

Meeting of the Federal Open Market Committee
December 21, 1999

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, December 21, 1999, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Ferguson
Mr. Gramlich
Mr. Kelley
Mr. McTeer
Mr. Meyer
Mr. Moskow
Mr. Stern

Messrs. Broaddus, Guynn, Jordan, and Parry, Alternate Members of the
Federal Open Market Committee

Mr. Hoenig, Ms. Minehan, and Mr. Poole, Presidents of the Federal
Reserve Banks of Kansas City, Boston, and St. Louis respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Fox, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Ms. Johnson, Economist
Mr. Prell, Economist

Ms. Cumming, Messrs. Howard, Hunter, Lang, Rosenblum,
Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members,
Board of Governors

Messrs. Ettin and Reinhart, Deputy Directors, Divisions of Research and
Statistics and International Finance respectively, Board of Governors

Messrs. Madigan and Simpson, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Ms. Roseman, 1/ Director, Division of Reserve Bank Operations and Payment Systems, Board of Governors

Messrs. Dennis 1/ and Whitesell, Assistant Directors, Divisions of Reserve Bank Operations and Payment Systems and Monetary Affairs respectively, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Moore, First Vice President, Federal Reserve Bank of San Francisco

Messrs. Beebe, Eisenbeis, Goodfriend, Hakkio, Rasche, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, Richmond, Kansas City, St. Louis, and Cleveland respectively

Ms. Perelmuter, Messrs. Rosengren and Weber, Vice Presidents, Federal Reserve Banks of New York, Boston, and Minneapolis respectively

1/ Attended portion of meeting relating to the Committee's consideration of the Report of Examination of the System Open Market Account.

Transcript of the Federal Open Market Committee Meeting of
December 21, 1999

CHAIRMAN GREENSPAN. Good morning, everyone. Would somebody like to move approval of the minutes for the November 16th meeting?

VICE CHAIRMAN MCDONOUGH. Move approval.

CHAIRMAN GREENSPAN. Without objection. Peter Fisher, you wanted to discuss the report of examination, I understand?

MR. FISHER. Yes. I wanted to elaborate a little on Louise Roseman's memo to Don Kohn about the unresolved difference between the internal accounting records of the Markets Group Accounting and Control Unit and those reflected in the Integrated Accounting System regarding the System's net interest accruals on foreign currency investments. I thought it would be helpful if I gave a couple minutes of background, if you will bear with me.

Last spring, as members of the Committee will recall, we entered into a series of transactions with the ESF to re-balance our euro and yen holdings so we could come to a better split both in terms of total holdings and the currency mix. This involved a number of transfers of ownership of a series of investments and resulted in quite a significant amount of accounting activity. In the course of reviewing that, our own accounting staff identified an error that had been introduced in the prior year in our treatment of the premium on bonds held in the accrual account, overstating the accrual account by about \$5 million. In the course of confirming that, they identified an additional \$26.6 million overstatement in the accrual account for interest on foreign currency investments. We have had a number of staff members working full time trying to trace the source of that \$26.6 million overstatement. They have worked back through the records to December 1994, before which detailed records at the transaction level just no longer exist due to the routine and appropriate destruction of documents.

The Board examiners were at our Bank to conduct an examination of the System Open Market Account in September and PricewaterhouseCoopers also has looked over our methodology to try to trace this overstatement back through time and find its source. PricewaterhouseCoopers is confident that we have traced it back as far as we can. They

have tested our work papers and agree with our conclusion that we simply can't go back any further.

There are two possible causes of this overstatement that we have to confront. One is the diversion of funds and the other is error. Now, we cannot rule out the possibility of a diversion of funds. But people from our own audit function and from PricewaterhouseCoopers have reviewed the control procedures we've had in place for the last decade and are very comfortable with the conclusion that these control procedures are sufficiently robust that the likelihood of diversion is remote. It cannot be ruled out, but for diversion to have occurred it would have had to involve the collusion of many people--just an extraordinary number of people--on several different staffs. If anything, our control procedures run a little to the "belt and suspenders" direction in regard to control of the flow. So, there is reasonable confidence that no diversion of funds occurred. The much more likely cause is a simple accounting error. The failure to credit the accrual account when cash was received would have left this account overstated. But we have worked the accounting back as far as we can take it and cannot find the erroneous entry or entries.

Dave Sheehy, the New York Fed's General Auditor, and I are both looking into a fundamental reappraisal of our control procedures. We have introduced an additional mechanical check to maintain detailed records of the accrual stream by instrument, so that when a final principal payment is received we can trace the record all the way back on each instrument and double check the accounting.

More fundamentally and more importantly, what troubles us is how we could have gone for so many years without scrubbing this account more vigorously. That is something we are looking into and we are going to be revising our control procedures--both the audit procedures and those in our own Markets Group. The Board's staff and our accounting function at the New York Fed have worked out an accounting treatment to correct for both the \$5 million and the \$26.6 million errors. That involves reducing the accrued interest asset account by the entire \$31.6 million, with an offsetting reduction in interest income on foreign currency investments. We will make that adjustment before the end of the year and spread it among all the Reserve Banks. Of course, for all of us with responsibilities for SOMA this is an embarrassing, indeed humbling, event. As a technical matter, though, I understand that PricewaterhouseCoopers is comfortable with the conclusion of both our

accounting and audit function and the Board staff that this is not a material event for purposes of disclosure for any Reserve Bank. I would be happy to try to answer any questions.

CHAIRMAN GREENSPAN. Is there any evidence of a surprising rise in standards of living of key people involved?

MR. FISHER. No, there is not.

CHAIRMAN GREENSPAN. Has somebody looked?

MR. FISHER. Yes, we have looked into that. Many of the staff people are still at the Bank, though others are not. But we have found nothing of that nature.

CHAIRMAN GREENSPAN. Were it an embezzlement, prior to what period would it have occurred?

MR. FISHER. We only know that the difference existed prior to December 1994.

CHAIRMAN GREENSPAN. It could have been any time prior to that? Is there a beginning point, other than 1914?

MR. FISHER. The details certainly don't exist for pre-December 1994 records, so I don't know how we could determine the beginning point--in 1973 or 1963 or where. Prior to 1994, the only interest income we were receiving in that account was coming from the BIS, the Bundesbank, and the Bank of Japan. So the source of the income was official institutions. It was really a very simple accounting process to bring that income in at that point; the complexities have been introduced since that time. So, as I say, Pricewaterhouse-Coopers and our audit function are confident in looking over the control procedures we have had in place that it's implausible that a diversion could have occurred. But we cannot rule it out.

CHAIRMAN GREENSPAN. Other questions on this issue? Let us go forward to your regular report.

MR. FISHER. Turning to the packet of colored charts,^{1/} page 1 depicts the rates implied by forward rate agreements. As you can see in the top panel, in the period since your last meeting forward rates rose steadily until the release of the employment report on December 3rd when the market reacted to a lower-than-expected average hourly earnings figure, and the forward rates came off a little. The rates then bounced backed up again on the release of retail sales data, reaching highs for the year.

^{1/} A copy of the material used by Mr. Fisher is appended to the transcript. (Appendix 1)

In the middle panel you can see that euro forward rates continued to follow the movement in dollar forward rates. I think I have been harping on this all year, but let me say it one more time: To me, the most unnerving thing in markets today is not the state of equity markets, the dollar/yen relationship, or the weakness of the euro, but rather the extent to which European interest rates at the short end follow the peaks and valleys of U.S. forward rates. I find it, as I say, unnerving that those rates fall even as the ECB raises rates and rise when we raise rates. It is really very odd and hard to understand.

In Japan, as you can see in the bottom panel, the forward rates backed up in mid-November. But this time the Nikkei was rallying and there was increasing anticipation of a strengthening recovery. By mid-November the 9-month forward 3-month rate, which as of now covers the fourth quarter of next year, had doubled since October. But with the release of third-quarter GDP numbers and the Tankan Survey, those rates began to wind down a bit. However, I should note that Bank of Japan officials have been candid, if muted, in explaining that they are beginning to look for an exit strategy from their zero interest rate policy, and that is seeping out into the markets a bit. So there is still a bit of lift in the Japanese forward rates.

Turning to our extraordinary year-end operations, on the next page you can see that we have completed the auctions of options on repos, with the final auction held on December 1st. If you scan down the page in the columns labeled "total propositions," "bid-to-cover ratio" and "awards/stop-out rate," you can see that those numbers were generally declining over the course of the auctions. In our view that reflected the fact that we did what we said we were going to do: We tried to meet demand--maybe not each and every last bid, but the serious bids for these options. The one exception to the general decline in these numbers was the last auction of the January 6 strip, as can be seen in the very bottom line. Total propositions jumped up from \$36 billion in the prior week to \$43 billion, the bid-to-cover ratio backed up, and the stop-out rate backed up a little from 2½ to 4 basis points. I don't want to make too much of that, but I think it reflects an epiphany of something going on in the markets. The closer we come to the end of the year, the more the anxieties and uncertainties seem to be about the first two weeks of January--what will be on the other side of the great divide of the millennium--and less about liquidity in late December. That is progress at least in one sense.

Turning to the next page, in the top panel you can see the cumulative reserve drain from currency in circulation. The two red dot-dash lines reflect the same projections--labeled "high" and "moderate"--I showed you last time. In the middle line I've shown the actual experience to date

and our current projection. That current projection is running a little closer to the high end than to the low end of our previous range of projections. Most of this still reflects growth in vault cash, although we do see some outflows to meet consumer demand that is higher than in prior years. We don't know whether to attribute that to Y2K or not, but we are beginning to see a little of the cash seeping out.

In the middle panel are the New York Bank staff's estimates of free reserves or reserve needs through year-end, including yesterday's operations but not yesterday's actual performance. As you can see, this produces about a \$42 billion need from here to year-end, not including whatever excess reserves we may need to put in on the last day, which might be around \$10 billion. So, from this point to year-end in our current forecast it looks as if we will need to provide about \$52 billion more.

This past August, I suggested to you that we might face reserve needs from then forward of about \$100 billion, with a band of uncertainty of \$100 billion--\$50 billion on either side of that estimate. At that point in August we had an underlying need of about \$8 billion. Since then we have purchased just under \$10 billion outright and have done \$60 billion in term operations through the turn of the year. So on the present course, dating back to August and adding in the \$50 billion for uncertainty, we are at about \$120 billion. That's roughly our estimate of reserve needs from where we were in August through year-end.

Looking toward the end of the year, some of the market estimates of year-end financing for mortgage-backed collateral that we were hearing about--and we were calculating ourselves--were coming close to and sometimes over 7 percent, which is the strike price for our options. That began to catch our attention. After thinking about it, we executed two forward transactions for the turn-of-the-year weekend. We thought we would take on in advance some of the mortgage-backed collateral that might be looking for financing over the century date change. Our reasoning was as follows: If it was going to be exercised as an option around the turn-of-the-year, we would have been taking it on anyway, so why not do it in advance? Also, as we thought more about it, we decided this would be an opportunity for price discovery both for us and for the market.

Let me take you through this bottom panel on page 3, which represents a bit of the evolution of estimates of term financing. On the far left, you can see that the implied turn-of-the-year repo rates from our term operations on October 8th were about 7 to 7½ percent for Treasuries, 10 to 12 percent for agency securities, and 11½ to almost 14 percent for mortgage-backed securities. Now, I want to be clear that a lot of heroic assumptions are built in here. There were uncertainties about Committee

policy and one had to make estimates of where other financing rates would be. But these are fairly typical of where most people in the market thought turn-of-the-year financing rates were, understanding they might be a little overstated. In the second column you can see the comparable implied rates from our longer-term operations on December 17th.

The next two columns are the bid and offer rates taken off broker screens yesterday for Treasury and agency collateral. And on the far right are the rates, taking the high proposition and the low proposition, in the two turn-of-the-year RPs we executed. Both came in a little lower than the rates on broker screens. The high bid was 6.27 percent and the low bid was 4.5 percent on the first five-day RP we did for the turn-of-the-year period; 6.38 and 5.25 percent were the comparable rates on the second one. I think the tightening up in the second operation actually just reflected the market coming to a sense of the pricing. The low bidders in the first operation were wishful thinkers, hoping financing would be that low. So, I view it as a sort of healthy bunching up. But looking at these rates again does suggest to me that more of the uncertainty the market is pricing for is in the early days in January, not just the century rollover date. Some of the assumptions we have been making are probably in error, in that they attribute much of the premium just to December 23rd; more of it is probably an uncertainty premium for the initial days in January. One way to put it is that the market may believe that we can keep financing rates low on any one day in light of our operations, but it may be harder to believe that for the first two weeks of January.

Finally, the last page depicts how the fed funds rate has traded since your last meeting. The upper right section shows the maintenance period surrounding Thanksgiving. In that period we had a slightly elevated funds rate as we faced pressures typical of the turn of the month and of Thanksgiving, especially when it comes so close to the beginning of December.

In the next maintenance period, from December 2nd to 15th, we leaned rather heavily in the direction of generosity, with the 15th being the end of the maintenance period and a tax payment date. We wanted to be very certain not to have firm rates on that day, which might set us up for the end of the year. So we were quite generous in providing excess reserves from the early through the middle part of the period. Then we worked down the period average excess to just \$1.1 billion, as you can see, but that gave us some soft rates over the last few days of the interval. That was intentional on our part.

That is all I have to report. We conducted no foreign exchange operations in the period. I would be happy to answer any questions.

CHAIRMAN GREENSPAN. Questions for Peter?

MS. MINEHAN. I have one little question.

CHAIRMAN GREENSPAN. I'm sorry. We have not yet approved the Examination Report of the System Open Market Account. That requires a motion.

MR. FERGUSON. I move that we approve the SOMA Examination Report.

CHAIRMAN GREENSPAN. Without objection. President Minehan.

MS. MINEHAN. You mentioned a couple of times, Peter, that you think anxieties about Y2K have shifted from the actual turn-of-the-year period of 12/31/99 to 1/1/00 to the first couple of weeks in January. Is there anything more substantial to it than that? Are there particular concerns in the market? I know there is a lot of concern, at least among some financial institutions I know of, about having more liquidity than they want coming into the end of the year. Do you think that concern is going to disappear quickly at the beginning of the year, or is there anything more to it than that?

MR. FISHER. It may just be a relative issue in that anxieties about the last few days of the year, when people thought markets would be most illiquid, have gone away. So relatively speaking, the state of anxiety, whatever it may be, is now about the first ten days of January.

MS. MINEHAN. It just got pushed out?

MR. FISHER. Yes, it was just shifted out into the new year. There are certainly a number of people who are more worried about the state of settlements and heavy volume after an accumulation of slow days. If the whole system gets as sticky as molasses, the problem is not going to be on January 3rd and 4th; it is going to be on the 6th or the 10th if everyone is being a little too cautious. I think that is where a lot of anxieties are focused. There are a number of other markets in the world where, notwithstanding when banks are closed for holidays, the authorities have not been as vigilant as we have tried to be in making sure the banks do not de facto close down the markets. Some small non-euro European countries have allowed their banks simply to declare the first ten days not good value days for foreign exchange transactions, for example, even though the banks are going to be open. So their retail customers can walk in the door and take out money, but their corporate customers can't get their foreign exchange trades settled. That's the sort of thing that is gnawing at confidence about those first ten days.

MS. MINEHAN. Thank you.

VICE CHAIRMAN MCDONOUGH. I move approval of the domestic operations.

CHAIRMAN GREENSPAN. Without objection they are approved. Mike Prell and Karen Johnson.

MR. PRELL. Thank you, Mr. Chairman.

If I were to put the Greenbook in a seasonal nutshell, I suppose I would say that we've brought you tidings of great joy, but maybe not great comfort.

In broad macro terms, the economy has been performing splendidly. Though we can't be especially confident at this point, it looks as if real GDP growth in the current quarter will be close to 5 percent, at an annual rate. If so, 1999 would be the fourth year running of growth of 4 percent or more. With job gains still strong, we've now enjoyed three straight years of average unemployment rates below 5 percent. The chain index for GDP prices has increased less than 2 percent for four consecutive years.

Moreover, the outlook as described in our baseline forecast is almost as good. GDP growth is projected to fall a little short of the 4 percent mark over the next two years. But the unemployment rate is expected to remain near 4 percent and GDP price increases below 2 percent. This is among the most upbeat forecasts for the U.S. economy that you'll find today.

So, if we're right, the basis for joy is pretty clear. You've entered Humphrey-Hawkins heaven. Unfortunately, you haven't been granted unconditional permanent residency there, and this is where the comfort side of the story comes in. We believe that the economy may be getting seriously overheated and in some ways significantly distorted.

This Committee has, of course, announced its focus on the mounting pressures in the labor market as the most likely potential source of deteriorating inflation performance and thus cyclical instability. But, though there's a near consensus among employers that qualified workers are terribly scarce, the official data actually show decelerating wages. I'll make just three quick comments on this dissonance.

First, we continue to think that the wage deceleration this year owes considerably to the downside surprise in price inflation that occurred last year when oil prices plummeted; on this view, this year's pickup in prices should be showing through in wages over coming quarters. Second, judging by the nonfarm compensation figures--though not by the less inclusive ECI--real wages (deflated by product prices) have been

increasing quite substantially even this year. But, third, none of the official pay series seems equipped to provide an accurate reading on labor costs in today's world where plain vanilla wages are becoming less important relative to many other components, including deferred--and less certain--compensation in the form of stock and stock options. This latter point is underscored by the stream of stories about people passing up big salaries to go to young firms offering equity lottery tickets and about established companies restructuring themselves so that they can compete on those terms. This suggests that the linkage between compensation changes and price pressures--never an especially tight and predictable one--has become even more problematic.

Given these vagaries of the wage picture and its interpretation, and on the thought that the proof of the inflation pudding might be in the eating, perhaps we should simply ask whether there's any evidence that prices themselves are beginning to accelerate. I would say that there is some evidence, though it may not yet be compelling.

Certainly, we've seen an upturn in core PPI crude and intermediate goods prices. At the same time, and helping to explain the acceleration of the PPI pipeline measures, the prices of non-oil imports (ex computers and semiconductors) have begun inching up as the dollar has stopped appreciating on a broad basis and as foreign economies have recovered. At the final goods and services level, with some greater firmness in the monthly figures of late, the core CPI has edged a couple of tenths above its low on a twelve-month change basis.

And, of course, as I've noted repeatedly, overall consumer prices have accelerated noticeably this year with the run-up in the cost of crude oil, something that may provide some momentum to inflation in the near term. One way in which that could occur is via expectations, and households' short-term inflation expectations do appear to have risen some this year. It might also be noted that the latest semi-annual NAPM survey showed purchasing managers expressing somewhat greater concern about increasing costs and inflation in 2000.

All of this may well be stretching the point statistically, but I think it's worth sounding a note of caution that strong productivity gains and intense competition--even accelerating productivity and intensifying competition--do not by themselves ensure that there can be no step-up in inflation. Unless supply is completely elastic, which seems unlikely in the short run, demand can become excessive.

That, we fear, is the current situation, with the rising stock market overriding the effects of monetary tightening. Once again in recent weeks, the market has defied our notions of valuation gravity by posting an

appreciable further advance. Moreover, it has done so in a way that seems to highlight the risk that it will continue doing so. I refer to the incredible run-up in "tech" and e-commerce stocks, some of which have entered the big-cap realm without ever earning a buck.

To illustrate the speculative character of the market, let me cite an excerpt from a recent IPO prospectus: "We incurred losses of \$14.5 million in fiscal 1999 primarily due to expansion of our operations, and we had an accumulated deficit of \$15.0 million as of July 31, 1999. We expect to continue to incur significant...expenses, particularly as a result of expanding our direct sales force.... We do not expect to generate sufficient revenues to achieve profitability and, therefore, we expect to continue to incur net losses for at least the foreseeable future. If we do achieve profitability, we may not be able to sustain it." Based on these prospects, the VA Linux IPO recorded a first-day price gain of about 700 percent and has a market cap of roughly \$9 billion. Not bad for a company that some analysts say has no hold on any significant technology.

The warning language I've just read is at least an improvement in disclosure compared to the classic prospectus of the South Sea Bubble era, in which someone offered shares in "A company for carrying on an undertaking of great advantage, but nobody to know what it is." But, I wonder whether the spirit of the times isn't becoming similar to that of the earlier period. Among other things, it may be noteworthy that the tech stocks have done so well of late in the face of rising interest rates. Earlier this year, those stocks supposedly were damaged when rates rose, because, people said, quite logically, that the present values of their distant earnings were greatly affected by the rising discount factor. At this point, those same people are abandoning all efforts at fundamental analysis and talking about momentum as the only thing that matters.

If this speculation were occurring on a scale that wasn't lifting the overall market, it might be of concern only for the distortions in resource allocation it might be causing. But it has in fact been giving rise to significant gains in household wealth and thereby contributing to the rapid growth of consumer demand--something reflected in the internal and external saving imbalances that are much discussed in some circles. Whether our assumed 75 basis point increase in the fed funds rate would be a sufficient shock to halt this financial locomotive is open to question.

A model simulation in the Greenbook gave some sense of what might happen if the stock market shrugged off that further tightening and continued rising. But another factor that will help determine just how much policy restraint is needed is what happens in the rest of the world economy, and Karen has a few words to say about the risks in that regard.

MS. JOHNSON. In my remarks I will first say a few words about the October trade data that were released after the Greenbook was completed and then will review what we perceive to be some of the risks confronting the global economy.

In October, the U.S. nominal trade deficit in goods and services reached \$25.9 billion, a new monthly record. Exports were about unchanged from their level in the previous two months, as increased exports of industrial materials about offset decreased exports of machinery, including computers. The value of imports jumped in October, with the largest increases registered in consumer goods and machinery.

The October number was very close to that embedded in the Greenbook forecast. By themselves, these data suggest a fourth-quarter outcome of real net exports that is slightly weaker than in the Greenbook. However, in combination with small adjustments to some domestic components of GDP in response to these data, they imply little net change in our estimate of current-quarter GDP growth.

Once again we have slightly revised upward our Greenbook projection for real output growth abroad during 2000 and 2001. This brings the total revision for 2000 to about plus $\frac{3}{4}$ percentage point since June and plus $\frac{1}{4}$ percentage points since last December. Our stronger outlook for the coming two years rests in part on the positive surprises in recent months for economic activity during this year for most regions of the world. It rests also on the likelihood that fiscal policy will be less contractionary in several regions while monetary policy remains generally accommodative abroad. The one major exception to the generally bright picture I am painting has been Japan, where although we have revised upward our forecast for next year, projected growth remains quite low, and we are somewhat pessimistic.

Together with the stronger view for the U. S. economy that Mike just reviewed, the staff forecast now calls for a substantially more robust global economy over the coming eight quarters than seemed probable a year ago. One risk to this upbeat picture is that we, and other forecasters, are still not fully taking into account the mutually reinforcing positive impulses that can be shared across countries during a simultaneous expansion. We may be underestimating the upward momentum in individual countries that can come from the interaction of improved confidence, higher capacity utilization, and wealth effects. For the global economy, we may be failing to allow for generally stronger export demand everywhere as spare capacity is reduced in many economies at the same time.

One class of markets where early indications of such growing momentum might become evident is global non-oil commodity markets. As yet, we do not see an indication that demand is putting severe pressure on supply in those markets. While prices have begun rising, it is from previously very low levels. Going forward, we will need to pay particular attention to those markets for signs of incipient inflationary pressures.

At the same time, we need to be open to the possibility that the factors causing accelerating productivity in the U.S. economy are beginning to have similar effects in other economies, especially the other industrial economies. In that event, the global economy would be capable of faster growth without inflation risk than was previously the case. Provided foreign officials do not unnecessarily limit output growth from achieving its new potential, such a development could result in stronger demand for U.S. exports and more balanced growth in the global economy. Such a scenario is one version of a so-called soft landing.

It now seems very likely that 2000 will see higher interest rates and more profitable investment opportunities abroad that could decrease demand for U.S. assets and raise the risk of downward pressure on the dollar. Such developments could in turn cause disturbances in other global financial markets as well. However, for the first time since the Asian crisis began in 1997, we need to be alert to the possibility of generalized global upside economic pressures and the challenges for policy that such a development would pose.

CHAIRMAN GREENSPAN. Questions for either of our colleagues? President Moskow.

MR. MOSKOW. Thank you, Mr. Chairman. I want to ask Mike a question about the outlook for automobile sales next year. The Greenbook projection for sales of light vehicles is 16.6 million, and I am sure you know that the auto companies are estimating around 15.9 million. We had a symposium at our Bank a few weeks ago with a group of forecasters from the region, and they were coming in around that same level--15.9 or 15.8 million even. I am just curious as to why the Greenbook is so much higher than the consensus forecast and the forecast of the auto companies themselves at this point.

MR. PRELL. Well, no one has had a particularly good track record on forecasting auto sales this year. Even the automobile manufacturers themselves, I think, have been quite surprised by the high level of sales. Our forecast of overall economic activity is, as I suggested, in the upper brackets of forecasts that one would find at this point and auto sales

are a cyclically sensitive sector of the economy. I think therein lies a very important element of explanation. I don't think there is much more that I can say on this. We consult a number of models, and they give somewhat different results about the likely pattern of auto demand over the next couple of years. But as we look back at recent experience--at how much sales seemed to be above reasonable trends in the past two or three years--we don't see a compelling case for a precipitous decline from here, especially in a fundamentally strong economic environment.

MR. PARRY. Mike, I thought the section in the Greenbook on alternative simulations was particularly interesting, especially the comparison between the baseline and the flat funds rate scenario. It seems to me, if one compares the effects of monetary policy actions on inflation expectations in the economy, that there is a greater sensitivity now than may have been the case a couple of years ago. And that makes sense to me. We are basically saying that markets are learning and responding to policy actions. But what is a bit confusing is that there is also, I would assume, considerable sensitivity to developments in equity markets as well. If one looks at those two Greenbook alternatives, there is a big impact on expectations as a result of the effect of a change in rates on equity prices. Could you talk a little about how expectations enter into the model now versus how they used to? Is there a greater sensitivity now to policy actions?

MR. PRELL. I'm not sure that I can provide a very good direct answer to the question of sensitivity to policy actions. We have looked to see whether the responses--in terms of long-term rate movements and so on--to changes in the funds rate are different now. I think there may be some small amount of evidence supporting that thesis.

MR. STOCKTON. The most important change in the model, relative to where it was a few years ago, is the reaction of the economy and the agents in the economy when we don't tighten in a period when the economy is strong. In that case, people think we have revised up our inflation target, whereas in the past our model basically assumed that all agents were backward-looking. People just looked at where inflation had been; and the way that monetary policy influenced the inflation outlook going forward was simply through its effect on aggregate demand. Now there is some independent effect through forward-looking expectations that leads to a more rapid adjustment of inflation expectations. I think that is the principal difference. In looking at the response of the economy to changes in the funds

rate, we were unable to convince ourselves that there had been a significant change in either the economic structure or the model's response to monetary policy at some deeper level. But I think the way the model is now constructed does make it more sensitive to the conduct of monetary policy. It wasn't even a question that arose in our old MPS model.

MR. PRELL. I should say that one of the nice features of our model is the ability to change the expectations formation mechanisms. And the one that we have used in doing these simulations is a very simple, small model that is supposed to capture the way people will react to a certain set of variables. It isn't a fully consistent model of expectations in that we are not taking a full rational expectations kind of approach. That would be another way of doing this. This is one of the areas of active continuing research, and conceivably there could be some changes in this small model in the not-too-distant future that would perhaps enrich that a bit. One of the things that we have pointed out repeatedly in the presentation of our simulations is the difference in the effect of lower interest rates versus higher stock prices for the inflation outcome. That's because the interest rate change induced by monetary policy is affecting people's inflation expectations to a greater degree than the higher stock prices, even though they both create more aggregate demand. So, this is one of the areas that I think we need to work on a bit further in an effort to come up with something that would be a little more realistic.

MR. STOCKTON. One other area where over time there has been some structural change in the economy that has tended to increase the sensitivity of output to interest rates has been through the increasing openness of the economy and the exchange rate mechanism.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mike, on the top of page 7 of the first part of the Greenbook, you say that you are expecting hours in the nonfarm sector to increase at a 2¼ percent rate this quarter. And you say that if we get nonfarm productivity increasing at a 3¼ percent rate we will get the 4.8 percent GDP forecast. That doesn't seem to add up. Does that imply that agricultural productivity is declining?

MR. PRELL. We have a government sector to account for and I think that is probably the--

CHAIRMAN GREENSPAN. The government and household sectors overwhelm it. Agricultural productivity is still accelerating according to the data that we have.

MR. BROADDUS. Yes, that's why I couldn't figure out--

CHAIRMAN GREENSPAN. Although agricultural productivity might slump if genetically modified organisms were made illegal.

MR. POOLE. On wages, is there any way to sort out the forward-looking expectations effects from the backward-looking effects of recent changes in the CPI, which I think you were using as a part of your outlook for wages?

MR. PRELL. I don't think there is a particularly good way. And I'm not sure, in fact, whether in the real world we don't have a mixture of both occurring. In a mechanical way we have cost of living adjustments in various contracts, so that is clearly backward-looking. I would think that in many informal wage adjustment systems people are looking at what has happened to the CPI over the past year or some other recent period to get a sense of what might be an appropriate wage increase. In other instances, people may be more forward-looking and the question is how they shape those expectations. We have tried to capture that econometrically in various ways by using lagged prices, survey measures, and so on. I don't think we can really separate the two in a clear way.

MR. STOCKTON. If you enter both the Michigan Survey's forward-looking expectations and lagged prices into a wage equation, typically both will have some explanatory power. Whether you really and truly have identified those two separate effects, given their co-linearities, would be a tough call.

CHAIRMAN GREENSPAN. As you know, we are getting some preliminary evidence that the wealth effect may be larger than the 3 or 4 percent stemming from capital gains that basic distributed lagged econometric analysis produces. As a general proposition is it true that because of the random noise in the system any very significant reduced form type of calculation that you're currently making to pick up the wealth effect is biased downward by the nature of the construction of the test? Or do you have ways to filter out whatever noise there may be to come up with cleaner coefficients? For example, suppose that in the real world there is an exact 10 percent coefficient and that if you could measure it in every detail you would get that number. But to the extent there is random noise in the data, of necessity the estimated coefficient will be biased downward, and if there is enough

noise in the system, at the limit it will go to zero. Do we have any sense, having looked only at one major upswing in stock prices to judge this, whether that 3 to 4 percent coefficient is realistic? Do we have actual useful evidence in the other direction? In other words, in the few periods of really significant declines in stock prices is there any evidence regarding the robustness of that coefficient?

MR. PRELL. We have looked at how robust those estimates are, examining different estimation periods and so on, and one would find some variation in that respect. On a priori grounds, one might think that this effect would not necessarily be perfectly stable over time as the demographic distribution of wealth changes. If more of the wealth was held by people with shorter expected remaining life spans and there was not a strong bequest motive, one would think the coefficient would go up because people would be spending that wealth more quickly. If younger people are getting wealthy and they spread the spending over a lifetime, one would expect the coefficient to go down. I think there are any number of reasons to expect that the coefficient is not going to be perfectly stable.

CHAIRMAN GREENSPAN. I'm not even raising the issue of stability. I am raising strictly the question of the size. It is perfectly possible to have all the things you are mentioning but for the bias to be there as a function of the data themselves. I'm just questioning whether or not--other than by disaggregating the data--we have any indication that we may be underestimating that coefficient. If you disaggregate the data, you clearly reduce the noise. That's the purpose of disaggregation. We have already started some modest disaggregation and we see some rather startlingly different results. I was just curious as to whether there was concern about that because if we are underestimating that coefficient on both the upside and the downside, it could be more destabilizing than even the less-than-optimistic appraisal of the overall outlook that you just gave.

MR. STOCKTON. There is one piece of evidence, though, suggesting that our estimated wealth effect is not too far off base. And that is that the decline in the saving rate we have seen has been roughly consistent with what the consumption equation uses--that is, what a 3 to 4 cents on the dollar wealth effect would suggest should be the case. You are absolutely right that the hard part in estimating these effects is that we know we are estimating ultimately the consumption effect from changes in stock prices. Those are very noisy. What people are really reacting to, in essence, is their perception of the persistence of

those stock prices. And what the distributed lag picks up is the fact that because the data are noisy we do not see an immediate response to every movement in stock prices. That's because many people, in making their decisions, are trying to determine how much of that movement in stock prices is, in fact, going to persist and how much is transitory. So the distributed lag would pick up smaller coefficients, let's say, of the effect of the stock price change in the first quarter simply because many people are uncertain as to whether or not that change will be permanent or transitory. If they knew for sure, the lagged coefficient would be biased down because they would, in fact, respond more strongly to that movement in stock prices.

In terms of the disaggregated data, we have a lot of work yet to do. We have a variety of different data sets and projects that we are pursuing to try to pin down better the size of this wealth effect. I would feel more comfortable if I saw micro level evidence that supported our hypothesis that we are actually experiencing a wealth effect of the size that the time series evidence is purporting to pick up. I say that because, as our colleagues in New York have pointed out, there is uncertainty in these estimates for sure.

CHAIRMAN GREENSPAN. Have you tried at all to capture potential stock price volatility as a factor that would delay the sense of persistence of the gains? Or is the period just too short to provide any useful insight?

MR. STOCKTON. I've asked our consumption experts that question. They claim that there has not been much success thus far in their effort to work the volatility in stock prices into those consumption functions. It may be a function of the fact that, when we are using the aggregate time series data, we are asking far too much from those data and more than they are going to be able to return. The micro level evidence may provide some better fix on that.

CHAIRMAN GREENSPAN. Thank you. Any further questions? If not, who would like to start the roundtable discussion? President Parry.

MR. PARRY. Mr. Chairman, economic activity in the Twelfth District has continued to expand rapidly in recent months, with the expansion broadly based across major District states. Every major sector in the District added jobs in recent months, with construction posting some of the largest gains. And manufacturing has been a new source of job growth in recent months despite a continued loss of aerospace jobs. A rebound is

particularly evident for manufacturers of high-tech equipment, who recently have benefited from improved exports to Asian countries that had suffered recessions in the 1997-1998 period.

High-tech firms have created a lot of jobs and wealth recently in the District, especially in California. This year a record-breaking amount of venture capital has been invested in California firms, particularly those in the Bay Area that are developing Internet applications. Proceeds from initial public offerings also have surged this year, following moderate amounts of IPO activity in 1997 and 1998. The strong performance of technology stocks is boosting spending not only in California but in other District states as well. For example, one of our directors reported that Californians are using their newfound riches to bid up the price of beachfront real estate in Hawaii. Analysis done by our staff suggests that successful IPOs have made a large number of employees wealthy, at least on paper. More than 150,000 persons are employed in the roughly 300 California- headquartered firms that have made IPOs in the last three years. About 125,000 of these employees probably have received stock or stock options as part of their compensation, giving them as a group about 15 percent ownership in their firms. Given the strong stock price performance this year, the aggregate market capitalization of these 300 firms recently jumped to about \$450 billion dollars. As a result, about 125,000 Californians have seen the value of their stock or stock options jump to an average level of more than \$300,000 per employee. Just as this newly created wealth is boosting demand, especially in California, it is clear that a collapse in market values would impose obvious downside risks.

Turning to the national economy, recent data continue to show the rapid growth in economic activity and moderate inflation that we have seen for four years now. These data serve to reinforce the impression that the supply side of the economy is expanding rapidly. Our forecast under an unchanged federal funds rate and flat stock market shows growth of just under 3¾ percent and 3½ percent respectively over the next two years.

With regard to inflation, tight labor markets are expected to impart an upward trend to the ECI, which rises in our forecast to 4¼ percent by 2001. However, the acceleration of productivity in recent years can be expected to counteract part of this pressure on goods prices. Moreover, corporate profit margins remain high, providing a further cushion between wages and prices. Balancing these factors, our staff forecast shows a slight upward

trend in core CPI from 2.1 percent this year to 2.3 and 2.4 percent in the next two years, considerably below the forecast in the Greenbook constant funds rate scenario.

There are significant risks on both sides of the forecast. The evidence of a continuing supply shock represents a downside risk for inflation. This shock has proven to be difficult to model, and inflation, once again, could come in lower than expected. In addition, the possibility of a significant stock market correction cannot by any means be ruled out, and that also would reduce inflationary risks. However, labor market tightness could begin to show through to price inflation in a more dramatic way, as would be expected from historical experience. This risk is illustrated rather forcefully by the Greenbook with its forecast that CPI inflation would rise to 3.2 percent in 2001 with no further tightening of monetary policy.

The key policy issues appear to remain the same. Accelerating productivity and actual results for inflation suggest room for guarded optimism, while labor market tightness implies problems ahead for inflation. While I am perhaps not as pessimistic as the Greenbook, I must admit that it has shifted my focus a bit toward the inflationary risks that we face with an unchanged federal funds rate. Thank you.

CHAIRMAN GREENSPAN. Incidentally, parenthetically, President Parry has suggested a disaggregation of the wealth effect by regions. [Laughter] President Hoenig.

MR. HOENIG. Thank you, Mr. Chairman. The underlying trends in the Tenth District economy have not materially changed since our last meeting. The economy remains healthy, with manufacturing actually showing some continued rebound. I am hearing more comments throughout the District that higher interest rates have slowed some construction sectors, especially residential building. Growth in home sales in the District was about 3 percent third quarter over third quarter this year compared with about 10 percent last year. At the same time, we are hearing from several of our business contacts that increases in public works construction such as roads--actually jails for the most part--are offsetting the falloff in other construction.

While private construction is slowing, manufacturing is continuing to show good signs of strength. Our Beigebook contacts reported high levels of capacity utilization last month. The recently released data on third-quarter manufacturing exports also showed continued improvement in foreign demand for District factory goods. Based on reports

throughout the District, holiday shopping centers are quite busy; seasonal sales are very strong and many retailers are reporting the best season that they have had in five years. While the number of business contacts reporting labor shortages increased slightly last month, it was probably not a significant increase. Moreover, most of the increase came in the manufacturing sector, which has been expanding production in the last couple of months. The District's unemployment rate is about 3¼ percent. Except for New Mexico and Wyoming, all District states have unemployment rates below 3¼ percent, and some are much below that. District contacts report that wage and price pressures remain subdued, however; that is no different from what I have been hearing for some time and have reported in past meetings.

Our energy sector has actually strengthened with the increase in prices and there are some signs now of wells being uncapped but very few new starts at this stage. The farm economy remains fundamentally weak, although there is some improvement in cattle prices. But for now that sector will continue to rely on transfer payments for its health.

Turning to the national economy, my view of the outlook has not changed fundamentally since the November FOMC meeting. The economy obviously continues to grow well, with few signs right now of rising inflation. I expect economic growth to slow over the forecast horizon based on our actions earlier this year. And, frankly, I find it highly unlikely that with an unchanged funds rate we would have growth in the 4 to 5 percent range as suggested by the Greenbook. My view of the Greenbook right now is that it provides a reasonable description of the upside risks to the outlook rather than the most likely outcome. In my mind the risks are balanced. We do have upward pressures; there's no question about it. But there are some other factors, such as our last three funds rate increases, that I think need to play out.

I agree with most people that core inflation is likely to rise to about 2¼ percent or maybe 2½ percent in the year 2000 and beyond. However, at this point I am not convinced that it will rise to a rate higher than 2½ percent in 2001. So in that sense, I think we do have some time to look at how things develop in the near future. Thank you.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Thank you. In recent reports from directors, the focus has been as much on the outlook for the next year as it has on current or recent conditions, especially

among those people who indicated they were in their profit-planning cycles or putting together business plans. We questioned them about the specifics they were putting in their business plans. One company that owns newspapers throughout the country said they expect ad revenue to be significantly stronger in 2000 than in the current year. But they are budgeting a 10 percent increase in newsprint costs and an 18 percent increase in corporate-wide medical costs. And they expect the rise in their total labor costs to be in the 6 to 7 percent range. A communications company reported what they refer to as an "explosion" of demand for communications equipment. Growth in data transmissions is currently running 10 times that of voice transmissions, and for the year 2000 they are budgeting for a 40 percent increase in fiber mileage that they expect to put into place. Previously, for the current year they had expected a fourth-quarter slowdown in orders and shipments because of the so-called lockdown effect. They said it did not occur. The quote is: "If there was a lockdown effect, it only delayed a further acceleration in telecommunications equipment shipments." And they will be watching for early signs to confirm that next year.

A company that basically makes items out of specialty metals--they supply the aerospace industry and the medical profession--said it expects most of its growth in the next few years to be in exports to Asia and Europe. Some recent signs of such growth proved of interest compared to what they had been seeing over the last couple of years. A major supplier worldwide of safety equipment had an abysmal summer but reported that exports from September to November were great and they do not believe the improvement was Y2K-related. They said that they had been concerned that the improvement could be a blip, but they don't think so now. Their foreign orders were picking up nicely and they expect next year to be even better.

The outlook for construction spending and employment in the region is reported to be one of continued strength but it involves mostly public spending on the highway infrastructure and the kinds of projects that Tom Hoenig also mentioned. It has been asserted by some of our contacts that the recent leveling in residential construction in the region reflects the lack of available labor, not the increase in mortgage rates. They feel it is really a deferral of residential construction because workers are not available. In unionized activity, our contacts say booming nonresidential construction has reduced the pool of available residential construction workers. They are simply being bid off to other kinds of

projects. We hear more reports of companies delaying or canceling expansion plans for warehouse facilities or for other distribution operations, mainly because of the lack of labor. We are told that some fast food restaurants in central Ohio have now gone to a weekends-only policy because they simply do not have the staff to operate in the middle of the week.

A western Pennsylvania company that produces air curtains reports that overall 1999 will be a record year. They are now expecting the fourth quarter to be the strongest single quarter they have ever had; the strength is in both domestic and foreign markets but the pickup has been in foreign markets recently. They think most of the growth in demand that they are seeing stems from retro-fit projects, not new construction.

Another company that is engaged in specialty food processing and distribution said that they estimate their December sales will turn out to be 25 percent above last December's. Over the course of this year their catalog sales have risen 20 percent and the share that is from the Internet has accelerated dramatically. In January of this year Internet sales were 2 percent of catalog sales and in November they were 10 percent. Their corporate sales--pastries and other packaged foods that I would call luxury food items--rose 30 percent this year. Most of that is for gifts to employees, customers, and suppliers.

In the steel sector, the orders for the first quarter are reported to be good. Price increases in the range of \$10 to \$20 a ton were put into effect in the fourth quarter. And price increases ranging from \$15 to \$30 a ton have been announced for the first half of the year; that would be about a 7 to 10 percent increase. If they are fully implemented--some of them don't take effect until April 1st--that would leave the average level of steel prices about 5 percent below where they were a year and a half ago in July of 1998.

Export demand for plastic-manufacturing equipment has recently picked up, and it is expected that demand in 2000 will be stronger. Again, it is said that most of the growth in new orders is going to be from foreign markets. They think Europe is picking up very nicely and are hopeful about Asia.

In the sports and entertainment sector, the average price of a ticket to an NBA game on opening day this year was up 11 percent versus a year ago on opening day. The average ticket price for entertainment events this year at Gund Arena in Cleveland--mostly for music performances--was 10 percent above 1998. Finally, let me cite one report on the labor markets in the region: We were told that in Pittsburgh this year the starting salary for a

worker with a bachelor's degree in biology and with computer proficiency was \$90,000.

Thank you.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mr. Chairman, I would like to say a few words about the directive when we get to that later in the meeting, so I'll try to compensate by being especially brief here. In any event, I don't have any great insights on the economic outlook.

In short, I don't detect a lot of change in conditions either in our District or in the national economy since the November FOMC meeting. Activity in our region continued to advance at a solid pace in November and early December according to our contacts and the surveys that we conduct. Consumer spending remains strong. Our retail contacts are looking for nominal increases in sales over last year in the range of 5 to 6 percent. Outside of the textile industry which, of course, is still declining, manufacturing continues to rebound. Prospects going forward look pretty good, with new orders rising in a large number of industries. There are a few signs of some deceleration in residential sales and construction in some local markets, but there is, of course, a lot of noise in the short-term housing data, especially at the regional and local levels. Activity remains at a high level in any event. Labor markets are still very tight in our area. We have heard a few reports recently of quite sharp wage increases in some service industries, but increases in the manufacturing sector remain fairly moderate. And many of our business contacts continue to report a lack of pricing power.

The same kind of story seems to hold true at the national level. As I see it, projections of a deceleration in the growth of demand continue to be pushed forward not only by the Board's staff but by other forecasters as well. I think the continuing momentum in consumer spending is particularly striking, although not terribly surprising, given strong growth in jobs and personal income. As I mentioned earlier, the Greenbook projects growth in hours worked at a 2¼ percent annual rate this quarter. It is hard to see how that kind of growth can be sustained without at some point generating inflation and inflationary wage demands, especially if the core CPI is accelerating as the Greenbook is projecting going forward.

One final point of interest: A teenage daughter of one of our Baltimore officers is reported to have been offered \$250 to baby sit for a local dentist on New Year's Eve. She

turned it down in order to go out with friends. We're not sure what that implies for the funds rate [laughter] but we still think the risks are on the upside and that we may be at least a little behind the curve. We're still working on it and we'll let you know when we figure it out!

CHAIRMAN GREENSPAN. I think you've stopped this meeting cold! That's a new statistic, which we had better absorb! President Gynn.

MR. GYNN. Mr. Chairman, I'm not sure I want to follow that! And I would also like to reserve a little time for the later discussion, but I won't trade away all of my time.

The beat goes on. Growth in our region remains strong and relatively balanced, and our contacts across almost all of our geographic areas and industries are expecting more of the same in the period ahead. Consumer spending during the important Christmas buying season is now reported to be quite strong after a slow start prior to Thanksgiving. High-end items, including expensive jewelry, are reported to be hot. Big Box and other discounters are reporting sales increases of more than 5 percent on a year-over-year basis. As has been the pattern in recent years, sales at traditional department stores are not quite as strong.

As I've reported at other recent meetings, real estate activity in our region has flattened noticeably. While current inventories of unsold units are at reasonable levels, one major builder in whose judgment I have a great deal of confidence told us recently that he expects to begin to see the first signs of overbuilding in some of our markets in coming months.

Manufacturing in the region continues to increase at a modest pace, except for apparel, which is experiencing a long secular decline. Our latest manufacturing survey did suggest some caution in investment spending plans in manufacturing in coming months. International trade from our region continues to suffer from the weak growth in Japan and Latin America, which account for 10 percent and 40 percent, respectively, of our region's total exports. Our examiners report that loan growth, except for mortgages, continues to be strong. There is more evidence of credit quality problems in health care lending, and substantial loan loss provisions have been made by several of our large lenders recently. It has also been suggested that after the year-end liquidity concerns abate, we could see a pop in investment and credit extensions as that money is put back to work.

The major threat to continuation of strong growth in our region is the availability of labor, which historically has been very dependent upon substantial in-migration to support our above national trend growth. And the pool of additional workers has dried up. The most notable price pressure points remain the same: health care, pharmaceuticals, and some commodities.

At the national level, I continue to be amazed at the raw strength of the continued expansion. Clearly, the consumption numbers and the anecdotal information indicate that the economy is carrying significant momentum into the first quarter. Like the Greenbook, both our judgmental and our VAR model forecasts show some slowing in the coming year--for somewhat different reasons--but upside surprises have become the norm. While we may have some unusual patterns over the Y2K year-end period, there now appears to be enough momentum and perhaps pent-up investment spending to counter the early 2000 slowing we expected earlier. If anything, the economy looks even more resource constrained now on the labor side and is likely on a unsustainable growth path regardless of one's views of productivity and the NAIRU. Moreover, there are few signs that our previous rate hikes have yet begun to bite except for the moderation in housing. As others have suggested, higher real rates may be necessary to get a comparable degree of monetary restraint in the current environment.

Like the Greenbook, our inflation forecast shows some gradual rise in measured inflation in 2000 and beyond. Like others, I find myself re-calibrating my expectations for productivity gains and reassessing other developments such as expanded world trade and its implications for the supply side and for pricing power. While I am comfortable building into my outlook and policy thinking some new views about sustainable increases in the potential for the economy to grow, I am not comfortable betting that all of the new-era phenomena are everlasting. Were it not for the special year-end considerations this year, I would be trying to develop the case more fully this morning for another snugging policy move. In my view, such a move would improve our chances of staying ahead of unsustainable developments that could threaten our gains against inflation and lead to a deterioration in inflation expectations. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Thank you, Mr. Chairman. The regional economy in the Philadelphia District continues to operate at high levels, with a general sense that the good times will roll on. Retail sales are robust throughout the District. Some high-end car dealers are having trouble getting deliveries, not because the manufacturers can't produce the cars but because there aren't enough truckers and trucks to get the cars to the customer. Home sales are unusually brisk for December, in part, realtors say, because of the unusually mild weather. In commercial real estate, the demand for properties is strong, and I am hearing reports here and there of some speculative building; it's not a lot, but I haven't heard much about speculative building for a number of years. Labor markets are very tight. We hear of some examples of large increases in compensation and special perks, but the general pattern is still one of modest gains. The report from bankers around the District is that they believe that Y2K will be a non-event. They have lots of cash in their vaults but few customers requesting unusually large withdrawals.

The national economy is clearly showing strong demand growth, with pressures evident on the supply side even with outsized productivity gains, and still generally benign inflation. Some further increases in interest rates to temper demand growth are highly likely as the new year unfolds. Our primary objective during the coming weeks, however, is to get into the new year with financial markets as settled as we can make them. We have gone to a lot of effort to do just that, and our decisions today should be consistent with those efforts.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. Thank you, Mr. Chairman. New England continues its recent pattern of moderate growth, at least as measured by the increase in employment levels, which have been a full percentage point below the nation for some time. For most of the region, however, labor force growth has also been slower. And it has been slower than the growth in the number of jobs, which is giving rise to declining rates of unemployment in all states in the region. This also gives credence to the numerous anecdotes that it is the labor constraint itself that is preventing higher rates of regional job growth. Nonetheless, the region's employment growth does exceed the nation's in two areas--construction job increases and the moderation in manufacturing job losses.

In the construction area, job growth reflects very good residential and commercial real estate markets in Boston and elsewhere. We continue to ask ourselves whether

construction job growth could be a precursor to a 1980s type real estate boom. But so far, construction jobs do not comprise nearly as large a fraction of total employment as they did in the 1980s, and there is very little, though some, speculative construction going on.

On the manufacturing side, regional job losses are more moderate than those for the nation as a whole, probably reflecting a turnaround in merchandise exports. Recent reports indicate that new orders for manufacturing goods in the region accelerated in recent months, led by a rebound in exports. Year over year New England exports grew fastest to South Korea, Mexico, and the Netherlands, though exports to South Korea are still not back to pre-crisis levels.

As compared with earlier this year, contacts noted a somewhat increased willingness to pay higher wages and to raise prices, at least for retail goods. Consumer confidence is high and growing, with surveys pointing to especially strong gains in expectations about future economic conditions. This is in marked contrast to earlier this year when such expectations were more moderate. To the extent that expectations were affected earlier by Y2K uncertainties--and I am not really positive that they were--the apparent lack of concern in this area may be feeding into higher levels of consumer confidence. It is hard to find any Y2K panic or even deep worries out there, and believe me we've tried to find it.

In looking around for signs of slowing in the region, I must admit I've had a hard time finding any. Bankers do report that mortgage originations are off. And while loans in general have been growing at a better pace than earlier this year, they are rising at only about half the pace for the nation as a whole. Aside from that, however, just about everything else seems to be going great. Stores are packed. The highways are jammed. Help in retail stores is extremely hard to come by. We held a series of bankers' forums this fall and the conversations among those present as well as among the bankers on our board were very upbeat. New England may be growing more slowly than the nation, at least as measured by overall employment, but our regional economy seems to have a very solid foundation for the foreseeable future.

Turning to the nation, I am struck, as others have been, by the fact that even in the few weeks since the last meeting things seem to have gotten that much hotter in the overall economy. Growth this quarter will be somewhere close to 5 percent. Labor markets are, if anything, tighter. The stock market continues to surprise on the upside, and financial

market conditions in general seem quite accommodative, notwithstanding our recent tightening. Foreign growth, despite the weakness in Japan, continues to be stronger than expected. And reflecting all of this, oil and other commodity prices continue on the upswing. True, there seem to be a few signs at the national level of slowing in interest-sensitive sectors; but we have seen these signs before and they've simply been pauses.

On the broad wage and price front, the total CPI has leveled off and the core is rising to fill the gap between the two of them. The one thing that remains somewhat puzzling, to me anyway, is why, given labor market pressures, we haven't seen much escalation in overall wages and in fact actually have seen some reduction in the rate of growth. If one believes that is because overall prices were lower last year due to the impact of declining oil prices, then I think there is reason to assume that the reverse will happen in the coming months and we will begin to see more wage pressures. One has to remain agnostic because we have expected to see that for some time now. But it does give one pause, in light of everything that has happened--given the stock market and the wealth effect, the change in overall price levels, and the increase in labor market pressures. Even given productivity changes, one has to wonder when compensation levels are going to be such that they will outstrip the growth in productivity and start to be a factor in terms of overall prices.

In that regard, as we prepared our forecast in Boston, we had some trouble accepting that trend productivity growth might be somewhere north of 2½ percent and that potential might be 3.8 percent or so. We are also a little less bullish, especially with regard to PCE spending. But overall, if we look at our forecast with an assumption of no policy change and compare it to the Greenbook's flat policy alternative, the differences are not substantial. We are in agreement with the staff that policy does need to be tighter to keep inflation from rising above 3 percent by late 2000 or early 2001. The questions are by how much--75 basis points or more--and when. It is hard to know the answer to how much since it is difficult to know what will happen when we make the next move and step on the brakes. In my view anyway, the next move may be seen differently than the last three. After all, it could be argued that those three tightenings were simply taking monetary policy back to where it was before the Asian crisis. The next move would bring short-term rates higher than they were in the spring of 1998 when we first adopted a bias toward tightening. There is at least a bit of a risk that the market will overreact, particularly given how frothy it has been of late.

When to move is also an issue largely because of Y2K. I, for one, don't see us putting at risk all the efforts we have made toward keeping markets calm and liquid through the century date change by making a policy change now that could just as easily be made early in 2000. Nonetheless, if it is risky to move now, which it might be, it is also risky to wait much longer. Thank you.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Economic growth in the Eleventh District has accelerated slightly over the last couple of months. Thanks to higher oil and natural gas prices, the energy sector has picked up somewhat, with the result that overall economic activity and optimism in Houston and the Gulf Coast area more generally have improved significantly. Houston had been the only spot of softness among our major metropolitan areas. Growth in our manufacturing industries has been robust of late. Higher interest rates combined with some overbuilding have acted to put a dent in the pace of new home and commercial construction activity. In spite of continued widespread talk about tight labor markets, retailers in the District report that, surprisingly, they were able to find a good supply of workers for the holiday season, contrary to Cathy Minehan's report on New England. Employers in the high-tech field continue to innovate in their practice of boosting non-base pay so that their overall increases in compensation are held within the boundaries necessary to maintain profit margins.

The national economy, if anything, seems stronger--and uniformly stronger--than even the most optimistic forecasters had anticipated. I understand that the variance in state employment growth rates is at its lowest level ever recorded, which reflects a national economy without any significant regional shocks and an economy with very low frictional unemployment associated with the need for labor mobility.

As forecasts are revised upward so, too, is the outlook for productivity gains and reduced unit labor costs. We seem to remain in the virtuous cycle of supply expanding in tandem with increased demand or vice versa. The improved growth prospects around the world do not seem to alter the situation. The Blue Chip median forecasts for the fifteen largest economies are uniformly positive--and significantly in all of them economic activity increased between March and November--consistent with Karen Johnson's report earlier regarding the staff's forecast for the rest of the world. But the strong performance of world

equity markets suggests that growing world demand can be accommodated without higher inflation.

In the coming weeks, the Fed should do nothing that will alter the markets' confidence that we stand ready to provide liquidity and stability to financial markets. After Y2K events are clearly behind us, we can address the longer-term policy issues at our February meeting. In my judgment, any public discussion of a bias in our thinking at this time can only cause disruption and should be avoided.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Thank you, Mr. Chairman. The Seventh District economy continues to be strong. Many of our retailers indicate that sales have been ahead of expectations since Thanksgiving. There are always some retailers who are nervous and, as one major retailer noted late last week, the play is at the plate. The light vehicles market continues to boom. We are seeing a modest shift in the composition of sales away from light trucks back toward passenger cars, and this shift bodes well for our District as we have a relatively higher concentration in the production of passenger cars than light trucks.

The situation in the farm economy is unchanged, with large grain inventories and low commodity prices. Even so, bankers we have talked to in the agricultural areas are feeling more comfortable because of the government subsidy checks that have recently gone out to farmers; those checks have added substantially to total farm income.

Our directors and other business contacts also continue to cite very tight labor markets and increasing wage pressures. Some restaurant chains that we look at have had substantial gains in productivity negated at least in part by increases in overtime costs. Ed Boehne mentioned the shortage of truck drivers. One of our former directors who runs a large trucking company noted that the shortage of truck drivers has led his firm to cut back on new truck orders. He maintains that he could use 500 more drivers if he could get them. In a similar vein, a major construction equipment manufacturer observed that his firm expects no growth in near-term sales because of the labor shortages facing construction contractors. Prices continue to be subdued; still, the pricing environment seems to be changing. Contacts in the steel industry reported some upward movement in prices. As Jerry Jordan mentioned before, not only have steel scrap prices gone up, so have contract prices for steel deliveries in the year 2000. These contract prices are up about 1 percent

relative to a year ago. This compares with contract prices that were down 5 percent in 1999 relative to 1998. We are also getting reports that advertising prices are moving up. To give some idea of the high volume of advertising, one large magazine printer mentioned to me that several major business magazines, including Forbes and Fortune, are now limiting the amount of advertising pages they can accept because they have reached a binding constraint on their maximum page count.

The Chicago Purchasing Managers' report indicates that the overall index as well as the prices paid and the supply and delivery components moved down in December, but all three components remained well above the 50 percent level. I would remind you that these data should be treated confidentially, as they won't be released until December 30th.

Jerry Jordan, as for basketball tickets, I can assure you that the price of tickets for the Chicago Bulls games did not go up this year. [Laughter] They are still \$80.

Y2K remains a question mark in the near term. Firms in our District indicate that they have made extensive preparation and they are ready. Many have set up centralized Y2K communication centers. In fact, a large temporary help firm in our District indicated that it has seen a heavy demand for temporary workers to staff these centers.

Finally, in response to a question about inventory building, the head of a national trucking firm observed that there was no need to worry about a buildup in retail inventories for Y2K. Business for his customers was so strong that they couldn't build inventories if they wanted to.

Turning to the national economy, our views have changed little since we last met. We remain in broad agreement with the general contours of the Greenbook forecast. Final domestic demand continues to run quite strong, as consumers and businesses spend their way to the end of the year. Given this momentum in final demand, labor markets may tighten slightly more in the next few months even as output growth decelerates to trend. Despite this, incoming labor compensation data have remained benign as productivity growth has repeatedly exceeded our expectations. However, the data now in hand suggest that the deceleration in our price measures has ended. Indeed, it seems likely that price and wage movements will worsen in the year ahead as we see the lagged effects of previous oil price hikes and changes in the dollar exchange rate.

Consequently, as has been true for some time, we are concerned that core inflationary pressures are likely to increase markedly over the next few quarters. Of course, I recognize that several key aspects of the outlook are quite uncertain. First, as we discussed earlier, we can't predict with any confidence the future path of stock prices or the wealth effects that they may induce. And I continue to be concerned about high valuation levels for the stock market, particularly for the Internet stocks. Second, we don't really know whether productivity growth will slow, remain high, or continue to accelerate. Third, although the futures market points to declining oil prices in the year ahead, the oil market has surprised us before, and consumer confidence may be quite vulnerable to such shocks. Despite these considerations, I believe the risks to the outlook are on the upside. However, given the uncertainties associated with the upcoming century rollover, this is not the time to be aggressive.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. The District economy remains in good shape and I will only comment on a few things that have changed relative to previous discussions. Agriculture, it turns out, has had a somewhat better year than many had feared. A lot of that is due to government payments. But in addition crops turned out to be large, which helped, and the cattle market has improved a bit. Commercial construction has been strong in the District for quite some time and a number of new office buildings will be coming on stream in the Twin Cities market over the next one to three years. It is now anticipated that as a consequence vacancy rates will probably double or triple in the Twin Cities. But that really doesn't seem to have caused any alarm. It is, I guess, the other side of the coin when a lot of buildings are built in a short period of time. Employment gains in the District have slowed; that appears to reflect mostly just a lack of unemployed workers. Labor markets remain very tight. Wage gains start at 3 or 4 percent and go up from there; but the distribution is skewed and most of the increases really are in the 3 to 4 percent range. But, of course, that leaves out all of the other extras that might go into compensation. There is still a general lack of broad inflationary pressures. And overall I would say that most of our contacts are quite positive about the economic outlook for the year ahead.

As far as the national economy is concerned, I have a fair amount of conviction about the outlook for economic expansion. Our model forecast is for growth of 3½ to 4

percent in real terms over the next two years. That's actually a little below the Greenbook forecast but it seems to me that conditions are right for a continuation of pretty solid real growth.

I have a lot less conviction about the inflation outlook. The Greenbook, of course, has a story of accelerating inflation. This is a familiar story and it has a certain logic to it. But the surprises to inflation over the last several years have been on the downside. There is a danger in extrapolating that kind of performance. On the other hand, we have been trying to do some serious statistical work on the unemployment/inflation/NAIRU relationship, and it looks as if that relationship really deteriorates a lot beginning in the mid-1980s. We are skeptical that there is any real relationship between unemployment and inflation if one concentrates on the period since about the mid-1980s. Now, I wouldn't bet the farm on this work just yet. We have more analysis to do. But our work thus far does suggest that we may want to look elsewhere for insights about inflation.

CHAIRMAN GREENSPAN. Vice Chair.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, the Second District's economy continues to grow at a moderate pace. Despite continued widespread evidence of price increases for manufacturing inputs and housing, overall inflation remains subdued at the consumer level.

You have all no doubt heard of the drama of the possible New York City transit strike. The Transit Authority reached an eleventh hour agreement with the transit workers union. The settlement calls for a 5 percent wage hike in the first year, 3 percent in the second year, and 4 percent in the third. That actually follows very much the pattern of the Long Island Railroad settlement about a year ago. Because the pension plan is well funded, employee pension deductions are being reduced substantially, boosting the average worker's take-home pay by an estimated additional 2.3 percent. The City's Transit Authority is actually funded through the State government. The Mayor is trying very hard to tell all the municipal workers whom he pays that the rather attractive settlement for transit workers should not confuse them into thinking that he is going to give them the same deal. So we may have some additional Sturm und Drang in New York on the labor front.

There has been much discussion, and I won't repeat it, on the levels of national and international economic activity. But why should one be concerned? I think foreign growth,

as Karen Johnson and others have said, is likely to be stronger. That will increase the demand for commodities and, *ceteris paribus*, increase their prices. It will also increase the demand for American exports, thus increasing overall demand in an economy in which demand already exceeds even the increased capacity of the supply side of the economy to provide goods and services. Despite probably higher exports, the current account deficit will still be very high. And, therefore, we are likely to have either a stable or somewhat weaker dollar. That will mean that we will not have the benefit in the next year or two of the very substantial help to core CPI that has come from import prices being significantly less strong than domestic prices. Our analysis, using a passthrough of about 0.4 of the exchange rate to import prices, tells us that the core CPI would have been 0.6 percent higher over recent years if we hadn't had that benefit from import prices, and I don't think we will continue to have it. Thus, we don't have to be concerned solely about whether we are going to run out of laborers, even though I think that is a valid concern.

The mere things that I've cited--essentially the effect on the United States of international developments--leads us to believe that the core CPI will start creeping up and, left to its own devices, will hit about 2.8 percent in 2001. I don't think that is something that the Committee should wish to see happen. But I feel very strongly that we have done such a good job of defusing Y2K tensions that the time to interest ourselves in that problem, which I believe is a very real one, is on February 1st and 2nd and not today. Thank you.

CHAIRMAN GREENSPAN. Governor Gramlich.

MR. GRAMLICH. Thank you, Mr. Chairman. Let me use my time to make some longer-term suggestions about how we should be operating, elaborating on some comments that I made earlier. Herb Stein once said something that comes close to capturing the essence of economics: "Things that can't go on, won't." What economists are good at, if anything, is putting together different logical postulates: demand, supply, arbitrage conditions, relationships between stocks and flows, and predictions of the way economies are likely to operate. In the end, economic forecasts rely on interactions between such basic logical assumptions.

As I think about my two years on this Committee, much of what has happened refutes Stein's quote. Things that couldn't go on, have gone right on! [Laughter] They may not do so forever, but they have continued much longer than anybody has forecast. The

first example is labor markets. Since I've been here we have been talking about very tight labor markets as indicated by the unemployment rate, other measures of labor tightness, and Beigebook reports. We have all felt that at some point wages would start to accelerate but as yet they really haven't--apart from some of the caveats that Mike Prell gave earlier. The second example is the stock market. Again, it has been seemingly overvalued since I've been here, but to this point stock prices have risen on balance. The third example is the dollar, which for a while now has seemingly been overvalued, if there is any limit at all on the accumulation by foreigners of dollar-denominated assets. But it is not yet falling. At the intellectual level we should, of course, keep studying these matters to see if we can improve our understanding of how the economy is operating. But studying and learning take time and in the meantime we have to know how to set monetary policy.

As I mentioned last time, an approach that may help us in these particular circumstances is inflation targeting, which is being adopted on a pervasive basis around the world. Last time--I suppose in a fit of exuberance--I reported being told that the number of countries now using inflation targeting was 44. I have since tried to verify that total and could only come up with 30. And even that number counts the EU as 11. [Laughter]

SPEAKER(?). So, it's only 20!

MR. GRAMLICH. That's right. Perhaps it's only 20. The adoption of inflation targeting is not as widespread as I said earlier, but it's still widespread. And it has worked well where it has been tried, as documented by a number of research papers. Perhaps more telling, no country that I know of has tried inflation targeting and then abandoned it.

What many academics like about inflation targeting is that it gives policy a nominal anchor and improves transparency and credibility. Those are important values. But I'd like to put inflation targeting on our table for a different reason. It seems to me that it would work well when we are facing just the sort of economic uncertainties that I mentioned above. First of all, when there are either productivity or competitive shocks in labor markets and wages just don't seem to be rising in the way forecast, inflation targeting permits us to follow the policy of watchful waiting we often talk about. Just what are we waiting for? It is really to see signs of an acceleration of inflation, in which case we can react by making appropriate policy changes.

Another uncertainty that inflation targeting permits us to finesse is that of deciding just what our target rate of inflation is. Around the world, most inflation-targeting countries do have fairly specific quantitative targets. I'm not sure that this group could agree on a precise inflation target, but I don't think we have to agree. What I think we can all agree on is that we should move against an acceleration of inflation. In effect, this pragmatic form of inflation targeting, where we move against an acceleration of inflation, may provide us a reasonable framework for thinking about monetary policy in the presence of either productivity or competitive shocks.

But even this pragmatic form of inflation targeting has one important difficulty. The big difficulty I see is in acting preemptively, which I think is necessary if we really are to stabilize inflation at present low levels. In order to act preemptively we must be able to forecast inflation, and that can present a problem. We could rely on modeling approaches to forecast inflation, but these have not been very successful precisely because of the supply shocks that have made the inflation-targeting approach attractive. We could rely on leading indicators, but there aren't many reliable leading indicators that are not already considered in models. We could rely on the forecasts of inflation of others, but those other forecasters may have the same trouble with their models or their leading indicators that we have.

I do think we could make some headway here, but it's not easy to do so. If we were to go through a pragmatic inflation-targeting exercise today, I think we would find that some added tightening might soon become necessary, though we might be able to delay for a short time. But stepping back from these specifics, I think an important early challenge for us is to learn how to deal effectively with the economic uncertainties, perhaps by inflation targeting or perhaps in some other way. Thank you.

CHAIRMAN GREENSPAN. President Poole.

MR. POOLE. Mr. Chairman, the comment that I hear around the Eighth District is that there is absolutely nothing new. That can't be quite absolute, but it is very close. After all, we met only five weeks ago and not all that much happens ordinarily in five weeks. In summary, our labor market continues to be tight but not impossible, pricing power remains limited for most firms, and there are small but noticeable effects in the housing industry from the increase in interest rates.

On the Y2K front notes that

Apparently

were planning to curtail operations on those two days. had
planned not to operate on the 31st but had so many requests from customers that it will be
operating, though it will not My sense of it is that

are finding the capacity--that the industry has responded and there
is really nothing more to be said about it. I'm guessing that at the end of the day we will
find virtually all of this Y2K effect lost in the rounding error and we are not going to see
much effect.

On the national economy, I would make just one comment, namely that as far as I
can tell there is no significant restraint from any quarter. Everything we're looking at is
solid, strong. I don't see anything on the downside. I still react negatively to the term
"drag" in terms of net exports. That term continues to annoy me. It seems to me that net
exports are about as much of a drag as a Styrofoam boat anchor. [Laughter] Thank you.

SPEAKER(?). A true sailor!

CHAIRMAN GREENSPAN. Governor Ferguson.

MR. FERGUSON. Thank you, Mr. Chairman. I think we are entering a period, as
others have said, that is going to be somewhat challenging for us. In the short run, we
clearly do not want to destabilize markets as we go into the Y2K period. One always hates
to see a marathon runner trip up at the end, and we certainly don't want to be the person
from the stands who runs out and trips that runner up. In the longer run, obviously, as
others have indicated, we don't want to lose our ongoing battle with inflation expectations
and inflation, or risk any damage to our own credibility.

During the intermeeting period, which has been short, we have received a variety of
data, some benign and some more troubling. On the benign side, the latest reports do show
that the rate of increase in core inflation has moderated even a bit more from that
experienced over the previous 12-month period. Additionally, productivity seems to have
ticked up again and growth in unit labor costs seems to be, if anything, slowing as opposed
to picking up. All of this is, as others have admitted, somewhat puzzling.

On the more troubling side, there are clearly growing signs of imbalances in our
economy. Others have touched on a number of them. I will emphasize just one, which is

the large and growing external deficit, a development I view as a sign of imbalance. As Karen Johnson indicated, there is a significant possibility that we will see interactions as a number of economies start to grow simultaneously. While our external balance will, I think, tend to be redressed as foreign economies return to health, there will be an increased demand for our exports, which might not be totally welcome from a price stability standpoint. Indeed, taking account of likely Y2K impacts, foreign demand for our goods does appear to be increasing already. As this happens, we can obviously expect some upward pressure on resource utilization, not just in labor markets but also in terms of capacity utilization. And I think the recent uptick in the latter measure may be just a precursor.

While I recognize that there are some uncertainties in these international forecasts, I do think the risks internationally are more on the upside than the downside. Clearly, there are some difficulties in Japan. But it is instructive to note that comments by individual members of the Monetary Policy Committee of Japan and the most recent monthly economic report coming out of Japan both seem to have a much firmer tone to them than had been the case even a month or two ago. Certainly the European economies seem to be firming. There is a possibility that they may start to enjoy some of the productivity surprises that we've experienced, but that is not entirely certain.

So, given this changing configuration, I think we would be well served to extend our cautious and prudent approach to policy. We should continue to recognize the benign effects of productivity improvements on unit cost structures, but we also should not be afraid to act in a well-modulated fashion in order to maintain our hard fought victory over inflation and also our credibility. Thank you very much.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Thank you, Mr. Chairman. I raised my hand this morning mainly to be recorded as present and participating in this section of the meeting. [Laughter] That's because little seems to have changed in recent weeks. The economy apparently continues to have a strong head of steam, the inflation news continues favorable, and productivity growth remains strong. Barring a significant shift in momentum or some external shock from Y2K or elsewhere, it appears likely that more tightening could well be required over the forecast period, with the Committee focused more heavily on how much and when. That outlook is

juxtaposed against the substantial tightening of recent months that has not yet had its full impact on the economy, and which could possibly provide all or most of the restraint necessary in this episode. Consequently, it is fortunate that the challenging millennium rollover period, which is now at hand, is also on its merits an appropriate time to rest on our oars just a bit and assume as low a profile as possible. Thank you.

CHAIRMAN GREENSPAN. Governor Meyer.

MR. MEYER. Thank you, Mr. Chairman. There is clearly strong momentum in private domestic demand and at the same time few signs of rising core inflation. So far so good. The issue is sustainability. The Greenbook weighs in with an assessment that the current state is not sustainable--not at the current monetary policy setting or even with the 75 basis point increase in the funds rate assumed in the Greenbook forecast. This, we all understand, is only a forecast and just one forecast at that. And as several speakers this morning have noted, there are many elements of uncertainty surrounding the outlook, especially about inflation dynamics, NAIRU, and productivity.

But I buy into the qualitative story of the Greenbook. I buy into the balance of risks that it identifies and into the message that I think it conveys about the challenges we may be facing next year. From my perspective the challenges are especially great because I think we face two reinforcing elements of unsustainability. We have an unsustainably rapid pace of growth on top of an already unsustainably high labor utilization rate. So, in short, I think we have our work cut out for us.

I believe next year will be an especially key one for monetary policy. Even if we do move to tighten policy next year, the overall picture of growth and inflation might still look quite favorable, particularly if the staff is correct that we will face declining oil prices after the peak in the first quarter. But in the coming year we will have the opportunity to take the steps that will improve the prospects of containing inflation going forward and, by doing so, hopefully extend even further this remarkable expansion. Thank you.

CHAIRMAN GREENSPAN. Thank you very much. Is coffee available?

MR. BERNARD. Yes.

CHAIRMAN GREENSPAN. Coffee is served.

[Coffee break]

CHAIRMAN GREENSPAN. Let's turn now to Don Kohn for his report.

MR. KOHN. The discussion in the Bluebook assumed that you would rule out a tightening at this meeting. While you might be troubled about the inflation outlook, a firming would come as a complete surprise to market participants. In the unusually illiquid conditions leading up to the century date change, such a surprise could have unintended consequences, including market disruptions. Moreover, any inflation threat would not seem so pressing that waiting six weeks to address it would make the problem materially worse. Neither surveys nor TIPS-nominal yield spreads indicate an upcreep in long-run inflation expectations; and these results suggest that economists, households, and market participants remain confident that the Federal Reserve will contain any emerging inflation pressures.

If the Committee agrees with this judgment about the inadvisability of tightening at this meeting, what remains on the table is how to assess the risks to the economy going forward and their implications for future policy, and how to convey that assessment to the markets.

Economic data over the last month followed the now-familiar pattern: Upward revisions to estimates and projections of economic growth in the second half of 1999 have been accompanied by mostly favorable indicators of cost and price pressures. In the latter category, CPI increases in the fourth quarter have been in line with staff expectations, and estimates of unit labor cost increases in the second half have been reduced noticeably, accentuating the deceleration in this measure from the first half of the year. The downward revision to unit labor cost increases, which occurred despite a small upward revision to the growth of compensation, owed to productivity gains that, again, seem to be coming in above projections. Faster productivity growth has helped to explain the limited drop in the unemployment rate this year; the unemployment rate and the pool of available workers cited in recent announcements were essentially unchanged last month despite the unexpected strength in the expansion of economic activity.

If stable labor utilization over the last month along with continuing uncertainties about the level and growth of aggregate supply implied by recent cost and price data make the Committee no more convinced than it was at its last meeting that it will need to firm policy in the near term, it might want to consider retaining a symmetric directive. With broad measures of core inflation still subdued, the Committee may wish to see more and firmer indicators that price pressures are likely to intensify before it gives serious consideration to raising rates further.

But one rationale for the symmetric directive at the last meeting was to allow the Committee time to gauge whether the cumulative tightening this year would begin to damp the expansion of the economy. Such a

slowing is needed because, despite rapid productivity increases, a widening output gap and falling unemployment rate in the second half of 1999 clearly indicate that the economy has been expanding at a rate in excess of the growth of its potential. However, in that regard, the incoming data on the real economy have not been encouraging. Moreover, the Greenbook forecast has growth remaining a little above trend in the first half of next year abstracting from Y2K effects, and Mike noted the upward risks to the outlook beyond that from the impetus to consumption from rising wealth. While one might guess that the increasingly narrow base and speculative character of the stock market advance carries the seeds of its own correction, the assumption of such a correction would seem to be a risky basis for making monetary policy.

Even if the Committee is agnostic for now about whether an unemployment rate in its recent range of 4 to 4¼ percent can be sustained without rising inflation, it may be particularly concerned about a potential further decline in that rate. If temporary factors played any role in damping core inflation in 1999 while the unemployment rate held in this range, the NAIRU is more likely to be higher than lower than the current unemployment rate. In that case, failing to resist a possible further tightening in labor markets runs a considerable risk of building in the need for larger and more disruptive adjustments later.

The persistent strength of domestic demand suggests that avoiding a further decline in the unemployment rate may well require at least the current degree of restraint in long-term interest rates. Forward-looking financial markets have built in expectations of substantial policy tightening in 2000, without any pickup in inflation. Although supply-side uncertainties complicate the conduct of policy, markets are presuming that the Committee will be preemptive, at least when it comes to inflation risks that might arise from possible further increases in labor resource utilization. Any signal that the Committee was significantly less concerned about potential inflation than the market perceived it to be would probably produce a considerable decrease in interest rates and rise in stock prices. Hence, if the Committee did see the risks as significantly tilted toward higher inflation, it would be important to convey that view to the markets.

An announcement that the Committee was asymmetrical in its outlook for the economy and policy next year would be unlikely to have a major effect on interest rates. Market prices have already built in a near certainty of a tightening at the next meeting--much higher odds than have normally followed the announcement of an asymmetric directive. And when surveyed, two-thirds of primary dealer economists indicated that they expect such a directive. But concerns about the sensitivity of thin and illiquid markets around the century date change may complicate how the

Committee communicates its assessment. Presumably, the Committee would not want to add unnecessarily to market volatility at this time by leaving open the possibility that an intermeeting tightening was on the table. Moreover, it especially might not want to convey the impression that it might be sluggish in responding to a market disruption that looked like more than a transitory event.

This suggests that the Committee might have three straightforward messages to convey to markets at 2:15 today: First, that it did not change the stance of policy; second, that it was concerned about inflation risks and would be giving serious consideration to the extent of the risks and the appropriate policy response at its next meeting; but third, that owing to uncertain market conditions around year-end it did not intend to respond to those risks before the next meeting and would be flexible over the century date change period.

Unfortunately, the choice of bias in the directive to associate with those messages is much less straightforward than the messages themselves. Simply stated, there is a disconnect between the language the Committee votes on in its directive, which specifically references the intermeeting period only, and the meaning that has come to be attached to that language. That meaning is that the bias applies less to the intermeeting period than to the period encompassing the next few FOMC meetings.

All of the options the Committee has to deal with this problem have more than a bit of improvisation in them, in that you would be skirting between what the words literally mean and the market conventions that have settled around them. For example, the Committee could couple an unbiased, that is symmetric, directive with a biased announcement that made it clear that the symmetry applied only to the intermeeting period. The Committee would count on the wording of the announcement to express its concerns about inflation risks and its intention to consider at its next meeting how to deal with those risks. A problem with this approach is that it could foster further confusion about the Committee's interpretation of the current directive. But so long as the announcement was clear about the Committee's present intentions and judgments, such confusion would not matter much since this is likely the last meeting that the current directive wording will be used.

The second option would be to adopt an asymmetric, that is biased, directive based on the meaning it has come to have with respect to future meetings, but to use the announcement to clarify that in light of the century date change the Committee did not intend to tighten over the intermeeting period and recognized the need to be ready to respond flexibly to any developments in coming weeks. While this approach

would be more consistent with recent uses of asymmetries, it would have the disadvantage that the Committee would be adopting words in the directive about the intermeeting period that it did not mean literally. And thus the media and markets might focus more on the choice of asymmetry than on the caveats in the announcement. In that sense transparency about your choice of bias might mislead markets about your very near-term intentions.

Thank you, Mr. Chairman. That concludes my briefing.

CHAIRMAN GREENSPAN. Questions for Don?

MR. HOENIG. Don, just listening to you tells me how difficult it will be to craft any kind of asymmetric announcement today. Wouldn't it seem practical to have this be one of those announcements where we say as little as possible--something along the lines of we met, we didn't do anything, and we'll see you next year?

MR. KOHN. That's an option we talked about a bit in the Bluebook. The issue in my mind was whether the Committee was really intent on keeping the current degree of tightening in the markets. There would be a risk if you did what you propose, it seems to me, though it very well might work: The markets might say the FOMC is symmetric, or unbiased, and it's because of Y2K. They are not telling us anything else, so we will assume that that is the only reason they are unbiased. But I think you can't rule out the possibility, however small, that the market would say the FOMC is unbiased because of Y2K and, because they didn't tell us anything about their expectations for the future, maybe they are not quite as worried about inflation as we thought they were. With two-thirds of market economists expecting an asymmetric directive and with about 80 or 90 percent tightening built in, that's a dilemma. The Committee's objective might be to leave the markets at 2:30 today where they were before our announcement at 2:15. It's just very hard to craft the set of statements and votes that will do that. I'm not sure that a terse announcement would do it. It's possible that it would, but there is a risk that it wouldn't.

CHAIRMAN GREENSPAN. Governor Meyer.

MR. MEYER. Don, I thought that was a particularly outstanding presentation except for the last sentence. In the very last sentence you expressed some concern that even if we were transparent and honest--if we told the market very clearly that our priority was to assure liquidity over the century date change and that we wouldn't be taking up the balance-

of-risks issue until the February meeting--an asymmetric directive could, nevertheless, mislead the market. Do you really think so?

MR. KOHN. I think either approach is likely to work: symmetry, but we're really asymmetric for the next meeting; or asymmetry, but we're really symmetric until the next meeting. It's a question of weighing, if you'll pardon the expression, the balance of risks-- [laughter]--not with respect to the economy but with respect to the market reaction. I was trying to point out that I think there is a risk, perhaps a small risk, that the initial headline will be "Fed goes asymmetric" rather than "Fed goes asymmetric but with a number of caveats." An unqualified headline could provoke a little market reaction. There is no perfect way to do this. The risk on the other side is that the headline will be "Fed goes symmetric," and the market doesn't read the announcement and begins to rally. I think probably after a day, after people have had a chance to read the announcement and newspapers have printed it, we would probably be in roughly the same place either way. It is just a question of what best represents what you intend and the clearest way to get that across. The other thing that bothers me a little about asymmetry is that the words in the directive literally say "over the intermeeting period," and the announcement would literally have to say "but we don't mean it."

MR. MEYER. There's nothing new there! [Laughter]

MR. KOHN. I think either way would work, or at least I hope so. Either way would be intended to produce the same result.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. You said one of the goals, and I totally agree with you, is to try to leave the market at 2:30 today the same way it was at 2:15.

MR. KOHN. Right.

MS. MINEHAN. In that regard, since there is a heavy degree of expectation that we will be asymmetric, it seems to me that asymmetry would be more likely than symmetry to produce that kind of stability in the market. If symmetry is going to be a surprise and gives an extra boost to the market, isn't that where the greater risk lies?

MR. KOHN. As I indicated in answer to Governor Meyer, I think the risk of publishing asymmetry is that it could produce a little more volatility. The risk of publishing

symmetry is that the markets might rally a bit. Maybe the 2:30 comparison isn't the right one; maybe it's really where the markets are by close of business the next day.

MS. MINEHAN. But if the expectations are that we see the same risks that the market sees and that we are alive and functioning here despite Y2K--

MR. KOHN. I think you could make that clear under either approach. It depends on the announcement and where you want to put the emphasis. If your emphasis is on the fact that you will be providing liquidity and you will be flexible over the intermeeting period-- and that's the near-term focus--then maybe symmetry is better. If your emphasis is more on the fact that there is a good chance that you'll be giving serious consideration to tightening at the next meeting, then asymmetry may be better, with less focus on the intermeeting period.

CHAIRMAN GREENSPAN. Further questions? If not, let me begin.

I think the evidence of a slowdown is quite marginal at this stage. It is showing up in the housing industry at the edges, where we are seeing some slippage or at least a flattening of activity. However, anything resembling a contraction induced by interest rates strikes me as not even remotely visible as yet. Motor vehicles, which also are supposed to be interest-sensitive, weakened significantly a month or two ago, but they have come back fairly substantially. And if we look across the spectrum of the capital goods markets, there is very little evidence of any weakening. Obviously, we still have disproportionately large orders for high-tech equipment versus other types of equipment; but orders for conventional equipment are still substantial, with farm equipment being an obvious exception.

In my view, what we have is a problem of whether to interpret developments as supply-side driven or demand-side driven. On the supply side, there is no evidence of any slowing in productivity growth. What we do have is some evidence from the industrial production numbers for October and November and from the hours data that is pointing to gangbuster gains in productivity for the fourth quarter.

The notion that when we see this strong demand we are looking at the old classical case of an economy that is heating up is, I submit, the wrong view. We don't know that the economy is heating up unless by "heating up" we mean anything that raises the GDP growth rate. At this stage we have a very unusual situation. There are very evident imbalances in demand over supply, and indeed one can readily argue that virtually all of the problems stem

from a wealth effect. Were it not for a significant rise in wealth-to-household income, we probably would find that the propensities to save would be relatively stable, that the unemployment rate would be very low but also stable, and that the current account deficit, while large, would not be increasing. All in all, the fact that underlying price inflation was not accelerating would argue against a scenario of an economy that is heating up. It would be a scenario of very strong growth--indeed, one credibly involving accelerating growth--but all of it stemming from the productivity numbers.

All I'm saying at this point is that one could not argue that this economy is heating up were it not for the gradual decline in the pool of people who are willing to work and an increasing share of overall demand being met from the import side. The heat, if any, is coming from the wealth effect. And that clearly is something that cannot go on indefinitely.

The bottom line is that the wealth effect--in line with Herb Stein's remark--cannot continue and, therefore, will not continue. The reason is that it creates a fundamental instability in that it fosters more effective demand than supply. The two must be balanced in some manner. They currently are being balanced, as I indicated last month and previously, by more domestic production coming from previously unemployed workers and by increased imports as a share of total demand. Neither of those two sources of supply can continue to satisfy rising demand without limit. Obviously, on the import side it is not credible that our economy can continuously attract investments to fund the current account deficit in our balance of payments. And on the labor side there is a level, called zero, where the availability of added employees disappears. The one caveat with regard to the availability of workers is immigration, which I will get to shortly.

The reason I raise this issue is essentially to say that the wealth effect cannot continue to stimulate excess demand indefinitely. By wealth effect, I mean a rise in the value of assets in relation to income. Such a rise does accommodate higher equity values but it cannot continue at the pace we have been seeing. There are only two ways in which such a rise can be thwarted, as indeed it must. One is a decline in long-term expected earnings, for which I find no evidence. Indeed, if anything, it is the other way around. The other is a rise in the discount factor. This is basically true by definition when we disaggregate equity market values. To talk in terms of momentum, or price/sales ratios, or, even better, how much in losses a firm has experienced as reasons for higher stock prices is

clearly just nonsense. The fundamental consideration is that a buyer is purchasing claims against future cash. If neither lower expectations of future cash nor a higher discount occurs, then stock prices presumably will continue to rise, maybe in excess of the rate of increase in household incomes.

The crucial consideration here is that, while we may not be seeing a change in earnings expectations, we very clearly are seeing the beginnings of a significant rise in discount factors. Yields on BBB-rated corporates, which are very close proxies for the average corporate cost of capital, have been rising quite appreciably in real terms since late 1997. They have risen more than yields on U.S. Treasuries, as evidenced by widening spreads. One can evaluate the discount factors on equities in terms of risk, the rate of interest on corporate bonds, and then derive an equity premium. But it is far more useful to look at the bond equivalent rates in real terms to get a judgment of what type of discount factors are showing up. I think that discounting process is appreciably under way at this stage. Therefore, at the end of the day, I think the Greenbook has to be right that the Wilshire 5000 will flatten out despite continuous revisions in the data underlying that projection. It is only a question of how much of a bubble there is in this process.

I think we have to be wary, however, of our disinclination to recognize that what is going on in this economy is really quite unprecedented in the post-World War II period in that productivity growth continues to rise. And it is rising to a very substantial extent in the multifactor productivity component--the residual in growth accounting. So, it is not solely increased capital investment that is driving up the productivity numbers. There is a very substantial rise in productivity growth--in fact it is almost 2 percentage points--which is not attributable to capital deepening. Cyclically adjusted, this rivals what went on in the 1950s and 1960s and through the oil embargo of early 1973. This basically suggests that we are getting increases in multifactor productivity on the order of magnitude that was occurring after World War II, but without the catch-ups of the earlier period. In one sense, the recent experience is far more significant than the labor productivity gains in earlier periods, which as you may recall were at fairly attractive rates of around 3 percent for quite a period of time. Part of that acceleration came from the move out of agriculture into industry; but what we are beginning to observe now is something beyond that.

Acrophobia is a problem that confronts every statistician. The concern about putting down on paper a number that is larger than has been seen historically is very inhibiting. What I am saying is that that is happening. So, while we do have these extraordinary imbalances, I don't think we ought to be looking at demand and saying it's unbelievable and the economy is heating up. The point is that we do not have solely a demand-driven phenomenon here. The demand phenomenon stems from a wealth effect, and that should concern us because it has obvious repercussions. But we cannot look merely at demand and say that housing sales are high, capital goods orders are high, and consumption expenditures are high. Of course they are high. They had better be high or we are mismeasuring what is going on because gross domestic income is rising even faster than its conceptually equivalent counterpart, gross domestic product.

It may well be that if we had better estimates we could resolve the question of which of these two is the relevant measure of economic growth. My own suspicion is that gross domestic income may be giving a better reading. The reason I say that is that gross domestic income is consistent with the data we see on prices, profit margins, and the underlying acceleration in productivity. And that is really saying that our estimates of retail sales are biased downward in one way or another or that some of the measures we have in other product areas are biased downward. If we had more accurate numbers, we would be inclined to say "Wow!" and it would be "Wow!" squared. What I want to say essentially is that we have to be careful about looking only at the demand side rather than the gap between effective demand on the one hand and supply on the other. The two taken together are what the widening current account deficit and the declining unemployment rate basically reflect.

We need to know precisely what is causing our good fortune because when it changes, and it is certainly going to change at some point, our basic analysis will matter. And I am concerned that we might misread contractions in the economy or rates of growth, and as a consequence misunderstand where the forces in the economy are leading us. I don't think it matters in the current context because I believe the notion that at the end of the day we are going to need to tighten more comes out of any type of evaluation. It's when we are on the other side that I think we will have to be very careful.

I mentioned previously that I see no overheating other than in the stock market. The price indexes are really quite benign. In this regard, I think we ought to set aside the consumer price index. The reason I say that is that the PCE deflator is far more usable for analyzing what is really going on. The owners' equivalent rent component in the CPI is 20 percent of the total index. Now, owners' equivalent rent is going to start to accelerate unless I misread how asset prices interact with consumer prices. The reason is that the ratio of owners' equivalent rent to the value of housing has been going down continuously, and the implicit rate of return that that is suggesting cannot credibly be expected to continue on a prolonged basis. So the little "pop" we saw in owners' equivalent rent in the most recent CPI is probably a harbinger of a slightly stronger number there.

The reason the PCE deflator is a better indicator in my view is that it incorporates a far more accurate estimate of the weight of housing in total consumer prices than the CPI. The latter is based upon a survey of consumer expenditures, which as we all know very dramatically underestimates the consumption of alcohol and tobacco, just to name a couple of its components. It also depends on people's recollections of what they spent, and we have much harder evidence of that in the retail sales data, which is where the PCE deflator comes from. Why we should look at data based on a distorted sample when we have a universe whose data are more accurate is beyond me. The reasons that are given theoretically are that we want to measure urban or suburban consumer prices and that's not what gets picked up in the total. It would be so easy to make a simple adjustment in the aggregate data to cover only the urban component by using appropriate ratios if we want to do that. That is, we could use the base universe of what is consumed to give us our weights, but that is not what the CPI does. So if I had my way, the CPI would be abolished for all uses other than labor union contracts, Social Security benefits, and all the other uses that would create an undue amount of political noise if we tried to change them. It's not statistical noise that I am talking about at the moment. In sum, I think we have to be careful about any reading of inflation trends from the CPI.

What I hear from everybody in business I talk to is that pricing power, if anything, has gotten tougher rather than easier. And while it is certainly the case, as Mike Prell points out, that a number of prices are going up, it is by no means clear how significant those increases are as yet.

The one area where we may be underestimating supply-side potential is in population growth and the underlying expansion of the working-age population. We recently made an effort to find out why increases in household employment are running 50,000 a month less than those in payroll employment. We were trying to get a sense of which measure is giving us the better picture. If we look at the only really significant independent estimate of the number of households, measured by the number of electric meter accounts excluding the double accounts that a lot of people have, we should be able to get a reasonably good estimate of the number of households. Indeed, if we take the utility account numbers literally, they suggest that the CPS household estimates, which are based on population estimates, have been underestimated on a cumulative basis by something in the area of 1 percent since the 1990 Census. If that is in fact the case, given that we have some reasonably accurate numbers on the average size of households--remember, we estimate the average size of households from samples of 50,000--we can then apply that average to the population estimate extrapolated from the 1990 data. In doing that we must take account of estimates of births minus deaths plus immigrations, both legal and otherwise. A key question here is whether births and deaths are underestimated or biased. That is a possibility, but surely the immigration numbers are a real guess. If we take the household electrical connections numbers seriously, then the issue of closing the gap in the household employment data versus the payroll data moves forward a pace.

The Census Bureau, which does not use the electric utility data to make its aggregated overall estimates but does use them for some of its local area estimates, argues that if we are getting a big increase in immigration we should see it in the births and the deaths data. But I wonder if many illegal immigrants have babies that are born in hospitals where somebody records the babies' names. If the parents are illegal immigrants, the last thing they want to do is to have births recorded. Clearly, deaths are another issue, but if there has been an acceleration of immigration, that should affect the death rate in 2010, not now. So there is a reasonable expectation that when the 2000 Census comes out, it's going to revise upward the population numbers, the household numbers, and the household employment growth numbers. I might say that it will also explain why housing starts are as high as they are with household formation being as low as it is.

This hypothesis fits a number of holes in the data, but it also tells us that potential working-age population growth is higher. And, therefore, since our productivity numbers are based on payroll data, raising the working-age population will obviously also raise the long-term potential for economic growth. We won't know until we see the preliminary numbers coming out of the 2000 Census, which I guess we will get in 2002 or 2003. Mike, do you remember offhand when they will come out? Who knows how quickly that will get done with the computers they are working with now!

MR. PRELL. They have to find some workers to do the census! [Laughter]

CHAIRMAN GREENSPAN. We may have it sooner than I suggested. Who knows! All in all, my point is that I think we have some statistical problems that are not irrelevant to intermediate- and longer-term monetary policy.

Having said all that, my view on policy is, if I may reference Governor Kelley's comment about raising his hand and saying present, that I almost think the best way we could have gotten through this period would have been somehow to cancel this meeting. The reason is that markets, as far as I can see, seem to be pretty much where we as a Committee would like them to be. I don't know whether we will want the numbers in the markets at 2:30 to be the same as they are before our announcement at 2:15, but I think they currently are at appropriate levels.

The crucial issue for this meeting, as Don Kohn very clearly pointed out, is to recognize that we have a Y2K problem. It is a problem about which we do not want to become complacent and presume that it doesn't matter. We want to communicate as effectively as we can that we have no intention of doing anything through the year-end and maybe for a short period thereafter. But we also don't want to remove the general view in the market that we retain an upward bias and have not completed the tightening that we think needs to be done. We therefore face a tricky problem of trying to find a way to communicate all of that, taking into account what we think the market perceives about what we may or may not do, if our purpose is not to disturb the markets one way or the other. With that in mind, we have endeavored to craft two possible announcements. One, as Don mentioned, would accompany a "B" symmetric decision and the other a "B" asymmetric decision. Both incorporate language that tries to produce precisely the same result in either case.

Accordingly, in what is a rather unusual procedure for us, I would like to distribute both of these drafts.^{2/} The evaluation of what we perceive the outlook to be is the same in both, but it is positioned in different paragraphs. And rather than request your comments on specific wording preferences, I would appreciate it if you would confine your comments to the alternative you feel more comfortable with, symmetry or asymmetry. I assume that nobody here wants to raise rates at this time. At least I didn't hear that view expressed in any of the comments today. So, if we are going to vote "B," I would appreciate a judgment as to which of the two versions you feel most comfortable with. In this regard I switch back and forth between the two every 10 minutes! It just depends on what time I happen to be expressing an opinion. At the moment I feel slightly more inclined toward asymmetry; but by the time we vote it is just as likely, knowing how my view on this has changed frequently over the last day or two, that I will be on the other side. Frankly, I don't think our decision on this issue today matters one way or the other. It's only a question of one's judgment on minor issues, and I would appreciate any great insights.

I might just note parenthetically in reference to what Don said about the issue of the intermeeting bias, that this will be the last directive that incorporates a sentence on symmetry on the old basis. However, this directive won't be published until after the next meeting and is very likely to be an anachronism by then, so it is not going to matter terribly much which alternative we choose. But there is the question, as Don correctly points out, about how we want to state our consensus. So let us take a few minutes to look at both of these versions and then I'll open the meeting up for discussion. I might note that both of these drafts are saying, in effect, that we are very likely to move rates at the next meeting. [Pause] Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Thank you, Mr. Chairman. For somebody who likes to have firm views on most subjects, it's difficult to have a firm view on this unless one is a theologian rather than a central banker. I think both draft statements make it clear, as you've said, that we will have a serious discussion about policy at the February 1st and 2nd meeting and that there is presently a bias toward tightening at that meeting. And both texts make it clear that we will not change the funds rate until then.

^{2/} The language of the two drafts is provided in Appendix 2.

What I read in the marketplace now is a conviction that the Fed will tighten but that the tightening will be sensible and realistic. I am a bit concerned that if we put out an asymmetric directive, the marketplace would pick up not so much what we think but what some observers think we think. That could increase the likelihood of a tightening in markets--markets that may be very illiquid over the rest of this year--with possible difficulties in settlement systems in the first two weeks of next year.

On the other hand, if we put out the draft with the symmetric language--which is probably the most hawkish symmetric language any human being has ever seen--I believe there is very little likelihood that the markets would think the Fed is somehow kinder, nicer and gentler so let's rally. Even if they did that for five minutes, market participants would read the text very quickly and the markets would settle down, maybe not within five minutes but rather quickly. I'm basing my view, frankly, on this being my 33rd year of very active involvement in financial markets. I think that the balance of risks is such that the symmetric language is very unlikely to have any negative result for us. With asymmetric language there is a possibility--I'm not stating that it's a certainty--that the market would price in additional Fed tightening over the course of 2000. And in my view the markets are just too slim and we've invested too much in the effort to ensure that the Y2K transition is a smooth one to take that risk.

Where do I stand on it? I'm probably leaning 55/45, 60/40 at most, toward the view that symmetric is better than asymmetric. I certainly am not even remotely thinking of dissenting if there is a majority in the other direction. But I do have 33 years invested in looking at markets and that's my assessment of it.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Thank you. My first choice would be that at 2:15 p.m. today we issue a statement that says "Happy Holidays," as I think Tom Hoenig was suggesting. It seems likely that in the very near future our directive language will no longer refer to likely future policy actions but rather to the balance of risks in the economy. If that is the case, I don't know why we would want to move from symmetry to asymmetry with respect to future policy actions when we will never do that again. To put out a symmetric directive today does no harm. I doubt that there is anybody in the world who doesn't think that we will have a very serious discussion at our meeting on February 1st and 2nd. I cannot imagine

that that would be a surprise to anyone. Everyone knows that meeting will be a tough one. There will be a lot of new information, and maybe even some reliable information, although I don't know about that. So, I see nothing to be gained by putting out an asymmetric directive. I see potential negatives. And I don't see any negatives in putting out a symmetric directive.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. I guess I'll take the opposite position, Mr. Chairman. I can live with either of these statements. But the way I heard our discussion today, this Committee essentially is asymmetric and pretty clearly so except for concerns about the century date change. And I think we ought to say so. It seems to me that the last sentence in the main paragraph of the draft with asymmetric language says it very well. The whole tone of it and the way it's structured make that point very clearly. I wouldn't expect that to result in a market overreaction or concerns from a Y2K perspective. So, I think asymmetry is the best way to go.

CHAIRMAN GREENSPAN. President Poole.

MR. POOLE. Mr. Chairman, I agree with Al Broaddus that the Committee is clearly anticipating, on the basis of what we know now, that we will make a policy move in February, provided that in the interim no data come in that would disconfirm that expectation. That is what I think is the sense around the table. And I believe that the asymmetric directive draft provides a better sense of that view.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Mr. Chairman, I agree it is a close call. I think both drafts accomplish the same objective. I happen to prefer the symmetric one. First of all, it's technically accurate, as you pointed out, whereas the asymmetric one is not technically accurate. If the markets don't understand it in 15 minutes, clearly they are going to understand the language as soon as they read it. I think it's very clear. And I agree with Jerry Jordan that, hopefully, we are going to change to a new announcement policy as of the February meeting, so I just wouldn't muddy the waters by using an asymmetric directive at this point.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. I favor, by a small margin, the symmetric directive as well. When I read the two, the symmetric one seems to speak a little more clearly about our thoughts and concerns. I don't see big differences, but if I had to state a preference it would be for the symmetric alternative.

CHAIRMAN GREENSPAN. Governor Gramlich.

MR. GRAMLICH. I'm for asymmetry. It is a close call and I could live with either. But I think asymmetry is a more honest description of where the Committee is at this point. I find the grammar of the asymmetric language a little simpler. There are fewer words like "however," "nonetheless," and so forth. It's a little more direct and I like that. I'm also persuaded by the fact that it is more in line with what economists think we will do. And if our objective is to not change markets, that wording is telling them that.

I know you said we shouldn't make wording changes, but let me suggest just one. I would say a smooth transition "into" rather than "to" the year 2000 to show that we are not holding steady only for another nine days.

CHAIRMAN GREENSPAN. I will accept that. Does anybody disagree? We accept your apology! President Stern.

MR. STERN. I have a mild preference for the symmetric version. I've been struck in recent weeks by the fact that market participants seem to have been tracking right along with us. They have been interpreting the incoming data pretty much as we have. I doubt that anybody will be misled or surprised by the language of the symmetric directive and I think they will continue to do what they have been doing. And given that we do face uncertainties associated with Y2K and have invested a lot in avoiding Y2K-related disruptions, I don't see any particular advantage to an asymmetric directive at this stage.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I can certainly live with either. In my view they are almost as broad as they are long. I do favor the symmetric language because I think it is our clear intention at this point not to change policy, and symmetry is the way to say we are not going to raise the funds rate. I do have one concern--with apologies, I think! It does seem possible that this Committee might feel forced into an intermeeting move as we get into January--well after the Y2K experience but before the February meeting. If that is a possibility, then the language of the symmetric directive tends to foreclose that when it says,

“At its next scheduled meeting the Committee will assess....” I think we could fix that, again with apologies.

CHAIRMAN GREENSPAN. How would you fix it?

MR. KELLEY. I'd simply remove the word “scheduled.”

SPEAKER(?). That's right. We could have an unscheduled meeting.

MR. KELLEY. Then it would read “at its next meeting.”

CHAIRMAN GREENSPAN. Governor Ferguson.

MR. FERGUSON. Like everyone else, I think I could live with either. I have a slight preference for the symmetric one because in my mind it really does put the horse before the cart in that it says quite clearly that first we have the rollover to the year 2000 and then we have next year. And I think it's important to keep reinforcing that sense of priority of getting into the year 2000 and focusing then on the next move.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I prefer the symmetric directive. This is a meeting that in many ways we didn't need to have and I think the symmetric approach essentially reaffirms where we are. And it comes closest to having perceptions after the meeting stay exactly where they were before the meeting.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. I prefer the symmetric one, Mr. Chairman. After all we have invested in Y2K preparations, with options and special liquidity programs, changing our bias as we get to this point near the end does not seem to me to be the best thing to do. To my mind the symmetric language makes clear to the market that a smooth Y2K transition is still our priority and that we will get through that period before we take up the issue of tightening again. So, I much prefer the symmetric directive.

CHAIRMAN GREENSPAN. President Guynn.

MR. GUYNN. I prefer symmetry as well. I hope that won't be interpreted as any lack of enthusiasm for getting back to our work after the first of the year. I think all the arguments have been made. To change from symmetry at this point and give people even six weeks to try to figure out why we did it and whether we anticipate doing something different soon after the first of the year is, in my view, a distraction that we just don't need.

I'm part of the "Happy Holidays" camp as well. If we could get by with doing that, I would like it very much.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. I could have gotten by with "Happy Holidays" as well. But given this choice--and not wanting to go into any on-the-fly editing of language--I would feel, for a lot of reasons, that asymmetry is marginally the better way to go. First of all, I don't like the additional words in the language for symmetry nor the focus on policy in the intermeeting period, which is after all very long. I believe the asymmetric language is more honest, as Governor Gramlich said, about where we feel things are. I think it is reflective of where the market is and where the market thinks we are. And it gives us the opportunity to do something after Y2K and before the next meeting if we want to, whereas the third paragraph of the symmetric press release I think forecloses that a bit. I'd be worried about that. I could go either way, but my concern about the symmetric directive is the wording "in order to indicate the focus of policy in the intermeeting period." That's a long period of time.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Symmetric.

CHAIRMAN GREENSPAN. Governor Meyer.

MR. MEYER. As I was thinking about this decision coming into this meeting, my inclination was for an asymmetric directive with language that during the intermeeting period we would be focused on insuring liquidity in financial markets. Basically I thought that would be the most transparent and honest approach we could take. But I must say that the symmetric directive draft is extremely well done and I would be very comfortable with that. I feel that's honest and transparent as well. I'm 51/49 asymmetric, but I'm quite comfortable with the symmetric one, too, because I think it is extremely well crafted.

VICE CHAIRMAN MCDONOUGH. It's the most hawkish symmetric directive in history!

CHAIRMAN GREENSPAN. The arguments for symmetry have won the day. I think that is what we ought to read and vote upon. May I say before I conclude that I just raised the barrier a little: The two changes suggested were worthwhile getting. I think they both are very helpful. Now, the last sentence on each of the drafts is bracketed because

whether we include that will depend on our subsequent discussion. The one thing I do not think it is advisable for us to say is that the Committee plans to make a public announcement in January, if for some reason we are not absolutely sure that that is going to happen. If we're not sure, saying it is, shall I say, a less than thoughtful thing to do. Inclusion of that sentence does have the advantage of indicating that we will be altering our policy perspective and it reinforces the fact that the symmetry issue is not a significant policy matter. But we have to be a little careful about forecasting that we will do something if it turns out that we are going to be unable to accomplish that. So let's leave the bracketed issue for judgment later; that judgment should be reasonably easy to make after we have our discussion. Please read the directive accordingly.

MR. BERNARD. The wording is on page 14 of the Bluebook: "To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 5½ percent. In view of the evidence currently available, the Committee believes that prospective developments are equally likely to warrant an increase or a decrease in the federal funds rate operating objective during the intermeeting period."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
President Boehne	Yes
Governor Ferguson	Yes
Governor Gramlich	Yes
Governor Kelley	Yes
President McTeer	Yes
Governor Meyer	Yes
President Moskow	Yes
President Stern	Yes

CHAIRMAN GREENSPAN. Let us move on to consider the directive language and disclosure policy. Governor Ferguson, would you lead us as you have in the past?

MR. FERGUSON. Thank you, Mr. Chairman. I'd like to refer to the memo that I sent to the Committee dated December 17, 1999. Let me start by simply reviewing the state of play, if you will.

At our last meeting the principal issues we discussed related to whether or not we wanted to do two things: (1) change the directive language used to describe the Committee's assessment of prospective developments; and (2) define more precisely the Chairman's latitude for making an intermeeting move. On the first point, the issue was whether we wanted to move more toward language about the balance of risks to describe the Committee's view of the future and move away from what we call "symmetry/asymmetry" today. And the consensus, though there were objecting points of view, was that we did want to make that move. You sent your Working Group back to consider that language in a more detailed way, and revised language is now in this memo starting on page 5. That is one point that we need to discuss further.

The second thing you asked the Working Group to do was to consider how best to express the Chairman's latitude for an intermeeting move. We took a look at the language that we had suggested and made some slight adjustments. That is on page 5, section B.

A third question emerged, involving a couple of other recommendations from Cathy Minehan on how to handle the directive wording. That is on page 6. The fourth issue that emerged as we proceeded was an expectation that we would have some form of public announcement of this change in January. And the latter two pages of the memo describe what would go into an announcement, though it is not a draft.

Let me also remind you that at our November meeting we looked at nine other areas on which there was a strong consensus within our Working Group, and I got no sense that there was any change from what we agreed on then. That is the state of play.

Now, what I would like to do is as follows: Though a general consensus emerged in the FOMC and there was a clear majority in the Working Group that we wanted to move toward this language that focuses more on the balance of risks and is more tied to our legislative goals, a few people still clearly felt that we needed to make sure we are comfortable with that decision. So first I'd like to ask President Poole to give his perspective on why he as a member of the Working Group still feels uncomfortable with the balance-of-risks language. I just want to make sure we have thought this through carefully

because, as pleasant as this experience was, I don't look forward to repeating it again next year! [Laughter] So, careful thought is important here. Then, I would like to call on the other members of the Working Group to give their perspectives on this issue. Also, as we go around to others, I'd like to hear your thoughts not just on the balance-of-risks language but on the other elements in our memo, including the language on intermeeting moves, Cathy Minehan's proposals on the directive language, and how we should communicate all this publicly. I hope that is reasonably clear. Bill Poole, let me turn it over to you; I see Bill has handed out a memo.

MR. POOLE. I think I have enough copies to go around if you'll keep passing them on. I wanted to put my thoughts down on paper because that allows me to state things more concisely. The Working Group's proposal on the balance-of-risks language, what I am calling Option 1, has been slightly modified since we last discussed it. But my major concern has to do with the last part of it involving a statement by the Committee on its views about future economic conditions, and that is what I want to focus on. Let me go through my points.

First, I think it is going to be much easier for us to agree on a possible policy action than on a statement concerning possible future economic conditions. Second, I believe that the Option 1 language has an implicit Phillips curve analytic framework behind it and in my view not every member of the Committee will be comfortable with that framework. Third, I think that many in the market will view the Option 1 language as essentially a code for the existing tilt language--that, in fact, it will be read as a Committee view about future policy. And it is important for us not to allow perceptions to develop that we're talking in code. Another issue, my point four, is why we would be talking about economic conditions rather than future policy action. If we are truly talking about economic conditions, why do we take a Committee vote on the matter--a statement about our forecast, if you will. So, I think the markets will tend to view our language about economic conditions as really code for future policy.

Furthermore, I am concerned about the way in which the general public may interpret this language. I think we are inviting headlines that say "Fed sees economic weakness ahead" if we vote on a directive that says we see possible economic weakness. I don't think that is going to be helpful to us.

I'm also concerned that the language in Option 1 has an analytical weakness. If we are successful in being preemptive, then the changing economic conditions we see will lead us to take a policy action and will not at the end of the day create either economic weakness or inflation. That's the whole idea we're trying to get across: We see the possibility of economic conditions that, if not offset by policy action, would generate economic weakness or inflation. We want to preempt the changes in the economy that we don't want to occur. So, I think the language proposed in Option 2 is really more accurate. The change in economic conditions that we see developing is going to generate policy action and will not, in fact, generate economic weakness or inflation.

Lastly, I think the majority on the Working Group overreacted to the market's response to our announcement in May. We had explicitly told the market that we would disclose the tilt when the Committee wished "to communicate to the public a major shift in its views about the balance of risks or the likely direction of future policy." So it is not surprising to me that the market reacted when we first used that device because we said we would announce the tilt when we had something major to say. In fact, since May, I think the market has understood that we were using this device on a much more routine basis. And in my view the responses since May when we have used an asymmetric directive have been helpful and have not reflected an overreaction.

So, those are my seven reasons for having a strong preference for what I'm calling Option 2. I must say that I wish I had had this all straight in my mind 10 or 12 weeks ago when I started to think about it, but my views have evolved as we've gone along. My initial view was one of a mild preference for what I'm calling Option 2 over Option 1. The more I've thought about it, the more I have become concerned about the Option 1 approach.

MR. FERGUSON. Thank you. Let me just quickly summarize what I think the majority of our Working Group believes on this. I won't go point by point, but in general I think the majority is concerned that if we don't make a clear break away from the current language, we still risk the possibility that market participants will overreact, even though they are perhaps beginning to understand a little better what we are trying to convey.

The majority of our Working Group does not suggest that the balance-of-risks language has no implications for future interest rates or policy moves. But we believe that language more accurately reflects what the Committee actually anticipates about the future

because we all recognize that, indeed, the decisions about policy moves have not yet been made when we talk about the balance of risks. They aren't actually made until the vote occurs at a meeting or conference call, whichever it may be. Therefore, we don't want to leave too strong an implication that anything is baked in the cake. I think the majority felt that the existing language does leave too much of that implication.

There was, just so you know, some exchange of views on the analytics. We ended up among Bill Poole, Don Kohn, Dave Lindsey, and myself in disagreement on the analytics. I'll spare all of you the details, unless you want to hear them, but let me just note that there is some disagreement on whether President Poole has the analytics exactly right. With that brief summary of the majority perspective, let me go to my Working Group colleagues first--just in the order in which they are sitting--and then we will go round robin. Mike Kelley.

MR. KELLEY. Yes, I'll start, Roger. I don't know that I can add much either to Roger's excellent memo or the summary he just gave or to Bill's very cogent disagreement, which everyone has given an enormous amount of attention to. I'm in the majority that favors Option 1. First of all, I would like to say relative to the analytics and other concerns that there are sophisticated market analysts who make a very good living--I carefully do not say earn a good living--opining, criticizing, and questioning the Fed. Some are academics and they have academic purposes, and others are either speculating or doing the intellectual work for speculators on the basis of the way they read the Fed. I doubt that any language exists anywhere that will foreclose this process completely. I don't think either of these options or anything else anybody would be able to craft can achieve that end, much as I wish we could.

I believe that our objective here is to be as informative as we can while ensuring to the best of our ability that we are accurate and clear about what we actually say. We want to take care not to mislead the public, either explicitly by saying more than we intend to say or implicitly by opening up possibilities that we could be misunderstood through the implications that somebody could draw from what we say. I think all of our discussions have been focused on how best to do that. The facts are that at each meeting where we adopt a tilt, bias, or asymmetry or whatever you want to call it--or decide not to do so--it doesn't mean any more than what our proclivity is at the time of that meeting. It can't mean

any more than that because conditions always change, as we know, and considerations always change. That's why we have a zero-based review at every meeting that we have. And the record will show, I think, that the tilt evaluation has very little or no predictive power concerning future policy moves over any particular time period. And in my view, we should be very careful not to leave any impression that it does.

In my opinion, the best way to do that is simply to place the weight of the evidence on the scales as it relates to our two objectives, which we have in this proposed statement-- price stability on the one hand and sustainable growth on the other. Then we should articulate how those scales read at the time we are looking at them. They will either be balanced or they will be weighted toward a danger in one direction or the other. If we feel that we have to expound further on that, it can be done through a statement released to the press. That is where I come down.

MR. FERGUSON. Thank you. Larry Meyer.

MR. MEYER. Thank you. It was clear at the last meeting, as it has been during the deliberations of the Working Group, that I am part of a very small minority on this issue-- maybe it's just Bill Poole and I. Nevertheless, I thank you for the opportunity to talk a little about my views because I am strongly in favor of language in the tilt that refers directly to prospective policy actions.

I believe the best way to think about this is to reflect on why we are engaged in this process and what we are trying to accomplish. In my view, two concerns led to this reconsideration of our directive and disclosure practices. First, we became uncomfortable with the market's reaction to our announcements, particularly with its assessment of the immediacy and the certainty of a policy move whenever we announced a shift to an asymmetric directive. Second, there was an additional uncertainty engendered by the absence of a consistent interpretation of the tilt by members of the Committee. Now, the second problem is easy to deal with. We have a process under way to develop a consensus, and I think we have an agreement around the table that whatever that consensus is we are all going to be bound by it going forward, whether we agreed with it or not.

But the first problem, which I'm going to call the immediacy/certainty problem, resulted in large part from the decisions we made when we adopted this disclosure policy last December. First, we decided only to announce a change in the tilt when the change was

significant and important for the public to know. In retrospect, I think that was a mistake. It was as if we had said: "If we are going to have a significant change in the directive, we want to have it flashing on that big neon sign in Times Square." And then we were surprised about how intense the market response was! Second, by explicitly tying the tilt to the intermeeting language of the directive, we reinforced the presumption that the bias referred to a very short-term policy horizon. So, I think we unintentionally created the problems that we are trying to respond to today.

Now what do we do? We have already reached consensus on three constructive steps to alleviate these problems. First, we are always going to announce changes in the tilt, thus removing the special sense of immediacy and certainty of announced tilts. Second, we are going to remove the tilt from the directive and not tie it to the intermeeting period language. And third, as I noted above, we are going to agree to be bound by the consensus interpretation. What more do we need to do? Here is where we differ.

The majority also wants to change the language to focus on the balance of risks in the forecast in order to detach it from an explicit reference to policy. Two quite different reasons have been put forth for why we should not explicitly refer to the policy direction in expressing the tilt. The first is that by not linking the tilt directly to future policy prospects we are taking a further effective step toward resolving the immediacy and certainty problem. The logic is that if we don't mention policy, the markets will be less likely to infer from the announcement of a tilt a sense of immediacy and certainty of a subsequent policy action. That may be the case. But I'm not sure it will be.

The second argument is that we can legitimately have an assessment of the balance of risks to the forecast, but that it makes no sense to have a policy bias because we can't commit a future FOMC to a policy decision. The view is that somehow the balance of risks is accurate, but we can't have an accurate policy bias. I don't understand it. I'll give you an example. We sat around this table today and discussed the outlook, and I think we all were talking as if it was very likely that we would have to tighten policy even at our next meeting in February. Does that mean when February comes along that we won't start afresh with a zero-based review of the data and the forecast? Of course not. Of course we will start afresh, as we are required to do. So I would reject that notion. I don't think that's a good argument.

But there is a legitimate question as to whether or not the balance-of-risks language will deal with this certainty/immediacy problem. The markets really want to know about our policy bias and they will infer that policy bias however we express the tilt. We would be deluding ourselves to think otherwise. We can couch this bias in the language of the forecast, but the market will read right through it to our policy intention. Therefore, I prefer the direct, transparent approach. Specifically, I'd use the language we've been using rather than this alternative language that Bill Poole has suggested. And I would use the press release to set out our interpretation of the tilt--specifically, that we don't intend it to indicate a precommitment to action at the next meeting, but to indicate a greater likelihood of moving in one direction rather than the other over a longer time frame.

If the majority view is nevertheless in favor of the balance-of-risks language, I would strongly urge that we not assume that this language alone will convey the message we want to send in terms of immediacy and certainty of subsequent policy action. We should make these points explicitly in the press release in exactly the same way we would do if we used the policy bias language. Thank you.

MR. FERGUSON. Before we continue, let me ask if any other members of the Working Group want to give their perspectives or elaborate on a majority or minority point of view. Mike Moskow.

MR. MOSKOW. I'll be very brief. I just want to add a couple of points. I am in the majority here; I prefer the language that is in the Ferguson memo. I just want to point out that we discussed this at great length in the Working Group. Memos have been exchanged, e-mails have been exchanged, and I forget the number of meetings we've had but it has been many. So we have discussed it at great length already. The key here, as I see it, is that we are trying to educate the public; we are trying to get away from the notion that we are automatically going to move at the next meeting and that we have our finger on the trigger and are ready to act. That is really, from my standpoint, our key objective. And what the Ferguson language does is to take a step back and put the balance of risks on the table rather than the possible need for a change in the stance of policy. Larry Meyer said that the markets are going to read right through this to our "true intentions." I'm not sure that is going to happen because over time they are going to see that it isn't a good predictor of what we will do. If history is any guide, it predicts what we are going to do only half of the time.

So, I think we may be able to educate the market over time. At least this takes a step back from the notion that we are automatically going to change our policy at the next meeting. That was driving my thinking on this issue from the beginning and I think the way the proposed language is phrased now follows through on that point.

MR. FERGUSON. Bob Parry, do you want to add something?

MR. PARRY. I started out at a position that was very close to Bill Poole's, although I indicated that I probably could live with either option. I've moved a bit more in the direction of Option 1 recently. The advantage of Option 2, of course, is that it's very direct. To me the disadvantage is that it may not accurately convey the probabilities of a change in policy. Clearly, we were using the tilt language in the past in a way that very often did not lead to a change in policy after we had adopted an asymmetric directive. And I even worry about the possibility that markets may almost force us to make a move if we've indicated asymmetry, as has been the case once in the recent past.

With regard to Option 1, what I like about it is that it seems to capture how I've interpreted symmetry in the past: I concluded what I thought was appropriate with regard to the funds rate and then considered the question of where the balance of risks, in terms of the economic outcomes, was likely to be in the period ahead, knowing full well that things could change very quickly. So it seems to me that perhaps Option 1 would provide a little more flexibility than Option 2.

MR. FERGUSON. Thanks. Ned Gramlich is next, and then we will open up the discussion to the rest of you.

MR. GRAMLICH. I've been for Option 1 by a close margin all along and I still am. I think Bill Poole and Larry Meyer have put their case very well, but I still like Option 1. Let me make three points.

To me the biggest point all along has been what we are calling the "trigger" issue. That involves our standing back from policy changes a bit--being understated and letting the market make its interpretation but not predicting future developments that will not necessarily materialize. That has been the major issue to me throughout these deliberations.

On Bill Poole's point 2, regarding an implied Phillips curve framework, I don't think this language means at all that the FOMC is a captive of Phillips curves. The wording that Mike Kelley worked out, which is on page 5 of Roger's memo, tries to make it a little

clearer that the issue is not so much that we believe the Phillips curve but that price stability and sustainable economic growth are our mandates.

On the "talking in code" issue, I don't consider it speaking in code if we say exactly what we're thinking at any particular point. In fact, that's one thing I find attractive about the balance-of-risks language. So I am still in the Option 1 camp, though Bill and Larry have weakened my resolve a bit.

MR. FERGUSON. I'd like to open up the discussion now and we'll use the usual approach. I would remind you that there are a number of different elements in the memo and I would appreciate it if you would indicate places where you agree or disagree. I will be assuming that if you don't indicate a disagreement that you are basically agreeing with what's in the memo. First on my list is Jerry Jordan.

MR. JORDAN. Thank you. We know, of course, that what matters from this point forward over the next two years or longer is what we do, not what we say. Whatever box one wants to run monetary policy through, it's our actions that influence economic activity, inflation, growth, and so on, not the words that we use. But it seems to me that we've gotten ourselves in a situation this year where more and more focus has been on our words and the transitory market reactions to our words and that has taken attention away from what we do. What mattered in 1998 was that we lowered the funds rate three times; what mattered this year was that we raised the funds rate three times. The reason I don't like Option 1 is the stress on both goals and the way that has been rephrased in the bracketed expression to imply more strongly that the goals are separable, which I do not believe. At a time when we would vote for asymmetry toward tightening, I would want the directive to say "weighted mainly toward conditions that may generate heightened inflationary pressures, which would cause economic weakness." It is increases in inflation that send false signals to market participants, producers, and households, and weakens economic growth. The other option, to leave out any reference to inflation at all and say "weighted mainly toward conditions that may generate economic weakness"--that's asymmetry toward ease, I guess--I don't know when we would use this option. I can't imagine that we would adopt that kind of directive unless we foresaw something like the Asian crisis, the Russian default, or some other adverse shock. In such a case I think we'd do what we believe is the right thing to do--cut rates, as we did in 1998--rather than announce that we'll think hard

about it at the next meeting. I don't see any benefit at all in trying to give these kinds of signals about future meetings and future actions.

MR. FERGUSON. Bob McTeer.

MR. MCTEER. I'm persuaded by Bill Poole's arguments. The argument he made that is most significant to me is point 2, having to do with the Phillips curve. In the language of Option 1, the opposite of economic weakness is inflation. That's a built-in Phillips curve, and for that reason I would go with Option 2.

MR. FERGUSON. Ed Boehne.

MR. BOEHNE. Roger, I think you and your associates have done a first-rate job on this and I support the majority recommendations. To me the balance-of-risks approach is the preferred course and, separately, I think the language laying out the Chairman's authority is much improved. And if it's on the table, Cathy Minehan's editorial suggestions also have merit, in my judgment.

MR. FERGUSON. That is on the table. Al Broaddus.

MR. BROADDUS. Roger, first, I would second Ed Boehne's compliments to you and your colleagues on the Working Group. You've done a lot of hard work. You've done a great job, I think, in framing the issues and getting them on the table. But I continue to have reservations about two aspects of the proposals: the balance-of-risks language and also the amendment to the Authorization for Domestic Open Market Operations, which has not been focused on so far. Let me just run through my views on these issues as quickly as I can.

On the balance-of-risks issue, I'm very much in the same camp as Bill Poole and Larry Meyer, and I guess Bob Parry as well. Inevitably, in my view, this language is going to have the effect of reinforcing the short-term Phillips curve tradeoff mentality that pervades public discussion of monetary policy in particular and of economic policy generally. I recognize that the recommended language, if read and analyzed carefully, does not necessarily imply that the Committee in its decisions assumes such a tradeoff, although the language is certainly consistent with that assumption. But to most readers and to most reporters in particular, the language will almost certainly still seem to posit a choice between fighting inflation on the one hand and stimulating growth on the other. Again, while it doesn't necessarily follow, I think a lot of people will infer that we are implying that

addressing one of these two objectives necessarily means neglecting the other. I think this is really important. The notion of a tradeoff between resisting inflation and stimulating growth is deeply ingrained in Americans, or at least among those people who think about policy. I believe it's arguably the single biggest obstacle that we face in communicating clearly to the public about policy. And I would hate to see us reinforce this perverse idea with the recommended new language, which to my mind inevitably it would do. I would much prefer something like Option 2 in Bill Poole's memorandum. In fact, I had written down wording that's amazingly close to that; it's almost identical. I don't think anything is lost by referring candidly and directly to prospects for policy. As I think Larry Meyer said at our previous meeting, people are not interested in our views on the balance of risks per se. They are interested in them only from the standpoint of their implications for policy. I don't think we are going to change that by avoiding the "P" word. And the risk is that we will tend to reinforce the popular notion that the Fed is not able to speak clearly and in a straightforward manner about policy.

Let me shift now to the proposed amendment to the Authorization. This is obviously a tough subject to discuss here. We have a great Chairman currently, one who takes most of the heat that is directed at the Fed, and no one, including me, wants to seem to be advocating restrictions on his authority to act, especially in a crisis. But I have to tell you that I have tried to think this through and I'm still uncomfortable with the proposal. It represents a significant and, most importantly for me at least, permanent institutional change that could serve us poorly in the long run. The idea, as it has been presented, seems to be that we are simply codifying current practice or our current understanding about this. But if that's the case, I think it's fair to ask if we are all clearly on the same page with respect to exactly what the understanding is, how we arrived at it, and whether it's firmly grounded. When the amendment is made public, I think informed people are going to ask those kinds of questions as they try to figure out what we are really trying to do and what we really mean. At the present time at least, I'm not sure we have crisp and convincing answers to these questions. To be candid, I'm not sure that the current understanding has a firm basis. I'm not sure I'm clear on exactly what the understanding is, though I may be the only one here who feels that way. But that is where I am. More broadly, it seems to me to run counter to our federal structure.

Of course, the fundamental question involved is whether a chairman should have the authority, either implicitly through some sort of understanding or explicitly through the Authorization, to act unilaterally even in clearly delimited circumstances--that is, whether it's wise and desirable for the Committee to confer that authority. Obviously, we always can. I recognize that I'm swimming upstream here and that some people--maybe everybody else at the table here--believe it is wise to do this. I don't pretend to be all knowing on this and I acknowledge that that may be true. But I have to tell you I'm still not convinced, after having tried to assess the benefits and the risks.

It seems to me that the gains of doing something like this, either explicitly or implicitly, are small at best. Presumably we're talking here mainly about emergency or crisis situations. But under our current operating procedures, we can already accommodate increased demands for currency and reserves and the interest rate implications of that in a crisis by amending our funds rate target. The Chairman and other senior System people can and will--as they have historically--continue to exert strong leadership in managing a crisis, using the discount window and other tools at our disposal. Also in such circumstances, I think markets would generally expect us to move fairly promptly, so that is going to get reflected in the yield curve rather quickly in any event. And importantly, in a crisis I think it's really important for the public to understand that the whole Committee is fully behind any action that is taken and will follow through on it. It is hard to imagine that they wouldn't think that with Chairman Greenspan at the helm, but we don't know who is going to be Chairman in the year 2050, for example, and what the attitude might be.

Finally, at just a practical level, with today's technology--we've been talking about that a lot around this table--it's pretty easy to get the Committee together quickly. So it's not clear to me that we buy a lot by conferring this authority. And I think the longer-term risks of doing so--I mean the real long-term risks, the permanent institutional risks--are not inconsequential. Most importantly, it seems to me that it is precisely in a crisis situation that a Chairman is most exposed to external political pressure. Full Committee deliberation and participation in a situation like that I think is a protection for the System and for the Chairman. If the President calls, the Chairman can say, "I have to talk to the Committee" and, of course, benefit from any deliberation that takes place. Also, full Committee

participation ensures a detailed public record of what occurs, which I think is consistent with our very appropriate drift toward greater transparency and greater accountability.

The bottom line--again, I realize I'm swimming upstream on this--is that I would urge the Committee to think very carefully about this. Before we do it, we should be really confident that this is in the best interests of the Committee and the Chairman in particular as well as the System and the country.

MR. FERGUSON. Thank you. Cathy Minehan.

MS. MINEHAN. Wow, it's hard to follow that! Let me start with first things first. I've long been of the opinion that we should announce something after every meeting. And if it's the bias discussion or the tilt discussion that gets us to the point where we are at the end of the meeting, I believe some reflection of that should be incorporated in the public announcement that will be made after every meeting. In fact, at one point or another I think I was the one who suggested the balance-of-risks language. Nevertheless, I must say that a couple of Bill Poole's arguments really resonate with me: point 5, the possible headline "Fed sees economic weakness ahead;" and point 6, the idea that we are supposed to be preemptive. If we see economic weakness ahead, shouldn't we try to do something about it or shouldn't we anticipate that we could alter policy so as to offset it, along the lines President Jordan talked about? So, I thought I'd be firmly in the Option 1 camp, but I can see some benefits to Option 2, frankly. Option 2 still talks about risks. And I don't think it commits us to any more than what the market thinks we're committed to--or not committed to as the case may be--because time will determine what we're going to do. Whether or not we in fact move with any greater frequency than we have to date after we change our language is what ultimately is going to decide how the market accepts this. I also believe that the basic thrust of President Poole's point 7 is right as well. When we started this announcement policy, we led the market to have unrealistic assumptions about what we meant by the language. And they overreacted. We encouraged them to overreact. We didn't mean to, but we did. I think the situation has gotten better since then and there's an improved understanding of our consensus on where we are going. So, I'm really on the fence and I could be a marginal Option 2 person.

Before I get to Al Broaddus' second comment, let me just say a few words on my suggested modifications to the directive language. I assume that nobody has major

objections, or you would have said so already, about what ends up being just an editorial perspective about shortening the directive. What I tried to do when I was analyzing the issues for this discussion was to go through all of our public announcements for the year and rewrite them the way they would have been written under the proposals made at the last meeting and in Roger Ferguson's subsequent memo. And as I tried to rewrite the directive, I found that all I was rewriting every month was a paragraph that focused on the monetary aggregates, which we really don't talk about at our meetings. Well, Don Kohn does--excuse me, Don. I felt that that kind of laser focus on that subject each and every month really didn't serve us well. So, that was basically where my suggestions for shortening the directive came from.

Finally, turning to what Al was just saying, I am a firm believer that FOMC decisions ought to be Committee decisions. We have a responsibility; making policy decisions is what we are here for, for all the reasons that Al articulated much better than I ever could. My understanding in terms of this paragraph was that it was codifying an accepted position of the Committee that has changed over a period of years, but that this wording basically reflected current Committee practice. I had not really asked myself some of the questions that Al raised in his discussion, and I must admit they bear thinking about. So, I'm a little on the fence in that area, too.

MR. FERGUSON. Okay, that's an acceptable place to be. Let me propose the following. It is now 1:00 p.m. Perhaps some food would be helpful as a way to make sure that we're still feeling our best. Is food available?

MR. BERNARD. Yes.

CHAIRMAN GREENSPAN. We can just break for lunch and continue the discussion during lunch.

MR. FERGUSON. Yes, let's take a brief recess and continue over lunch.

[Lunch recess]

MR. FERGUSON. Bill McDonough, may I ask you to interrupt your eating to give us your perspective on the issues on the table?

VICE CHAIRMAN MCDONOUGH. I am in support of the recommendations in the Ferguson memo in all areas. Let me direct myself, however, to the discussion of the Chairman's intermeeting authority. We are not establishing anything new. If a member of

the Committee doesn't know what the current practice is, I would think it is a matter of having failed to ask. When I joined the Committee, I asked what the understanding was and somebody told me--probably Don Kohn--so I knew what it was. So, we are codifying that which already exists--much against my wishes I should tell you, because I didn't think it was appropriate for the matter to be discussed since it already existed. The General Counsel thought it would be better to codify a practice that already existed, and that is why we have a General Counsel. So rather than practice law, I very reluctantly came to the view that we had to discuss this.

The idea that we would take away the intermeeting authority from this Chairman is to me unthinkable. As for the question of whether a future chairman would deserve that confidence: If somebody were nominated for Chairman and I were still here and thought the person didn't merit that confidence, I would resign so I could go up to the Hill and testify about why the person shouldn't be approved by the Senate. Robert's Rules of Order dictate the way this Committee works. If at some stage the Committee decided that its Chairman had abused this authority, at the next meeting of the Committee we could say we hereby disapprove of the Chairman's action. And we could change the Authorization if we thought the Chairman at the time was capable of abusing the authority again. That is absolutely just a "no-brainer" application of Robert's Rules. So I think we should recognize that it is on the advice of the General Counsel that we are codifying a practice that already exists. And I can't imagine why we would think of doing anything else. Thank you.

MR. FERGUSON. Thank you. Gary Stern.

MR. STERN. Thank you, Roger. Let me comment first on the intermeeting authority issue that Bill McDonough just mentioned. I share Al Broaddus' concerns and perspectives on this, but I am persuaded when I look at this language that it is satisfactory. I think it does protect us adequately and I am not troubled by what has been proposed.

With regard to the bias language, originally I was in favor of the recommendation in the memo, Option 1. As I've thought about it some more, I have to say--and I realize this is not the world's most constructive observation--I'm not entirely happy with either option. The reason is that staying with something close to the asymmetry wording we have been using does imply I think some presumption about a move at the next meeting, which history suggests often has not materialized. In Option 1, the option in the memo, I don't think this

is necessarily a fatal flaw. But my reservation is that we could find ourselves from time to time in a somewhat awkward position of having changed policy but not changed where we think the risks lie. That is quite likely and in some cases appropriate. But it may also raise the question: If the Committee thinks that's where the risks are, why didn't we move more aggressively? Maybe that can be handled in subsequent statements or in other ways. If I had to vote, I would vote in favor of Option 1. But I must say I have some reservations about both options.

MR. FERGUSON. May I speak to that? I think the general consensus of the majority in our Working Group is that, just as Gary has indicated, even if we adopt the new language in Option 1 we would provide an explanation of a vote for a bias if we thought that was necessary. There was a clear expectation that we may need to have a sentence or two that would flesh out our reasoning just to avoid that risk. So, I think that was thoroughly considered by the Working Group. Tom Hoenig is next and then Jack Guynn.

MR. HOENIG. Governor Ferguson, I've listened to all of the arguments, and they are all good arguments. When I sort through them, I'm back with the original recommendations of your Working Group. We can fool with this language to the nth degree and something is going to be wrong with it. Your draft language talks about risks and I feel more comfortable personally talking to the public about risks than I do talking about which way we are going to move the next time we take a policy action.

The issue of the Chairman's authority to make intermeeting policy moves is a tough one, Al, and I have some sympathy for your point of view. But it is related to a longstanding practice and this amendment to the Authorization does codify that practice. To my mind, in some ways it sets the boundaries more clearly. If some future chair abuses the authority, that is something the Committee will have to deal with. But the way the Authorization reads now gives me a sense of confidence that it would be used only in the most dire circumstances, and I think the Chairman has to have some flexibility to act in a crisis. So, I can generally accept the Working Group's recommendations.

MR. FERGUSON. Jack Guynn.

MR. GUYNN. Roger, of the two options presented, I rather strongly prefer Option 1 as recommended by the majority in your Working Group. In fact, I'm very uncomfortable

forecasting policy actions, which the second option implies, as Mike Kelly, Ed Boehne, and others have commented.

What Bill Poole's dissection of Option 1 did for me was not so much talk me out of it but expose what I would refer to as fundamental flaws--Gary Stern used the term fatal flaw--or shortcomings in what we are trying to do here, even in my preferred option. And those flaws relate to Bill's point number 2--that we come here with forecasts, on which we base our judgment of the risks, from very different models. And if nothing else, that's going to lead to continued debate, the Chairman allowing it, about the statements we put out and the language we use to further describe the balance of risks.

Actually, more fundamentally troublesome is the fact that each of our respective outlooks is conditional on the assumptions we have made about the stance of policy and future policy actions. That has been demonstrated very vividly in our Humphrey-Hawkins discussions; we have made very different assumptions at this table about future policy that are embedded in the forecasts we provide at Humphrey-Hawkins meetings. It always troubles me to see those added up and averaged to come up with numbers that purportedly reflect the Committee's outlook, when we admit that we have made very different assumptions.

The final fundamental flaw or shortcoming in Option 1, which I still prefer, is that we have no formal target--no formal inflation target or GDP target or whatever--along the lines of Ned Gramlich's comments today. That leaves open the question of risks related to what. We have not been able or willing to answer that question. So, in my view, there are some fundamental problems--fundamental may be too strong a word--with even the good work that the Working Group has done. I, for one, think there is a high probability that, even after these repairs, people are going to find the repaired process still substantially flawed. In fact, I feel so strongly about it that I think we may want to re-open the question--either at this point or after we've tried these repairs--of whether at the end of the day we have made a contribution, as we were trying to do, in terms of transparency. I think it is still an open question.

Finally, I have just a couple of quick comments on Al Broaddus' remarks. I want to swim upstream a bit with Al on that issue. I, too, share the thought that we are all trying to understand exactly what authority we have delegated to the Chairman. Even though the

Working Group has responded to one of my comments and tried to fix the language to address my concerns, I still would like to see the circle drawn a bit tighter around that delegation. It's very likely that if the Chairman were acting between meetings he would be responding to developments we could not possibly foresee at our previous meeting or, in fact, we would have dealt with them. I suggested words like "extraordinary," or some other term to emphasize that this authority would only apply when something very out of the ordinary--some very short-term problem not related to the long-term objectives of the Committee--had emerged. I would be most comfortable with a delegation of that kind as opposed to a more open-ended delegation, which I'm less than completely certain could be fixed after the fact. I just think it would be better to do that. Thank you for the chance to comment.

MR. FERGUSON. Thank you. Let me tell you where we are and then we have to decide two or three issues.

MR. JORDAN. May I ask a question just for clarification?

MR. FERGUSON. Sure.

MR. JORDAN. Suppose we had been operating under Option 1 at the October meeting and had adopted an upward tilt--using the balance-of-risks language--and then at the November meeting raised rates as we did. Do you think we would have retained that tilt with the balance-of-risks language or taken it off as we did under the old approach?

MR. FERGUSON. I'm not terribly comfortable speculating about that.

MR. JORDAN. But to raise rates and then take off the balance of risks toward higher inflation would seem peculiar.

MR. FERGUSON. I think there are two ways we might have handled it. Again, this is speculation; what we would have done, I'm not sure. We might have decided that the balance of risks was still tilted toward greater inflation but decided to take a "wait and see" approach because we already would have made three moves. So it is quite conceivable, Jerry, that we could have said at that meeting that we were not sure about the likely direction of our next move. The risks might be in the direction of greater inflation, but we would have wanted to be quite clear that we were waiting to see because we already had made three moves. Or we might have taken the view at that time that we had now done three moves and, in effect, we thought we were out of this for some time and in a wait-and-

see posture. Therefore, we really thought that after these moves the risks were balanced. Now, where we would have ended up would have depended very much on how close that call was about where we thought the economy was going to be after the third move. That's why it's hard to say. One could have made a case either way, if I recall the meeting. That's one of the complications here.

MR. KELLEY. And one would have to try to do that within the context of what we knew at that time--

MR. FERGUSON. Absolutely.

MR. KELLEY. --not what we know today, which is considerably more. More weight has been given to the risk of inflation than we knew would be the case at the time that statement would have been made.

MR. FERGUSON. Yes. In hindsight, obviously, we'd know somewhat more.

Let me summarize what I have heard and where I think we are. In some sense not surprisingly--though there are some caveats and a few people are in between--we still seem to have, as we did the last time, four people who feel on the core question of the balance of risks that the current language is clearly preferable. We have one person actually who would prefer neither. Then everybody else seems to feel, though they see some faults or have some concerns, that the balance-of-risks language is a step forward. We have two alternative courses of action. One alternative is simply to vote today on the recommendations in the memo--and this in some sense depends on the strength of our convictions on this--which will then set the ground rules for next year. That strikes me as a reasonable alternative, knowing that we have four people who will probably be uncomfortable about it but that everyone else, generally speaking, is ready to vote. The only other choice, frankly, is to say--and the Working Group may disagree because we have put in as many hours as we can on this to get the issues on the table--that we don't want to move forward on this. But if the Committee as a whole thinks we should not, recognizing that there are four people who clearly agree and don't want to move forward, then that is a Committee decision. I would be concerned about that decision because, effectively, it would mean that we are stuck with the status quo, and I'm not sure that that's terribly attractive. And frankly, after working on this for several months, I'm not sure that further discussion either in January or at the February meeting is going to help us go any further.

The only other thing that makes this question complex is that we have to handle what goes into today's announcement. But I think we should leave that question to one side. Larry Meyer.

MR. MEYER. We have gone through a process here and we have reached a consensus. It's a quite overwhelming consensus, though it's not 100 percent. So I'm perfectly satisfied that the process has worked. I got the chance to try to persuade others to my viewpoint and I was unsuccessful. And I would certainly consider myself bound by this consensus, so I think we ought to vote.

SEVERAL. Agreed.

MR. FERGUSON. Well, Larry Meyer has proven himself to be not just a great economist, but a diplomat.

VICE CHAIRMAN MCDONOUGH. And a gentleman on top of that!

MR. FERGUSON. Well, we knew he was that! If that's the case, Mr. Chairman, could you ask for a motion on this?

MR. KOHN. In the past, Governor Ferguson, we haven't actually had formal Committee votes on matters such as these. But, obviously, you might want to see a show of hands to make sure that people could "live with" the decisions. Among other things, the Committee has often wanted to include everybody, even nonvoting members, on these kinds of decisions since they have to live with the consequences.

CHAIRMAN GREENSPAN. Yes, on a matter like this, it's everybody.

MR. FERGUSON. It's clearly everybody. I was thinking more of just a show of hands from all, not dividing it by members and nonmembers.

MR. GRAMLICH. I think it might be helpful to take each of the matters separately.

MR. FERGUSON. Fine. We will go through the memo and basically have a show of hands on each issue, still being quite democratic. Section one dealt with nine general points on which there was consensus. I heard no one dispute those, but let me just ask for a show of hands on Section one, which deals with the nine points. Is there general agreement for those? There seems to be no objection on that.

In Section two, I will turn your attention to the balance-of-risks language at the top of page 5, which has been the focus of most of our conversation. All in favor of adopting

that as the way to deal with our perspective on the future, please raise your hand. Okay. And those opposed? There are four opposed.

At the bottom of page 5 in Section B is language dealing with the Chairman's latitude for intermeeting moves. All in favor of handling the intermeeting latitude that way and making it a part of the Authorization when we vote on that in February raise your hand. Any opposed?

MR. KELLEY. Two opposed.

MR. FERGUSON. In Section C on page 6, Cathy Minehan has proposed a slight rewording of the directive. Although Cathy referred to it in our go-around, we did not have much discussion on it. Let me just ask for a show of hands on the language, which is actually on the top of page 7 in Section C. All in favor of that approach? Those opposed? I see none opposed.

I think we are clear on what we are going to do with respect to the directive when we get to February. We have a new approach that I think has been determined democratically.

Let me talk about the next step and then give some guidance. The plan, as you can see on pages 7 and 8, is that we will issue a press release some time in January that describes the major substantive changes that we have made. The expectation is that everyone will have a chance to look at a draft of that press release and send comments back to me or Dave Lindsey or Don Kohn. So, everyone will have a chance to review it. That will be the way we communicate to the public what our intentions were in making these changes. Then in February we will start using this new procedure. Are there any objections to that approach? Hearing none, I assume there are no objections.

Now we can turn to the next issue, which is the announcement for today. You may recall that the Chairman pointed out the bracketed language at the bottom of the draft press release. Lynn Fox has now taken away all the copies of that announcement. Lynn, could you just read that bracketed language?

MS. FOX. The last sentence was: "Separately, the Committee indicated that it plans in January to make a public announcement about future adjustments to its disclosure policy and the so-called 'bias' statement."

MR. FERGUSON. Does anyone have an objection to including that sentence in today's announcement? Yes, go ahead Peter.

MR. FISHER. Could I just give a perspective from the market? In my view, if you put out that statement, it's like putting up a neon sign that says. "Coming soon: A big change in our bias!" I just don't think the market is going wait and give you a chance to draft a well crafted press release. The crescendo of interest in that, I think, is going to be extraordinary.

MS. MINEHAN. That's a good point.

VICE CHAIRMAN MCDONOUGH. I think that's a good point. Let's just put out the press release when it's ready in January.

MR. FERGUSON. Does anyone have a counterpoint to that?

MS. FOX. One reason to include it in today's statement was to make sure that the market understood that there had been no change in policy today and that the changes would be announced later.

CHAIRMAN GREENSPAN. I don't think that's really necessary. The press release on our vote today was pretty clear. It's unambiguous. That issue could surface, but I don't think it will.

MS. FOX. Our stance then, when we're asked about the Committee's decision, is to say that we have nothing to announce, period?

VICE CHAIRMAN MCDONOUGH. Right. At least the truth will set you free!

CHAIRMAN GREENSPAN. That brings us to the end of our agenda, except for the pro forma announcement that our next meeting--as I'm sure you're all acutely aware--is scheduled for February 1st and 2nd. Merry Christmas everybody and hopefully a Happy New Year!

END OF MEETING