very, very modest wage increases. So, certainly, those contracts have gone well. But one labor negotiation that has not gone well, and I've commented on it before, is the Caterpillar contract; the strike is now almost five months old. They held the first talk in quite some while last week, but nothing came out of that. In fact, the union rejected what the company said was absolutely its final offer. So, the discussions broke off and both sides left. The pattern issue is what is holding them up. Both sides have said that absolutely under no circumstances will they give on that particular issue. In the interim Caterpillar's inventories are running down to pretty low levels; and current production, of course, is very spotty. I talked to somebody yesterday

That for the union would be a very tough situation. The expectation is that this could get to be pretty vicious before we're all done.

Net, while the anecdotal reports and certainly the data continue to be positive in a modest sense, I continue to think the risks are very much on the down side. They are perhaps not as great as they were a few months ago but, still, I think that's where the risk is. Therefore, in terms of policy response, I think we should be geared to deal with any signs of weakening should they appear. Thank you.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, there has been a marked change in the degree of optimism in our area, which seems to be very similar to what is happening in the rest of the country. For example, in our recent regular survey of retailers and manufacturers for the Beigebook, we found more signs of optimism, both nationally and locally, than we had at any time since 1989. Contacts with our directors and others since then have pretty well verified that sort of sentiment. And we are seeing in the actual figures some pickup in physical activity. For example, new home sales and residential construction are rising pretty much across the District; and sales and production in industries related to housing--like furniture, textiles, and homebuilding products--are also picking up in strength. At our last meeting, one of our most astute directors said he sees absolutely nobody who thinks the recession is not over. The way he put it, the only question in people's minds is what the strength of the recovery will be.

So, against that kind of regional background, and taking account of the latest information that we have gotten on a national basis, I think the staff was justified in making the upward revision in the forecast that it did. The overall profile of the Greenbook is quite close to what we would expect. The key question is where the risk of error lies. And on this we come out a little differently from some of the others who have spoken in that we think the risk of error is on the high side even after these upward revisions in the forecast are taken into account. That is because we continue to believe that the easing we put into effect in November and December was pretty strong medicine and that its full potential impacts have not yet shown up and probably are not captured fully in the Greenbook and other forecasts. But we have less confidence in that now than we did because of the weakening in the behavior of M2 in March. One of our economists did a simulation that suggested the widespread uncertainty about jobs probably was reducing consumption by maybe 2-1/2 percent from what it otherwise would be. It's really an interesting study; it's econometric but nevertheless pretty revealing, and it sort of verifies what everybody assumed was happening.

I'm happy to see that the staff still expects that the disinflation trend will continue and that inflation can be brought down somewhere below 3 percent by the second half of this year. As the Greenbook notes, this projection is pretty much at odds with most of the current market expectations. It's also at odds with most of the forecasts that we've seen, which call for an early increase in inflationary pressures as the economy improves. But the difference between the staff forecast and these other forecasts now is that we can make ours happen if we play our cards right! And I'm increasingly confident that we will.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. The Eleventh District economy has held up throughout the recession and slow recovery better than most Districts, I think. Our total employment is almost 2 percent higher than it was in July of 1990, just before the recession started. Initially, our economy was supported by improvement in the energy sector, resulting from the temporary spike in oil prices. But since about the middle of 1991, the energy sector has become a major drag rather than a source of impetus. Bob Forrestal already referred to the low gas prices and

the effect that is having on the gas industry. And the oil exploration and production business is rapidly disappearing in our District through layoffs and moves abroad. That's a long-run decline that people are very gloomy about, particularly with the Clean Air Act having just passed; that's going to have an impact on refineries as well as exploration. The gap, though, since the middle of '91 has been largely made up in our District by the reaction of residential construction, single-family housing, to the lower interest rates. We've also benefited throughout this past year and a half from a fairly strong Mexican economy and fairly robust exports from the Eleventh District to Mexico. The mood in the District seemed to improve dramatically when we first started hearing reports on retail sales in January and February, before the data were announced. So, things have picked up optimism-wise and that's reflected in our Beigebook survey as well.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. I'm not sure that we have very much to report as far as the region goes that is different from what people are talking about nationally. We have seen some signs even in New England of tentative recovery consistent with what people have talked about [happening] elsewhere in terms of retail sales, housing sales, and sentiment. We've been seeing some increase in employment, which is interesting because we find that in the current household survey but not in the payroll numbers. Trying to reconcile the two we find that there are a lot of new electrical and gas hookups and new firms starting that are not yet picked up in the payroll survey but are picked up in the current population survey.

On the banking side, there are some stirrings of very, very tentative improvement in loan demand though a leveling off. I would say, on the side of asset problems which we think probably have peaked. I would think that housing prices--not commercial real estate but housing prices--probably have reached their low point; and that, combined with [lower] mortgage rates, has been stimulating some activity. As for manufacturing, the paper industry is actually doing quite well and the computer industry is seeing some improvement, but there is some more recent concern about exports. There is, of course, a lot of variance in this across the region--the defense influence. I would have to say, and probably one shouldn't read too much into this because of the problems with seasonals, etc., that in conversations since the Beigebook--in calling people in the last few days before coming to the meeting--both retailers including auto dealers and people in the real estate business report some slack in the last 2 to 2-1/2 weeks. There may not be too much to that, but some of it is attributed to the rise in rates at the long end.

As far as the national economy goes, we share the view that the economy is improving. We continue to be worried, though, about the durability [of the improvement] and how [developments] will cumulate. We do have an uneasy feeling, which one can't avoid, about vulnerability to swings in mood. Just in talking to people generally --and others have mentioned this--we see a degree of dissatisfaction generally and a fragility in people's confidence about the future that require us to stay on our toes. As I say, I pretty much agree with the Greenbook. I am concerned about two things: (1) the cumulative

process that I referred to earlier and (2) the possibility of exports being a little softer than we have talked about before.

As far as policy goes, I think this leaves us with two issues. One: Is the economy turning? I think the answer to that is probably yes. The second issue, though, is: How strongly is it turning? I would say that one place where we might have a slight disagreement with the Greenbook is that we see the unemployment rate possibly increasing a little further. Based on work that we've done on the relationship to claims, we don't really see the unemployment rate declining until we get claims dropping below 400,000 for a long period. So, we still think that the strength of the upturn will be on the soft side. That is consistent, of course, with our quite optimistic view of continued improvement on the inflation side. We think that Mike's interpretation of long-term bonds is probably correct because if inflation does continue to come in fairly well, it will tend to convince markets further as we go along.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Developments in our District are broadly consistent with what is going on in the rest of the country. There is noticeable improvement in the residential area, including the construction of new houses. The retailers feel better and the sales data are there. But when they look at their sales it's year-over-year, and last year sales were very weak. So there's concern about how these retail sales will look a couple of months from now. The manufacturing area has shown some strength. In the nonresidential area, the District really has a long way to go before it digs its way out of the hole; I think that sector is just going to be a drag for some time to come. Bankers report essentially flat loan demand outside the residential area, although more of them are reporting that the share of new financing is rising and the share of refinancings is falling. I think that's consistent with the data we're getting on the residential side. Employment growth is still flat to down, and I think it will be some months before we see any improvement there. In terms of attitudes, I think "optimism" is too strong a word. I would say "cautiously hopeful" describes business sentiment more [accurately]. I think [business executives] see a turn, but they just are not optimistic yet. In terms of consumers and rank and file citizens of the District, the mood is certainly not optimistic but more one of frustration than of pessimism. How that will play out in consumer sales I'm not sure. But there is this dichotomy, I think, between hopefulness in the business sector and a very deep-seated frustration on the part of most other people.

As far as the nation goes, I think we do have a modest pickup in the making. The issue, as we've talked about around the table, is whether it is sustainable. I think the risks are less on the down side now than they were six weeks ago, but on net I still have more concern that this modest recovery will peter out rather than be significantly stronger than the Greenbook forecast. But my forecast would be very close to that in the Greenbook. I think a modest recovery is the most likely outcome.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Our District continues to show a mixed performance on balance with very slow recovery [emerging]. For example, our employment in January was up about 0.1 percent over the prior month. As for the positives, one is retail sales. Retailers around the District tell us that there has been a pickup in sales and they are, as we've been saying, cautiously optimistic that that will continue. Construction-wise, we are still seeing improvement. January was about 12 percent over a year ago for the District, but that was primarily in residential. Commercial property continues to be fairly weak, with vacancy rates in Colorado, for example, still in the 24 percent area and higher than that yet in Oklahoma. So, that sector is going to remain weak; but residential [construction] has been very strong. Manufacturing is mixed for us. In the auto industry there are still plans to continue with two shifts, but there has not been enough optimism for them to reverse [the decision] in process of being implemented to lay off 1,000 employees in Kansas City. Also, other manufacturers we talk with are seeing some pickup, but it's very modest and they're not at all convinced that business is going to continue strong as we go forward. They're waiting to see. Economic activity is also being dragged down a bit with some defense cutbacks. Martin Marietta in Denver, for example, is laying off 1,000 workers; and Allied Signal in Kansas City is laying off about 750. So that's a bit of a drag offsetting the anticipation of stronger sales in the auto industry. Clearly, our weak sector is energy. It's still very weak. The rig count is down 25 percent from a year ago--not as much as in Louisiana, but down. As you may have read this morning, Oklahoma has passed a law trying to restrict production of natural gas in an effort to boost its price; we'll see how successful they are. In agriculture, the outlook is a little mixed. In the grain area, there is some optimism with regard to prices. In the cattle area, there is more pessimism. Land values have remained virtually unchanged because of some concerns about pricing going forward. So, our economy is mixed, although people are trying to be optimistic.

Nationally, we generally agree with the Greenbook although our forecast is not quite as strong. We anticipate and we're optimistic that the economy will grow a little less than 2-1/2 percent over the year. However, we differ a little. We think investment will be a little stronger and consumption a bit weaker than the Greenbook is projecting. On the inflation front, we are also about in line with the Greenbook in terms of seeing core inflation continue to trend down. So, that's where we see things right now.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. With regard to the national economy first, Mr. Chairman, I'm struck by how much better the readings on the national economy are relative to what we were seeing as recently as three months ago and relative to what we expected to see. I think the Greenbook has the appropriate response to this. I personally am pretty cautious. A quite modest recovery by historic standards is still what I think we're most likely to get, and that's what is reflected in the Greenbook. So, I'm comfortable with that outlook. But the probability of achieving something like that looks to me to be a good deal higher than we might have expected just a few months ago.

At the District level, we've seen modest improvement for some time. That seems to be continuing. Attitudes have improved. I

wouldn't say that they're positive necessarily, but the gloom seems to have lifted. And the expansion seems to be reasonably broadly based. It's evident in housing, of course, retail sales, agriculture, and tourism, so that the District seems to me to be consistent with the national picture as well.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. In our District the statistics continue to be generally positive. We have modest nonagricultural employment growth; manufacturing employment is down modestly compared to the prior three-month period but that's more than offset by gains in nonmanufacturing. I would say that manufacturing has been bouncing around a little; I think I reported a modest increase last time. Both residential and nonresidential construction contracts are quite strong, up about 15 percent in each category against the prior three-month period. And the banking numbers that I report on periodically have continued strong through the fourth quarter. Basically, the question always is: Will those numbers hold up through year-end reserving and so forth? And in our case they did. ROAs are still around 1 percent; ROEs are around 12 percent; nonperforming loans are flat and also are fully reserved.

On the anecdotal side, I've had three or four contacts with branch boards or our board and other groups since our conference call, and I would say that the pattern I've heard there supports the more positive tone that seemed to emerge on that call. I continue to be struck by people reporting plant relocations, plant expansions, labor callbacks, and so forth. So, I get the sense that this [better tone] is gradually working its way back into the manufacturing sector. We had a group of CFOs in from major St. Louis companies, and I would say that in general the picture I got from them was not as positive as some of this other information. They still view this as a very difficult business environment with not a lot of flexibility on the price side. They are basically either maintaining or increasing earnings through a lot of focus on the cost side. So, that pattern goes on.

Nationally, the only comment I would have is that our forecast generally is in line with the Board staff's in terms of real growth looking out to 1993. On the price side, we're not quite as optimistic and generally are getting increasingly concerned about the stance of policy vis-a-vis what might be shaping up on the real side.

CHAIRMAN GREENSPAN. Vice Chairman.

MR. CORRIGAN. Let me just start with a couple of rifle shots on individual points. First of all, I do get the sense from business leaders and others that things feel better. How pervasive or lasting it will be I think is still a big question. But even among some of the CEOs of major companies that are notoriously bearish we do get reports of a quite discernible uptick in activity in orders in the past couple of months. Upon reflection, I think a lot of what is showing, at least to date, seems to be directly or indirectly related to the pickup in housing activity and the more modest pickup in the auto sector. But for what it's worth, even among the most notoriously bearish that comes across.

Just an outlier point, to get back to something that Ted Truman mentioned in passing. I have to say, Mr. Chairman, that I'm getting more anxious about the situation in Japan, both in economic and financial terms. Some of that I think is for the reasons that Ted mentioned or alluded to, but just in the past few weeks I have had several [talks] with private-sector individuals on firemen's visits, and these guys are really bearish. At least in memory, I've never heard Japanese CEOs from both financial and nonfinancial firms speak with the concern that comes across. I don't know what to make of that, but I do think that situation is probably even more tenuous than perhaps the numbers themselves would indicate at this point.

CHAIRMAN GREENSPAN. I think there's a lot of whistling in the dark there, too.

MR. CORRIGAN. Well, that's part of what I mean. Closer to home, as several others have said and as I've said at a couple of previous meetings at least about the greater New York area, commercial real estate in price terms and in rental rate terms does indeed seem to be firming.

CHAIRMAN GREENSPAN. Firming, not stable?

MR. CORRIGAN. Firming, yes. Now, as others have said, that doesn't mean the beginning of new projects. And needless to say, this Olympia and York [situation] could queer that firming depending upon how that shakes itself out. My sense of that right now is that while there is a lot of international exposure, it's sufficiently widely distributed and diversified that in and of itself it would not materially add to our problem. The larger question is whether [Olympia and York] is having a liquidity problem or worse. I fear it's probably worse. And I think the danger, aside from the obvious point about creditor exposure, is that it could reverse the apparent stabilization or slight improvement in commercial real estate in a lot of places, not just in New York or London. That's an uncertainty even if the credit exposure part of it can be effectively managed.

On the banking side, loan demand is still quite clearly slack. I think it's also fair to say that financial fundamentals do look slightly better, partly because the real estate situation has stopped getting worse. Another point that's relevant is that at the moment it's probably fair to say that the fiscal threat is reduced but not eliminated by recognition of the real dangers of highly reckless fiscal policies.

CHAIRMAN GREENSPAN. As recommended by a number of our colleagues!

MR. CORRIGAN. I was going to say that if we had a few of these Nobel laureates under a little better control, I might feel a little better! Notwithstanding that, the risks there don't look to me to be as bad as I thought they would be.

One last point I'd make in terms of the national outlook--and Mike touched on this--is that the employment outlook is very important in our thinking about the forecast, partly for the psychological reasons that people have talked a lot about. I do think this confidence issue is importantly rooted in uncertainties about

employment prospects. But beyond that, as Mike said, it would be quite unrealistic to assume that we're going to finance even a modest rise in consumer spending with a decline in the saving rate. In the Greenbook there is a tiny decline over the next couple of quarters. If you look at our own forecast or Mike's forecast--in round numbers, Mike, you have growth of something like 800,000 Q4-to-Q4 in payroll employment, give or take. Now, that number doesn't sound all that crazy; it's 65,000 to 75,000 a month on average. Those are not horrendously big numbers. And that gives me some confidence in the internal consistency of the forecast. But I do think that the employment situation, both for psychological reasons and for income-flow reasons, is going to turn out to be very, very important. Having said all of that and recognizing that there are a lot of crosscurrents out there, I personally feel that the staff forecast is a good one. Despite all the problems, I think there's a reasonably good chance that we can see a pattern that looks very much like that over the course of the year.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I would agree that the staff forecast is a reasonable forecast. I would be on the side of slightly lower nominal GNP, if I had any difference, over the coming two or three quarters. I agree with Jerry Corrigan that the circumstances in Japan are really close to being super worrisome. Asset price deflations once underway may not respond as well as some may believe to a monetary policy adjustment. And I think we all know about the run-up in real estate prices in Japan. It's not as if it were a magnitude of 2 times or 3 times as high as would seem reasonable, but it might be more a magnitude of 5 to 10 times as high as might be reasonable! I guess all of us have had confidence that they will be able to produce a soft landing a lot better than we could, and yet it does seem to me that their reluctance to respond to rather low monetary growth does indicate that the tide among central banks internationally, including the G-7, is still pretty conservative. It seems to me that the European community also has its own problems, and driving European monetary policy by the Bundesbank's particular set of parameters affecting Germany and not affecting others seems to me to [drive fiscal policy in Europe to] equal in some sense the fiscal policy in Germany, which is out of accord with the Maastrich rules. That is, they're not going to qualify for being a part of the club if their fiscal policies deteriorate. So, even though I expect some change, as Ted Truman suggested, it does seem to me that it will be on the conservative side. And when you look at those European economies and the amount of subsidies that are there and the pressures that are on them, it does seem to me that they are not quite in the promised land in regard to the economic growth that one would expect to be a part of the Common Market phenomenon. I think we will find more and more that a common economic market without a common political market has a lot of obstacles and they haven't found the way to crawl over all the boulders yet. And there seem to be a lot of boulders.

This would then suggest that U.S. exports or net exports would be even more of a drag than Mr. Truman and the staff suggest. And I suppose my optimism shines forth here in regard to my belief that with cost-cutting in U.S. firms, with the exchange value of the dollar where it is and the learning curve that our exporters are on, I

expect to see us do as well as the staff suggests if not slightly better, even with a somewhat weaker foreign economy.

Now, it seems to me that the driving force in regard to monetary growth in the United States is not so much what happens on the liabilities side of the commercial banks' balance sheets but what happens on the assets side. When commercial banks have been looking at spreads between loans and CDs and all of a sudden on the margin the assets they are picking up are U.S. government securities, then in a sense the spread that they're chasing is a quite different spread. So the only way that they're going to have the kind of earnings they insist on is to have CD rates that tend to continue to run lower than rates on governments, which it seems to me is going to [encourage] disintermediation to some extent and hold up M2 growth as compared to M1 and the monetary base. So, in this environment it seems to me we end up with really quite a bit of rope out on the table. And, frankly, I don't think it would make much difference in the growth of the monetary aggregates if we had fed funds rates 50 basis points lower than they are. So, I would still expect the monetary aggregates to come in at around the midpoint [of their ranges] or below. And if the monetary aggregates surprise me and are stronger than that, then I think it's probably getting pretty late in the game. My guess would be that once private credit demands increase--and I think the good news we are hearing around the table gives some notion that there might be some increases in private credit demands--if they begin to expand as fast as we would like them to grow, then we would probably find growth of M2 headed toward double-digit rates, though again I'm talking quite a few quarters down the road, farther than I can really see. My guess is that we might have to have an adjustment in the fed funds rate of 200 basis points to [rein] that in. But I think that's a long ways down the pike.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Let me first characterize my thoughts about the economy in the last couple of years to put things in the context of where I think we are now. When the economy doesn't expand, I look for the depressants because I think there's an inherent tendency for the economy to expand and that [if it does not], something is either causing it to contract or have sub-par growth or preventing very rapid growth. Two years ago there were many depressants, but two certainly stood out and are still with us today. One was the cuts in defense spending, and that [depressant] may even be increasing in some local economies. The other was the unwinding of commercial construction. That has not been a depressant in the Fourth District but it's still there in some parts of the country, though lessening I think. A third was the oil shock, as brief as it was. Nevertheless, I think that was the factor that did push us into negative GDP for a couple of quarters, but that is now reversed. Except to the extent that falling energy prices may be a very mild depressant--energy is weak--I don't think we're getting any depressing impulse there. The fourth is monetary policy. There were occasions in the last couple of years when I thought that it was too restrictive. But I don't think that now; I think it is adequately stimulative. And the depressant that has emerged or been reinforced over the last several months is the one that Jerry Corrigan mentioned also, the fiscal side. I think that is feeding into the psychology affecting longer-term interest rates in the bond markets. And concerns about the lack of fiscal discipline in

this country are either direct threats to the economy or indirect threats to the actions we can take through monetary policy.

Where I come out is that I don't disagree with Mike Prell's description of the economy in 1992, but for 1993 I would be a little stronger than he is. The arguments for why [growth] is going to slow [over the course of] 1993 I don't find satisfying at this point.

At the District level, we held a small business roundtable discussion and advisory meeting ten days ago. We had twelve bankers from around the District. All parts of the District were represented and all but one reported better conditions. They said their local economies were improving. One banker in northwest Pennsylvania said that the economy was still pretty much flat. The others seemed to think that their situation had improved over the last few months. There was a general sense of optimism, of things getting better. Residential construction, including even some commercial construction, [was up] and all reported that retail sales were better, though there was not a lot of confidence that it would continue so. Capital goods manufacturing has been quite strong. The recession that we went through a couple of quarters ago was the mildest in Ohio in the postwar period. Always in every recession before Ohio has had a sharper decline in employment than the nation. That didn't happen this time. So, the contrast between Ohio in my District and Michigan is really dramatic. Ohio didn't have the stimulus of commercial construction before so the state didn't have the depressant of it going away. And the state had the benefit of good export demand and probably more importantly import substitution, taking back domestic markets previously lost for capital goods industries. The general mood in that part of the Great Lakes region is very [upbeat].

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Well, I guess the consensus is that we have the makings of a recovery with this strong consumer spending. It's nice to see that spending reinforced by the increase in confidence [reported in recent] surveys. This morning the Conference Board reported an increase in March to 54 from 47 percent, the largest jump since the Gulf War. I think the issues that Mike Prell laid out are worth reviewing because we were in this position last year and things didn't work out. Will this year be different? There are a lot of positive signs on the durability or sustainability issue. There's ample evidence that we've made progress on this 3-year depressant of the deleveraging process with the improvement in corporate balance sheets. Interest coverage is looking more like it did in the mid- or late '80s than it did in the early '90s. Consumer installment debt to disposable income is down to where it was in 1985, so we've rolled that back; and we're reclaiming the decade on consumer indebtedness. I think mortgage refinancing has helped a lot. And the banking system is clearly in much better shape to support [growing] demands should they ever come about. So in this [unintelligible] we seem to be poised to abate at this time. There is also this issue of pent-up [consumer] demand. Measuring it against the late '80s raises the question of how much of that was real demand or conspicuous consumption, but I guess we'll find out. There's also the possibility of pent-up demand in business spending--replacement spending and capital equipment spending that has been postponed. And most fundamentally from our perspective, what is different this year is the

fact that rates are much lower now; the fed funds rate since last summer has come down 175 basis points. And the dollar, despite its recent rise, is still substantially below where it was last summer.

On the negative side compared to last year, Governor Angell and President Corrigan and others have mentioned that exports look less encouraging given the deterioration in western Europe and Japan, and I would share that view. Consumer confidence, despite the recent gains, is still well below levels of last spring. And last year we were looking at what I thought were lean inventories--of course, one can never tell until a few months later whether they were lean or not --and now we have a little overhang. And the employment picture continues to be weak. There's concern over what we'll see in the upcoming report. So, I think an issue is: Where does the income growth come from for sustainability?

A number of people have mentioned the issue of long rates, and that's an important input into the environment. The Board staff has been doing a lot of work looking at that 30-year bond and trying to figure out what is causing its yield to go up. One way to think of a 30-year bond is that it is composed of 30, 1-year forward rates implied by the yield curve. That allows us to look at these forward rates, which we can back out of the yield curve, and see where the pressure is coming from. The Board staff has done this. I think they've come up with some interesting results. The 1-year rates expected to prevail 20 or 25 years out in the future haven't changed much at all in recent years. In fact, they are about where they were in the early '70s. So, we haven't seen a big shift in long-term inflationary expectations or long-term expectations of rates at least. What has pushed the 30-year bond around has been the movement of the short- and intermediate-term rates. The first three forward rates account for 25 percent in weight of the overall 30-year coupon, and the big increase in these 3-year rates has driven up the overall 30-year rate. In fact, the increase in the forward rates in the first 5 years of the overall 30-year structure accounts for virtually all of the increase in the long rate. When you look at it, that increase is pretty dramatic. As you recall, all these rates responded well to our cut in December and then rates bottomed out in January and started up. Those 3-year forward rates have gone up 150 basis points; and if you look at the 1-year rate today it's 4-3/4 percent. The forward rate in year two is up to 7 percent and by year three the market is expecting in some sense an 8 percent 1-year rate. Then it levels out at about year five at 8-3/4 percent. So, the way to think of it is that the market is expecting very large increases. I don't know if they heard Governor Angell's talk on this, but they're expecting very large increases in rates in the very near future. And the weight of that is pushing up overall long rates as well. I think it's worth asking why people would expect that; I think there are three possible explanations. First, they expect inflation to increase; secondly, there's this fiscal argument, a fiscal crowding out; and third, they expect a recovery that is a lot stronger than perhaps the Greenbook forecast.

I think the inflation explanation is not very satisfying because when these rates turned around in early January the dollar was also rising and the price of gold was falling off. In the survey evidence that Mike mentioned, the Michigan survey, inflation expectations continue to fall. The 1-year inflation expectation in

March was 3.3 percent whereas last October it was 4.7 percent. Even the 5- to 10-year inflation expectation last March in the Michigan survey was a little over 6 percent and now it's about 4-1/2 percent. So, I think it's hard to ascribe this expected increase in short- and medium-term rates to a rekindling of inflation.

The deficit argument, as President Jordan and others have mentioned, is a better explanation. First, if one looks at the timing of these rate increases, they really turned around in early January when the budget was released and this so-called bidding war started. And as the probabilities of a big fiscal package have gone down, we've seen some easing of those rates. But what I think has happened is that in the fall of 1990 many participants in the market saw a budget agreement that they thought held the promise of a multi-year disciplinary mechanism, a pay-as-you-go mechanism that finally was going to work. And that confidence has come unwound this year. In this town there's more hopelessness on the deficit issue than I've seen in years because there's a feeling that these structures--whether it's Gramm-Rudman or the new structure--simply aren't working. The 1990 structure worked flawlessly and we've had no new spending initiatives. Despite the fact that pay-as-you-go has worked, the deficit continues to rise. So, I think that's a major factor. And the other factor, which Jerry alluded to earlier, is the interaction of the deficit and the strength of recovery because, with the deficit out of control, there's relatively little private savings left over to finance a recovery. And that implies that when those demands occur, rates and the dollar have to rise to [accommodate them].

I think we can usefully ask what we can do about this situation if the market is expecting big deficits and any private demands to push up rates dramatically. While we can usefully ask that question, the answer on monetary policy fundamentally is that there is nothing that we can offset if the deficit is going to be out of control. We can't offset the increase in real rates. We could accommodate it, and this is the secondary risk that might be included here. But I don't think we would do that because we understand the problems there. So, there is some concern about the contractionary impact of this; and certainly at the margin it's something we have to think about in the overall mix even though fundamentally it's not something that monetary policy can cure. I don't think it's inflationary expectations; rather it's these factors.

When you pull all this together, I think we have a positive cast here to the economy. I do worry about it some. Since January a number of elements have shown at the margin some tightening of [financial conditions], including the increase in the dollar even though it's well below where it was last year. Medium-term rates have been moving up; the short-term inflation expectation is moving down; and, of course, there's the falloff in M2 growth. We had a couple of good months of M2 growth, held up primarily by M1 growth, compensating balances, mortgage repayments, and the like. Now, measured from the fourth quarter, we're down to about 4 percent M2 growth which, as Governor Angell mentioned, is below the midpoint. If we look over longer periods of 6 months or 9 months or a year, again, we're very low in our ranges. I had held the expectation that we would be above the midpoint for awhile. And we find ourselves here once again in this position of having to depend upon the velocity increase to bail us out, to make the Greenbook forecast come true. So, I think that's

something to be a bit concerned about. And as people have mentioned, growth in credit also remains slow. We ought to be sensitive to the risks of a second false start, which I think are fairly substantial in terms of confidence, the fiscal actions, and the monetary pressures. On balance, I think the reading is more positive. But because of the consequences of a second false start and the slowdown in M2 growth, we still need to be sensitive to the down side.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, in my still fairly brief time on the Committee I don't recall seeing as much change in sentiment from one meeting to the next as has happened between February and now. In the last meeting, most people shared a fairly strong consensus that the first quarter was going to be flat or maybe slightly up and that there was still a substantial balance of risks on the down side. There were some reasons to hope that we might get an upside surprise and improvement somewhat sooner than expected, but that was a bit weaker case. Now we seem to be having that upside surprise. As we hear this morning--and it began to show up on the telephone call several weeks ago--most areas are showing distinct improvement. And many sectors of the economy are showing a great deal of improvement. Now the question before us is whether or not this improvement is going to sustain itself or whether it's going to fizzle again. Certainly, there are forces that cut both ways; Governor Mullins and many others have run that liturgy and I won't repeat it. There are lots of concerns and I have lots of concerns. But [I'd make] two points. First, as Jerry Jordan mentioned a while ago, there's an historical bias in favor of growth in this economy. I don't think that has gone away; I think it's still there. And secondly, more times than not--maybe most of the time--momentum creates momentum and trends tend to sustain themselves. I think we're beginning to have a favorable trend here and the more probable outlook is that it will sustain itself. That would be my best guess, for whatever it's worth. But it certainly does seem to be too early to be sure of that. At the next meeting, or maybe the July meeting, we'll have a firmer feeling about it, I would hope, one way or the other. For now it seems to me that this is the time to watch and wait.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, I'm one who has felt that we were in a genuine recovery for some time, and the current forecast--if it is accurate and I think it probably is--seems to sustain that. Certainly, consumer confidence has improved even though it's not exactly ebullient at the moment. Corporate profits are somewhat better, but business confidence is still restrained. The fragility in the financial system that we have worried over for the last two or three years seems to be mending, particularly within the banking system, although there are still a number of large troubled institutions that command a major share of media attention. And media attention, I think, has a psychological effect on these confidence factors. Bank earnings are certainly much better and the availability of capital has improved, and that's encouraging for further strengthening of balance sheets. Banker confidence I believe is still a problem, and that may be at least partly responsible for the slow pace of growth.

Having said all that, I think there are still some pitfalls that could abort or at least sidetrack this recovery. A dollar at its current level, or perhaps even a little stronger, and weaker economies in our major trading partners could reverse our recent export performance, which has certainly helped keep this recent recession a shallow one. I guess I'm politically skeptical enough to believe that there is still a possibility that irresponsible legislation to provide a quick fix could happen, and it might in fact be counterproductive. Defense cutbacks, I believe, will create long and painful transitions because the laid off workers are going to be permanently displaced, and they will have difficulty relocating in any short time frame. I think that effect will be more regional than general and will have important impacts in states like California. As a matter of fact, the current issue of The Economist has a real scare article about the effects in California, Washington, New Mexico, Connecticut, New Hampshire, Maine, and one or two other states. A further increase in long-term interest rates could certainly smother the recovery of the housing market and discourage long-term financing for investment or refinancing of higher-cost debt. I believe that, properly managed, all of those problems can be limited to a minor drag on the rate of recovery. The [interest] rate issue is the most important one in my view, and it suggests a position of vigilance, although I remain skeptical about the ability of further easing of policy to stimulate the economy or bring down long rates. In fact, further easing might have the perverse effect of driving up long rates. I think our stance needs to be flexible at the moment. And, as I said to begin with, I think the Greenbook forecast looks pretty good.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I must say that in my six years in Washington I have never worked with such a modest group of people. We have talked this morning about the improvement in optimism in the last few months. We've also talked about the derailing of what could have been a disastrous fiscal package. I think my colleagues are much too modest; we should have patted ourselves on the back. I think the decision that was made in December is one of the main reasons for the rise in optimism; had that decision not been made, I think we would be facing a much less pleasant fiscal situation today. So, I believe we have much to commend ourselves for, although you are all too modest to say it.

I'd also like to commend the staff. I think the Greenbook forecast is certainly the most likely outcome and is also one in which the risks are about balanced. I also think the conclusion of the Greenbook that the disinflation process is continuing is one that is easily buttressed by the data--Governor Mullins stated it quite well--the survey data on forward rates, the strong dollar, and commodity prices. Indeed, I would be positively ebullient--in fact I was three weeks ago--but my concern at the moment has to do with what has happened recently with M2 growth. It has fallen. It is going to continue to fall. Using the projections in the [Bluebook] we will have had from the fourth quarter through March 4.1 percent M2 growth and through June we will have had 3.8 percent M2 growth. That is well below the midpoint of the target range. I don't think that is necessarily a disaster, but it is something that raises cause for concern. I think one has to take into account not only the fact that the risks are balanced but also what is involved if we're wrong. M2

is signaling an economic risk, which is the risk of perhaps another failure of the economy. Confidence would be very severely damaged, and I think we would see a replay of the headlines we saw last year that the Federal Reserve no longer has clout over the economy and that monetary policy has failed. In reality what I think has happened is that the desired debt reductions have lowered the effective elasticities on monetary policy and, therefore, greater policy action is needed. I think those elasticities would fall further and monetary policy would in fact be weakened if we had a collapse of confidence again and a recurrence of recession.

There's another factor about which I'd like to speak briefly. Let's put ourselves a year from now and say that the economy in fact has not improved and we are in a second dip or what have you. We shouldn't look at political risks except with regard to how they affect the independence of our judgment. And one concern we should have has to do with changes that are going to come in this election. Yesterday our staff briefed us about the British election and said that there's going to be a hung Parliament. I think there are a lot of people who would like to see a hung Congress as well at this point. I don't know whether the devils we're going to come to know are going to be any better or worse than the devils we now know. But the fact is we know those devils and we don't know what the new devils are going to do. If we have a turnover of a quarter to a third of the House and similar types of numbers in the Senate, we would have to be concerned about developing relationships with a new group of people who may not know of our independence. In fact, we take a higher risk next year. I would think we'd want to be able to look back and have them look back on our performance as one that is commendable and beyond reproach because, while they may get bounced because of rubber checks, we face some risk in that process as well. Therefore, I think we have to be very concerned about the risks on the down side and we should probably keep our policy as it was following the last meeting. I think alternative A is probably unnecessary. Alternative B has the advantages of staying the course, but I do think we have to keep our guns loaded. The downside losses, should the economy begin to dip back into a recession, could be quite severe not only for the economy but for this institution. And I think the problems in Japan that were mentioned by several of my colleagues only reinforce the need to keep our guns loaded. Thank you.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Thank you. I guess I'm on cleanup again! I find myself in a great deal of agreement with what has been said around the table. I am pleased that the positive signals seem to be strengthening in more than just a few parts of the country. At least today we were hearing a little more positive signs from both coasts. Like others, I am concerned about whether this fledgling recovery is going to be self sustaining or if we're going to continue to bounce along the bottom for a while or falter again. I won't go through all of the areas of risks because several folks have elucidated most of them. One area I would mention that hasn't been talked about quite as much is the question of employment and unemployment: the pervasiveness of the levels of unemployment and how long it's going to take until we start to see something on the unemployment rate with the first digit being a "6" as opposed to a "7." And like the Greenbook, I'd be pleased if it didn't get worse before it got better. But

because corporate America is on an efficiency drive in a recessionary period, I believe the cost-cutting and the drive to cut out layers of management are creating a situation where it's going to be harder to pull out of the unemployment situation. To the extent that occurs, it may keep us either bumping along the bottom or create a situation where it's going to take longer to climb out.

The question of restructuring is also an issue I'd like to talk about a bit. We clearly have made a lot of progress, as Governor Mullins mentioned, on the restructuring. The question I wonder about is: How much more progress are households and corporate America looking to make? I wonder how much longer that restructuring is going to take and whether that will continue to draw away some of the monetary ease that I do think remains in the pipeline. So, along with the questions of long-term rates and the vulnerability of exports, there are some [other] areas of risks. I'm not sure that necessarily indicates that we should change our monetary policy at this point. However, I do think we need to be vigilant. If we don't start to see some improvement, we perhaps should be prepared to reassess that situation. Some of the tightening that has occurred in the last couple of weeks that Governor Lindsey alluded to may be the early signs of a need to be vigilant. But certainly at this point we have every reason to be pleased with the progress that has been made and [with the signs] that the monetary policy steps that were taken last year are beginning to bear fruit.

CHAIRMAN GREENSPAN. Thank you. We've run a little long and as a consequence I've a note from Norm which says that the coffee is cooling. The bad news is that he gave that note to me ten minutes ago! Let's find out whether or not it's iced coffee.

[Coffee break]

CHAIRMAN GREENSPAN. Mr. Kohn.

MR. KOHN. Thank you, Mr. Chairman. [Statement--see Appendix.

Finally, Mr. Chairman let me briefly update the Committee on the money supply data received this morning. It's very weak, much weaker than we expected and than we built into the Bluebook path. For the week we're about to publish--and these data ought to be reasonably [firm] by now--we're looking at about a \$4-1/2 billion decline in M1, a \$10 billion decline in M2, and a \$12 or \$13 billion decline in M3. The downward revisions were mostly in demand deposits but in many other categories as well. The very preliminary data for the week of March 30th show no snapback from that. In fact, they show further declines. Now, these are based on only 3 days of information, so they can revise; but they do show further declines, with M2 approaching the lower end of its range if they were to come out that way. Thank you.

CHAIRMAN GREENSPAN. It seems as though we started on a high note but ended on a low one! [Laughter]

MR. KOHN. Don't blame the messenger, please!

MR. ANGELL. Well, Don, they are your seasonal adjustment numbers!

CHAIRMAN GREENSPAN. Let me start off in the vein these data are basically addressing. I think we're all aware that by any of the measures we use for physical slack--that is, with respect to the GDP potential--the economy is very loose and has very considerable areas for improvement shall I say without any [price] pressures being evident as a consequence. I'm not sure that that is in fact the case if one defines capacity in a financial sense. The way I would read that as a concern is to reiterate some of the notions that several around the table have mentioned this morning: most specifically, the rise in long-term rates in the context of what is really a relatively mild improvement in economic expectations. We're all aware that gross private savings is not a particularly large number and we're also aware that the Federal government with its extremely heavy demands is absorbing a very large preemptive part of that. If the economy were rising fairly sharply, one would assume that the net available savings after the government takes its preemptive [share] would be modest and that the demand would squeeze against a small base and drive interest rates fairly significantly higher. What we are looking at is something which feels that way but it is hard to make the case, even with the optimism that is emerging here, that we're looking at a very strong surge in activity. So, I conclude, granted with very little evidence, that the base of private savings off which we are running is inordinately low and that very small pressures are creating interest rate responses that could essentially act, for reasons we've all discussed, to choke off the recovery.

The financial structure also has some of these characteristics in the sense that we are aware that capital restraints have made the flexibility of intermediation less than we would otherwise like it to be. And if we are running into a net savings problem and an intermediation problem, which are obviously related, we essentially are saying that we are running up against some financial capacity problems. I don't know whether or not one could ascribe the most recent weakness in M2 to this phenomenon. Obviously, one can make the case, but I think it's premature to argue that these numbers mean all that much. We're not really clear as to the structure of M2 and what causes it; and even though we ran into a problem last year, it is not clear in retrospect how significant that impact was. So, I think we're treading ground at this point in areas for which we have no really hard evidence but a number of concerns that are suggestive of the possibility that indeed we might run into another stone wall and find that we're having difficulty reaching the [economy] as it recovers.

If that occurs, we could very readily get a pulling back of capital investment plans. And we could get some cumulative weakening [in the growth of economic activity], somewhat more than we're looking at here. That, [coupled with] the external situation--not only Japan but some questions about Europe--raises some serious questions about the future in the context in which all of the hard evidence we're looking at today is really quite good. It may well be that this is essentially a short-term housing development, which is driving appliance sales, auto sales, and the like. There seems to be more in it. There seems to be a pickup of profit margins; there seems to be a broader general view of some improvement in the future; and capital goods expenditures do seem to be picking up. And even though we may be running into a seasonal problem in the sense that six straight winters, I think, of above normal temperatures may be altering the

seasonal adjustment factors, it's conceivable that the March data, seasonally adjusted, are going to look weaker than one would ordinarily expect. Then, we could get this [economy] turning very readily.

At the moment, I think there is no question that monetary policy should stay on hold. However, in view of the various developments that are occurring, it is probably premature to switch from asymmetric toward ease to symmetric. Were it not for the financial factors that we're looking at, I would say this is a classic symmetric case. But until we get beyond the concerns about the behavior of the financial markets, which we do not fundamentally understand, it strikes me that we should stay asymmetric if for no other reason than that the probability we would wish to tighten over the next six weeks seems rather remote. And, having had an asymmetric toward ease directive in the last eight weeks and finding no need to alter policy, I would hope that we may be able to get through the next six weeks in the same stance. So, while I must say I would have no difficulty accepting symmetrical language with alternative B, I would much prefer to see us stay with the asymmetric language until we get beyond this period of uncertainties about what all of these data really mean. I'd be curious to get people's concerns, responses, and views. Who would like to start off? President Syron.

MR. SYRON. Mr. Chairman, for the reasons that you have gone through, I find myself very strongly supportive of your fairly pronounced preference not to change policy. I think you're right that it is premature at this stage to switch back to pure symmetry because, while the risks of the outcome in the Greenbook I think are pretty well balanced, the damage that would be done by making a mistake is not. As for the likelihood that we may have to do something between meetings: While we do think that we're seeing a turn here in a number of areas, if I weigh the factors that are out there--the concerns in Japan, and some of the concerns in the financial markets which you alluded to related in turn to the real estate problems, etc.--I find it hard to think that we're going to be in a situation where the probability is equal that we're going to have to tighten between meetings as compared to [easing]. That to me says that we're in a classical "stay asymmetric" [mode]. Also, while I have to confess that I'm not one of those who think that the Ms mean everything, I certainly think they mean something. And looking at what we've said we intended to do this year--not increasing the range but wanting to come in at least at the midpoint of the range--though I realize the numbers are extremely preliminary, I find the trend we're seeing in M2 particularly disturbing. So, I think we're in a world, and many people agree with this, where we need to remain vigilant. The likelihood of having to take action, perhaps because of an unforeseen event, is greater on the stimulative rather than the tightening side, and I think that is consistent with staying asymmetric.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Mr. Chairman, I would prefer to be symmetric. It seems to me that the foreign central bankers perceive our policy as being easier than it is. And they tend to have this history [of believing] that the United States always sort of leads the way to too much inflation. I think we really have a very delicate matter here in regard to the foreign perspective as to where we are, and how those

central banks feel about us spills over into the capital markets. Of course, I can see that there might be some circumstance--if the Bank of Japan made a significant easing move and the yen became extra weak while factors here made it consistent with price level stability-- [where it would be appropriate] for us to make a move; I could understand that. And I can vote for a policy that's not my preference based upon what I said at the last FOMC meeting. Mr. Chairman, I also said at that time that I had all the confidence in the world that you wanted to meet the same price level stability objectives. I have a great deal of confidence in that, so I can vote for asymmetry [toward ease], but I have to express a little caution when I do.

CHAIRMAN GREENSPAN. I need to say one additional thing. I realize we don't put a great deal of moment in the P^* calculations, but we are below trend now in [that calculation]. In other words, we have brought the money supply numbers down to a point which is certainly consistent with a noninflationary environment. If anything, we've overshot the mark. So, we actually have some room to respond to those who are concerned abroad that we would create an engine of inflation because I think--this is the wrong phrase, but--we have money in the bank. The truth of the matter is, it's the sign that's negative.

MR. ANGELL. I guess it's the yield curve problem that I consider. And [despite] Governor Mullins's careful analysis of that yield structure, I don't quite agree with his view that it's the fiscal [situation] that drives it. It seems to me the driving factor is that monetary policy was seen to be eased on the basis of real economy data. And the bond markets say that if we ease on the basis of the real economy, then we're going to tighten if the real economy is strong. So, I think it's this anticipation of stronger growth that has caused the yield curve to falter. So, even though we've got money in the bank, in the real bank, I don't think we have much money in the perception bank.

CHAIRMAN GREENSPAN. No, that's a very important point, I think that's true. President Melzer.

MR. MELZER. I'd prefer "B" symmetric but I can live with what you proposed. One of the concerns I have in that regard is the public relations aspect of it. I know [our directive] doesn't get [published] for a long time but if we were releasing it today after the meeting I think a lot of people would react by saying: "Oh my god, what are they worried about?"

CHAIRMAN GREENSPAN. That's the argument for not releasing the directive. Indeed, I think it would be a mistake for us to release it.

MR. MELZER. Well, I'm not suggesting that it should be.

CHAIRMAN GREENSPAN. Well, I meant if we had to release it today I'm not sure I personally would recommend going asymmetric.

MR. MELZER. Well, I guess unfortunately, I always operate on the theory--and I'm not commenting on the FOMC in particular but in general--that if I make a decision, no matter how hard I try, it's likely to become known. So, I frankly worry about that. And I think

symmetric language gives us every bit of flexibility that asymmetric does to respond.

Let me just comment about what I touched on earlier when I said I was becoming increasingly concerned about the posture of policy. I think M2 over long periods of time is a reasonable indicator of economic activity. I think it's helpful in that regard, but it doesn't tell us anything about the thrust of policy. And I do think we have to pay some attention to the narrower aggregates whether it's reserves, the base, or M1. I'd be ready to admit, as a lot of other people would point out, that some technical factors very likely are influencing the growth of M1 right now. But what I worry about, and I've said these things before, is this: In an interest rate targeting regime like we have, if we have that rate pegged at the wrong level in relation to where policy ought to be given what the economy is doing, the only way we're going to keep it there if it's pegged too low is by pumping in more and more reserves. Now, we've seen short-term market rates in this period move up 20 to 25 basis points. I'm willing to say in that connection that that probably just reflects wringing out expectations that were built into the yield curve that short rates were going to continue to fall--that policy would continued to be eased--and I think those have been washed out. For at least some period of time here, I think the market is discounting an unchanged policy. But I would begin to get more and more concerned if short-term market rates worked their way up even further and we continued to hold the funds rate at 4 percent because in effect that would be indicating to us that we're having to pursue a more and more stimulative policy to hold it there. So, that's my concern. But at this meeting, I think there's enough uncertainty in terms of what is going on with M1 on the technical side to come out for an unchanged policy and watch for a while. But what I'm worried about is that we may conceivably be getting out of position in a longer-term sense.

CHAIRMAN GREENSPAN. Vice Chairman.

MR. CORRIGAN. I would favor "B" asymmetric. I basically come out there for two reasons. First, I think the forecast that's on the table, as I said before, is fine as a forecast. There are so many crosscurrents [producing] uncertainties that a slight hedge--that's how I would think of this asymmetry--makes some sense. The other thing I have to say is that even before I heard Mr. Kohn's latest M2 numbers, I was a little nervous about M2, not that I have ever pledged allegiance to that number. My nervousness is in part because I don't understand it; I can't figure it out. But beyond that, if M2 were systematically to tank again, it certainly would make our external relationships more difficult. So, "B" asymmetric.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I came prepared to argue for "B" symmetric. I wanted to point out that we could move in either direction but that if the economy did strengthen, as I thought it most likely would, then we would look very omniscient to have moved at this particular time when this [directive] is released in late May. But after absorbing the new numbers on M2 and listening to your other comments, I come closer to where you are. The only difference I have

is that your disinheriting the P* model bothers me a little because I still have a lot of faith in that.

CHAIRMAN GREENSPAN. I thought I did not disinherit it. In fact, I thought I was stipulating that I thought it was indicating that we had a little slack to accelerate M2 without violating our price stability goals.

MR. BLACK. That part I agree with; you made that very clear. But there was a statement you made in the beginning against giving too much credit to the P* model.

LAWARE. He was being modest.

MR. BLACK. I have a lot of faith in it because I don't think we have any evidence yet that there's not a shift in the secular trend of V2. But I would comfortably--

CHAIRMAN GREENSPAN. No, frankly, I think it's working.

MR. BLACK. Well, I think it is, too. As a matter of fact, if you take M2 at face value and say that we thought we had a reason to explain its weakness, it has pretty darn well predicted what happened even without any adjustments. So, maybe it didn't lose some of its meaning. I did think that we would be [tightening policy] and it would be nice to show that we anticipated this a little. But I have some more doubts as a result of the behavior of the money numbers than I had. That being true, I can put that off for another meeting. At the next meeting I hope we will be able to move to symmetric language if events go our way between now and then.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, the Greenbook forecast certainly is more optimistic now than it was at the time of our meeting in February. In addition, it seems to me that the recent data suggest that the risks are more evenly balanced than they were, far more than appeared in February. That leads me to have a preference for alternative B and a slight preference for a symmetric directive. I must admit, though, that I do fear the possibility that we'll see a situation similar to what we had last year. And I certainly don't take much comfort from what we just heard about the aggregates. So, I would not object to asymmetry.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I came prepared to argue for symmetric language and for alternative B, and I guess the news report from Don Kohn tended to sap my courage. I must say that in the first few meetings I attended here I was puzzled about the lengthy debate over precious changes in language or changes in precious language. But I now know that the world watches so carefully everything we say and exactly how we say it and in what order that I guess the debate is worthwhile. And I think probably staying the course and keeping the flexibility that's implied by the asymmetric language is appropriate.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Well, I certainly prefer alternative B, and I have a mild preference for symmetric language mainly because that's my usual preference. I rather like the thought of just letting the evidence come in and analyzing it as the period unfolds. And I think we have plenty of flexibility and have reacted quickly even with symmetric directives, but I don't feel all that strongly about it. I don't know that I understand what is going on with M2 either, but I won't let that stop me from making a few comments! I think it's a little premature to get too worked up about it. For one thing, I don't know what Don's numbers are precisely, but for the December through March period it looks as if M2 still grew at least as fast as we had expected at the last meeting or two. So, while it bounces around a lot month to month, it's still coming in more or less as expected or a bit on the high side. I'm not sure we're going to learn much more in April and May if the tax payments and so forth [distort] the data as they have in the past from time to time. Finally--and I think you touched upon this in a way--if our objective is to achieve price stability, then I've been of the view for a long time that we want M2 growth at about the midpoint of its range or somewhat lower over a sustained period of time if we're going to get to price stability. And that's certainly what I have in mind.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, because the Greenbook and our forecast agree that the economy is improving and because year-to-date, at least as Gary said, the money numbers are near the midpoint, I'm comfortable with alternative B. At the same time, I recognize that the money numbers that have just come in cause us to flinch. But more importantly, I can support the asymmetry [because], although our economy is being projected as stronger now than it was in February, it still remains a very modest recovery by any [historical] comparisons and it is in my mind still a very tender recovery. Therefore, I feel comfortable with the asymmetric language toward ease.

MR. KOHN. Mr. Chairman, on President Stern's point, he is correct that even with these very weak numbers, we would have growth for December to March of around 3-1/2 percent, which is what we expected before. But the other part of that is that we would be coming out of March in a week that is billions and billions of dollars below the monthly average; i.e., the monthly average weakness is coming in this next number.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I'm not quite as agile as some of my colleagues. I came in prepared to support symmetric and I'm still there! To me the risks have become symmetric and that suggests a symmetric directive. I concur with you that an intermeeting change this time around is fairly unlikely; hopefully that's true. That also suggests symmetric. And generally, I think [asymmetric] is intended to be used when there's a meaningful expectation that there will be a move in a certain direction--a reasonable confidence that that will occur--and I don't see that here. All of that having been said, I do believe that if there should be an occasion to change policy between meetings here, it is far more likely to be on the easing than the tightening side. Also I believe that if we do get a downside surprise, the consequences would be quite serious and should be

guarded against. So, for those reasons I would prefer symmetric but can accept asymmetric.

CHAIRMAN GREENSPAN. President Boehne.

BOEHNE. Well, I came here supporting "B" asymmetric and I am pleased.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. There's no question in my view that the forecast risks are far more balanced this time. I agree with what others have said about the consequences of the downside problem being more severe, and I think it's a good idea to be asymmetric with the current uncertainty in the markets and the aggregates. I would also like to mention Tom Melzer's point, which is rather interesting, that last year it was the Treasury bill rate that was leading the fed funds rate down and this year it is the reverse. So, I think we have some interesting times ahead of us. Governor Angell mentioned our problems with the foreign central bankers. [My response to them] is to point out our record of very low growth in money over a long period of time. I don't have much success with that!

CHAIRMAN GREENSPAN. I'm surprised that you don't.

MR. MULLINS. Well, it's a lingering problem. If you look at the record--to pick a time let's say over four or five years--it is pretty impressive that there is this lingering suspicion. And one feels it [in discussions with foreign officials] as we go around the room. We can look through all the economic fundamentals currently, whether it's commodity prices or slack or the dollar going up, and we're in pretty good position. Yet this is something we're going to face, I think, for a long time until we wring [inflation] out. And I don't think it can be wrung out until we go through a recovery and show at that time that we've come out of this without going too far. On balance, I still prefer to stick with asymmetric.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, while we are moving through this transition pretty well and the tone and numbers are a little better this time than they were the last time, nonetheless, as I said earlier, I think the risks continue to be on the down side. I also think the inflationary outlook is better than [unintelligible]. To me it would be very premature to make a shift from asymmetric to symmetric language and, therefore, I'd be in favor of alternative B asymmetric toward ease.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I think policy really needs to stay on a steady course at the moment. I, too, like many others, came prepared to argue for symmetric language because I thought the balance [of risks] was a little more evenly distributed. But I don't have the same courage of my convictions as does Governor Kelley, so I tipped over to asymmetric during the course of the discussion today basically because I think the vulnerability that we have of missing on the down side is so much greater. If we miss on the up side, it won't be all

that significant. And I would just say that I would not give a great deal of weight to what Don Kohn just said about the Ms at this point. I don't think we ought to be guided too much by one week's money supply numbers. So, I would support "B" asymmetric.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Mr. Chairman, all this discussion about the difference between symmetric and asymmetric makes me think I probably don't understand the difference well enough. It seems to me that the main difference between the two is a telephone call. And if I'm right in that, it would seem to me that we ought to prefer symmetric language and talk about it if developments warrant.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I support your preference for asymmetric. I think we want our words to be both precious and prescient, the words I heard earlier. And like Don, I've taken to carrying my calculator. I have M2 growth through the end of March from the fourth quarter at 2.3 percent.

MR. MULLINS. That's from the fourth quarter base, not from December?

MR. LINDSEY. From the fourth quarter base and also it is to the end of March.

MR. KOHN. It's right around 2.5 percent.

MR. LINDSEY. It's 2.5 percent? Okay. I think that we will be both precious and prescient in our words if we keep that in mind.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I support your proposal of "B" asymmetric, and I appreciate your comments on getting past this period of conflicting data. I hope that we will start to see better corporate earnings reports coming out following the first quarter so that we can see some sustainability in the equity market that is at a fairly high level. With regard to the Ms, I agree with you, President Syron. I'm not sure exactly what they mean. I know they mean something and maybe they only mean something in hindsight. So, I certainly agree that it's something we need to pay attention to but shouldn't get rattled by. But there are a number of remaining concerns, so I would support your proposal based on them, Mr. Chairman.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Over the last couple of months we have had the steepest yield curve in several decades from bills to bonds. And putting bills on a coupon equivalent basis so we can understand what it is [and say] anything with any confidence at all about the future would indicate that the yield curve tends to flatten as the expansion progresses so that most likely later this year, or a year from now, we'll get a yield curve that is flatter than it is today. And I hope very, very much that it comes from the long end. In fact, if I were still in the private sector I'd probably be willing to bet that that

flattening will occur at the long end as concerns over fiscal policy tend to dissipate and people become comfortable with the idea that expansion can not only occur but may even be robust without any kind of inflation. But I am concerned about what has been happening to the yield curve in the last several weeks. The flattening has been occurring starting at the long end and kind of rolling down the curve, first with the 10-year note moving up toward the 3-year area and rolling down to the 3-year area. And David Mullins's comments about the forward rates I thought were very perceptive [unintelligible] market. So, we have had a flattening from 3 years on out and a considerable steepening from 1 year to 3 years, and at the same time a shift up in the 3- and 6-month and 1-year bill rates.

I was interested in the go-around on the economy to hear about the false start last year and concerns that it might happen again. But one of the differences today is that we have a bill rate above the funds rate and it has been so for some weeks. That hasn't happened in a couple of years. If that continues with the flattening or rolling down of the yield curve toward the shorter end and we get upward pressure on short rates, especially from the bill rates pushing up relative to the funds rate, then I would like to know what the implications for Desk operations are going to be if the funds rate is held firm at the 4 percent level. I think, if we're right about the outlook, that the funds rate at 4 percent is too high as inflation expectations subside and as the long end rallies back down. But I'd be concerned about not having the leeway to allow the funds rate to be pulled up if these bill rates start to be under a lot of upward pressure in the spring months. So, for that reason I'd like to see [the language] symmetric in either direction.

CHAIRMAN GREENSPAN. The consensus as I hear it is to support the last directive. So, if the Secretary would read it for us--

MR. KOHN. Mr. Chairman, one further point. I'm quite sure that if our staff sat down and had to do money projections right now, they'd probably come out lower than the 3-1/2 and 1-1/2 percent [shown for] M2 and M3 with constant interest rates. At the same time, if the Committee were to write those lower, say at 3 and 1 percent, that would in effect be allowing and accepting a bit of the undershoot that is coming, and the Committee may not want to do that. That is, you might want to stick with the 3-1/2 and 1-1/2 percent, which is still slipping below the midpoint. But I thought it wise to warn you.

CHAIRMAN GREENSPAN. Yes, I think that is right because the concerns that we have are [that] it will slip down; and if we say we're accepting that, then there's no meaning to having it consistent.

MR. KOHN(?). That's right.

CHAIRMAN GREENSPAN. If it has any meaning as a goal, we should have what you originally had in it.

MR. KOHN. So, you would stick with the 3-1/2 and 1-1/2 percent?

CHAIRMAN GREENSPAN. That would be my inclination. Is there general agreement on that?

MR. SYRON. Well, I don't think we should be in the business of changing it because the numbers that just came in were weaker, unless we want to change the targets because we don't like the number.

CHAIRMAN GREENSPAN. We have to be careful about these numbers because they are extraordinary numbers.

MR. BERNARD. [The directive would read]: "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint might or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from March through June at annual rates of about 3-1/2 and 1-1/2 percent, respectively."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Hoenig	Yes
President Jordan	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President Melzer	Yes
Governor Mullins	Yes
Governor Phillips	Yes
President Syron	Yes

CHAIRMAN GREENSPAN. Okay. Thank you very much, everyone. Our next meeting is on May the 19th.

END OF MEETING