Meeting of the Federal Open Market Committee

July 2-3, 1990

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 Monday, July 2, 1990, at 3:10 p.m., and was continued on Tuesday, July 3, 1990, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Boehne [1]
Mr. Boykin
Mr. Hoskins
Mr. Kelley
Mr. LaWare
Mr. Mullins
Ms. Seger
Mr. Stern

Messrs. Black, Forrestal, Keehn, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Guffey, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Assistant Secretary
Mr. Gillum, Deputy Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, [2] Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. J. Davis, R. Davis, Lang, Lindsey, Promisel, Rolnick, Rosenblum, Siegman, Simpson, and Stockton, Associate Economists

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

1. Mr. Boehne entered this meeting after the action to approve the minutes for the May meeting.
2. Attended Tuesday session only.

Mr. Coyne, Assistant to the Board, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Slifman, Associate Director, Division of Research and Statistics,[3] Board of Governors
Ms. Danker,[3] Chief, Banking and Money Market Analysis Section, Division of Monetary Affairs, Board of Governors
Messrs. Feinman[3] and Krane,[3] Economists, Divisions of Monetary Affairs and Research and Statistics, respectively, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, T. Davis, Scheld, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Kansas City, Chicago, and Atlanta, respectively

Mr. Cook, Ms. Lovett, and Mr. McNees, Vice Presidents, Federal Reserve Banks of Richmond, New York, and Boston, respectively

Mr. Thornton, Assistant Vice President, Federal Reserve Bank of St. Louis

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

3. Attended portion of meeting relating to the Committee's discussion of the economic outlook and its longer-run objectives for monetary and debt aggregates.

Transcript of Federal Open Market Committee Meeting
of July 2-3, 1990

July 2, 1990--Afternoon Session

CHAIRMAN GREENSPAN. Can we get started, please? If somebody would like to move approval of the minutes--

VICE CHAIRMAN CORRIGAN. So move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Mr. Cross, would you carry us through your operations since the last meeting?

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

CHAIRMAN GREENSPAN. Questions for Mr. Cross?

MR. CROSS. I'm sorry, it was Honduras rather than Costa Rica in the ESF arrangement.

CHAIRMAN GREENSPAN. Questions? If not, would somebody like to move to ratify the transactions?

MS. SEGER. Move it.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Ms. Lovett, would you take us through domestic open market operations?

MS. LOVETT. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Ms. Lovett?

MR. HOSKINS. I noticed in the New York Fed's [report on its] financial panel that there was a comment by Scott Pardee indicating that he felt the pegging of the funds rate was not allowing market forces to show through and was creating a situation whereby even moving the funds rate a little would be viewed as a very strong signal. Can you evaluate that? Do you sense the same thing?

MS. LOVETT. Well, in the six weeks since you met last, it has been the case that market forces have shown through by the time the maintenance period has come to an end. So, we ended up with federal funds either being quite comfortable on the settlement day or quite tight on the settlement day. Some of that has been reflected in banks' behavior, based on their expectations of what the funds rate was going to be. In the first couple of periods they were quite convinced it was going to be a soft settlement day, and so it was. As we got into the June 13th period they were so sure it was going to be comfortable that they waited until the very end even though there was a real need for reserves. Some market [participants] chance this; they put off [action] until there is no more room.

CHAIRMAN GREENSPAN. Any other questions? If not, would somebody like to move the ratification of the actions of the Desk since the last meeting?

MS. SEGER. I'll move it.

CHAIRMAN GREENSPAN. Second?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. We'll now move on to the "Chart Show" by Messrs. Prell and Truman.

MR. PRELL. Thank you, Mr. Chairman. We'll be referring to the charts in the package with the bright red lettering, which you should be able to distinguish from the other materials before you. [Statement--see Appendix.]

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

CHAIRMAN GREENSPAN. Questions for either gentleman?

MR. FORRESTAL. Ted, that 3.9 percent inflation rate for Germany [for 1991] looks awfully high by historical standards. Why do you think the Bundesbank won't resist that?

MR. TRUMAN. Politics.

MR. FORRESTAL. Politics still?

MR. TRUMAN. Our sense is that they would resist something above 4 percent but that for a period of time they will tolerate something in the high 3s. That's part of the forecast. And, as I said, they may [unintelligible] more, in which case the forecast [unintelligible].

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. I'd like to ask a question of Mike on the basic assumption that a shift in credit supply conditions has occurred. Throughout the Greenbook and the Bluebook there was certainly discussion of these events. Could you give me some idea as to how important those conditions are in terms of the forecast? Did they represent some percentage of GNP that did not occur as a result?

MR. PRELL. Well, we don't have a quantification. It is woven into the forecast and, as I suggested, is not a big effect. If I had to quantify it, I'd say it's a fraction of a percent.

MR. PARRY. A quarter of a percent, then?

MR. PRELL. It's just very hard to trace this through. My guess would be maybe a little more than that. Part of the problem is the semantic difficulty of identifying what is the credit crunch. If you build in the recognition of all the declining investment opportunities in real estate and so on and call that a part of the credit crunch you have a bigger effect than if you are thinking simply of the shift in credit terms offered to people of a given level. Congress is--

MR. PARRY. Well, I was thinking of risks of changes in supply, which could originate from both of those factors.

MR. PRELL. Right. Well, I think it's a fraction of a percent. Implicitly, given the changes we've made over time as we thought we recognized this, I'd say it's considerably less than a percent.

CHAIRMAN GREENSPAN. Well, there's one way of coming at that in a slightly different manner. The data that have just come in from the survey on lending terms suggest that the combination of increased collateral requirements and increased spreads on loans over open market rates has a [unintelligible] of something like 25 basis points. So another way to look at this is to think of it in terms of how we would view the real rates if we had tightened the funds rate by, say, 25 basis points.

MR. PRELL. I think the difficulty with that, Mr. Chairman, is that those effects seem to have been greatest for relatively small businesses. And as best we can assess it, the role of smaller businesses in total investment, for example, is not overwhelming. But then there are these secondary effects. Looking at corporate bonds, if you took the--

CHAIRMAN GREENSPAN. Well, Mike, I think Bob was raising an interesting question about something we're all aware of. I can see the [unintelligible] and the point at issue is that it's crucial for us to get a feel for what the order of magnitude is. It's clearly not a percentage point, but how do we know [how much it is]? If the real interpretation of what I said is correct, it's less than 25 basis points. But there are a lot of other forces going on and this really gets down to a very tricky issue of what the definition is. What in the world does a term mean? We are looking at such complex forces here. How does one get a feel for how to separate them?

MR. PARRY. Well, did you make any adjustments in the model to reflect the kinds of things that typically would not be captured by a model?

MR. PRELL. [Unintelligible.]

MR. PARRY. So, what you had in there are the typical types of changes in the supply of credit due to diminished prospects with regard to growth of income, employment, etc.

MR. PRELL. Well, if this forecast were spit out by a model, then yes, I'd have a better basis. But, of course, we always are adjusting for various surprises, and to isolate this one would be very difficult. But I think one needs to lay on top of those direct interest rate effects whatever allowance one makes for collateral requirements. I suggested that perhaps the decline in consumer sentiment might have been affected to some degree by all of the press discussion of shortages of credit and the possibly bad effects on business. That might be why consumers are less confident than they were before. So I think it gets to be very, very difficult.

CHAIRMAN GREENSPAN. Well, I think Bob is saying that in a very structural sense consumer confidence is an element in the model and interest rates are an element in the model but the credit crunch is not. And the issue here is how you embody that [in your forecast], other than, say, through consumer confidence or some other variable--or in this particular case, I would assume, add-factor adjustments. How do you capture that? That's the issue he is raising.

MR. PRELL. I don't have an answer. I'd like to, but it's very hard because there are too many things going on at once. We would have to settle on exactly what categories these things would fall in. The land price story, if it is significant, is another thing that affects people's thinking on a number of decisions, and that isn't obviously related to the credit crunch. So, though I'd like to, I just don't have a good answer.

MR. PARRY. Don't get me wrong; I don't think you're understating these events. I just wondered how you did it, that's all. I think the effects are probably on the low side of what you're saying. It is difficult to know how to deal with it.

MR. MELZER. Mike, on Chart 9, the alternative fiscal scenarios, I wanted to ask you just what happens in your model for the longer-term growth rates of money where interest rates are adjusted to keep output close to the baseline path? Is there a change in the model in the longer-term growth rates of money yet?

MR. PRELL. We have to have substantially higher money growth in order to accomplish this. Let me see, I must have those numbers here. Let me check and give you some idea.

MR. KOHN. The rule of thumb we have been using is that [a decrease of] about 2 percentage points on the funds rate for the year will give you about 2 more percentage points in M2 growth on the standard M2 demand [function]. Now, whether that still pertains is another question.

MR. PRELL. I don't have the corresponding money numbers but, clearly, having a little higher nominal GNP level here and substantially lower interest rates implies through the money demand function much more rapid money growth over the period.

MR. MELZER. My point in asking and my general concern about this is that, basically, I would view a dramatic shift in fiscal policy as some sort of a short-run shock, and we can use monetary policy to try to offset it. But we're going to be giving up something in the long run to do it and I guess the model would incorporate that in a sense with higher longer-term growth rates in money.

MR. PRELL. Well, longer term, perhaps one begins to look at things differently. But it's a matter of many years before these fiscal effects presumably would die out. We need to make some assumptions about what would happen to fiscal policy beyond this period. But in this period, obviously, we have to have that accommodation. And in this period, because of the balancing fiscal contraction, aggregate demand isn't growing much more rapidly and we don't have that inflation effect. If you maintain consistently higher money growth throughout the future--sort of along the lines of the Bluebook simulations--then you do begin to see these effects mount.

MR. KOHN. I would view this more as a shift in the level of the money supply as interest rates fell or rose--fell, in this case--and then growth would be along whatever you thought the old equilibrium was relative to whatever inflation rate you want it to be. I don't see why this would result in a permanent increase in the growth rate of money; rather, I think it's a level adjustment.

MR. MELZER. One other question I had with respect to rates: What occasioned the dramatic change in your assumption on the path of interest rates between this meeting and the prior meeting?

MR. PRELL. Several things were involved. One was the fact that in the near term the economy seems to be weaker in an underlying sense than we had anticipated previously. A second factor was our decision to make fiscal policy a bit more restrictive in 1991. On top of that, we already had brought our interest rate bulge down; we had thought rates would be going up and spiking in the first part of 1991 and then coming off. Those first two things moderated that considerably. Then we decided that it would be sensible, as a baseline for the discussion here, not to assume any significant change in rates because it still appears that we would have some mild disinflationary trajectory going into 1992. We felt this kind of scenario was in line with what we perceived to be the general policy objectives of the Committee, consistent with the symmetric directives recently and so on. This seemed a sensible baseline for the discussion.

MR. MELZER. Thank you.

VICE CHAIRMAN CORRIGAN. Mike, again in the area of the budget, but leaving aside RTC-type things, could you give me some sense as to the sensitivity of the [1991] budget deficit estimate to economic assumptions? What is [the effect of a difference of] 1 percentage point of GNP or 1 percent on the unemployment [rate] or something like that on the actual budget deficit excluding--

MR. PRELL. I can give you, for example, the CBO's rule of thumb. A one percent change in real growth starting at the beginning of a year yields--if you take the lower growth scenario--$7 billion in the first year.

VICE CHAIRMAN CORRIGAN. How much?

MR. PRELL. It's $7 billion in the first year and $26 billion in the second year. Was it real output that was your primary focus?

VICE CHAIRMAN CORRIGAN. What I was trying to ask was this: Looking at your earlier charts on page 3 for the differences in 1991 between the staff numbers and the Administration numbers for GNP, unemployment, etc., if you had to make a very rough ballpark guess, what does all that translate to in terms of the budget deficit?

MR. PRELL. For 1991, I would take it to be a fairly sizable difference once one builds in the difference in interest rate assumptions. For example, their Treasury bill rate in 1991--these are not published numbers yet--is an average of 6.8 percent. So that's a little lower than our forecast entails. Looking across the board that's probably worth somewhere between $5 and $10 billion; I don't know the particular phasing. If you add on the output path difference, I would think we're running a difference of something in the $10 to $20 billion area in terms of the economic assumptions. Inflation differences are very small; the projections aren't very sensitive to inflation differences. Clearly, this is small potatoes relative to all the other aspects of [unintelligible] deliberations.

VICE CHAIRMAN CORRIGAN. Yes, that was what I thought.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. Somewhat related to Jerry's question: How likely is it, if Congress goes for expenditure cuts on the budget and higher taxes, that that actually would produce a larger deficit because the impact of that fiscal restraint would be to slow growth even further?

MR. PRELL. Well, our simulation suggests that it's within the powers of monetary policy to offset any [expected] drag. It might take aggressive action, if you believe these models, but it's doable. I guess that's the most--

MS. SEGER. And you think the timing would work out and all that?

MR. PRELL. Mechanically, the models say you can do this. I guess I should say, to follow up on the earlier question about 1991 budget deficits, that I wasn't really building in the differences in the 1990 forecast, which would start things off a little worse and widen that gap.

CHAIRMAN GREENSPAN. The growth in output I think [depends on] a judgment as to when, for example, any tax increases that occur are effective.

MR. PRELL. Sure.

CHAIRMAN GREENSPAN. We will know what that date is well in advance. We won't know the expenditure numbers that easily. I think we'll have some judgment as to the fiscal tax results. Now, if you want to think in terms of appropriations and forward orders, current contract awards and that sort of thing, we can track those things fairly well and they're not going to fall on their face overnight. In other words, it's going to be a very extensive lag so that a lot of the initial effect would be anticipatory. You can get a good deal of anticipatory effect from monetary policy because people expect interest rates to change and reduce some of this. But unless a change in orders arrives at somebody's desk, he is not going to change [inventory policy]. I have been reading in the newspapers that there has been a contraction in the budget and there's nothing we can do [unintelligible] change inventory policy or any policy. But when you get something it sure will. And I think it's that sort of timing that we have to be sensitive to. My impression is that it's very difficult to write the budget deal without some significant [unintelligible] in their fiscal impact. And it should be of a nature that we have more than adequate lead time to respond, if in fact our decision is to do so.

MS. SEGER. My second question relates to what I thought I heard you say when you were talking about housing starts. I believe you said that you thought the credit availability problems for builders were a one-shot phenomenon. I hope that's true, but I'm not sure.

MR. PRELL. Well, I tried to say two conceptually separate things. One is that to the extent that it lowers activity, that's a one-time effect.

MS. SEGER. Right.

MR. PRELL. That's a one-time effect, and then a growth path can be pursued as determined by subsequent interest rate and income movements as well. The other thing is that to the extent that some builders have been displaced--for example, by their friendly S&L having been shut down or the loan-to-one-borrower restrictions having made their S&L less able to provide credit--we think that in time they will find alternative funding if they have viable projects. There will be people who want to make those loans. On a technical side, we think that institutions will find ways, such as participating loans and so on, to deal with the loan-to-one-borrower limitations. So in that sense we think that the level problem will diminish over time.

MS. SEGER. Thank you.

CHAIRMAN GREENSPAN. We were too focused on bidding Manley Johnson farewell and we forgot that we have a new member who now has the floor.

MR. MULLINS. Thank you, Mr. Chairman. My [question relates to] either the prospect or reality of higher state and local taxes in a number of populous regions. How is that included in the model?

MR. PRELL. Clearly, that has happened already. I heard a news story that something like 10 or 11 states had tax increases going into effect yesterday. And in our forecast we expect, among the actions taken to close the budget gaps in a number of states, more tax increases. We have in the forecast a significant increase in the average indirect business tax rate of state and local governments. That tends to give a little boost to inflation as we go out through 1991 in this forecast.

MR. MULLINS. Okay.

MR. PARRY. I have a question about timing in terms of monetary policy reactions to a change in fiscal policy. If greater fiscal tightness were imposed and one wanted, say, to keep output close to the baseline path, what do the different lag structures associated with monetary and fiscal policy tell you in terms of the timing requirements for monetary policy?

MR. PRELL. Well, unless we go to extreme cases, there is no timing requirement. If you act later, you have to act with greater force.

MR. PARRY. Do more.

MR. PRELL. Just to give you some sense, though, of the sensitivity of these numbers: We did another simulation where instead of waiting until the fourth quarter, as we've assumed in this, we adjusted the federal funds rate by 150 basis points in the third quarter of this year and then let the rate drift up very gradually, pretty much back to the path seen here. And that has essentially the same output effect. So, it took 50 basis points less if you moved one quarter earlier. That gives you some sense that there is considerable [room] to maneuver, if you're willing to move in rather gross ways in your policy adjustments--and if you believe the model.

SPEAKER(?). That's one big "if."

CHAIRMAN GREENSPAN. I'm trying to remember a comparable fiscal action that has taken place, and the only thing that comes to mind is the Johnson Administration's surtax and subsequent, or concurrent, monetary ease. What actually happened then in this context? Do you remember offhand?

MR. PRELL. Well, that was before my time. However, when I arrived at the Kansas City Federal Reserve Bank in 1970 it was legend. There were a lot of economists in the System who were still feeling that that was one of the biggest mistakes they had ever made. They had neglected to take a sort of permanent income view of a one-time tax surcharge. I think it was expected to have significant effects on expenditures and in retrospect it didn't seem to have that. Now, in this case, the presumption would be that we're talking about something more permanent and one wouldn't have that kind of surprise. But I think that was the analysis. There may be people around the table who have a direct recollection of what went on within the System.

CHAIRMAN GREENSPAN. That was a temporary surcharge?

MR. PRELL. Right.

CHAIRMAN GREENSPAN. So, basically, the model would take some marginal propensity to [consume]--0.7 or whatever the number would be--out of GNP when in effect it was probably 0.1.

MR. PARRY. Well, it warmed Milton Friedman's heart because the permanent income hypothesis explained it pretty well.

MR. PRELL. Yes.

CHAIRMAN GREENSPAN. The real issue is that there is a difference here, and we have to be careful that there's not another problem we haven't captured. The complexity of this issue is rather mind-boggling.

MR. PRELL. We recognize that this [presentation] makes it all look more pat than it is. I hope I threw in enough cautionary words on that part. But as I said, I think it gives one some sense of the orders of magnitude that conceivably could be involved.

VICE CHAIRMAN CORRIGAN. I don't know if my memory is very good this evening but I think there was another element in that surcharge in 1968. And that is that for a long time prior to the point when the surcharge was supposed to come into play, there were a number of senior Federal Reserve officials, including Chairman Martin, who were pushing publicly and privately very, very hard to get some kind of a tax to finance the war. I certainly wasn't around or close enough to the situation to know whether or not all of their pushing put them in a position where there might have been some understanding of a [quid pro quo]. Certainly, the visible case was the one that Mike cited: that it was treated--whether because it was misunderstood or for other reasons--as if it were a permanent large tax increase [unintelligible]. But I suspect there was a little more to it than that.

CHAIRMAN GREENSPAN. To be sure. Any more questions? David.

MR. MULLINS. I have one question on the bottom panel of Chart 4. Since we talked about Friedman some, we can talk about Modigliani some. Your model, I guess, is meant to suggest a rebound in consumer spending because household wealth is relatively high. How has that notion worked as a predictor in the past? For example, one can't help but notice the little dip in October of 1987 in total wealth. Can you trace out the consumption impact of that?

MR. PRELL. Yes, in a rough way. The fact is that after that period the personal saving rate did rise. There was not a recession, as some people expected, because there were some strong interest-income generating sectors--stronger than most people had realized at the time. The net export increase was sizable; the investment gains were sizable. That seemed to generate the income. And even if consumers wanted to spend less of it, they still increased their expenditures, and thus we glided through that period. But the index of the wealth effect would be the personal saving rate. So there's nothing in the data superficially, given everything else that was going on, to suggest that there wasn't the predicted effect.

MR. HOSKINS. Just one question for Mike. It really is not a fair one because he probably hasn't looked at it. But, if the average error in the forecast one quarter out is plus or minus 2 percentage points when we have normal times--that is, no fiscal policy change--what would you [estimate] the error is going to be with a fiscal policy change?

MR. PRELL. Well, I don't know. If I knew what the fiscal policy change was, we'd be able to [unintelligible]. I'm not sure the error would be any larger, but given that I don't know the [fiscal policy change] or the underlying strength of the economy, I'd say there is a very wide range of possibilities.

CHAIRMAN GREENSPAN. If there are no further questions, can we proceed to our usual roundtable discussion? Who would like to start off?

MR. BOEHNE. In the Philadelphia District, my sense is that both business sentiment and economic activity have deteriorated since the last meeting and that the outlook is more bearish now than even a month ago. Real estate is the weakest spot, with increasing reports of builders in trouble. The number of bankrupt properties is rising. One of our major firms that is closely tied to capital spending reports that new capital spending authorizations have moderated appreciably during the second quarter. The only major exception is for environmentally related projects. Spending commitments are off for steel, chemicals especially, pharmaceuticals, electric power generation, and oil and gas. And the prospect for continued weakness in capital spending authorizations is there. Retailers report essentially flat sales, and I would say that merchants are more cautious about the outlook than a couple of months ago. Manufacturing generally appears to have flattened out but at fairly low levels. And except for autos, I think most of the manufacturers in the District do not expect further slippage from these low levels. In general, bankers are increasingly gloomy; they are worried about loan quality, profit margins, and the next examination. Lending for real estate projects has been curtailed sharply and lending to small business--often collateralized with real estate assets--is under much more scrutiny. My sense is that against the background of a generally slowing economy and a general tightening of credit standards, most companies are falling short in terms of their targets and plans for sales and profits. I think all of those are ingredients for a period when business confidence is quite vulnerable and is susceptible to some significant deterioration in the months ahead.

Now, translating that into the national economic outlook, I continue to think that the modest growth forecast, as outlined in the Greenbook, is most likely. But in my judgment, there has been a significant increase in the amount of downside risk to the economy in the last few weeks. So, while I would say that modest growth is the most likely outcome, I'm much more concerned now about it coming to pass than I was in May.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Well, I guess this is a Northeast economic story. In New England our situation continues to worsen, and I'd have to say with some signs of cumulation. But I don't think this is largely because of national factors. Our own expectation for the region, given an economic performance nationally something like that in the Greenbook, is that the region will continue to decline well into 1992 and then level off but be slow coming back. Retail sales are now quite weak with aggressive pricing; there are some bankruptcies, and inventories are becoming a problem. There are some questions about weather influences because we have had a cool, rainy spring and purchases of things like gas grills and that sort of thing--once it gets past the fourth of July--may tend to be put off for another year unless they are priced very aggressively. Contributing to all this is the banking situation, which I think we'd have to say continues to deteriorate. We now have people actually becoming somewhat blase, about banking, which I guess could be either good or bad. We have had a bank failure about every two weeks for the last two months.

MS. SEGER. The people are blase or the outside--

MR. SYRON. As these things happen successively, I suppose it is human nature that they draw less attention in the press. It's really noticeable that they draw much less attention in the electronic media and on the radio than one might have thought. Now, these are [mostly] small institutions. With the exception of one $2-1/2 billion thrift institution, these are institutions of less than $1/2 billion in size, so the impact is not enormously great. But to cite one example: A story that a $1/2 billion institution was going to be closing was in a gossip column in one of the newspapers two days before and it ended up having some problems but no severe runs or anything like that. Interestingly, consumer confidence--and the decline we have had is pointed out in Mike's chart 4--is remaining about the same. It's no longer falling in the region, which is a little hard to figure out, but it is at a quite low level. Looking at sectors, construction is obviously at dead center, particularly in southern New Hampshire where it was very big. And that is going to be a drag on the New England economy.

CHAIRMAN GREENSPAN. Seasonally adjusted, it will soon turn negative!

MR. SYRON. It's almost conceivable! Interestingly, employment in services has been falling as well, particularly in finance, insurance and real estate, and also in wholesale and retail trade. You just notice the availability of labor where there really had been a problem with availability in the services sector. It is now much less of an issue at the wholesale and retail stores; the stores are actually tightening up and have not put as many salespeople on the floor as they had before because of the concern that they have. Interestingly, the credit crunch question, although I'm not sure quantitatively or qualitatively that it has gotten any less pressing one way or the other, is becoming much less newsworthy and is drawing much less attention. We took some loan data and adjusted for sales of loans and items that were changed to writeoffs and things like that, and we found that loan data pretty flat except for real estate, and there was some decline in consumer loans. Manufacturing was really one bright spot, believe it or not. Sales were mixed for our manufacturers--from 0 to 15 percent. The two [unintelligible] see an increase [unintelligible] holding up relatively decently but a lot of these things are special factors. For manufacturers, exports are more and more becoming an important source of sales. Also, a lot of these things are in areas you might expect--in aerospace, as it has gone nationally, some types of electronics and defense-related products. Our computer sector is still quite weak. For the longer term there is quite a lot of concern about what defense means, and regionally I think we will see a substantial drag from state and local fiscal changes. The Massachusetts budget deficit is about $1.4 billion for the current fiscal year and the next fiscal year is forecast to be about another $1.4 billion. They are trying to arrange for some sort of [financing], part of that out 30-40 years. Connecticut has a substantial problem, so there is going to have to be very significant [unintelligible].

As far as the national economy goes, given the policy assumptions last time, our view is that the Greenbook seemed a little optimistic; and given the policy assumptions this time, it seems to us slightly pessimistic. I'd emphasize the "slightly," particularly on the unemployment rate. As has been noted, it does seem to put a lot of weight on this credit crunch issue. I think that is so; at least it's discussed frequently--let me put it that way. And it's very, very hard to know what that means. There are lots and lots of unknowns out there; things are definitely softening but it's hard to see whether this is a pause or a trend. In terms of policy, we need to see something on whether this will continue or not. There are a lot of weather-related issues in the retail sales data, particularly in fuels and personal consumption expenditures and in some of the GNP accounts. I'm also skeptical of the month-to-month retail sales numbers. So, I don't know that we can think at this point that the consumer sector is really going to weaken. The export sector looks relatively healthy; residential construction look weak. On the other hand, the purchasing managers survey this morning looked reasonably good. The indicators of a recession don't suggest a [high] probability of that. Unemployment hasn't risen; claims aren't rising, even though we've seen poor employment performance. We just have an awful lot of unknowns out there, not the least of which is what is going to happen with fiscal policy. We'll get into a discussion about this later today or tomorrow, but I think it's a very difficult period to make a decision to change [policy].

CHAIRMAN GREENSPAN. What is new in this whole process is that I don't think any of us has sat through this type of unraveling of an accelerated financial expansion. If you look at the flow-of-funds table, we go from double-digit [rates] to squeezing down, and that effect, I think, is really what we're hearing about. The question is: How does one read that? I think it explains the type of phenomenon that we see in New England at the extreme. But the rest of country is definitely [unintelligible].

MR. SYRON. Well, on this business of a credit crunch--and I think we have had some severe problems along that line--in looking at these figures it's interesting that, once you've adjusted them, a lot of the fall-off is in areas you wouldn't expect to be price-driven--i.e, in consumer lending. There is just no avoiding it; that's what's going on.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, the Twelfth District economy continues to grow, but the pace of growth has slowed recently. Employment grew at a 2.8 percent annual rate from January through May. That compares favorably to the U.S. rate of growth of employment of 1.8 percent, but it does represent a slowdown. From May of 1989 until January of 1990 employment in the District was growing at rate of about 3-1/2 percent. Conditions remain good in the trade and services sectors. Retailers report healthy sales, confirming moderate employment growth in recent months. In most parts of the West, home sales are still strong and median prices are rising but at a much slower rate. Reports of particularly robust activity come from Seattle, Sacramento, Oregon, and parts of Utah and Idaho. However, in the coastal areas of California, which are primarily Los Angeles, San Diego, and San Francisco, sales volumes and median prices have fallen from the high levels of a year ago. Although sales of more affordable homes continue to be robust, construction activity has fallen from the high levels of a few months ago. Nevertheless, the level of activity remains high with construction employment still registering solid gains over year-earlier levels. Manufacturing activity continues mixed. Production of commercial aircraft, aluminum, and some construction-related products is reported to be strong. However, employment gains in commercial aircraft are limited by both capacity constraints and also by improvements in labor productivity. It's interesting to note that Boeing has actually laid off some people and apparently has done that, as they explain it, as a result of increased labor productivity. High-technology-related industries are relatively flat overall with wide variations among firms and product lines. And layoffs and plant closures associated with defense cutbacks continue.

If I may turn to the national economy, we're in general agreement with the outlook in the Greenbook for this year, but we do have a few differences. Adopting the Greenbook assumption of no change in the current level of short-term interest rates, our forecast would be about a quarter of a percentage point stronger, at least in 1990 and continuing into the first part of 1991. I'm not sure exactly what the causes of these differences are, but I have a feeling that they might be accounted for to some extent by differences in the impacts of credit availability effects. Even in the absence of credit availability effects, we expect real GNP growth to be less than that of the growth of potential, putting some modest upward pressures on the unemployment rate and containing inflationary pressures, at least underlying inflationary pressures. Therefore, we anticipate inflation in the GNP fixed-weight price index to average about 4-1/4 to 4-1/2 percent over the next 18 months, which I believe is slightly higher than that in the Greenbook. Thank you.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, the economy has not changed appreciably in the Southeast since the last meeting. Growth is continuing along the slow path that we've been experiencing for some time now. We are seeing a fairly healthy expansion, I think, in services and in our export industries. Offshore energy exploration is also moving up higher and we continue to receive reports of severe labor shortages in the energy sector in Louisiana. Other manufacturing areas are quite weak, mainly due to the conditions at the national level for the automobile and construction-related industries.

I don't have to go out and ask people any more what they think about the economic situation; I'm inundated with advice about what we should do. But I must say that people are expressing increasingly their concerns about current conditions and the outlook. Now, that certainly has been true for some time in the real estate and housing areas, but increasingly we're hearing it from others as well and particularly from bankers. In recent weeks they seem to be a lot less concerned about regulatory pressures than they were and much more concerned about loan demand that has weakened across the board. That is one very notable change from the views a few weeks ago. And I would echo what Dick said: that the publicity about regulatory pressures seems to have waned quite a bit.

Looking at the national economy, our staff has somewhat faster real growth, especially in the early part of the forecast period, in comparison to the Greenbook forecast. The differences are basically because we have a small reduction in Federal spending and we have in fact [unintelligible] as much of an impact from the tighter credit conditions. We are also a bit more optimistic about the price outlook even though the forecast shows a somewhat tighter labor market. But as we go into 1991, our forecast does converge a little more on the inflation side. As I try to look at the outlook, like everybody else, I'm beset by a number of these uncertainties. I must say that one thing weighing heavily on my mind is that our bank directors, who have been very steadfast in supporting our anti-inflationary policies, are now leaning to the view that some reduction in restraint is needed right now. What is significant about that, I think, is that it is not only the business directors who are saying this but also the bank directors who have typically favored a relatively tight policy in comparison to the other directors. The business and financial contacts that I have spoken to in recent weeks are much more blunt in this regard--virtually without exception urging a reduction in rates. My take on this is that the negative sentiments really reflect the pressures, the temporary pressures I hope, to slow inflation after a period of pretty comfortable business conditions. Businesses seem to be having trouble, at least in the Southeast, raising final prices as much as they had expected to, and now they have to find ways to cut costs to preserve their margins. It seems to me that this is the pressure and the ultimate adjustment that we've been trying to achieve for a long time. But having said that, I still find myself now feeling--and even more so--that the risk is on the down side and that there is a greater chance of growth falling short of rather than exceeding our expectations.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, on balance the economy in the District is largely unchanged from the last meeting: mixed to just stable, at least at a moderate level. Clearly, there are some sectors that are weaker. Retail sales are down and I must say anecdotally I am hearing that June sales really have been very soft as compared to last June. Construction activity is down, both residential and nonresidential; yet our numbers I think are still running ahead of the national numbers. The Chicago purchasing managers report came out the other day; for June it was down a bit from May. Production, new orders, and order backlogs were lower. The manufacturing sector is generally unchanged, but there are some areas that are better. In the steel business, for example, as the year is moving along, the shipments level is being increased. They started the year off thinking it would be an 80 million ton year. Now, the numbers are up to as high as 84 million tons--a little lower than last year, but still a comparatively good year. Operating levels, at least at the company I talked to, are at about 89 percent. The electronic communications business is strong; the order rate is moving up and is now back up into the double-digit area. The paper industry is flat but at a high level, operating at about 98 percent. But having said that, an awful lot of capacity has come on in the paper business and, therefore, pricing is very, very intense. Liner board, for example, has gone down from $410 a ton to $370 a ton. In the manufacturing sector, not surprisingly, agricultural equipment is very strong; production levels are about 5 percent higher this year than last year. Sales of agricultural equipment at retailers are moving at a very good pace. Construction machinery, though, is weak; and in response to the decrease in construction activity, that category is down.

The auto sector continues to be very, very uncertain; the sales level in May and early June certainly was weak and as a consequence the forecast for the year is beginning to be pulled down a bit. One company's forecast is down to a little under 14-1/2 million units for the year and that's depending on 14-1/2 million for the second half. Even those levels, of course, are dependent on tremendous incentives. The incentives continue to be over $1,000 per car in order to maintain these even weaker numbers of sales. Auto inventories at retail continue to be at reasonable levels; dealers just aren't buying and, as a consequence, many of them are losing money. GM is quoted as saying that 35 to 40 percent of its dealers are currently losing money. The auto production levels in the third quarter will be significantly higher than last year but there is a comparative issue involved because the third quarter of last year was pretty weak.

In the agricultural sector, what started off a couple of months ago as being a near perfect growing season looks not quite as positive as a consequence of the heavy amount of rain we've had in the Midwest. We are having, to quote a new term, "ponding" in some areas and severe erosion. And as a consequence, the corn planting has been delayed and some of it has been shifted into soybeans, which can be planted a bit later. Depending on how things work from this point forward, I think we're still going to have a good production year, but it just isn't going to be quite as strong as it might otherwise have been.

On the pricing side, our outlook is more positive than the staff forecast. I am continuing to hear awfully good reports. The raw materials prices are stable to down. One large manufacturer I talked to says that his firm's raw materials costs for all of this year will be 1/2 percent lower than last year. In other respects I hear very good news on the raw materials side. Finally, with regard to the credit crunch, the banks that I talk to are saying that they certainly are being more careful in their approach to credit lending. They are lending very, very carefully, but everybody says that there is more than enough credit for good credits. And, of course, they would emphasize the word "good."

Just briefly, in a national context--and I think our view is reflective of our District outlook--we have been a little more positive than has the Board staff in the past and we continue to be so. Our outlook for this year particularly is stronger than the staff's and for next year we are a bit stronger. The difference really is in personal consumption, to some extent in nondurables but to a greater extent in the durables category and [more specifically] in household durables. Our outlook for home starts is a little higher than 1.3 million, whereas the Board staff's is a little under 1.3 million, and that works its way through in the household durables category. With regard to inflation, our outlook is a bit different from the Board staff's also. We think as we get into next year that the numbers will begin to show some improvement. And our outlook for inflation by the end of next year is certainly lower than the Board staff's. Thank you.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. In terms of our long-run outlook, we're right near the central tendencies in both years; we tend to be at the lower end in terms of nominal GNP, real GNP, and the CPI, and a bit at the higher end on unemployment. The one comment I would make is that in 1991 we're looking for somewhat lower inflation, just a quarter of a percentage point from the lower end of the central tendency. I would say that's based on the progress in the trend growth in money and the decline from double-digit rates in the 1986-to-1987 period to less than 4 percent now. Essentially, I think that kept us from overreacting earlier this year to the temporary runup in prices. And it also influences us now in the sense that we have built such a good base here that I think there's some reluctance to trade away a lot of that. Now, there's concern about the recent slowdown in money, but in general where I come out--and not everybody would agree with this--is that I'd need to see more before I reacted to that, particularly in the context of trading away some of this longer-term progress.

As far as the District goes, the situation still looks pretty good right now. We have had growth in nonagricultural employment in the most recent three-month period that's right in line with the national numbers and over the last year almost right on top of them. Our manufacturing component is actually a bit stronger; it's growing sluggishly but that compares to declines nationally in the most recent three months and over the last year. On the horizon, however, there are clearly some problems. We have a lot of auto industry exposure in Missouri--in St. Louis and Kansas City. Chrysler has a shift that is scheduled to go out this fall and as I recall it involves about 1,900 workers. And recently McDonnell Douglas has talked about layoffs; they have not made any specific announcements but the rumors are that 4,000 jobs in St. Louis will be eliminated, and that would be 0.3 to 0.4 of a percentage point in terms of our metropolitan area unemployment rate. The interesting thing about that is that I would attribute those layoffs solely to current inefficiencies. That is, it may put them in a better position as contract cuts come a couple of years down the road, but basically this is dealing with current problems. And I think it caught people a bit by surprise in that they weren't really looking for any winding down until 1992 or some time around then. On the banking side, asset quality continues to improve in our District. Nonperforming loans are going down; real estate problems have gone up a little but they are still well below national averages. In St. Louis, for example, nonperforming real estate loans are less than 2 percent, compared to much higher numbers in some other metropolitan areas. On the agricultural side, the weather has affected the wheat crop. We have had, of course, very wet weather. It also has affected planting but I think corn is the only crop that would possibly be affected by that; soybeans and cotton are in pretty good shape.

I wanted to comment on one other thing quickly. We had a series of meetings a week ago with our pension fund managers. I think it's dangerous to draw conclusions from a relatively small sample of managers, even though they're very professional, but what struck me was that I did not pick up from any of them a great deal of anxiety about the outlook. Basically they are assuming a soft-landing type of scenario. In other words--or I guess to put words in their mouths--they are assuming continued sluggish growth, a continued unwinding of inflationary pressures, and a gradual decline in interest rates. I would say that, in effect, what most of them were doing was looking through current [profit] margin pressures, which are very evident, and the effect that will have on earnings. They feel that a gradual decline in interest rates will offset that and that from a valuation point of view they will be okay. The flip side of that--and we didn't ask this across the board but we talked to one group--is to ask what they would worry more about. And I think in general they would be much more worried in a longer-term context about a resumption of inflationary pressures as opposed to some shallow recession. Of course, they were quick to add that once a recession started who knows whether it would be shallow. So, that was kind of a soft question. Generally, in the bond part of the portfolio there is usually not much of an interest rate bet; in fact some of them won't make any at all. They just stick right around the Shearson-Lehman index in terms of their duration. But there were two standouts, one on either side. One manager is betting on declining rates and another on rising rates. So, overall, there's a pretty neutral view there.

MR. PARRY. We're not supposed to adjust policy based on that, are we?

MR. MELZER. No.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. With regard first to the District economy, for some time I have reported that it was doing better than the nation as a whole. We just had some data revisions; the series we follow most closely are nonfarm employment and income, and the data revisions confirm those reports. Both for 1989 and early in 1990 at least, the District has outperformed the nation. I think essentially what is going on is that the natural resource industries in the District, which sometimes act as a drag, have actually been pulling things up. In that regard, I'm referring to mining and forest products and paper and, of course more recently, agriculture. In fact, the farmers in our District have just about run out of things to complain about and that almost never happens. We too have had a lot of rain but it was much needed. So, people's spirits are up and that has positive implications not only for morale and farm output but for implement spending and so forth. On top of what has happened to natural resources, as I have reported before, the diversified economies in the Twin Cities and some of the other mid-size metropolitan areas have done pretty well throughout most of this expansion. We recently had meetings not just with our directors but also with our advisory council on small business, agriculture, and labor. And, based on those meetings, I would say the general tenor is positive. It is not ebullient; there certainly is not a great deal of confidence going forward, but in general they are relatively satisfied with what is happening at the moment. There are a couple of exceptions, both of which are obvious: anybody whose business is related to defense is concerned as are those in construction--although they are not concerned about new home sales, I must add, which continue to run above year-ago levels in many places in the District. Generally, I don't think the District is going to continue to outperform the national economy much longer. It is likely to perform much like the national economy; that is, I think things are going to become a bit more sluggish as we go ahead.

Commenting very briefly on the national situation, I have a [unintelligible] sense that, as Tom Melzer and a couple of others suggested, we may be poised for some progress on inflation in terms of disinflation here. I say that in part because of the slow growth in money that we've had over an extended series of years now, but also because in terms of anecdotes from people in the District I really haven't had any reports of growing inflation pressures in at least a year. Of course, the latest aggregate price statistics look a bit better. Now, the obvious kickers are the services sector and some of the things that Mike pointed out in his report about the [unintelligible] and so forth. Nevertheless, I think we may be close to a point where we finally start to see some progress there. As far as real growth is concerned, I'm pretty comfortable with the Greenbook forecast or maybe even something a bit better. I think most of the fundamentals are in place for some acceleration of growth. But having said that, I must say that the statistics for the last few months on employment and consumer spending, and my impression of what is happening with home prices, raise the yellow flag.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, our projections for GNP are pretty close to the staff's; they are almost right on the button for this year, but they are a little lower next year than the staff is projecting. As we see it, this seems to be pretty compatible with the kind of growth we've had in the aggregates recently and the Greenbook's assumption that we'll have the same degree of restraint over the forecast period. We would guess that the risk of error would be on the down side and perhaps very much on the down side for the next six months or so. I say that partly because there doesn't seem to be a real thrust in the economy anywhere right now, with the exception perhaps of exports, and also because of the sharp deceleration in the aggregates. The staff memo did a good job of eliminating a lot of the worries I had about the slowing in the aggregates, but as the staff admits--and, of course, we all know--this could be reflecting to some degree a slower growth in the economy than would be healthy. And we, like Bob Forrestal, Si Keehn, Tom Melzer, Gary Stern, and maybe some others, are more optimistic than the staff about the degree of inflation that we will have, and we have felt that way for some time. We think the staff is about right for this year because of what is already in place for the first quarter, and that puts us at 4-3/4 percent on the CPI for the year. But we're expecting a deceleration in 1991, down to the neighborhood of 3-3/4 percent maybe, because of the drop in M2 growth in the second quarter and also the projection on the part of the staff that we will have a constant federal funds rate over the forecast period. And, finally, we think the credibility we will get on our anti-inflation policy, if in fact we do hold the federal funds rate steady over the next 18 months in the face of rather sluggish real growth, really ought to have at least a moderate [salutary] effect on the rate of inflation that we actually achieve. I was intrigued by Si Keehn's comments about "ponding" in his District; we've had a little dry spell, Si, and I think we would be happy with a little "puddling."

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Mr. Chairman, on the national picture our view is not very different from the staff's forecast. We see slightly more strength for the rest of the year and about the same for 1991. I don't quite share my friend Bob Black's and others' optimism on inflation. I continue to remain a little pessimistic there.

With respect to the District, the economic recovery continues but its strength seems to have diminished in the last two months. At the May meeting I spoke about how, for the first time in three years, the recovery in the Eleventh District had time finally to spread across all sectors and all geographic regions in the District. A definite slowdown has occurred recently, probably in response to the slower growth nationally. Our manufacturing industries are still out-performing the nation. We actually have slow-to-modest employment growth, but the gains have been concentrated in chemicals and energy-related manufacturing. Electronic equipment, apparel, paper and several other sectors that had held up manufacturing strength have slipped recently. Defense contractors, of course, have been cutting back heavily. In spite of lower energy prices, drilling activity has continued to increase significantly and all the leading indicators suggest that this should continue for several months to come. Retail sales have softened and construction contracts have declined. Most disturbing, however, is the noticeable slowdown in the service-related sectors. This has been an area of persistently strong growth, but the most recent three-month period marks the weakest growth this group of industries has exhibited since a recovery began three years ago. In spite of what I've been saying, for some strange reason business sentiment seems to have improved a little lately, perhaps because steady slow growth in a stable, predictable environment has finally come to be viewed as preferable to an uncertain stop-and-go environment. Nonetheless, the talk of credit shortages--and I'm not just talking here about real estate nor just for the smallest firms--is becoming more widespread down our way. To keep [my report] balanced, I guess I should say that our directors are probably not quite as optimistic as I am.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Mr. Chairman, the good news is that the drought is over as far as our District is concerned. We had "ponding" and "puddling" but the fact of the matter is that the farm sector still remains the primary source of the strength in this rather slow-growing District economy. With respect to the agricultural sector, the wheat crop, which has been mentioned here already today, is in a sense [unintelligible]. Mother Nature plays tricks on the farmers as she does annually, I guess. But overall the wheat crop is projected to be at or near a record level. As a matter of fact, earlier today I received a report that wheat in western Kansas had yielded 10 percent more than it ever had before.

CHAIRMAN GREENSPAN. Better subtract the fraction of a bushel that Wayne brought back and we lost!

MR. GUFFEY. The fact of the matter is that some of the wheat crop, which 30 days ago looked outstanding throughout most of our District, has been lost because of high winds and wet weather. But overall it apparently will come out very well. In addition, there has been a delay in planting corn and the corn acreage will be down this year, but that is [offset] by the soybean crop because of the later planting date for that crop. Red meat prices for the farmers still are very good and as a result the agricultural economy looks very strong.

With respect to the credit crunch that has been mentioned, with some diligence [in our search] we simply don't see it in our area of the country. As a matter of fact, the complaint is that there is very little loan demand and liquidity is very high in most of the small agricultural banks particularly, as well as in some of the bigger banks. Employment continues to grow throughout the District;

in fact, in each of the metropolitan areas the unemployment rate is lower than the national rate, and there is some strain on skilled labor in the District. The District automobile manufacturing sector remains in the doldrums. There is some continued modest improvement in the general aviation manufacturing area. As for construction, home building is at a low level and there is very little commercial construction taking place because of the overhang that still exists in the energy areas such as Denver, Oklahoma City, and Tulsa. Although there is some [construction] in Kansas City and a little in Omaha, by and large it does not measure up to year-ago levels. In the energy sector, the OPEC overproduction has driven down prices, as noted earlier today. However, the rig count in the District still remains fairly stable and in fact is higher than a year ago. Overall, I would characterize the District as being in fairly good shape in most areas. I hear very few comments from people that I or my staff have been in contact with concerning the economy itself. People are pretty well satisfied, but one has to lay that against the fact that some of them suffered rather dramatically in the 1980s, so they think current conditions are pretty good.

On the national level, we have no real divergence from what was presented in the Greenbook with the exception that in 1990 we're about 1/4 percentage point stronger [on GNP] than the Greenbook and inflation is roughly 1/4 percentage point more. We're back together in 1991, however. So, over the total horizon our forecast is not greatly different than the one the Greenbook portrays.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Mr. Chairman, to start with, our own forecast continues to be very, very similar to Mike's forecast both in terms of GNP and inflation. There are some minor differences around the edges but they are really quite small. But insofar as the kind of bias [unintelligible] around the forecast is concerned, I associate myself with the comments that Mr. Boehne made at the opening of this discussion. And that is, if somebody put a gun to my head and said "You have to put a forecast down," that's the forecast I would put down. But I don't think I'd have quite the same confidence in that forecast that I would have had three or four months ago--again, for some of the reasons that Ed Boehne mentioned. Anecdotally, there are some aspects of the consensus forecast that look pretty good. Certainly, the impression I get is that the export sector still is quite strong, quite similar to Ted's forecast if not even a bit stronger in volume terms. Again from what people say, the capital goods sector seems to be hanging in there but it is not robust by any stretch of the imagination. One interesting thing that someone mentioned to me just the other day--I don't know, Bob Parry, if you picked this up--was that this was the first instance that this individual could remember of a domestic airline failing to exercise options on Boeing 737s that they had had for three years. I get the sense that the capital goods sector is okay, but certainly not robust.

The real estate sector is a tough call. Two or three things strike me there: one is that I do get the sense that the second- and third-level effects of the contraction of real estate are beginning to show up a little more directly for derivative products. That's not by any means confined to the Northeast. On the other hand, having spent a lot of time over the past several weeks with both bankers and with my own examiners, some of whom I think are pretty darn good at this real estate stuff, the feeling I get is that while there is more bad news in the pipeline there isn't a sense of any kind of rout yet to come. There may be pockets geographically or otherwise in which that is true. But even in terms of what my own examiners tell me, drawing from the credit files and so forth, they see some things out there that still worry them, but they do not see a collapse in real estate markets generally.

On the other hand, for what it's worth, those same examiners are more concerned today than they were 6 or 12 months ago about another round of LBO-related problems. This is stuff that they don't feel they know enough or are sure enough about to be able to significantly downgrade some of these [unintelligible] credits, but based on their experience their comfort zone is lower. [They cannot] justify substantial changes in classifications but they do tell me that they are more concerned about some of the LBO-related loans that are in there right now. So, there are some good aspects in that they don't see, nor do I sense from the major banks, a further black hole with regard to the real estate situation, although in the case of some of the small banks and some of the regional banks in the Northeast I don't think they would be quite as confident because those institutions have a much higher concentration in real estate loans than big banks. In the minds of everybody I talk to who has a broad-based business concern or lending concern, the big question is the consumer and what the consumer is thinking and going to do. I come away with an impression, not unlike what Gary Stern was saying, of so far so good. But I have this nagging feeling that any kind of a shock could knock consumer spending off in the wrong direction.

Now, on the credit crunch issue more generally, I think we all have problems trying to rationalize [or to] quantify what we seem to see. I think that's partly because it is a financial shrinkage that has many different aspects to it. Much of it is demand-side oriented; some of it is supply-side oriented. But a lot of it is a reaction of both supply and demand to excesses of the past. When you try to put that all together, it's very hard to quantify; but I continue to think that there is something of consequence going on. Take the example that Joan Lovett referred to in her remarks about the Chrysler matter a couple of weeks ago, where it was announced that Chrysler was being put on a credit watch list for its commercial paper ratings and, just on the basis of the announcement alone, within three or four business days Chrysler had drawn down its bank lines by almost $3-1/2 billion to replace commercial paper that it couldn't roll over. That was just on the basis of an announcement! Now, one of the interesting things about that is that Chrysler had fully paid backup lines throughout the banking system. The bankers are saying to me point blank that if somebody comes in looking to draw on their lines and they don't have fully paid lines, forget it--the loans simply aren't going to be made. I think that is symptomatic of this very, very cautious, and ultimately healthy, process of shrinkage and consolidation that's going on. But any way you cut it, I think there is clearly something there. Again, I go back to Mr. Boehne's comment.

On the inflation front, my sense of the situation at the moment is that the so-called core inflation rate hasn't changed. Maybe it is poised to go down, but when I read articles like I read in this morning's paper about automobile price increases I have to wonder. In that sector everything is--

CHAIRMAN GREENSPAN. [Unintelligible] your core inflation is psychiatric--

VICE CHAIRMAN CORRIGAN. --identified with responding to problems [by raising] prices. I don't think that quite tells me we're out of the woods yet on the inflation side. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. Well, the Fourth District is a little more like Si Keehn's District than it is Ed Boehne's. There is not much of a change from the last time I reported. In terms of the manufacturing side, I would say we're more upbeat than the national counterpart, perhaps because we focused on capital spending and it turns out that in real terms capital spending plans for most firms are running increases of between 5 and 10 percent, whereas the Commerce Department's [number] is running at 3-1/2 percent. Again, like Si's District, steel is relatively strong. I don't have a really good explanation for that. In carbon, they are looking for a pretty good second half. And in stainless, a major firm in our area has very close to a record year in terms of its order book in the next two months. Also, a good portion of this is driven by a very strong export sector in the District. The weakness, as you might suspect, is in retail sales and construction.

In terms of the credit crunch issue, we have talked to our small bank advisory council and, of course, to all of the major banks. Small bankers report no change in their standards; they are worried about the regulators coming in. And these small banks are seeing more deals come across now from S&Ls that have been closed; developers are moving over and searching the banks. So, there are plenty of deals in front of them, but most of them aren't very good. In terms of larger banks, we see rather flat to modest growth in loan demand--nothing spectacular. The one thing that I do sense in talking to my directors, who have been and remain very concerned about inflation--and it's very apparent more recently--is that there is some concern about the economy. When I press them on their own firms, all of them are doing all right--some robust and some flat, but nobody's going over the cliff. Their perception is that somebody else is going over the cliff, but they don't know who at this point in time. So, there is a greater degree of caution in the minds of the business community in the District, it seems to me, than there was just last month.

As far as the national outlook goes, we're a little stronger in terms of real growth than the Greenbook and a little less optimistic about reductions in inflation. I think the difficult times, looking at what has happened to money, are making some sort of sense out of that. Staff [unintelligible] but the confidence level around the forecast of velocity leaves me a little cold as well. The problem with retail sales is also a bit of a concern. I don't like to be much of a fine tuner; it has been going on for a time so I'm comfortable watching things for a while.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I was a little struck, Jerry, when you said that we could knock consumer spending off in the wrong direction; I was rather startled by that. That's a new worry, because I presume you meant it might be knocked down. And, of course, if it is knocked down that means the saving rate is higher, and it means we would be getting this long-awaited adjustment in household behavior. I think it's an adjustment that comes quite naturally, given what has been showing up in the housing sector. It's quite clear that during most of the post-World War II economy, American households one-by-one went from better to worse [unintelligible]. The last old word was that the more money you borrowed to buy a house, the more money you made; and the only sad thing was that you didn't buy a bigger house. Of course, farmers learned that if you borrowed money to buy land or machinery, you made more money; and the oil people learned that if you borrowed more money to drill holes in the ground, you made more money. One-by-one all of these notions have bit the dust; housing in a sense is the last one. So, I'm somewhat optimistic that the U.S. saving rate will stay at the 6 percent level, whereas the staff is forecasting that it will fall back to 5-1/4 percent. So in this new environment of opportunity, we get just what we've been asking for for a long time. It does appear that what everybody said--that real interest rates do not determine savings rates--was wrong, like most everything else we were taught. And it does appear that we're making some real progress.

Now, my forecast is somewhat weaker on nominal and real GNP than the staff's, but not as much as you would think, given my 6 percent saving rate, because I do anticipate that the export sector is going to continue [to support domestic output]. I have a great deal [unintelligible] and if we have more capacity opportunities and we have rather low profit margins in the domestic sector I think our economy is responding in rather an amazing way. I just note that hardly anyone talks about the fact that the trade deficit and the current account deficit now are projected to be less than half of what they were at the highest point. And it does seem quite likely now, from my perspective of course, that we're going to move into a balance-of-trade surplus position before my term is over. So it just looks to me as if--

VICE CHAIRMAN CORRIGAN. When is your term over?

MR. ANGELL. It's a secret! I know this sounds too optimistic for most of you but I'll add to it by joining in with Si Keehn, Tom Melzer, Gary Stern, and Bob Black. I also believe that 1991 is the year that we will get the rather dramatic move on inflation numbers. The way the numbers are set I think the year-over-year CPI is not going to change much from the present 4.2 to 4.4 percent level until about next January. And then all of a sudden I think we're going to be seeing 3 percent numbers. But you better discount that, because I've been saying that the last two years!

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Well, I'm also in general agreement with the Greenbook except that for 1991 I'm not quite as optimistic about the rate of growth, given the interest rate assumptions. I don't think we have much room to maneuver. I think we're walking along a path that's rather close to the edge--if not the edge of the cliff, at least the edge of the ditch. And I believe that the downside risk is greater than the upside risk, maybe significantly greater. I sense that this real estate malaise is spreading. It's not contained; it's creeping down the East Coast; we have it right here on the Potomac. And I think that's a matter of serious concern. The loan demand that has been cited as being relatively soft is a reflection of attitudes and confidence--not only individual confidence but business confidence as well. I think the publicity about taxes and the savings and loan [bail-out] costs and the debt problems of Trump and RJR and the whole junk bond story and all the other stories that are out there in the press can further depress the markets. Personal consumption expenditures are not exuberant by any means, and in a consumer-driven economy that doesn't spell much of an increase in growth to me. The saving rate is more likely to stay at 6 percent or even go higher because I think consumers are far more cautious than the Greenbook forecast would indicate. So, I think these psychological factors, if we did happen to slip into a recession for a couple of months, would accelerate the downhill slide. The watch words ought to be "be alert and be cautious."

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, in the brief time that I've been on this Committee I can't remember an intermeeting period where it seems to me that less has changed. I almost have the sense that since May 15th we've been in a kind of suspended animation, with no startling new strengths or weaknesses showing up. Maybe the most important news is what didn't happen. Inflation was scary in the first quarter; we all expected and hoped that it would slow, and fortunately it has done that. So far the credit crunch hasn't eaten us alive. It still could, I suppose, but usually these things have a way of either gaining momentum or losing momentum. My sense is--and I hope it's correct--that it is not gaining momentum. Short term, I have some of the same concerns that Governor LaWare noted in the sense that a couple of things that are going on are unavoidable. One is in the area of construction. Commercial construction, housing--real estate generally--has probably not seen the bottom yet; and I worry about whether it could drag other things along with it excessively. The automobile industry has been borrowing from the future for some time and that's going to catch up with them sooner or later. And I must say that the notion of answering slow demand with rising prices strikes me as bizarre, and that's what they have just done. It's clear that things are going to change if we have been in a period of suspended animation; maybe no one will agree that we have. But shortly we will know much more than we know so far about the fiscal outlook. For better or worse, that's going to become clear quite soon. And perhaps as the next year develops, we're going to know much more about the impact of foreign events on our economy. They promise to be profound, perhaps more so than they have been in the past. But it seems to me that, for now at least, we can feel pretty good about the fact that our strategy continues to look like it's working and that we are on track: that we largely have the conditions that we had hoped to get, and that there is a reasonable prospect that the results flowing from that will be the ones that we had hoped for. So for the moment, I feel that the thing to do is to sit tight and watch closely.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I really don't have much to add to the extensive review given by the presidents and my fellow governors. When I look at the data, it's clear to me that the economy is weaker than was projected earlier, but there are no compelling signs that we are headed for a recession. There are some positive signs, perhaps, on the inflation front but mostly in terms of breathing a sigh of relief that the early numbers for the year were transitory. I think one would have to look really hard to see strong evidence of any breakout on the down side. I would argue that there is greater risk on the down side. The consumer risk has been talked about. It is true that the retail sales numbers were only for one month, but they were accompanied by downward revisions for March and April, and the breadth of that retail sales report was not too encouraging since all categories fell except one. Pretty soon we will know whether we will get the bounceback we are hoping for or not. I tend to agree with Governor LaWare, though, that there are a lot of bad vibes coming across to consumers through the tube and through their home prices. And the confidence survey shows confidence to be a little low, although there doesn't seem to be any hard evidence that there's any kind of dive.

I also worry a little about the services sector. We have had no real growth in employment in that sector, at least recently. And it seems to me that sooner or later they're going to have to deal with their cost structure. Inventories, the way I look at the data, show no real evidence of impending recession; the same is true for capital goods. Construction is obviously not in great shape. Exports have been really helpful. I wonder about the buoyancy of western Europe. The industrial production numbers of Germany have not seemed to me to be all that encouraging. On the inflation side, again, I don't see any major changes. I just went back and looked at a whole series of commodity prices a year ago versus now and it looks like there's nothing to be upset about there on the up side, and there may be some encouragement on the down side. Lumber is way up due to the spotted owl [unintelligible]. Scrap steel was higher than I expected, perhaps having to do with the auto companies thinking about strikes coming up and so forth. The one factor, which has been discussed here a little, that I find puzzling and concerning is the slow growth in monetary aggregates--not only M2 and M3, but also demand deposits, which presumably are mostly corporate demand deposits. When you look at a period in which all the aggregates have been growing more slowly than projected and add to that the notion of some sort of credit crunch going on, it's conceivable that monetary conditions are implicitly tighter than intended or projected. Over time that's going to be helpful on inflation but perhaps [adds] some risk to growth in the economy. So, I wonder about the implications of that. And while I generally would not disagree with the Greenbook, I guess that's what makes me believe that if there is a risk, it tends to be more on the down side than the up side.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. I have a couple of comments. First of all, I do agree with Mike and the Greenbook that the economy is sluggish. In fact, I would even use the word "weak" to describe some sectors. I'm pleased to see some of the estimates getting down more in my neighborhood, which is a very low number for economic growth this year and no growth next year. Maybe I'll have some company for next year as well.

I will note just a couple of concerns that I have. Autos have been mentioned quite a bit, and I too was surprised by the announcement in today's Wall Street Journal about price hikes. I checked with two friends of mine, including one who is and his explanation was that they added on to the sticker so they can give bigger incentives. I'm not a marketing person, so you can explain to me later whether that makes sense. It still has a negative impact as far as the public is concerned. And I don't think it's too bright, especially when some of these same people have been telling me for some time that there has been a problem with sticker shock, particularly in parts of the country where income levels are a lot lower than they are around Washington. So, that's a problem. Also, the consumer debt load is a growing problem and the auto companies have been having trouble getting some of the would-be buyers qualified to get loans even by their own captive finance companies. You would think that they would bend over backwards to get the sale made, but I think that says something. On the credit availability side, I picked up some comments that some of the dealers themselves have been kicked out of commercial banks for their floor planning. So, credit availability is entering into autos in that way rather than on the individual consumer side. I talked with people at has been expected to fill this void by providing funds for floor planning; but because of their own problems, they're not always able to do that. And a growing number of car dealers are having financial difficulties, to the point of going bankrupt. The number of dealers going bankrupt in the first 6 months of this year is equal to the number that went into bankruptcy in 1987 and 1988 combined and is 50 percent above the number that went bankrupt in all of 1989. So, I think this is getting to be a serious problem and it [unintelligible] in a couple of ways. One is that they are not going to be around to make sales; the second is that they're unwilling to come up with a good order stream because they're just so stretched themselves that they cannot afford to carry decent-sized inventories. Everything I heard I don't view as a temporary phenomenon--something that's going to go away in the next couple of months, unfortunately. Then, of course, the auto makers have the UAW to negotiate with. I can't get anybody to admit, by the way, that they're adding to production in order to stockpile; that just does not seem to come through. In fact, what I hear more is that they're having a hard time getting enough orders from dealers to do their build out just so they can handle the production for which they already had ordered parts and supplies.

Another area I want to say a few words about is housing. I probably deal with less-than-spectacular builders, but I don't think the problems are all going to be resolved in a hurry--particularly in smaller towns. I don't believe that it is easy just to walk out and find alternative sources of funds. Even though it would be nice to assume that, that doesn't seem to be the case. A person just called me this morning from California with another whole raft of stories about small and medium-size builders who are having problems getting financing. In some cases they are builders of single-family homes; others are builders of small apartments--10 to 12 unit apartments, not the big ones by developers who have been engaging in all sorts of wild extremes. I would like to think that housing starts have bottomed out, Mike, but I'm not necessarily convinced that that's the case.

Finally, on inventories, even though the aggregate numbers may look pretty good, there are growing examples of firms in the retailing industry, and to some extent in manufacturing, whose inventories are creeping up above where they would like to have them. So, these are the areas that I'm most concerned about at the moment. In looking ahead for 1991, my problem is that I can't see what's going to give this rather sad-sack situation a boost and turn it around, particularly with the talk about the tax hike. I had the TV on yesterday and it seemed to me that every program--every one of these "Face the Nation" kinds of shows--was going into this subject of the tax hike and President Bush breaking his pledge of no new taxes. You would have to be deaf and a low-grade moron to have missed this. And I think that is going to have a real impact going forward.

On inflation psychology, I talked to the head of a big paper company and I'll just tell you what he said because I remember a year or year and a half ago paper was one of the industries that we worried about having shortages of capacity and that were passing out price hikes with abandon. Anyway, he said that they have ample to excess capacity at the moment and that there's nothing in the way of price increases either in the works now or on the horizon. Many prices of this particular producer are actually well below where they were a year ago and at the moment some prices are still declining. He thinks the rest of 1990 and 1991 should be [a period] of price stability for their whole industry, not just for his company. There has been new capacity added in the last year, year and a half, and there is going to be more coming on all the way through 1991 which, of course, will make it still tougher just to pass through any higher costs. From his point of view inflation is not a big problem, and he doesn't hear other business people that he speaks with mentioning inflation as a big problem either. He thinks the so-called inflation psychology is much more evident in the financial community than in the manufacturing arena. And I think he's probably right. Thank you.

CHAIRMAN GREENSPAN. Well, that concludes the go-around, but I think we have time, as the last item on this evening's agenda, for Don Kohn to at least discuss the longer-term ranges for monetary policy. Then we will call it an evening. Remember, we're invited to the British Embassy for cocktails, I believe at 7:30 p.m., and dinner thereafter. Don.

MR. KOHN. Thank you, Mr. Chairman. I will be referring to tables in the Bluebook as I go along. [Statement--see Appendix.]

[Meeting recessed]

July 3, 1990--Morning Session

CHAIRMAN GREENSPAN. We left off yesterday with the completion of Don Kohn's presentation on the long-term ranges and we are now open to questions.

MR. PARRY. The growth rates for M2 and M3 in 1990 and 1991, particularly 1991, assume that the special factors that impacted 1990 will persist in 1991. Is that correct, particularly with regard to M3?

MR. KOHN. Yes, especially with regard to M3. We are assuming that the thrifts continue to shrink in 1991 and shrink at close to the rate that they did in 1990, or a little less. The marginally solvent ones will remain under pressure and there are enough assets and liabilities out there in the conservator thrifts to keep the RTC going at a pretty good clip for the next six quarters at least. So, we built in a continuing shrinkage of the thrift industry and [continuing] activity of the RTC. We built in moderate growth in bank credit--about 6-1/2 to 7 percent--which would be a slight pickup from now. So, we have diminishing effects relative to the second quarter when we had no growth in M2 and M3. We don't have that built in; we have that moving down or decreasing over time. But there are still some effects, yes.

CHAIRMAN GREENSPAN. If there are no other questions, I would like the members now to address the issue of the 1990 ranges--whether they should be the current ones or perhaps the alternate ranges--and I also would appreciate having the members' views on the 1991 ranges with respect to M2, M3, and debt. We will have to vote separately on the two sets of ranges, but I think it would be useful in this discussion around the table for the members to combine both years.

MR. FORRESTAL. Mr. Chairman, first of all, I would like to compliment the staff on the excellent Bluebook. It's always good, of course, but the provision of the extensive longer-term alternatives was very helpful. Before I turn to the longer-term ranges, let me say a few words about the alternative [strategies] that were set out in the Bluebook. As I look at those, the first two scenarios are the only ones that seem consistent with our policy of trying to push down inflation; the third does not really accomplish our objective. The first scenario seems to me to be representative of the policy of gradualism that we have been following. I certainly endorse that policy; it is a policy that we ought to continue. It is a policy that is very frustrating in the sense that it does not produce very quick results, but I think we need to accept that anyway. It seems to me that a more aggressive policy at this time really would jeopardize the achievement of our long-term goal of price stability. One could argue about the credibility associated with a more aggressive stance, but I'm not convinced that that's a practical solution. I think we ought to be very pleased essentially with where we are with respect to policy. We obviously would like to have had [better] results in terms of the inflation numbers, but that will come if we exercise patience. I think we've done very well considering the posture of fiscal policy over this time.

With that as a preamble on where I'm coming from, let me turn to the ranges. I would favor keeping the range for M2 at its present level of 3 to 7 percent for 1990. Tampering with it six months into the year would reflect a degree of precision that we don't really have. There's a lot of uncertainty surrounding M2, and I think that any potential shortfall for 1990 can be explained when you testify. Now, with respect to M2 for 1991, I realize that as a signal effect we've had a tradition of generally lowering the range to indicate our continued attention to inflation. But with all of the uncertainty surrounding velocity and the state of M2, I would leave that range alone. Also, we have projections from the staff that it may grow more quickly anyway. So, I don't think it would be good to change the M2 range either for this year or for 1991; I would keep it at 3 to 7 percent. I would keep the M3 range the same in 1990 as well. An argument can be made to reduce that range for 1991; but again, given all of the uncertainty surrounding the S&L situation and velocity and all the things that Don indicated, I think the argument is stronger for keeping the range for M3 the same. So, I would not change the ranges either in 1990 or 1991 for either M2 or M3; nor would I change debt.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. I concur, Mr. Chairman, with Bob Forrestal's statement about how useful these longer-run [Bluebook] simulations are because I like to look at monetary policy from a particularly long-run viewpoint. As I studied these, I found myself thinking about the Neal Resolution. If we can assume hypothetically--I'm sure it's purely hypothetical--that the Neal Resolution would pass Congress this year, we would be mandated to bring inflation down to zero by the year 1995, the last year shown in the simulations. Since we supported this resolution publicly in part of the testimony [presented by] many of us, the deceleration shown in the simulations in strategy II would seem to be the very least that we ought to be aiming for over the long run. Two percent is certainly not zero, but it's considerably closer than the 3-1/4 percent that we would have in the baseline simulation. And the simulations for strategy II do suggest that GNP growth would be very modest over this extended period of time in order to get inflation down to the 2 percent level over the five-year period. But as we are well aware, there are various kinds of models and the Board's model is not a particularly forward-looking model. I think one that took more consideration of the rational expectations [theory] might show that there would be a [higher] rate of real growth consistent with the progress against inflation that is shown in strategy II. In any case, the inflation rate in strategy II seems to me to be the minimum progress that would be consistent with our stated objectives. To help achieve this minimum progress--and I would hope we could do even better although I'm doubtful about that--I think we ought to reduce the ranges for M2 steadily over this entire period of time, with the goal of eventually bringing them down to 2-1/2 or 3 percent no later than 1995. I had this sort of thinking in mind when I argued--I felt very persuasively but later found out very unconvincingly--in February that we ought to go to 2-1/2 to 6-1/2 percent for 1990. So, I would like to see us do that, and we can explain it on the basis of its behavior. There is some risk, I suppose, that some might think that was a tightening move, which I would not consider it to be. In any event, I do feel very strongly, whatever we do with the 1990 ranges, that we ought to cut them for 1991--in the case of M2, to 2 to 6 percent. I think the adoption of such a range would send the public a pretty clear signal that we have a continued firm commitment to our anti-inflationary strategy. And it may be especially helpful to send this signal right now because of the recent fiscal developments and the likelihood that we're going to get added political pressure to ease policy aggressively if anything significant comes out of this. Now, if we did reduce the M2 ranges, it obviously makes sense to lower the M3 ranges too, although I really don't think that does a lot for us operationally. I'm pretty sympathetic to Governor Angell's suggestion that we eliminate M3. But I do think the staff produced a good memo that suggests that there is some marginal value in maintaining it.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Yes. Even though I proposed eliminating M3, and I hold that position as the proper policy, I do not believe this is the right time to make that move. I think it would signal something we don't want to signal or to deal with at this time. In regard to the 1990 ranges, I wish to reaffirm the ranges adopted previously. I believe it's better for us to look at the target ranges as targets that we're planning to hit, based upon the assumptions we had at the beginning of the year, and then explain why we didn't hit them than it is for us to move the targets to hit the growth path. So, I am not--and never have been before--very open to changing at mid-year. On the 1991 ranges, I agree with Bob Black that strategy II is the only alternative that's consistent with our stated objectives. Frankly, I wonder why I wasn't able to see a year ago that M2 growth might not be larger. But I really anticipated a somewhat weaker economy this year than we really ended up with, and my guess was that we might need the 3 to 7 percent for this year. But it seems to me that the behavior of households has changed and that many households, for example, find that they probably want to hold smaller balances and hold less non-tax-exempt interest-rate debt. And as the consumer saving rate has risen, that in a way brings with it a desire to hold a lower balance largely because of consumers' intolerance for debt, which I think finally has caught up. It does seem to me also that there may be other behavioral changes in people's willingness to hold M2. So I believe it's quite consistent to choose alternative I and alternative II and to choose for 1991 2 to 6 percent for M2. Now, I would also choose 2 to 6 percent for M3 on the basis that I have a commitment to only lower these ranges and never to raise them. And even though we may think that 0 to 4 percent makes sense for M3 for alternative II for 1991, I would hate to see us chase it down to that aberration and then end up moving it back. So, I prefer to leave the consistency of 2 to 6 percent for both M2 and M3. I recognize that there could be a scenario developed in which M2's growth path in 1991 might push the upper boundary of that 2 to 6 percent; that kind of risk is there. I'm very, very pleased, Mr. Chairman, that we've been able to get M2 growth down from those 9-1/2 percent [rates] that we had in 1985 and 1986 and to squeeze that M2 growth down without ever having the monetary shock that all of our critics thought we were producing. We're looking at four-year average growth of M2 of 5 percent, three-year average growth of M2 of 4-1/2 percent, two-year growth of M2 of about 4.2 percent, and one-year growth, I suppose, of less than 5 percent right now. So, we have the one-year, two-year, three-year, and four-year all there together and we're going to be able to get it to the 2 to 6 percent range without a monetary shock. It's just almost an ideal situation. On the debt, I'd use 5 to 9 percent.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Well, I agree with everything that President Forrestal, President Black, and Governor Angell have said. I think that we are just about where we want to be, perhaps in the aggregates as well as in the real economy. There is just an awful large number of unknowns out there with respect to the real economy, the behavior of velocity, and what is going on in financial markets. From a policy perspective, I come out with a somewhat different result, but it's largely a matter of how one presents these things. I agree that strategies I and II are the only relevant choices, given what we need to accomplish. This really is a matter of velocity. In terms of how one presents this in testimony to the [Congressional] Committees and how it's read in the broader financial public community, there is some value to indicating that we're willing to change targets as velocity changes and to indicating that these [ranges] do not have [the certainty] of a physical science by a long shot. It makes it easier when we do have a problem to have indicated beforehand that we made these adjustments because of changes in velocity. Generally I also think that we should try to have targets that are somewhere in the middle of the range that we adopt rather than going up [to Congress] and extensively explaining that we're not going to be in the range but that's because of all of these [reasons]. I can see arguments on both sides of that, but that would be my preference. Given that and given the slight change in or flat velocity between 1990 and 1991, I would be in favor of the staff's alternative shown on page 17 [of the Bluebook] for both 1990 and 1991. Because we would be making a substantial change this year, I think that would require a change next year given that we expect a more normal pattern of economic growth in relation to velocity. Having said that, I would not be uncomfortable with--but I'm very worried about how to fine tune this image for 1990--changing, say, to an M2 range of 2-1/2 to 6-1/2 percent and whatever corresponding M3 range would be involved and then going to these ranges for 1991. But just as a matter of presentation, I'd prefer that we go up [to Congress] now and explain that there have been these changes and explain what our longer-term expectations are and how the monetary targets have to be adjusted for changes in velocity. So, that's the direction I would take.

CHAIRMAN GREENSPAN. President Syron, what about debt?

MR. SYRON. On debt, I'm comfortable with 5 to 9 percent.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, according to our projections, the present 3 to 7 percent range seems likely to accommodate the uncertainty about M2 over the remainder of this year, although it's likely to end up toward the bottom part of that range. Therefore, I recommend that we reaffirm our M2 target for 1990. For 1991, at least based upon our projections, I would recommend a 1/2 point reduction in the M2 target, but I certainly wouldn't have any problem if we reduced it a full point to 2 to 6 percent. On the basis of our projections a [reduction of] 1/2 point would accommodate the growth of M2 that we would see and put M2 exactly in the middle [of that lower range]. With regard to M3, the special factors that we've seen probably will continue to depress M3 in the second half of the year. And, of course, that's going to place the aggregate well below the current range in December. But I prefer to retain the present M3 range for 1990 and just explain to the [Congressional] Committee that there are some very special factors--and uncertainty as to how long they're going to last as well--that may cause it to end up below the lower end. For 1991, I would suggest a reduction of 1 percentage point in the M3 range. Again, that would be consistent with the forecast of M3 that we have for 1991. I must admit, though, that the uncertainties associated with M3 are so great that my confidence in that range or the range that is in the alternative in the Bluebook is not very high. With regard to debt, 5 to 9 percent in 1990 and 4 to 8 percent in 1991 would be appropriate in my view.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Where I start on all this, Mr. Chairman, is with the M2 growth rates that Governor Angell enumerated. We are well into our fourth year of moderate growth in that aggregate and I think it's important that we sustain that kind of performance. It's important principally because that's what is going to get us to our long-run objectives and to the kind of overall economic performance that we want to achieve in the long run. So having said that, I think we should lower the ranges for 1991, consistent with the alternatives specified here. I would apply that to all the variables although, as I said before, M2 is the one that I at least focus on principally. I think it's important that we consolidate what we have accomplished over the past several years, and in my judgment that's the kind of range that will help us do that. With regard to 1990, the current year, I feel a little less strongly about what we ought to do with the ranges. Despite some of the mysteries surrounding what has happened to M2 [and M3] recently, it seems to me that we have enough information with regard to the thrift contraction and so forth that it probably does make sense to lower the ranges for 1990 as well. That's where I would come out with regard to that issue. As I think Don mentioned yesterday, and certainly we're all aware of it, if we were to get some meaningful budget package and a meaningful shift in fiscal policy--and that's a big "if"--we might want to reexamine all this. I certainly wouldn't prejudge where we would come out were that to happen; that's going to depend on an awful lot of things, including progress toward our objective and what's happening to market rates and bank offering rates, and the list goes on and on. So, at this point I think we just have to put that issue aside and be prepared to deal with it if and when it becomes appropriate.

CHAIRMAN GREENSPAN. So you would reaffirm the 1990 ranges?

MR. STERN. No, I would lower those because I think we have enough information to make the case that that's the sensible thing to do.

VICE CHAIRMAN CORRIGAN. So you'd have 2 to 6 percent in both years, then?

MR. STERN. Yes.

VICE CHAIRMAN CORRIGAN. What about M3?

MR. STERN. I'd lower that as well.

CHAIRMAN GREENSPAN. To the 0 to 4 percent?

MR. STERN. Yes.

CHAIRMAN GREENSPAN. I'd like to backtrack just a minute and re-ask the question that [Don Kohn] raised relative to this issue. Whether or not we can forecast quarter-by-quarter what the level of RTC resolutions will be, I feel uncomfortable arguing that the [anticipated trends of] the thrift changes alter our ranges. If in fact we knew about it and were able to make that judgment at the beginning of the year, then it can't be the thrift [developments] per se that create the [deviations from] our target.

MR. STERN. Well, I have two reactions. One is that I don't think we felt that we knew the magnitude of the thrift [effects] with any precision. But I don't think it's just the question of the thrifts. The year is half over, so in some sense we have the 3-1/2 percent or so growth of M2 behind us for six months. We're looking at relatively modest projections for M2 growth for the third quarter as well. Those may turn out to be wrong, admittedly; but if they are in the ballpark, we have pretty modest growth for about 3/4 of the year and that's a fair amount of information it seems to me.

CHAIRMAN GREENSPAN. Well, let me tell you the argument we would get up on the Hill. We're supposed to run monetary policy, at least in theory, on the basis of the targets that we set. If we set targets on the basis of the monetary policy that we run, they will argue that we have it backwards. Adjusting [the ranges] because of the fact that the money supply is veering off our targets is not an acceptable view up there. That's the reason I feel uncomfortable with this form of explanation. If there's a proved [or] partly anticipated structural change, then that's a valid statement. But I don't know how we can argue that because, in fact, the degree of [thrift] resolutions going on is not all that different from what we were telling the Congress they were going to be. It's just that the RTC didn't even do it for a while and finally they are trying to catch up at this particular stage.

MR. STERN. Well, I guess I can't judge the degree of precision with which Congress views this [target-setting]. I've always viewed it as clearly having a wide range of uncertainty.

CHAIRMAN GREENSPAN. Well, we can also raise some serious questions about the targets themselves; but I'm just talking about the issue of what's in the law and how we handle it. I hate to interrupt at this stage, but I need to ask the question of Don: How do we handle this?

MR. KOHN. Well, I can't tell you exactly what we were assuming for thrift resolutions in the face of the decline in thrift assets last February. I'm sure that the staff was not assuming as much as we got in the second quarter. But I think maybe the more fundamental point here is that, whatever our assumptions were, we have never tried to set monetary targets in a period in which the depository institutions system was shrinking the way it is now. This is unprecedented. I agree with your point and Governor Mullins' point that we knew something was going on; we knew things were going to happen. I hope I'm not being too defensive if I say that in this situation it's very difficult to judge how the whole thing is going to play out. One can easily get surprised and have it then seen as more of a velocity shift or a structural shift rather than a violation of the underlying policy. But there is some of the other too because we've had very weak bank credit growth; some of that may be a restraint on the economy, and one can't excuse that altogether. So, there is a mixture, I think, and it's not easy to sort out.

MR. PRELL. Mr. Chairman, if I can follow-up: In thinking back to where we were when putting together the flow-of-funds projection at the beginning of the year, our focus was very much on our view that the thrift industry was going to contract and that that would result in some disruption of the mortgage market. We were very much concerned about who would pick up the mortgages. We anticipated that banks would pick up many of the liabilities the thrifts were giving up. I think we were sort of right in our analysis of the mortgage market effects of the thrift institution change, but we didn't anticipate the weakening in bank credit. And at that time we didn't anticipate all of the hits on bank capital that would arise as real estate loans were recognized to be less valuable and as these other events occurred, especially in New England, that affected bank capital and the growth of bank assets. That was another surprise. So we've had some significant surprises relative to what we were thinking on the supply side of the credit market and at depository institutions in particular.

CHAIRMAN GREENSPAN. Let me play Senator Foghorn or whomever.

MS. SEGER. Is he in the Senate?

MR. ANGELL. I doubt you'd be very successful. "Fedspeak" is too much a part of you!

CHAIRMAN GREENSPAN. You're right. The argument will be made that that is precisely what the targets are for. In the event that the economy is weakening and money supply slows, the expectation up on the Hill is that the Fed would then ease to push them back [on track].

MR. PRELL. But the economy is roughly on the track that we charted at the beginning of the year. The central tendency of the forecasts at this point looks very similar to what we had, except that the inflation rate is a little higher. Debt is on target, around the middle of its range, and I think that's what we indicated. In a sense it's this depository element, which is so important for the monetary aggregates, that has been disturbed.

CHAIRMAN GREENSPAN. What you're saying is that it was mis-estimated with respect to things on which we had no historical experience?

MR. PRELL. Right, so I think there's a rationale--

CHAIRMAN GREENSPAN. Oh! Now, that's more like it. It's got to be something on which there was a judgment about how markets would behave under certain structural changes--not economic changes, not the business cycle. We took a shot at it; we didn't quite hit it; and we are readjusting. That's a credible argument.

MR. PRELL. Also, the Committee should have to decide what it is trying to communicate [via] the monetary aggregates. Are they closer to ultimate objectives for your purpose in policymaking or are they just instruments? In a sense it's as if you were shooting at the moon; you set your direction initially and then found you were off target. It seems to me completely reasonable to say you adjusted your instruments rather than shoot past the moon and then explain later why you missed. That may be an exaggeration of the differences here in the way one can view it, but I think you have to decide just how important the monetary aggregates are per se as a representation of your policy.

MR. HOSKINS. Don, I think you mentioned the other day that we did mid-year adjustments twice before. Do you remember in what kinds of circumstances and for what rationales?

MR. KOHN. Well, I think they were both M1 adjustments; the M1 ranges were increased [because] we had velocity surprises. They happened to be in the direction of increases rather than decreases.

MR. BLACK. Which were easy to explain to Congress at the time--

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. For 1990, I would keep M2 and debt the same, but I would make a technical adjustment on M3. The rationale for keeping M2 and debt the same is that we are fundamentally on target, that there are uncertainties, but the ranges that we have, with a 4-point spread, are wide enough to accommodate that. I think that conveys a message that we are fundamentally happy with the basic thrust of policy. M3 I would adjust technically, largely for the argument that was just given. We have a target for M3 that we almost surely cannot hit because we mis-estimated what it ought to be at the beginning of the year. We mis-estimated these deposit flows and I think we ought simply to face up to it and make that adjustment. So, I would go with a 0 to 4 percent range for M3 in 1990.

For 1991, I think it is important to continue on this longer-run track of lowering the aggregates, conveying the notion that we are serious about working inflation down. I would lower the ranges for M2 and debt by 1/2 percentage point so that we would end up with 2-1/2 to 6-1/2 percent for M2 and 4-1/2 to 8-1/2 percent for debt. I would keep M3 the same, 0 to 4 percent, on grounds that we made a technical adjustment now and we ought to wait and see whether that's accurate. If we have to adjust it again, we have to adjust it again.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I'd like to join those who start from the premise that strategy II on the long run--the one labeled "tighter" [in the Bluebook]--is consistent with our objective. I also would join those who have indicated that where we are today is about where we want to be and about where we had projected in the past. I think it's rather remarkable. With that background, I would prefer to take the opportunity that I think is now available to ratchet down M2, simply because over the long term 6 percent growth in M2 is the maximum growth that we can sustain and still achieve the objectives that we're looking for. As a result, I would ratchet down M2 by 1 percentage point on both the top and the bottom for both 1990 and 1991, simply taking advantage of the window that seems to me to be available. With regard to M3, there's some debate as to whether or not we should keep M3. There are those who have spoken on that in the past--particularly Governor Angell, who says that he would not pursue his feeling about doing away with M3. I would want to keep M3. But as has been indicated in the discussions before by the staff and others, it seems that M3 needs to be adjusted because of the uncertainties that have occurred. I don't like the proposal by the staff of a 0 to 4 percent range; I don't like the 0. As a result, I would like to see an adjustment to a 1 to 5 percent range for M3 and I would maintain debt at 5 to 9 percent. I would do both of those adjustments, to M2 and M3, now rather than later.

CHAIRMAN GREENSPAN. Debt?

MR. GUFFEY. Debt at 5 to 9 percent.

MR. ANGELL. Both years?

MR. GUFFEY. Both years.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, I'm persuaded that to go to strategy II may accelerate us a little toward that ditch I was talking about yesterday. So, I would rather stay with strategy I. Consistent with that, I would like to keep the range of 3 to 7 percent for M2 for 1990 but reduce it to 2-1/2 to 6-1/2 percent for 1991. I agree with President Boehne that we can make a rational and credible argument for a reduction in the M3 range and we should do it now. I don't get so disturbed by 0 because I don't consider it nothing; I just consider it [another] point on a range. So far as debt is concerned, the 5 to 9 percent for 1990 is acceptable, but I would move it down to 4-1/2 to 8-1/2 percent for 1991.

CHAIRMAN GREENSPAN. For M3 in 1991, 0 to 4 percent?

MR. LAWARE. Yes, sorry.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I have a couple of general thoughts on this. I would say first of all, in terms of long-run strategies, that I would be in favor of strategy II. Generally, I think there is a lot more informational value in the ranges if we gear them to what we believe long-term trends are. In other words, I get very concerned about [moving around] these ranges over time. Given where we are and where we're headed, there is very much the prospect of ratcheting these ranges down at some point to accommodate some short-term velocity development and then having to bump them back up. And I think that becomes very confusing. Personally, I like to think of these ranges much as Bob Black does--in terms of where we want them to be in a long-term sense--and I'd move them gradually toward that. I guess that view leads to two points: (1) with respect to problems in the current year, I would [allow actual growth outside] the ranges and explain that and not reset them; and (2) as to the future year, particularly with something like M3 which I think has limited value anyway, I would set a range that's reasonable in the context of what we think the long-term trends are, knowing full well that actual growth probably will miss it. I'd telegraph that right up front and indicate that we are going to be putting less weight on it for that reason.

The other point I would make is that while I'm in favor of strategy II, I don't think we have all that far to go. If you take the number Bob Black threw out--around 3 percent--as what we might want to get in terms of M2 growth, that would assume roughly 3 percent potential growth in the economy, with roughly 0 percent velocity. Taking that as the center point of the range, that means we have the potential of eventually getting down to 1 to 5 percent on the range. Therefore, we'd be taking a pretty big bite out of what we have left if we ratchet the ranges down a full percentage point right now. So, all of that put together would lead me simply to reaffirm the 1990 ranges. And in 1991, I would ratchet M2 down by 1/2 percentage point and, if it is in a longer-term sense consistent with that, do the same with M3 and debt. I look to the staff for guidance on that, but that's essentially where I am.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, Bob Forrestal summed it up well for me when he started us off this morning. I think our strategy is on track. There are good prospects that it will work acceptably and I think we have reason to be fairly pleased so far. And I would like to give that strategy every chance to work. I think that strategy definitely calls for an inflation result on the strategy II matrix, but I'm not quite sure what necessarily is going to be required in the way of aggregates growth to achieve that. As far as 1990 goes, I am definitely of the school of targeting and budgeting that would say we shouldn't shift in the middle of the game. If we are missing the targets, then we should explain why we are missing them but not shift the target at that point in time. So for that reason, I would reaffirm all the ranges for 1990 and, if we miss on M3, explain the technical reasons why that happened. For 1991 I would stay with 3 to 7 percent for M2 because, given where it is now and where it looks like it is going to be in the rest of 1990, I would not be comfortable with the prospect of having an even lower number, 2 percent, be in the range of acceptability. So, I would leave the target for M2 in 1991 at the 3 to 7 percent we presently have. I have been convinced by Don and others that the M3 realities have changed. As a consequence, for 1991 I would go to the 0 to 4 percent range because of those technical realities. On the debt side, I could be comfortable with either 4 to 8 or 5 to 9 percent.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, for reasons that I think are clear from the discussion, we are going through a period where the uncertainties are particularly high with regard to the aggregates. While it's clear we will be low in the range for M2 and below the range for M3, I think changing at this point implies a [degree of certainty] that we just don't have. Therefore, I'd be inclined to maintain the 1990 ranges as they are. In your testimony you can explain it. It does seem to me that the exchange that you had with

Mike and Don a moment ago begins to provide a good basis for reducing the ranges. First, Don's model and our models are not perfect; they certainly give as good an educated guess as we can come up with as to how things are going to work out. So, I do think there's a basis for lowering [the ranges]. Secondly, Don used the word "symbolism" in his text and I think that is important. In effect, it's why we should continue the program of lowering the ranges. So, I would lower the 1991 ranges. Specifically, for M2 I'd be a bit more comfortable with 2-1/2 to 6-1/2 percent. I don't feel strongly about it, but I have a minor preference there. I think we definitely should continue targeting M3. In a period of uncertainty, the more alternatives we have the better off we are; therefore, I'd continue M3. Somehow reducing it to 0 to 4 percent seems like a big drop; I have a minor preference for 1 to 5 percent. I don't feel very strongly about debt, but it does seem to me that the economy may begin to pick up next year as the forecast suggests that it might; therefore, I'd prefer to keep the debt range at 5 to 9 percent for next year.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Well, Mr. Chairman, I will have to confess that the arguments are very persuasive for leaving the ranges the way they are for 1990 or for changing them!

CHAIRMAN GREENSPAN. That's almost as good as your colleague across the way quoting that famous philosopher who said that 95 percent of the putts don't go in the hole!

MR. BOYKIN. Being forced to have to take some [position] here, I would lean a little toward the alternative of reducing [the ranges for] 1990, although I don't know how to sort through how to explain that and how it would be read. So, that's a slight but not a strong preference; I could certainly accept leaving the 1990 ranges the way they are. Now, I do have a little more definite feeling on 1991. Of course, I agree with continuing to indicate our long-term commitment toward reducing inflation. And I would favor 1991 ranges of 2 to 6 percent for M2, 0 to 4 percent for M3; and 4 to 8 percent for debt.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. I favor strategy II for the long term. I think that [presentation of alternative strategies] was nicely done. I think we ought to be comfortable, as many people around this table have already indicated, that we have made good progress toward that [objective], probably more than I thought we would early on. I agree with Tom Melzer's point that it is important not to bounce the ranges around. I would not want to see them have to be moved up because of suspected shifts in velocity. But that doesn't pose a particular problem for me since I wanted a 2 to 6 percent range [for M2] anyway. I have some concerns about the aggregates and about the point that Dave Mullins made--that they all are sending us the same signal and they are slowing rather dramatically. But since I was comfortable in February with 2 to 6 percent, I think we ought to go to 2 to 6 percent. There is a rationale to explain that: It is our best estimate of where we are at this point in time and I think Congress ought to have that information. I would accept all the other ranges--for M3 and debt--under the alternative for 1990.

CHAIRMAN GREENSPAN. That is, 2 to 6 percent on M2, 0 to 4 percent on M3, and 5 to 9 percent on debt?

MR. HOSKINS. Yes.

CHAIRMAN GREENSPAN. Both 1990 and 1991?

MR. HOSKINS. Yes.

MR. ANGELL. You want 4 to 8 percent for 1991?

MR. HOSKINS. The 1991 alternative as listed by the staff [in the Bluebook].

CHAIRMAN GREENSPAN. 5 to 9 percent.

MR. ANGELL. Well, for 1991 it's 4 to 8 percent.

MR. HOSKINS. It's 4 to 8 percent for 1991.

CHAIRMAN GREENSPAN. Let me get this straight.

MR. HOSKINS. I want the staff's alternatives both for 1990 and 1991.

CHAIRMAN GREENSPAN. Okay. It's 2 to 6, 0 to 4, and 5 to 9 percent for both 1990 and 1991.

MR. HOSKINS. No, it's 4 to 8 percent [for debt] for 1991.

CHAIRMAN GREENSPAN. Well, something I'm looking at has a mistake on it. Governor Seger.

MS. SEGER. Well, like everybody else here, I think it's great to be a long-range thinker and strategist. I'm also looking backward 6 years to the first Humphrey-Hawkins meeting I attended in 1984. Just to remind you folks, we had an M2 range of 6 to 9 percent and we have brought it down to 3 to 7 percent, which is quite a significant change. The actual M2 growth ran 7.7 percent for 1984 and we are estimating it at around 3-1/2 percent this year. I think that's very significant. Also, these ranges have been moved down very consistently; we haven't had them popping around like popcorn, and I think that's good also. On M3 we went from a 6 to 9 percent range down to where we are now, 2-1/2 to 6-1/2 percent, and the actual growth went from 10-1/2 percent down to an estimated 1.1 percent this year. I'm just mentioning this because there has been a very significant amount of squeezing out of liquidity in the economy over that period. So, having pointed that out and looking ahead with respect to the strategies, I'm a baseline strategy supporter. With all due respect to the forecasters, I'm just not convinced, looking out 5 years at the additional inflation relief we would get from going the tighter route, that it's worth taking a chance on. I realize that's a value judgment; but it's the way I feel. I'm also not convinced that tightening policy will generate greater growth out in 1995. So, I would go with strategy I.

In terms of the ranges for 1990, I've never supported changing the ranges in the middle of the year; I just don't think it's a good idea. I believe that these ought to be set with some idea of stability and [we should] just keep moving them downward; we can pause [in implementing the] decline, but I just think it's very disruptive to have too much volatility in the ranges themselves. So, I would be for keeping the ranges where there are, including the M3 range of 2-1/2 to 6-1/2 percent. And instead of just dismissing this [shortfall] as a technicality because of RTC activities, I think a big part of the credit crunch story is in here. Maybe we ought to look at this and ask ourselves whether we should be satisfied with a 1 percent increase in M3 for 1990. If many people up on the Hill are continuing to get letters from their unhappy constituents, they might be asking that same question or a similar one. So, I would support keeping the same ranges for this year that we established earlier. And for 1991, I also would keep the same ranges for the main reason that we have another crack at these in February. There are a lot of uncertainties about velocity and the economy in general--the RTC activities and a whole lot of other things. Therefore, there's something to be said for hanging in there with the existing ranges and then, with six months' additional information and knowledge, if we're off we can adjust them at the next Humphrey-Hawkins meeting. Thank you.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Let me make a general comment first, and that is that I cannot quite shake the feeling that there may be something going on here that's a little more real. Even all the discussion about the RTC represents something very real; and what it represents is that in the prior period there was a heck of a lot of bad debt created in the financial system. So, it's not just a kind of accounting change. What I keep toying with in my mind is that there is perhaps a small possibility that we are going through a phase here where this retrenchment of the financial system, as symbolized by the RTC and the slow growth of bank credit and the slowdown of overall debt, is something quite real and something that need not even be transitory. If you look at the great bulk of experience over recent years, we have had this very substantial disconnection, for example, between the growth of debt in the economy and the growth of GNP. And it turns out that a lot of that disconnection reflects the fact that a lot of that debt was bad debt. It's now showing up as RTC and bank write-offs and junk bond write-offs, etc. So, there may be something here that goes beyond the so-called transitory factors.

I tend to take a rather eclectic view of all these Ms, but I am struck that even Mr. Kohn can't explain, no matter how hard he tries, a sizable part of the shortfall in M2 in the second quarter. So, again, I'm not quite sure that we fully grasp, or at least that I fully grasp, all that's going on here in these relationships. For that reason I think we do have to be a bit more cautious about the interpretations that we put on these things.

Now, with that general point in mind, Mr. Chairman, for 1990 I would keep M2 where it is at 3 to 7 percent and keep debt where it is at 5 to 9 percent. For 1991, I'd be thinking in terms of 2-1/2 to 6-1/2 percent for M2 and 4-1/2 to 8-1/2 percent for debt. For M3, I'm quite prepared to let you do whatever you feel most comfortable doing. But even in the framework of letting you do whatever you feel most comfortable doing, it's possible that a compromise--in the interest of cohesion in the Committee--might be to put it at 1 to 5 percent for both years. But I have no strong feeling on that at all; I'm quite prepared to let you explain it because basically you've got to explain it one way or another. Either you have to explain why we changed it or you have to explain why we didn't change it. And I would leave that to you.

CHAIRMAN GREENSPAN. Thank you. Governor Mullins.

MR. MULLINS. My preference would be to leave the 1990 ranges essentially the same. I don't like the perception of moving the targets to fit the data; I think monetary aggregates are pretty important and not just instruments. It also bothers me--the point that the Vice Chairman made--that there's an unexplained component of this. If we really could explain it as just a portfolio shift from one part to another part, I'd feel a little more comfortable with it. I think we ought to have the burden of explaining what's going on, and I generally agree with Tom's point that we ought to set ranges based upon long-term factors and have the discipline put on us of explaining aberrations rather than shift the ranges to try to fit the aberrations. So, for 1990, I would keep the same ranges.

On 1991, again, I don't like the idea of moving the targets around. I am concerned with lowering the tentative targets for 1991 in the current environment of fiscal uncertainty as well as the uncertainty of what really is happening to the monetary aggregates. The way I would view the [appropriate] stance for monetary policy, I would hate for us to come back and tentatively have to move the ranges in the opposite direction. Also, I agree with Governor Kelly on M2; I'm not entirely comfortable with the notion that 2 percent would be acceptable. So, I would prefer that the M2 range for 1991 be kept at 3 to 7 percent, although to be honest with you--maybe because I'm new on the Board and I have less courage than the old warriors--I wouldn't be uncomfortable moving it down 1/2 percentage point. On M3, I still would prefer to try to have a range that is more consistent with what we expect it to be over the longer term. I think the RTC is going to go in fits and starts. When the new guy gets in there, I wouldn't be surprised to see a period of time in which there is not a lot of action--a period in which they gear up and change strategies. So, I would prefer not moving that range to 0 to 4 percent, but keeping it at more the long-term average range. I wouldn't fight keeping it where it is, but I would feel comfortable with 2 to 6 percent, which would require the Chairman to explain the deviations in 1991 as well. For debt I think 5 to 9 percent would be fine and I could [accept] a 4-1/2 to 8-1/2 percent range as well. So, my general stance is that we ought to stick with the targets, especially as long as there is uncertainty. If there were no unexplained component, then I would feel much better about shifting the targets. I guess I'm a little more cautious about 1991, given the current stance. If we move the ranges down, [we might] then find ourselves in a position of having to consider a move back.

CHAIRMAN GREENSPAN. Thank you. I have here in front of me a set of numbers [on the members' preferences], which led me to ask whether the coffee was ready. But frankly, whether it is or not, we will have a short recess.

[Coffee break]

CHAIRMAN GREENSPAN. Our abacuses evolved the following results, which I will eventually put to an official vote: There is for 1990 an overwhelming balance [of preferences] for no change for the M2 range; a marginal [preference to] shift toward 0 to 4 percent for M3; and overwhelming, if not unanimous, support for keeping debt unchanged. For 1991, it's not that we're all over the place; we are close. I inferred with great insight, because that's what it required, that the mode or mean was something resembling 2-1/2 to 6-1/2 percent for M2. The predominance of 0 to 4 percent for M3 in 1991 was rather large, and for debt it looks to be 4-1/2 to 8-1/2 percent. So, what I shall do is to call for two votes, one for 1990 and one for 1991.

MR. KOHN. Mr. Chairman, there is language in the Bluebook suggested, if the Committee did decide to reduce the 1990 range for M3 and wanted to consider special language.

CHAIRMAN GREENSPAN. Well, Norm, why don't you read it?

MR. BERNARD. I'm reading from page 4 starting with line 72 if you're using the draft directive; if you're using the Bluebook it's page 27, paragraph 29. "In furtherance of these objectives the Committee reaffirmed at this meeting the range it had established in February for M2 growth of 3 to 7 percent, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The Committee also retained the monitoring range of 5 to 9 percent for the year that it had set for growth of total domestic nonfinancial debt. With regard to M3, the Committee recognized that the ongoing restructuring of thrift depository institutions had depressed its growth relative to spending and total credit, though to an uncertain extent. Taking account of the outlook for unusually strong M3 velocity, the Committee decided to reduce the 1990 range to 0 to 4 percent."

MR. ANGELL. Mr. Chairman, since the other items seem to be compromises, I wonder why there isn't room for a compromise on M3, as the Vice Chairman of the Committee suggested. That is, the 1 to 5 percent range does accommodate what we expect to happen in 1990, I think, and it increases the odds for those of us who do not want to vote for an increase in the range to have a better chance of not having to do so. You did not have a majority vote, as I counted, on the 0 to 4 percent.

CHAIRMAN GREENSPAN. That's correct; it was a very close showing.

MR. ANGELL. So, I'm just wondering why we couldn't take the compromise between those of us who are for 2 to 6 percent and those who are for 0 to 4 percent and come out with 1 to 5 percent.

MR. KELLEY. If that is a substitute motion, I will second it.

CHAIRMAN GREENSPAN. I was about to suggest that we do this officially. I will read it as 0 to 4 percent; you propose an amendment to raise it to 1 to 5 percent and we'll vote on that particular amendment. You may well be right that there is support for that. I was puzzled a little about the reasons that we had discussed earlier about the restructuring of the thrift depository institutions.

[I'd suggest adding] "more than anticipated" to the phrase "depressed its growth relative to spending and total credit."

MR. ANGELL. Well, getting into this is a kind of trap. I just think that this will pose a problem for you when you start using that language up on the Hill. I think your suggestion is a great idea.

CHAIRMAN GREENSPAN. Unless the Committee votes for no change, we have to use some language and this is the least--

MR. ANGELL. I'd use the least language possible.

CHAIRMAN GREENSPAN. Frankly, I don't think that this is where our problem lies. Would the Secretary read the sentence with the revision in question put into it?

MR. BERNARD. "With regard to M3, the Committee recognized that the ongoing restructuring of thrift depository institutions had depressed its growth relative to spending and total credit more than anticipated, though to an uncertain extent."

MR. PRELL. Do you want to put "though still to an uncertain extent?"

MR. ANGELL. No, take it out.

MR. KELLEY. It doesn't ring right.

CHAIRMAN GREENSPAN. I think not; take it out.

MR. ANGELL. I'd say "more than anticipated" period.

MR. KOHN. And maybe then just say "taking account of the unusually strong M3 velocity" instead of "the outlook for".

CHAIRMAN GREENSPAN. Taking account of what?

MR. KOHN. Just take out "the outlook for" there since you already would have said it's more than anticipated; so you're saying it's unusually strong.

MR. PRELL. You could make it "unexpectedly strong" if you want to reinforce your earlier thought.

CHAIRMAN GREENSPAN. Okay, use "taking account of the unexpectedly strong." Would somebody like to move that paragraph?

SPEAKER(?). Sure.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

MR. ANGELL. Now, Mr. Chairman, I presume that has the 0 to 4 percent range for [M3]?

CHAIRMAN GREENSPAN. That's correct.

MR. ANGELL. Mr. Chairman, I move to substitute 1 to 5 percent for 0 to 4 percent in paragraph 29.

CHAIRMAN GREENSPAN. Is there a second? Let's vote on that.

MR. BERNARD. You're voting on the 1 to 5 percent?

CHAIRMAN GREENSPAN. Yes, I assume there's no discussion.

MR. KOHN. You could take a straw vote, Mr. Chairman; that way we wouldn't have to record it.

MR. ANGELL. Then we won't have to record it. I don't think this is the kind of vote that we would want to record.

CHAIRMAN GREENSPAN. Well, let me put it this way: All those in favor of 1 to 5 percent instead of 0 to 4 percent raise your hand. Opposed? The ayes have it; the amendment carries. We will now move to a vote on the paragraph itself.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Boehne	Yes
President Boykin	Yes
President Hoskins	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Mullins	Yes
Governor Seger	No
President Stern	Yes

CHAIRMAN GREENSPAN. Okay, we'll now move to 1991. As I indicated to you before, we have 2-1/2 to 6-1/2 percent for M2; 0 to 4 percent for M3, which is consistent with 1 to 5 percent; and 4-1/2 to 8-1/2 percent for debt. Why don't you read the paragraph itself?

MR. BERNARD. I'm reading from line 63 if you're using the draft directive or from the top of page 27 [in the Bluebook], about 4 lines down, starting with "For 1991." "For 1991 the Committee agreed on provisional ranges for monetary growth, measured from the fourth quarter of 1990 to the fourth quarter of 1991, of 2-1/2 to 6-1/2 percent for M2 and--" Is it 1 to 5 percent instead of 0 to 4 percent?

CHAIRMAN GREENSPAN. No, it's still 0 to 4 percent. If somebody wants to propose an amendment, they can.

MR. BERNARD. --"and 0 to 4 percent for M3. The Committee tentatively set the associated monitoring range for growth of total domestic nonfinancial debt at 4-1/2 to 8-1/2 percent for 1991."

MR. ANGELL. Mr. Chairman, I would move to amend the 0 to 4 percent on M3 to read 1 to 5 percent.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. There is a second. All in favor raise your hand. One, two, three, four. five. Opposed? One, two, three, four. I'm sorry, it's five.

MR. ANGELL. Four.

SPEAKER(?). You have 9 voters in here.

CHAIRMAN GREENSPAN. I will then move my vote to 1 to 5 percent and let it carry.

MR. LAWARE. What was the vote?

MS. SEGER. Five to five.

MR. ANGELL. Five to five.

CHAIRMAN GREENSPAN. Who's missing?

SPEAKER(?). Governor Johnson is absent.

SPEAKER(?). President Corrigan didn't vote.

CHAIRMAN GREENSPAN. Let us now vote on the paragraph for 1991, with 1 to 5 percent for the M3 range.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Boehne	Yes
President Boykin	Yes
President Hoskins	Yes
Governor Kelley	Yes
Governor LaWare	No
Governor Mullins	Yes
Governor Seger	No
President Stern	Yes

CHAIRMAN GREENSPAN. Okay, we now move to our regular short-term monetary targets. Don Kohn.

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

CHAIRMAN GREENSPAN. Questions for Don? If not, why don't I get started then on the Committee's [unintelligible]. The same forces that I discussed at the last meeting are still operative but, as best I can judge, they turned up a notch. I think we are observing the unwinding from several years of excess credit expansion relative to the economy. One can see that in virtually all the aggregates for the money supply, obviously, and just as importantly in a wide variety of other sub-elements within the flow-of-funds [accounts]. As you may recall, they exhibited some fairly significant credit acceleration, in part as a result of real estate appreciation, mergers and acquisitions, LBOs, and some overall degree of exuberance in the middle 1980s, which I think carried forward and is now gradually unwinding. I think what we are looking at is a credit slowing in which in large measure we're going back to historical relationships. And the only question that we really have to focus upon is whether in the process the contraction is overdone, which of course is what one normally would expect whenever one gets these types of adjustments. In any event, I think we're seeing the credit slowing interacting with the hard asset balance sheet items--that is, the stock adjustment processes--which I believe I mentioned at the last meeting. Motor vehicles--which had a long run with the number of cars on the road [increasing] as the number of two- and three-car families [rose]--and a variety of other elements all were above trend and then ran into a stone wall in 1989. We're looking at that sort of adjustment. We're obviously seeing the same problem in a more extravagant way in the commercial real estate markets with the vacancies involved; we're also getting some of the problems in residential real estate, though it's obviously far less of a problem than in commercial real estate. There is some slowing in the rate of increase in equipment stock as well.

As I indicated last time and would reiterate today, I think the reason why that process, which I believe historically would almost always have dumped us into a recession, failed to do so was because the inventory management change has created a much less volatile inventory investment pattern and essentially removed a major factor that tends to tilt the economy over into recession. In the very near term there's little evidence that I can see to suggest that in fact the economy is tilting over. The motor vehicle assemblies and the extraordinary electric utility output because of weather clearly suggest that there is some temporary uptick--perhaps a small one--in the June industrial production index. But from what everyone can see in there, one must conclude that it is probably temporary because there's really no other evidence of an acceleration taking place. While orders are holding up--or perhaps stated more appropriately they have stabilized [after] their decline--and we have some positive signs from the NAPM survey the other day, backlogs are stagnant; and some surveys suggest they may even be softening slightly.

On top of all this, there's at least a better case to be made at this point that inflationary pressures are cresting. The wage data are no longer carrying through with evidence of an acceleration. An experimental unit cost analysis of manufacturing, which the staff has been working on, had earlier indicated underlying cyclically adjusted unit costs actually rising. In effect, one way of looking at it was that with price inflation steady while profit margins were going down more than cyclically, the adjusted cost elements clearly were rising. That too now seems to have stabilized; but I would not want to put too much emphasis on those data because they do kick around a good deal. But at least they are no longer signalling a firmer inflationary tone.

In any event, in this particular economic context I would say that it would be inappropriate for the money markets to be tightening either on their own or through Federal Reserve action. While the evidence here is clearly difficult to come by, it strikes me that it is becoming increasingly evident both from fragmentary data and anecdotal reports, as well as history I guess, that the money markets at the current funds rate are actually tightening. We are seeing up through May, the last survey period, some marginal evidence of an increase in some loan rates and an opening up of the spread of loan rates against the funds rate. My suspicion, however, is that when the data come out for the current period--I don't know when that will be but it's a number of weeks away--what we are picking up anecdotally has to show through in some evidence that there has been some pulling back. By pulling back, I mean essentially that commercial banks are concerned about their capital positions and are doing some form of marginal credit rationing. I think the anecdotal evidence has reached a point at this stage that it is extremely unlikely to be without any basis whatever. To be sure, when one goes from excess credit extension to normal, it feels as though it's a tightening; and that, I would expect, is unquestionably the vast majority of what this credit crunch is all about. But I would suspect that there is a little more to this. The particular statistic that bothers me the most as a consequence of all this is the unexplained part of M2, which has clearly sneaked down into a no change range. According to what Don was saying, it's holding--I would say has settled--several percentage points under where all the other factors that we're looking at would suggest is likely. So, this is obviously not a definitive case where one would say that there's clear evidence that this credit rationing is going on. I don't think we ever get that evidence except six years after the fact. But from what I can gather and from the contacts I have I would say that at this stage the odds that we are not seeing some actual money market tightening are very slim indeed. Put another way, the funds market is trying to ease and we are essentially holding it in check.

Our job is really not so much to focus on trying to fine tune the economy; we can't do it. All that we can do is get ourselves involved with money supply, credit, and financial systems; and as I read the data at this particular stage I would say that we probably have been sitting here with an inadvertent minor tightening, which I think would be appropriate if the economy were showing some significant signs of firming. But at the moment the evidence of that is really quite remote. As a consequence, I would be inclined to go with an unchanged directive, asymmetrical toward ease, but with the expectation that unless a firmer tone in the financial aggregates--and indirectly in the economy--began to exhibit itself fairly soon that it would call for a small, 25 basis point, decline in the funds rate. So, I would like to put that somewhat complex issue on the table and would be most interested in the responses I get to it.

MR. SYRON. A technical question, Mr. Chairman. Are you suggesting a 25 basis point cut anticipating we will have a conference call or are we voting for that now essentially unless there's a--

CHAIRMAN GREENSPAN. I would say voting now. My view is that a conference call shouldn't be necessary. In other words, we've discussed at great length the types of things we're looking at, and unless something unusual happens of a nature that always indicates the need for a conference call, I don't think that I could convey very much more. Governor LaWare.

MR. LAWARE. I'm encouraged that my economic education seems to be going along in pretty good style because you have expressed exactly the thoughts that I had intended to express. I strongly endorse "B" with an asymmetric tilt toward ease.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. I will second Governor LaWare's remarks.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, I'm basically in the same place. I came to the meeting thinking that there were three choices available to the Committee. One was an asymmetric plain vanilla kind of directive; the second was a strongly asymmetric directive, which is what I think your suggestion amounts to; and the third was even the possibility of easing right now. My own strong position was the second of those choices, the strongly asymmetric directive, so I support completely your proposition.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. I support your proposition, Mr. Chairman. I have a technical question: I'm not quite clear in my mind what data you would be looking at to trigger the 25 basis point cut.

CHAIRMAN GREENSPAN. Basically the data that are coming out at the end of this week--including average hourly earnings, which is not a minor player as far as I'm concerned. Also, the money supply data early next week and--

MR. FORRESTAL. The employment number.

CHAIRMAN GREENSPAN. --the employment figure on Friday.

MR. FORRESTAL. So, you're looking at a fairly near-term adjustment?

CHAIRMAN GREENSPAN. Yes, I would say within the next week to 10 days. President Parry.

MR. PARRY. Mr. Chairman, I would favor alternative "B." However, since I think there is a good chance that economic growth will be faster in the second half than in the first half, I would prefer symmetrical language.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Where I stumble a bit with your suggestion is with the automaticity of the move. I too have a great deal of interest not only in the upcoming data but in how the economy is likely to perform over the next several months given the situation as it has changed with regard to consumer spending and whatever wealth effects we may get out of housing. I must admit to a lot of uncertainty as to how that's all going to play out. I'm a little concerned by the asymmetric directive with the automaticity of moving on the basis of another week or two weeks' worth of data; that gives me some pause.

CHAIRMAN GREENSPAN. Obviously, if there is evidence of firmness in the data, that would suggest to us that the money supply data are not as terribly [weak] as we think. I would say the money supply data are really the crucial data as far as I'm concerned, because we're getting to the point where what we affect essentially is the credit system. And to the extent that the credit system is contracting--and it is showing as far as I can see <u>no</u> signs of stabilizing--it means that the process is still going on. And if it is, what I'm arguing for is not an easing. I'm arguing for [unintelligible] holding. The question, therefore, is basically: Do we want to be tightening in this particular context? I would say only if there is evidence that the economy is picking up, and I must tell you that at the moment I don't see a single statistic out there suggestive of such an acceleration. That's [unintelligible] basically. Obviously, we could wait for three weeks, two months, whatever. It may--

MR. STERN. I don't disagree with your interpretation of the latest data at all. It's just that I've watched these data bounce around an awful lot.

CHAIRMAN GREENSPAN. Well, so have I. And this is the first time in six months that I have nudged off the middle because I was unconvinced by all of this evidence until now. And it's not economic weakness; it's credit. I'm sorry, I interrupted you.

MR. STERN. No, actually, I had concluded what I was going to say. You've elaborated your views on how you see this. And, as I said before, my concern was with the automaticity of the move not with the asymmetric language on "B".

CHAIRMAN GREENSPAN. Well, there's no such thing as an automatic move.

MR. STERN. No, I would say I'm somewhat comforted by your comments.

VICE CHAIRMAN CORRIGAN. It's an asymmetric comfort then.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Well, I appreciate what President Stern has said. It really is a very important difference for me, Mr. Chairman, because I do want to vote with you on this. I would admit that I'm not able to discern so accurately the need to stay symmetric versus the possibility that incoming data will tell us that we need to ease. I would prefer symmetric language but I can compromise away from that if we are going to be looking at the data and, if the data coming in say that we ought to subsequently make a decision to ease, I can go with that. But I cannot go with the notion here that we really are going to ease, because if we really are going to ease, we might as well do it now and then those of us who are going to vote "no" can vote "no." And I will just vote "no."

CHAIRMAN GREENSPAN. I think that's a correct [interpretation of the] difference. It's [essentially] why we raise the issue of automatic; if it's automatic, then it can't be asymmetric.

MR. ANGELL. So, I suggest that we not put into "Fedspeak" all this new language that the Vice Chairman is about to introduce in regard to super ease. I really don't think we need to fine tune our language. My understanding, based upon what you said, is that we're going to be recommending that we have no change in policy, alternative "B," which I can support with the "mights" tilted [toward ease]. I can go with that. I don't want to make too much over little differences, but I do believe strongly that we have reached a point where we're just about to succeed in something that we've been trying to get done. You put it so well last year when you talked about the view that we have to err on the side of restraint. All of us know that there is risk in doing that. I want to continue to err on the side of restraint, but I definitely do not want to get this economy into recession. I want us to reap the fruits of what we're about to [achieve], and I think the sooner we move the more likely the bond markets are to misinterpret and say that the Fed really gave up before we were there. I think the whole [issue] is that attitudes concerning inflation are at a very delicate point. I noted in the staff's laying out of strategy II on the long-run model, that in 1995 that results in the highest real GNP growth of any of the alternatives. Now, I just think it happens faster. I think the whole monetary world works faster than it ever worked before. And if we really stand here and are prepared to do what needs to be done, I believe we'll get lower long-term interest rates. Frankly, one reason that we got into slow money growth is because we lowered the fed funds rate in December, ran the long bond rates up 70-80 basis points, and the opportunity cost [of] the M2 balances has [risen] so that the shortfall of our aggregates is due entirely to our premature ease in December.

CHAIRMAN GREENSPAN. I don't think that's correct.

MR. ANGELL. Well, I do.

CHAIRMAN GREENSPAN. Well, that's your evaluation. I think--

MR. ANGELL. Well, you see, what has happened is that the opportunity cost on the M2 balances has changed and then you get the lagged effect of that change from March and you get low growth of M2 in May. My view is that we need the lowest long-term interest rates we can get for the second half of 1990. And I happen to think that being patient here for a [while] will get us lower rates than we will get if we jump the gun on easing.

CHAIRMAN GREENSPAN. The difference, Wayne, is that I think we're closer to having success here than you think.

MR. ANGELL. Well, I think we're closer in that respect too.

CHAIRMAN GREENSPAN. I think we're very close. If I believed otherwise, I wouldn't be arguing for the type of asymmetry that we're talking about.

MR. ANGELL. I'm somewhat impatient for patience.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I'd be in favor of alternative "B" with the current asymmetric language, and I'm entirely comfortable with the explanation that you gave Bob Forrestal on what would trip using the asymmetric language. Perhaps I have a slightly more positive outlook on the economy than some, and perhaps more so than you, but I think it's awfully important that we provide an environment in which we can continue to have these kinds of results. It does seem to me that the move that you suggest will give us that.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. Obviously, you know that I'm in favor of easing. I'm just sitting here trying to decide what we gain by doing it in a couple of weeks rather than now. I'm thinking about the lags that I thought I had been taught about by Don Kohn and his pals. Whatever we do today or in two weeks or three weeks is going to impact the economy some time in the future, not immediately. The way I read the economy, I'm not sure we have until Christmas Eve or New Year's Eve to have some stimulus actually being felt. The employment numbers are not my favorite numbers, but I do read them. As I remember, in the April and May statistics the whole show was the hiring of temporary workers by the Census Department. And from what I've seen previewed, those folks are leaving; a lot of them--something like 160,000--left in June. That number came from Barbara Bryant who heads the Census; it isn't something I just threw out. That's going to have an impact on the employment numbers again and not a very good impact. Some more of these folks are going to be turned out on the street in July. So, I think we're going to get some weaker employment numbers as we go along here. Also, I read the retail sales numbers as weak. I don't think we have had three months in a row [of weak data] that have been flukes or aberrations; I think there's something going on there. I hate to repeat myself unnecessarily, but I believe that this so-called credit crunch has had a big impact on construction in many parts of the country; it's worse certainly in some parts than in others, but it's not confined to New England or Arizona. And I don't think that is over as an influence. I also believe that lower interest rates amazingly would help the strength of the financial system; it would provide some of the marginal institutions a better chance to make it because it would allow them to get a lower cost of funds rather promptly and improve their margins. And I think we need to do that very swiftly. I would argue that lower interest rates would help even on the liquidation of the S&Ls by the RTC. So, I certainly agree with your notion of some ease, but if I wanted to split hairs--which I won't do; I will support your position--I would feel more comfortable doing it sooner rather than later.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I think the last several years of monetary policy have been some of our very finest; I wouldn't go back and change any vote that I've cast during that time. It has been many years since I went through an entire session without dissenting in favor of tighter money. I started off thinking about the short-run objectives with exactly what you had in mind: an asymmetrical directive because of this apparent softness in the economy and the slow growth in the aggregates. Then I started looking at the economy a little more closely and I read Don's and his associates' memo. And when I looked at the economy, I couldn't see what it was that was going to make us turn down; and his memo on the behavior of the aggregates gave me a good deal of comfort. So, I became somewhat uncomfortable with the asymmetrical part of it, since I think our objective is price stability and we're going to have to take some responsible risks on the side of restraint if we're going to get there. I came out with alternative B, but I favor symmetry. I certainly wouldn't dissent on this, but I do think that in general it's better to have a symmetrical directive because that suggests we are able to go either way. I think that would give sufficient leeway to do exactly what you have in mind. I don't have any great problem with asymmetry, but I have a slight preference, as I think Governor Angell has also, for symmetrical language. But I think you're very close to where we ought to be on this. You made a good statement; I found particularly helpful your analysis of the current conditions, and I take some comfort in your view of inventories. I share that feeling. I don't know what's going to make us turn down. So, if I voted, I would go with symmetrical but not dissent on asymmetrical.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. This may be hair-splitting a bit, but my preference would be "B" with a symmetric directive. I don't see that there is accumulating evidence of a tightening of credit markets. As a result, a symmetric directive--to the extent that it will be read six weeks from now as a sort of "steady-as-you-go" policy--seems to me to be a reasonable outcome [of our meeting]. On the other hand, if I have understood the discussions around this table in the past, particularly as articulated by Don, with a symmetric directive you have the ability to take one cut--if you will, a quarter point [on the funds rate], which is what we are talking about--without the necessity of a conference call or consultation. As a result, it seems to me that "B" with a symmetric directive gives you what you want and I wouldn't object to that.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. "B" asymmetric. I'll skip the subtleties.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I'd favor "B" symmetric but I could certainly accept "B" asymmetric as you specified it.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. "B." I have a marginal preference for symmetric but I can certainly accept asymmetric. I do have some of the concerns that Gary Stern expressed on the automaticity of the approach, but I am comforted by your explanation. I think it's important to have in the Humphrey-Hawkins testimony an indication that we are not trying to lead the market down, but that we are not effectively trying to ease policy--that there has been some tightening in policy not at our volition and that we see this as bringing policy back more to where we get the [unintelligible] rather than the other way around. I think that's actually quite an important distinction.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. In my view, the economy has been weaker than [the staff has] projected and I haven't felt especially comfortable with the low growth in the aggregates. I have been concerned, given the notion of the low growth and the credit crunch, that we might be implicitly tighter than what the Committee had committed to earlier. To believe differently is to put a lot of faith in adjustments and still accept an unexplained error. I don't believe that a tighter stance at this time is warranted. And I wonder whether a marginally lower funds rate wouldn't be consistent with maintaining the stance of monetary policy voted on earlier this year. The advantage of this approach is more discretion, more time to adjust to the new data; and it has less automaticity than the approach of easing directly. I think Dick's point is extremely important because that's exactly the way I view it--that we essentially are maintaining the intended moderately restrictive monetary conditions and, when there's unintended tightening out there, we're simply not easing but moving back to that position. So, I would wholeheartedly support "B" with asymmetry toward easing or returning to the [degree of] restraint that we intended earlier.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Mr. Chairman, I would favor alternative "B." Coming into the meeting I had felt that symmetric language would be preferable. However, the explanation that you gave would cause me to accept asymmetric language. But I do want to say that I agree with about 85 percent of what you said, Governor Angell. I share a lot of sympathy for not letting go prematurely just as we're about there. I don't know what the next week or week and a half is going to show, but I have a slight uneasiness in the sense that it's almost preordained that there's going to be a downward move shortly. That may be necessary and it may be what's called for; I just can't read that. But I would accept asymmetry.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. Mr. Chairman, as someone who has worried consistently about the growth rates in the aggregates, I find myself in one sense pleasantly surprised that the aggregates are at about the growth rates that I thought were appropriate for the year. Unfortunately, I'm uncomfortable with how we got there. I think your explanation may well have some merit for pegging the funds rate [when] the economy is weak. We're not running monetary policy by supplying reserves; we're running it through interest rates. Having said all that, and given the staff's forecast of where we're likely to be, I'm equally uncomfortable with the velocity projections. So, that leaves me in a position of great uncertainty. And in that position, I'd be more comfortable with "B" symmetric.

CHAIRMAN GREENSPAN. Well, I think that with the appropriate money supply targets, I'd like a vote on the asymmetric directive.

MR. BERNARD. The operational paragraph would read: "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from June through September at annual rates of about 3 and 1 percent respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Boehne	Yes
President Boykin	Yes
President Hoskins	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Mullins	Yes
Governor Seger	Yes
President Stern	Yes

CHAIRMAN GREENSPAN. The next meeting is on August 21st.

MR. BOEHNE. Mr. Chairman, when is your testimony? Do you know?

CHAIRMAN GREENSPAN. The 18th.

MR. BOEHNE. The 18th. Is the Senate first or the House?

CHAIRMAN GREENSPAN. It's the Senate first, and I think the House testimony is either on the 19th or the 24th.

MR. COYNE. It's the 24th.

CHAIRMAN GREENSPAN. On revisions with respect to the projections, Mike Prell says as late as Monday morning will be no problem. Any changes can be faxed in, I assume, by that time.

MR. PRELL. We use the administrative message system, if it's convenient.

CHAIRMAN GREENSPAN. If there is no further business, the meeting is finally adjourned.

END OF MEETING