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INSIDE THE VAULT | FALL 2000
https://www.stlouisfed.org/publications/inside-the-vault/fall-2000/whats-in-greenspans-briefcase

What's in Greenspan's Briefcase?

The Federal Reserve is famous for being tight-lipped about its potential monetary policy moves. In desperate attempts to predict what Fed policy-makers are thinking, market-watchers occasionally resort to rather odd measures. For example, on mornings when the Federal Open Market Committee (FOMC) meets to discuss the economy and make decisions regarding monetary policy, the media often focus on the image of Fed Chairman Alan Greenspan carrying his briefcase into the front door of the Federal Reserve Board building. In fact, www.CNNfn.com updates its "Eyes on the Fed" section with commentary and pictures of the chairman's briefcase on the mornings of FOMC meetings at www.cnnfn.com/news/specials/eyes_on_fed. If the briefcase is bulging, so the speculation goes, it is full of evidence that has been gathered by Greenspan to persuade other members of the FOMC to vote for a higher interest rate target. If the briefcase is thin, so the theory goes, then markets can relax because no change is likely.

Does Size Matter?

Unfortunately for the Fed watchers, the size of the briefcase is not always a good predictor of the Fed's actions. A look at the May 2000 FOMC meeting highlights this point. Despite the fact that Greenspan's briefcase was reportedly at its thinnest in years that morning, the FOMC raised its interest rate target by half a percentage point, its largest increase in five years. Therefore, it's not the size of the briefcase that matters, but the type and quality of information found inside.

What's in the Briefcase?

Most likely, the information in the briefcase is data released by government statistical agencies—information about labor markets, prices, industrial production, capacity utilization, business inventories, factory orders and shipments, etc. Most, if not all, of this information is in the public domain. The question is, what do the data tell the Fed about the economy that will cause the FOMC members to make a decision to either tighten the money supply, loosen the money supply or leave it the same?

Before trying to predict the Fed's actions, one must first understand the Fed's objective of promoting maximum sustainable growth in our economy. Because monetary policy is the primary determinant of inflation in the long run, the Fed achieves this objective by supplying just enough money and credit so that the economy will operate at its potential without igniting inflation. However, at the time the Fed takes a policy action, it does not know, and can only do its best to predict, what effects its decisions will have on the future. The information inside the Fed chairman's briefcase is used to make these predictions.

Beyond the Briefcase

In principle, knowing the forecasts and the latest information about the economy—that is, the contents of the briefcase—should help one predict what decision the FOMC will make about monetary policy. In practice, Fed forecasts are not available to the public on a timely basis. Private business economic forecasts, however, closely mirror Fed forecasts and can help one to predict FOMC decisions. People use economic forecasts and the deviations of actual inflation and growth from the forecasts as tea leaves for reading the Fed's objectives. For example, let's assume the Fed's forecast for inflation is 2.5 percent for the year, and data on prices indicate that inflation is running 3.5 percent for this quarter. In that event, people will expect the Fed to tighten the money supply so that spending will decrease. This should eventually cause demand for goods and services—and thus, prices—to decline. Sometimes monetary policy is relatively straightforward. For example, if output and inflation are both coming in above expectations, then FOMC members and the marketplace are likely to agree that the Fed must tighten policy. Similarly, if inflation and GDP growth are both coming in below expectations, then the market should not be surprised to see the Fed ease its policy stance.

The more difficult cases occur when GDP growth and inflation surprise us in opposite directions. This means that if growth is weaker than expected and inflation is higher, there will be a debate between those who want to fight inflation and those who want to stimulate output. Conversely, with surprisingly high growth and unexpectedly low inflation, some will want to tighten the money supply because they fear that the rapid growth is not sustainable without inflation. The concern is that failing to tighten policy now will lead to higher inflation down the road. Others, though, will note that inflation is below expectations, so why not wait for more information before changing the policy stance? Such are the policymaking challenges presented by the contents of the chairman's briefcase.

This article was adapted from "Inside the Briefcase: the Art of Predicting the Federal Reserve" which was written by William T. Gavin and Rachel J. Mandal and appeared in the July 2000 issue of The Regional Economist*, a St. Louis Fed publication.*

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Q & A

What are household savings?

Households use their income for purchasing goods and services and for making required payments such as rent/mortgage, interest, and taxes. What's left over is household savings. Savings allows households to make future purchases, travel, leave money to children or charities, buy stocks and other securities, or acquire physical assets such as a new house.

Our economy has been stable for quite some time now. Why is saving for a rainy day all that important?

Personal saving is important for several reasons. First, prosperity goes in cycles. Although our current economic expansion is the longest in history, most economists would agree that—at some point—our economy will continue the path of a business cycle, which means an eventual recession. Second, most people have some flexibility to save and invest during good times. During economic downturns, unemployment rises, which limits many people's ability to save. This is why it is so alarming that the personal savings rate has dropped steadily from 8.7 percent during 1992 to about zero during 2000. This has been a period of steady economic growth and widespread gains in disposable income, yet people are not saving.

Why do Americans need to save if the stock markets and housing prices continue to rise?

Counting on a rising stock or real estate market to substitute for current saving is very risky. First, markets can go down as well as up. History is replete with unexpected crashes in stock and real estate markets. Second, counting on capital gains as a long-term saving plan is actually betting on future profits and incomes that may or may not occur. Unfortunately, as a nation, many people have chosen to forgo personal saving. Instead, they have borrowed money to pay for today's higher spending—spending that may or may not be justified by future prosperity. And, if future corporate profits and personal incomes are disappointing, asset prices will fall. People without savings will not be able to repay the debt they took on earlier to buy their higher standard of living.

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Economic Snapshot

3rd Quarter 2000

	Q4-99	Q1-00	Q2-00	Q3-01
Growth Rate—Real Gross Domestic Product	8.3%	4.8%	5.6%	2.7*
Inflation Rate—Consumer Price Index	2.9%	4.3%	3.7%	3.1%
Civilian Unemployment Rate	4.1%	4.1%	4.0%	4.0%

**Advance estimate*

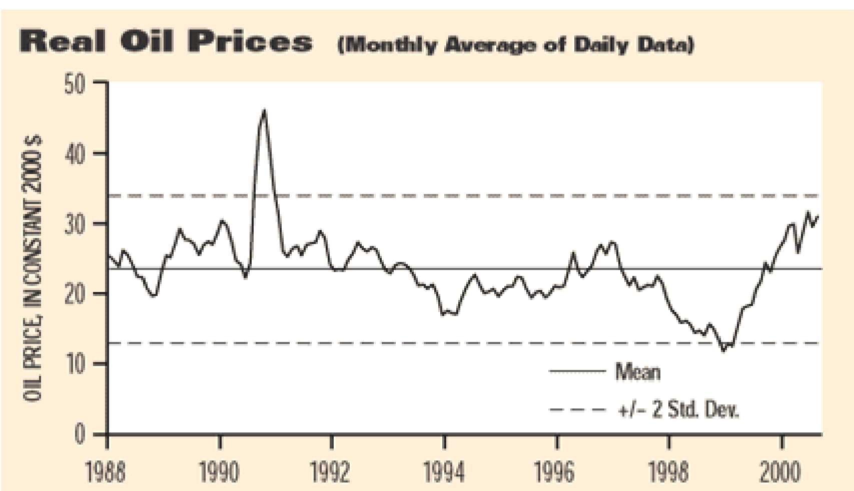

Table from National Economic Trends *cover, October 2000.*

How do oil prices today compare to those of the 1980s?

The real or constant-dollar price of crude oil—the spot crude oil price deflated by the consumer price index—was quite a bit higher in the past, peaking at more than $75 per barrel (in today's dollars) during the early 1980's, versus a current price of around $35 per barrel.

Is the recent rise in oil prices one of the highest ever?

The price of oil is determined in a volatile global market. One way economists examine the volatility is to analyze the magnitude of changes in prices. According to the chart, and "unusually high" oil price would be one that deviated beyond the bands—two standard deviations from the mean. Using this analysis, there were only two periods of very unusual real crude oil prices from 1988 to the present. During 1990-91, the Gulf War caused oil prices to spike, whereas in 1998 the Asian Crisis sent prices to very low levels. Current prices, by contrast, do not seem very unusual by this calculation. Thus, while the real price of oil has increased substantially from its significantly low level in 1998, much of the increase represents a return to historical trends in the average price of oil, which is around $23.50 from 1988 to present.