Federal Open Market Committee
Conference Call
April 18, 1994

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Broaddus
Mr. Forrestal
Mr. Jordan
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. Parry
Ms. Phillips

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

Messrs. Boehne, McTeer, and Stern, Presidents of the Federal Reserve Banks of Philadelphia, Dallas, and Minneapolis, respectively

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

Messrs. Beebe, Goodfriend, Lindsey, Promisel, Siegman, Simpson, Stockton, and Associate Economists

Ms. Lovett, Manager for Domestic Operations, System Open Market Account
Mr. Fisher, Manager for Foreign Operations, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Wiles, Secretary, Office of the Secretary, Board of Governors
Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Moore, Special Assistant to the Board, Office of Board Members, Board of Governor
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Minehan, First Vice President, Federal Reserve Bank of Boston

Mr. Bennett, Ms. Browne, Messrs. T. Davis, Dewald, Lang, and Scheld, Senior Vice Presidents, Federal Reserve Banks of New York, Boston, Kansas City, St. Louis, Philadelphia, and Chicago, respectively

Transcript of Federal Open Market Committee Conference Call of April 18, 1994

CHAIRMAN GREENSPAN. Good morning, everyone. I think this morning's meeting can start off in the usual manner. Peter Fisher, if you are on, would you get us started?

MR. FISHER. I'd be happy to. Following the Committee's last meeting, the dollar declined against both the mark and the yen--from roughly 1.59 marks and 106 yen on March 22nd to lows of about 1.57 marks and 102 yen on March 31st. The dollar then rose sharply after the nonfarm payroll release on Friday, April 1st, moving above 1.71 marks and 104 yen by the following Tuesday when European trading had fully resumed after the Easter holiday. Although initially the dollar strengthened against the yen on Friday April 8th, following the announcement of Prime Minister Hosokawa's resignation, by last Monday the dollar had fallen back to around the 103 yen level on the perception that the process of forming a new Japanese government would delay any wish to resolve trade issues and also the completion of the already delayed budget. Ten-year interest rate differentials with both the mark and the yen have moved by 30 to 70 basis points in the dollar's direction since the 13th of March. On balance, the dollar is little changed against the mark and weaker against the yen.

Against the yen, the dollar appears to be constrained in a narrow trading range by conflicting U.S. and Japanese official views. Despite the apparent stability of the perceived tolerated trading range since last fall, with the dollar now at the bottom of that range, market participants remain anxious that some of this could cause the dollar to test the record lows.

Against the mark, the dollar's movement was muted on the one hand by the constraint on the dollar/yen and the risks of abrupt strengthening of the yen and, on the other hand, by the seeming transparency of both Bundesbank and Federal Reserve policies. While the Bundesbank may periodically lower official rates by discernible increments as it did last Thursday when it lowered both the Lombard and the discount rate by 25 basis points, market participants perceive that the Bundesbank will continue to restrain decreases in the more important repo rate to no more than a handful of basis points per week and that the pace of reductions will be managed to ensure only a gradual erosion of the differential with the dollar. At the same time, the Federal Reserve is expected to continue its tightening moves in 25 basis point increments. With these two gradual policy trajectories priced into current dollar/mark levels, the most likely causes of a pronounced upward movement in dollar/mark would be either a pronounced acceleration of expected U.S. or German policy actions or of signs of weakness in the German economy or strength in the U.S. economy. That's the end of my remarks.

CHAIRMAN GREENSPAN. Are there any questions for Peter? If not, I'd like to move on to Joan Lovett. Joan.

MS. LOVETT. Thank you, Mr. Chairman. Since your meeting of March 22, yields in the 2- to 10-year area of the Treasury market are up some 50 to 60 basis points and yields in the long-bond area are up 45 basis points, bringing the yield level on the 30-year issue to 7.30 percent. The major catalyst in the market continues to be the view that the economy has put in a strong first-quarter performance even in the face of the damping effects from adverse weather and the California earthquake. Market estimates are now in the 3-1/2 to 4 percent range for first-quarter GPD growth. The second quarter is expected to come in around 4 percent as well. Thus, the biggest jump in yields during the period came surrounding the Easter weekend when the March nonfarm payroll numbers showed a large rise of 456,000. Yields were up 30 or 40 basis points in a day and a half surrounding the announcement of a rise in employment that was much stronger than had been built into the market. And I would have to say that Easter Monday, the 4th of April, trading markets in the Treasury area came pretty close to being disorderly. There was an emotional selling climate that day that pushed yields up 30 or 40 basis points before subsiding over the period since then. The mortgage markets saw broad-based selling as did municipal markets and those markets exerted a drag on the Treasury market as the institutional customers were brought into all three markets, with selling begetting more selling. The limited price action of late has come because professional market participants are becoming more uncomfortable about shorting the market further at these yield levels. At the same time, customers are not buying in the market with any particular enthusiasm because they feel we're still in a rising rate environment and the Fed will be moving rates upward again. The short end of the market moved up by less, with the short end of the yield curve pretty flat to up 10 basis points, while rates out in the longer end are up about 3/8 of a point. Bills have benefited from a combination of quarter-end window-dressing buying and safe-haven purchases and some paydowns from the Treasury in various of its maturities. There will be some additional paydowns in that market later this week. In recent days, the market has tended to trade in a fairly narrow rate range, as I mentioned before, giving back some of the increases that we had just after the Easter holiday. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Any questions for Joan?

MR. BOEHNE. Yes, Mr. Chairman. Joan, how much of an increase in the federal funds rate do you think the current structure of interest rates has built into it?

MS. LOVETT. Using the 2-year note as the benchmark for that, there is a 25 basis point increase that people have been building in; I think that is priced into the 2-year note as we speak. When we look at the forward curve in the federal funds market, we see the market pricing in some additional increases going forward in time.

MR. LAWARE. Joan, what effect do you expect--maybe none--in the markets from Secretary Bentsen's comment yesterday that he expected short rates to go to 4 percent by the end of the year and that he was not particularly concerned about that?

MS. LOVETT. There was an outlook in the market at the end of 1993 that the funds rate would be at 4 percent at the end of 1994. But the most recent market outlook has been that we'll be at 4 percent sooner than year-end. And so people really haven't paid much attention to those comments; that hasn't had an influence on the market. I think people have been expecting to see a 4 percent level closer to midyear than year-end in the domestic markets.

MR. LAWARE. Thank you.

VICE CHAIRMAN MCDONOUGH. This is Bill McDonough. We might want a comment from Peter on what the Euro-dollar contracts are telling us about Fed policy.

MR. FISHER. I'll just note that the trajectory of 3-month rates on Euro-dollars has the 3-month Euro-dollar at 4.5 percent by June and above 5.5 percent by December. Now, that's for a longer maturity than the fed funds rate, of course, and we have to take that into account. But it's a rather steep acceleration of short-term rates.

CHAIRMAN GREENSPAN. I notice you're not commenting on the federal funds futures markets. Is it that you're uncomfortable with them as being useful or that the same information is better embodied in other instruments?

MS. LOVETT. Well, we tend to look at the federal funds futures contracts, but the volumes are small and in that sense I don't think they give the same kind of liquidity picture as the Euro-dollar futures contracts. The reason that we look at them, though, is because we don't have to make the quality adjustments that one has to do for the Euro-dollar futures. In looking at those fed funds futures contracts, although they're too small to reach firm conclusions about them, I would have said they were pointing to something in the 5 percent range by year-end. Of course, a lot of that is still a degree of market speculation as to what the second half of the year is going to look like for the economy and whether the Fed is going to have to go from "neutral" to restrictive. That would be embedded, I think, in those December levels.

VICE CHAIRMAN MCDONOUGH. In short, we look at both of them.

CHAIRMAN GREENSPAN. Any further questions for Joan? If not, I'd like to turn to Mike Prell to update us.

MR. PRELL. Thank you, Mr. Chairman. The recent news we've received suggests that growth in real GDP in the first quarter probably was somewhere around 4 percent at an annual rate. You will recall that that's where we were a couple of Greenbooks ago. In the last Greenbook, on the news of the winter retardation, we had dipped down to 3-1/4 percent. Some of the data that have come in have shown upward revisions, particularly the retail sales figures for January and February. Those revisions, combined with the strong auto sales data for March, have moved our estimate of consumer expenditures growth in the first quarter up to about 4 percent. The other major ingredient in our upward revision of the first quarter has been the incoming data on inventories which show that, at least through February, inventory accumulation was running considerably higher than we had previously anticipated. At this juncture, we would expect to see a substantial contribution to GDP growth in the first quarter coming from nonfarm, non-auto inventory accumulation. Obviously, there are many pieces of data still missing and some volatile components, including the trade data and the missing inventory data. But at this juncture, the upward revision to our GDP forecast does not seem to put us out of line with the incoming evidence on employment or industrial production. Our estimate of manufacturing output for the first quarter is about 8 percent growth at an annual rate, and the payroll employment figure for March, showing a very sizable increase, puts the first-quarter average increase at about 200,000 workers a month, comparable to the fourth quarter of last year.

As for the more recent indications, the level of initial claims in recent weeks and the scattered anecdotal evidence would suggest that labor demand has not slackened since the March survey. Indeed, one hears--and I've seen this to some extent in the memos from the Reserve Banks relating to discount rate discussions--that there seem to be signs of some tightness here and there in the labor market and some scattered wage pressures. Overall, there are no clear statistical signs of general wage or price acceleration yet. The recent average hourly earnings and the PPI and CPI news were broadly in line with our expectations. We think that maintaining the favorable trends on the price side will likely require a considerable deceleration of activity in the near term. We don't have a whole lot of new evidence on the economy as it enters the second quarter. We still anticipate a substantial drop-off on a seasonally adjusted basis in motor vehicle production, perhaps enough to subtract about 1-1/2 points from GDP growth in the second quarter. That would reverse the comparable increment to production in the first quarter. So that sets up a considerable swing from that sector. But if demand does not fall off significantly, we're either going to see very tight inventories heading into the summer or increasing price pressures or some mixture of those two.

In other sectors of the economy, we still think that there is a strong upward trend in producers' durable equipment. We think that we're going to see some pickup in nonresidential construction after what seems to have been a weather-related downturn at the beginning of the year. The residential housing sector will clearly warrant some close attention. Our sense is that there will be a near-term rebound in housing starts, but we're anticipating that it will be more muted than we had projected earlier when we were looking at current and prospective interest rates in our forecast that were considerably lower than those now prevailing. Mr. Chairman, that concludes my remarks.

CHAIRMAN GREENSPAN. Questions for Mike? If not, I'll move to Don Kohn.

MR. KOHN. Mr. Chairman, traditional measures of money and credit have shown some strength over the last month or two. Bank credit picked up in March to a 10-1/2 percent annual rate and the first week of April, which are the latest data we have available, showed another sizable jump. I think the notable aspect of the bank credit picture is strength for three months running in business loans. This is the first quarter we've had a plus in business loans in several years, certainly a sizable plus in business loans, and consumer loans continue to run strong. Overall credit growth edged down a little in the first quarter of this year from late last year but that's mostly because of the Federal government. Private credit expansion remains at the stronger 5 percent plus pace of late last year.

The broad monetary aggregates have picked up considerably in the last few months, both relative to previously and relative to

Bluebook expectations. With half of April still projected, we're projecting a March/April M2 of 5-1/2 percent; that's up from less than 1 percent in January and February. And we're projecting a March/April average M3 growth rate of 3-1/2 percent; that's up from minus 3-1/2 percent in January and February. M1 growth remains around 5-1/2 percent as it was early this year, but that's down considerably from last year. We have two influences at work here. Higher interest rates are damping money demand. We can see a rise in noncompetitive tenders at bill auctions. Deposit rates are lagging market rates, and those developments plus the decline in mortgage prepayments are certainly holding down M1 growth and feeding through to M2. But those factors are more than offset by the action in the bond and stock mutual funds; stock mutual funds fell at the end of March and continued to decline in the first week of April. Bond mutual funds have experienced net redemptions; abstracting from capital gains they have been falling since the end of February. This has been reflected in very sizable increases in money market fund flows into M2, which have more than offset any effects of higher short-term interest rates on holding down growth in the aggregates. Basically, the money market funds account for the stronger growth in the broad aggregates in the last two months.

CHAIRMAN GREENSPAN. Questions for Don?

MR. LAWARE. Yes, Don, did I misunderstand? Did you say that net redemptions had been falling?

MR. KOHN. No, I said that there had been net redemptions in stock mutual funds the last two weeks. We have data from ICI for the end of March and the first week of April which show net redemptions in bond mutual funds since the end of February.

MR. BOEHNE. Don, why do you think that the long bond market doesn't agree with the analysis that a less accommodative monetary policy is in its own best interest? Here we have a growing economy that's well along in the expansion; growth is widespread. We have increases in loan demand. It's a classic environment for the Federal Reserve to be raising short-term interest rates, and yet the bond market seems to react just the opposite of what one might expect. Do you have any thoughts about that?

MR. KOHN. Well, I think there are a couple of things going on here. Number one, I think we would expect, as the Fed raises short-term interest rates, for long-term rates to go up at least a little; that would be the usual kind of response. And experience has shown that when the Fed turns around and makes the first one or two steps in a series of interest rate increases that that sometimes has greater effects on bond rates than the typical 25 basis point increase in the federal funds rate. People know that the Fed tends to move in series and once we get started, they start projecting that tightening series out a little further. At the same time that the Fed has tightened, I think that the news on the economy, as both Joan and Mike have indicated, has been stronger than most people anticipated and has exacerbated this bond rate increase. Yes, the Fed has tightened; but also the economy is much stronger. So, it'll take higher real interest rates than people previously thought to keep inflation in check. Also, it's possible that at least some of the increase in bond yields was on the inflation expectations side. It's very hard to parse this out, but if the economy is stronger, if we have less slack than people thought we had, if we're going to get to potential sooner than we thought, we'll probably get there with at least a slightly higher rate of inflation than people thought before. And finally, there are these market dynamics that Joan and Peter have discussed--selling begetting selling, as Joan said; people rushing for the door at the same time trying to limit losses. And I think there may be an element there of greater increases than one might expect because everyone's expectations turned around at the same time and a lot of people headed for the exits at the same time. Also, at least in retrospect, the previous rates may be seen as, in effect, too low. That is, if there was overshooting, at least in part it was last summer and fall when rates declined a lot, perhaps because people thought the economy wouldn't be so strong; and that in itself is one of the things responsible for the pickup in aggregate demand. So, there are a number of factors here, but I would think that a major factor is the realization that underlying demands in the economy are considerably stronger than most people had expected before.

CHAIRMAN GREENSPAN. Further questions for Don?

MS. MINEHAN. Could I ask Mike a question, Mr. Chairman?

CHAIRMAN GREENSPAN. Certainly.

MS. MINEHAN. Mike, with your stronger feelings now about the first quarter in particular, have you changed your projections for the year? What do your GDP numbers look like in the third and fourth quarters?

MR. PRELL. Well, as I said, we still see in the near term the likelihood of a deceleration; perhaps I didn't state that clearly. We think that there's enough of a swing in motor vehicle production that is not likely to be offset by other factors that we will get a slowing in the second quarter. At this juncture, I wouldn't want to put too fine a point on this, but we don't see anything to move us very greatly from the 2 to 3 percent range of our last forecast for the second quarter. Looking beyond this, I think the wealth effects and the cost of capital effects that will come from what now is a substantially higher level of longer-term interest rates than we had anticipated in our forecast would tend to offset any indications that consumers or others might be inclined to spend more aggressively than we had thought previously. So, at this juncture, very tentatively, I wouldn't anticipate a substantially different outcome if I were to attempt to update our forecast through the end of the year.

MS. MINEHAN. Thank you.

CHAIRMAN GREENSPAN. Any further questions? If not, let me get to my general view of what has been going on. Having listened in some detail to comments of Committee members at the last couple of meetings as well as a lot of bilateral discussions, I think the consensus of this Committee is that we eventually would like to move in excess of 4 percent on the federal funds rate. As you may recall in the last meeting, we had hoped to wait until the May 17 FOMC meeting for the next move. But there are certain events that have evolved since the March 22 meeting, which probably make it desirable to move before the next meeting.

First, with regard to the comments that Mike Prell made, I think that the issue of inventories is a very crucial question here. You may recall back in the January or February meetings I was raising the point that we had to be careful about lead times on deliveries beginning to move up and that that, in turn, could engender some cyclical pressures coming from the inventory area. It's certainly much too soon to conclude that that process is irreversibly under way; but certainly, there are indications of lead times now moving at least modestly and there's some evidence in the inventory data which suggests that our revisions for the rest of the year will doubtless be ratcheted upward.

Secondly, the sharp declines in both stock and bond prices since our last meeting, I think, have defused a significant part of the bubble which had been previously built up. We let a lot of air out of the tire, so to speak, and the dangers of breaking the surface tension of the markets clearly are less than they were at the time of the last meeting. There has been and continues to be a major restructuring of portfolios since earlier this year, but that process has accelerated especially since our last meeting. And I think we have observed clear evidence of a marked move in holdings of longer-term securities from weak to stronger hands. This process, however, is probably no more than half complete as best I can judge; it has a way to go. That doesn't necessarily mean that prices have to move down as the adjustment process occurs, although that's the typical pattern. But it does mean that there has to be a continuing reshuffling of positions until the people who are holding the longer-term assets at the lower prices are doing so because they believe it's their long-term position. The problem, as I've argued in recent meetings, is that we have to be careful about breaking this so-called surface tension of the market and, as Joan Lovett says, selling begetting selling. That is potentially quite dangerous. I think it has a low probability at all times, but the consequences if it happens are very large. We saw that occur in 1987 with the markets compounding each other on the down side, but unlike the 1987 experience--when as best I can judge the sharp decline in the stock market essentially defused an overheated part of the economy and just barely got into the muscle of the economy--I don't think such conditions exist today.

If we were to get a major contraction or implosion of the financial markets, I suspect that the economic effects would be quite evident. Consequently, since I think there is a lesser danger in financial markets, although they are still precarious, this enables us to move somewhat faster than our previous planning presupposed. Moreover, the acceleration of the inventory process suggests that it is desirable not to wait until our next meeting. Accordingly, it's my view that we should adjust the funds rate by 25 basis points today and reassess any additional moves at the May meeting. I also would plan to announce the change in a manner similar to recent moves. Does anyone have any objections to that?

MR. BROADDUS. Mr. Chairman, this is Al Broaddus. I can go along with that. I must say though, as I mentioned at our March meeting, that in view of the apparent strength of the economy we are hearing more frequent comments of rising prices and expected future increases in prices, especially for basic materials like paper, building materials, and textiles. And at least some of that is going on in other regions of the country. In this situation, I think that a relatively strong and decisive move could serve us well. If I had my "druthers," I would like to see a 1/2 point increase in the discount rate; and with all of that allowed to show through, that would put the funds rate at 4 percent. I certainly recognize that there is some risk to that kind of action. On the other hand, it strikes me that these rates are still quite manageable in the context of the overall strength of the economy; it's hard for me to believe that it would take us beyond what I would describe as a neutral policy stance at this juncture. So, that would be my preference. I think it would have the advantage of allowing us at least to catch up with market expectations and possibly put us a little ahead of the curve for a change.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, this is Bill McDonough. May I make a comment?

CHAIRMAN GREENSPAN. Certainly.

VICE CHAIRMAN MCDONOUGH. I think, just to agree largely with your own presentation, that the economy is clearly a good deal stronger than we thought it was at the last meeting. Although I happen to agree with Mike Prell's position that this tremendous strength in motor vehicle sales is not likely to continue, a lot of people in the market think it is more likely to move along at about the present pace, at least for a while. The financial markets are healthier than they were in that the unwinding, as you described it, from weaker hands to stronger hands is continuing. But I also agree that it's in no way over and we have to expect that it will continue at least through this quarter. The market, as Joan and Peter pointed out, has factored in at least a 25 basis point rise at this time and then ongoing 25 basis point increases. But it has not assumed this timing. I think that we will see something of a surprise to our moving as early as today. And that leads me to believe that the 25 basis point recommendation of the Chairman is a considerably better choice than anything stronger. We in New York have not recommended an increase in the discount rate. I believe there was a time when we were alone in that position. I have the view that we have to be concerned about not appearing to know more than the market does about inflation expectations. I think the combination of announcing the fed funds rate increase--as I agree we should do if we should determine to move this morning--with the big banner of a discount rate increase would be overdoing it. Certainly, it is not something we should contemplate until we are all together at the next meeting. Thank you.

MR. BOEHNE. Mr. Chairman, I think that we have two considerations, which you have laid out well. One is the economy, which is stronger. I've just come back from a swing around Pennsylvania, which is still on the slow end of things, but it's clear to me in talking to people--a lot of people--that growth is solid and that these inventory problems are there or will be there. So I think that, on the side of the economy, a 25 basis point increase almost surely leaves us behind the curve. That's one factor. You have ably laid out, however, the financial market risks and I really don't have anything to contribute to that. I think you said it right: While we need to be less concerned, there still is room for caution. So the 25 basis points, while not enough on the economic side, probably is the safe thing to do on the financial markets side.

As far as the discount rate goes, however, I believe that it would be better to announce an increase in the discount rate. And my reason is this: If we go to 3.75 percent on the funds rate, it is almost immediately going to set off speculation about when the discount rate is going to go up. Is it going to be tomorrow, the next day, next Monday, or when? I think that it would be better to announce an increase in the discount rate today and indicate that this change is to keep the discount rate in line with the federal funds rate and market rates. It would put the speculation behind us about an immediate need for a discount rate hike and I think it would minimize the problem of the small increase in the funds rate, which on economic grounds still leaves us behind the curve and raises questions about when we are going to raise it again. Just 25 basis points alone on the funds rate is going to buy us only 15 minutes, frankly, and then we're going to be right back to this speculation on what the Fed is going to do next. So, while I agree with the 25 basis points, and I think it does balance the financial market and the economic considerations, I believe a higher discount rate would actually be helpful to quiet speculation and would also be helpful on the economic side.

MR. KEEHN. This is Si Keehn. I completely agree with the statements that Ed Boehne has just made. I am very sensitive to the risks that Bill McDonough pointed out, but it seems to me that as we move for the third time and do not bring the discount rate along, it does open up the question as to when that will occur. And while I quite understand that it's a sense of what the markets might do, I just have the intuitive feeling that the markets are probably ready for this kind of a change; and not to make the change, given this particular set of circumstances, would be a mistake.

CHAIRMAN GREENSPAN. Si and Ed, I'd just like to say that, obviously, we have been considering this question. I would note that, first of all, we moved the federal funds rate to a level right on top of the discount rate, and I think it's desirable to open up a gap. I think that we're going to have to move the discount rate, and my guess is either at or before the next meeting, in conjunction with our next move. I'm inclined at this stage to be a little cautious on the grounds that, while we have defused a goodly part of the bubble, we have an awful lot left in there. I would agree with Ed Boehne that as far as the economy is concerned, a 1/4 point move in the funds rate will still leave us behind the curve. But there's a much bigger financial market out there than I think any of us realized was developing. I don't mean imbalances; I mean the size of the overall market and the advent of worldwide efficiency and an aggregate level of transactions that I think is somewhat disturbing, if I may put it that way. At this point, were we to raise the discount rate, especially since the market does not expect us to move today, we would create more of a jolt than I think we would wish to create. A few more weeks of waiting, and moving the discount rate in conjunction with our next move, strikes me as a much more sensible and less risky approach to get to where we want to be.

MR. PARRY. Mr. Chairman, this is Bob Parry.

CHAIRMAN GREENSPAN. Yes, Bob.

MR. PARRY. I basically agree with your position. It seems to me that we're in rough agreement about where we want to be by midyear. If we move today, we would have the benefit of an additional month's information before our next meeting, and we could have a complete discussion then. I have the feeling that there's going to be a strong argument at that meeting for another move, perhaps an even larger move. And at that time, it would seem that there would be a sufficient difference between the funds rate and the discount rate to support strongly the idea of moving the discount rate.

CHAIRMAN GREENSPAN. There is a good possibility that we may choose in the next meeting to move the discount rate 50 basis points and let the whole increase show through. That assumes the markets have simmered down enough, that we have gotten more of an adjustment in the portfolio restructuring, and that there's no change in the economic outlook. I think that would probably be the sensible call because, other things equal, we've got to move the funds rate up somewhat above 4 percent; and frankly, I don't know how much above 4 percent we're going to have to be from the economy's point of view.

MR. STERN. Mr. Chairman, this is Gary Stern. I certainly support what you're proposing, but just to cover the spectrum here, given the significant backup in intermediate- and long-term interest rates that we've already had, I would think that the outlook not only for the next one or two quarters but for the longer-term would be for slower growth relative to what we earlier expected. One way of describing what has happened in financial markets in recent months is we should add that wealth has been destroyed, at least a bit. And I would think that that, too, would have a restraining effect on the longer-term outlook.

MR. FORRESTAL. Mr. Chairman, this is Bob Forrestal. I think your prescription is entirely appropriate at this time. We're certainly seeing growth of the kind that Mike Prell described here in this District and our directors and other business people are forecasting quite good growth. They're not particularly enamored with the idea of higher interest rates, but I think that's because their focus is entirely on present inflation. This economy is moving much faster than most of us would have expected, and I think it's time that we tried to put to rest this inflationary expectation that is in the market. There is a risk, as you've described, to moving too aggressively. While I've been a proponent of gradualism, I would have been prepared this morning to move even 50 basis points in the face of the growth that I see in the economy. But I'm certainly willing to go along with 25 basis points and to reconsider the situation again at our next meeting. With respect to the discount rate, again, I would agree with you. I think that the differential between the funds rate and the discount rate at the moment is not out of line historically, and to move the discount rate now would be rather dangerous overkill, although I recognize that that move probably will come very soon. But if it comes with another 25 basis point move in the funds rate, the market will better understand it, at least technically. So, I would support the 25 basis point move in the funds rate today. And I might say I'm happy to see us move between meetings of the FOMC.

MR. MELZER. Tom Melzer. The question I would have is: Do we help longer-term markets sort themselves out by imparting greater conviction about the Fed's decisiveness in keeping inflation under control? I think that would argue for a stronger move along the lines of what Al Broaddus described. I could certainly support that sort of move, and, in very short order, we'll get to where eventually we need to get. So, in the long-term scheme of things, I think we're headed in the right direction. But my own view is that one of the problems in the longer-term markets, and the difficulty that's existed in sorting things out, is this question as to whether the Federal Reserve really is committed to price stability, if you will. I don't want to carry that too far; I'm using the term price stability in a very loose sense. To the extent markets were convinced of that, it's possible that they could sort themselves out more effectively than we've seen with incremental steps.

MR. HOENIG. Mr. Chairman, this is Tom Hoenig. I agree with where you are on this. I think that we're systematically moving in the right direction, which is what we talked about last time, and that this is the right time to move again.

MS. MINEHAN. You were basically looking for people who had objections to your recommendation, Mr. Chairman, and we have no objection to the 25 basis points; we're very much in favor of it. I do want to speak on the discount rate, though. We also believe that it would not be out of line, given historical data, for us to move another 25 basis points on the fed funds rate and keep the discount rate where it is. We also think that it would be good to move one step at a time--moving the fed funds rate now, perhaps, and the discount rate later for the purpose of keeping things relatively stable as far as the markets are concerned.

CHAIRMAN GREENSPAN. Any further comments? If not, we will make an announcement sometime within the next hour or so. And as a consequence, we look forward to seeing you at the next meeting and hope we don't feel a necessity of another call prior to then. Good morning.

END OF SESSION