

Meeting of the Federal Open Market Committee

February 4-5, 1992

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, February 4, 1992, at 2:30 p.m. and was continued on Wednesday, February 5, 1992, at 9:00 a.m.

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

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

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

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Deputy Secretary  
Mr. Coyne, Assistant Secretary  
Mr. Gillum, Assistant Secretary  
Mr. Mattingly,<sup>1</sup> General Counsel  
Mr. Patrikis, Deputy General Counsel  
Mr. Prell, Economist  
Mr. Truman, Economist

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

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

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1. Attended Tuesday session only.

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors  
Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors  
Mr. Hooper, Assistant Director, Division of International Finance,<sup>2</sup> Board of Governors  
Mr. Feinman,<sup>2</sup> Economist, Division of Monetary Affairs, Board of Governors  
Mr. Wascher,<sup>2</sup> Senior Economist, Division of Research and Statistics, Board of Governors  
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, Broaddus, Lang, Rolnick, Rosenblum, Scheld, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Richmond, Philadelphia, Minneapolis, Dallas, Chicago, and Atlanta, respectively

Mr. McNees, Vice President, Federal Reserve Bank of Boston

Mr. Guentner, Assistant Vice President, Federal Reserve Bank of New York

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- 2. Attended portion of meeting relating to the Committee's discussion of the economic outlook and its longer-run objectives for monetary and debt aggregates.
  - 3. Elected for the period in 1992 until a new president of the Federal Reserve Bank of Cleveland assumes office.

Transcript of Federal Open Market Committee Meeting  
of February 4-5, 1992

February 4, 1992--Afternoon Session

CHAIRMAN GREENSPAN. If we can get started.... I'd like first to welcome Bill McDonough. Welcome, William, to your inaugural meeting. This is our annual organization meeting. We start off with the election of officers, and I'd like to turn the gavel over to Governor Mullins.

MR. MULLINS. The floor is now open for nominations for the position of Chairman of the Federal Open Market Committee.

MR. ANGELL. Mr. Chairman, in an unplanned manner I would say that I think it would be a wonderful idea for us to have Alan Greenspan as Chairman. Now, would you want me to go ahead and do more [and nominate a Vice Chairman] or do you want to do one at a time?

CHAIRMAN GREENSPAN. No, let me request that you stop there.

MR. SYRON. You wouldn't like to take a chance on a group ticket!

MR. MULLINS. I think we need a second.

MR. KELLEY. Second.

MR. MULLINS. Without objection. The floor is now open for nominations for the position of Vice Chairman of the Federal Open Market Committee.

MR. KELLEY. In like spirit I will nominate President Corrigan.

MR. MULLINS. Is there a second?

SPEAKER(?). Second.

MR. MULLINS. Without objection. We have a new team.

CHAIRMAN GREENSPAN. I thank you and, speaking for the Vice Chairman, he thanks you! I now would like to have the Secretary read the list of staff officers for potential election.

MR. BERNARD.

Secretary and Economist, Donald Kohn;  
Deputy Secretary, Normand Bernard;  
Assistant Secretary, Joseph Coyne;  
Assistant Secretary, Gary Gillum;  
General Counsel, Virgil Mattingly;  
Deputy General Counsel, Ernest Patrikis;

Economist, Michael Prell;  
Economist, Edwin Truman;  
Associate Economists from the Board:  
    David Lindsey;  
    Larry Promisel;  
    Charles Siegman;  
    Thomas Simpson; and  
    David Stockton;  
Associate Economists from the Federal Reserve Banks:  
    Alicia Munnell, proposed by President Syron;  
    Richard Davis, proposed by President Corrigan;  
    John Davis, proposed by First Vice President Hendricks;  
    Anatol Balbach, proposed by President Melzer; and  
    Thomas Davis, proposed by President Hoenig;

CHAIRMAN GREENSPAN. Are there any objections?

MR. LAWARE. All good men and true!

MR. ANGELL. And women!

MR. LAWARE. And women!

CHAIRMAN GREENSPAN. If there are no objections and no additional nominations, I will assume the list is approved. I will now entertain a motion regarding the Bank--which I would require to be the Federal Reserve Bank of New York--to serve to execute transactions for the System Open Market Account. Would somebody like to do that?

MR. LAWARE. So move.

CHAIRMAN GREENSPAN. Is there a second?

MR. MELZER. Second.

CHAIRMAN GREENSPAN. Is there any objection? If not, so be it. We have now separately the selection of the Manager for Domestic Operations. Our current incumbent is Peter Sternlight, and I trust that somebody will nominate him for reelection.

SEVERAL. So move.

MR. MULLINS. Second.

CHAIRMAN GREENSPAN. It has been nominated and seconded. Is there any objection? If not, we move to the election of a Manager for Foreign Operations; our [candidate] is Bill McDonough and I would seek his nomination.

MR. MULLINS. So nominate.

MR. SYRON. Second.

CHAIRMAN GREENSPAN. Without objection. I think that we are now down to the review of--

MR. BERNARD. The Domestic Authorization.

CHAIRMAN GREENSPAN. Oh, yes. Would somebody like to move the adoption of the Domestic Authorization?

MR. CORRIGAN. So move.

CHAIRMAN GREENSPAN. Is there a second?

MR. SYRON. Second.

CHAIRMAN GREENSPAN. Without objection. I would now call on Ted Truman to review the three foreign currency instruments and the warehousing agreement.

MR. TRUMAN. We would recommend that you approve the Foreign Currency Authorization, the Foreign Currency Directive, and the Procedural Instructions as they now stand. With respect to the warehousing authority, as we discussed at earlier meetings of the Committee last year, the warehousing agreement with the Treasury on behalf of the Exchange Stabilization Fund and the Treasury's general fund is subject to annual review. You have received a memorandum from me on this subject. To summarize that memorandum, the amount of DM warehoused has been reduced from a peak of \$9 billion in March of 1990 to the current \$2 billion. And with the prospect of a further reduction in the near term to zero, it would seem appropriate to us to reduce the size of the arrangement from the current \$10 billion to the more historically normal level of \$5 billion; that level prevailed from 1978 to 1989. Therefore, I recommended a renewal of that size and Bill McDonough concurs with that recommendation.

I would note three points. First, if the Exchange Stabilization Fund repurchases the remaining \$2 billion, as we assume and expect it will, its dollar position will be relatively low, so we might have to reverse that later. Secondly, the Treasury has expressed some anxiety that conditions could change such that they might want to warehouse more than \$5 billion. In staff conversations with the Treasury, we noted that the size of the arrangement has been increased in the past and we assured them that the Committee is prepared to consider any reasonable request for changes in the future. Lastly, Bill McDonough and I have told the Treasury that once the \$2 billion is repurchased, the terms of the arrangement should be adjusted marginally to conform more closely to market practice. In the future, the forward "leg" would be at a forward market rate rather than being flat. This seems more sensible. It basically equalizes our interest returns and our foregone earnings. The Treasury staff has agreed in principle to this change and has agreed that it is appropriate to make the change not in the middle of an arrangement but once we've gotten it cleaned away. I'd be pleased to answer any questions.

CHAIRMAN GREENSPAN. Are there any questions? If not, would someone [make a motion]?

MR. ANGELL. I would be happy to move the adoption of the proposals that have been presented by Mr. Truman. And I would like to express appreciation and gratitude that we're back to [an authorized level of] \$5 billion and [the amount warehoused] will not be close to that amount.

CHAIRMAN GREENSPAN. Is there a second?

SEVERAL. Second.

CHAIRMAN GREENSPAN. Any further discussion? If not, all in favor say "aye."

SEVERAL. Aye.

CHAIRMAN GREENSPAN. Opposed? [Secretary's note: None heard.] The "ayes" have it. We're now up to approval of the minutes of the meeting of December 17. Would somebody like to move it?

MR. CORRIGAN. Move it.

CHAIRMAN GREENSPAN. Is there a second?

MR. KELLEY. Second.

CHAIRMAN GREENSPAN. Without exception. We'll now move to foreign currency operations and I call on Mr. McDonough.

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

CHAIRMAN GREENSPAN. Questions for Mr. McDonough?

MR. SYRON. I'm just curious about the intervention. I don't have any real problem with it, but could you give us a little more background on what was going on at the time? Were the markets felt to be particularly disorderly? What was happening that precipitated the decision to intervene at that particular point in time, presuming that we don't have a target?

MR. MCDONOUGH. The dollar had rallied very strongly and very quickly, as I mentioned, almost certainly basically on short covering. And that strength had continued through Thursday, January 16th. In the morning we had a rather [sloppy] market because of the questioning of how best to interpret the trade figures. At that time the Treasury expressed a very strong view that it was "appropriate," as they put it, to cap the dollar and to adjust it downward somewhat.

MR. TRUMAN. One additional point: This had been discussed at least in principle the day before in the context of a strong dollar--the dollar having gone up. The ambiguity came when we had the market that we had on Friday. On our part we felt that since the dollar was backing off, the Treasury probably would no longer be interested [in intervening]. But they turned out to be interested and we had to confront the question of whether to go along; we felt that on balance it was better to go along.

MR. SYRON. I think I understand why we did it.

MR. KELLEY. That puts you ahead of the rest of us!

CHAIRMAN GREENSPAN. Any other questions? Let me take a minute to review what occurred at the G-7 meeting.

MR. CORRIGAN. We need a motion on the transactions.

CHAIRMAN GREENSPAN. That's a nice idea.

MR. CORRIGAN. I will move it.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. This is a motion to ratify the actions  
of--

MR. MCDONOUGH. To ratify the Federal Reserve sale of \$25 million against yen on January 17th. That was our only operation on behalf of the Federal Reserve during the period.

CHAIRMAN GREENSPAN. It has been moved and seconded. Any objection? If not, I take it that is approved.

MR. ANGELL. Mr. Chairman, we've already talked about it, but let's just go ahead and vote for it anyway! [Laughter]

CHAIRMAN GREENSPAN. Let me just take a minute to update you on the G-7 meeting. That meeting obviously comes out of the Tokyo meeting between President Bush and Prime Minister Miazawa in which, as you may recall, there was a communique which specified that they were jointly in agreement on the issue of a "growth agenda" without specifying particularly what that concept meant. There was in the context of those discussions a reaching out to the other members of the G-7 to join them in that particular view of the world. And the Treasury decided that a meeting of the G-7 finance ministers and central bank governors would be the ideal vehicle by which that could occur. So the meeting was planned and as the days went on, in endeavoring to create the usual advance communique, it became fairly clear that uniformity of view was not exactly how one would describe the nature of those negotiations.

As a consequence of that at the end we all moved up to Garden City. It turned out that while the Treasury, I think, was quite successful in moving its broad philosophy of growth, it nonetheless acquiesced in language which very specifically maintained the long term anti-inflationary posture of the G-7 and the need to continue not to dissipate the gains that have been made against inflation. Discussions on potential intervention really got very little support and, as Bill McDonough indicated, the communique in that regard was relatively noncommittal.

We discussed the Soviet--or I should say the former Soviet--republics and their problems a good deal. The issue of a stabilization fund was raised by It got remarkably little support in the group; that never really proceeded very far. Although I suspect there is considerable latent support within the group to do something when the time is right, nobody at that meeting really held the view that the timing was such as to make it particularly useful. As a consequence, the communique ended up with a [statement in] support of the growth scenario promulgated in Tokyo and a number of individual country reports on their specific policies which struck me very much as national travel agencies describing the goodies of coming to visit. But nothing much else was involved. I think it was a harmonious meeting, certainly compared to the one in Bangkok. It did have a significant element in that there was a very

clear tilt in the basic philosophy of that group, which I must tell you I would more readily describe as the views of the finance ministers because we central bankers were sitting there on our hands to a large extent. The substance beyond the growth area was mainly in the discussion of the Soviet quota in the IMF; there was considerable discussion of it. It was assumed that a specific conclusion would not be reached except that obviously there [would be] discussions leading up to the Interim Committee meeting. Is that in April, Ted?

MR. TRUMAN. Late April.

CHAIRMAN GREENSPAN. That meeting would bring that to fruition. There was very strong support for a fairly quick resolution of the Russian federation's application and that of several of the other republics. That was pretty much all that was involved in the meeting. It was not one of the more significant endeavors on the part of the G-7, but certain things were accomplished.

Any questions? I'd be glad to entertain them. If not, we'll now move on to the Domestic Desk and Peter Sternlight.

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

CHAIRMAN GREENSPAN. Questions for Mr. Sternlight?

MR. PARRY. With regard to the increase in long-term rates, all of the factors you cited are domestic in nature. Did market participants ever refer to any international considerations that might have been placing some upward pressure on rates?

MR. STERNLIGHT. They did on occasion. President Parry. I perhaps should have mentioned that, although it did not seem to be a big factor in the recent period. But in the fairly recent past I was hearing as one reason for the rise in domestic long-term interest rates the competitive pull particularly of German rates.

MR. TRUMAN. Most German interest rates were down over the period since early January.

MR. PARRY. Okay.

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

MR. CORRIGAN. Move it.

CHAIRMAN GREENSPAN. Is there a second?

MR. MULLINS. Second.

CHAIRMAN GREENSPAN. Without objection. We now move on to the Chart Show with Messrs. Prell, Simpson, and Truman.

MESSRS. PRELL, SIMPSON and TRUMAN. [Statements--see Appendix.]

CHAIRMAN GREENSPAN. That report was pretty impressive, gentlemen. Questions for any of them?

MR. PARRY. One of the characteristics of the forecast is that the interest sensitivity of real spending is different than I think traditional elasticities are. Could you indicate how much of a difference there is and whether you assume that the historical difference between those elasticities has disappeared over the period? It seems to be a big factor in the forecast, for example in components such as commercial office space.

MR. PRELL. Well, that very clearly is a deviation from past norms of cyclical behavior, and I think it does reflect an unusually low degree of interest sensitivity. Basically, we think that process has been short-circuited by the buildup of so huge a stock of unoccupied buildings. Traditionally there has been a modest but significant contribution from nonresidential construction in the first couple of years of business upturns. Outside of that area, there are indications--and we've tried to gauge this econometrically--that housing may be less interest sensitive than it once was. It's a little hard to disentangle historically because of the disintermediation or reintermediation with segmented mortgage markets that produced a credit rationing effect that outweighed whatever interest rates effects there were. So, one has to disentangle that. There is also more reliance than in the past on adjustable rate mortgages, which scarcely existed earlier; and that conceivably may affect interest sensitivity. So, we may not have as great an interest sensitivity in the housing sector as one might expect. But, indeed, our models have been surprised at the weakness of residential construction. And that may be partly a matter of gauging the perceived real cost of home buying. It is quite conceivable that in the past year or so people have perceived the prospect of capital loss as being much greater than any trend in prices over recent years, which is the normal effect that the models capture. I think those are the major areas. It's possible, too, that inventories don't have a greater interest sensitivity than we have built into this. And in the consumer durables area, we're torn between a couple of considerations: (1) the interest sensitivity probably isn't all that high to begin with; and (2) the movements of consumer loan rates haven't been enormous, but on an after tax basis they have moved somewhat perversely in recent years. On the other hand, somebody looking at the option of whether to invest in a consumer durable with the expectation of a return of flow of services versus the 3 or 4 percent rate earned on a deposit might feel that isn't a bad deal and might be stimulated to spend a little more than otherwise.

MR. PARRY. On the issue of elasticities, my recollection is that the growth of imports is a little slower than one normally would expect, particularly in 1993. Is that correct that the income elasticities have been lower?

MR. TRUMAN. Yes, the models will give you a higher income elasticity. However, a statistical test in which we essentially re-estimated the elasticities suggested that those elasticities have come down over time pretty much like the [actual behavior] and are closer to an elasticity of one on both the export and import sides. Therefore, we have in the forecast a relatively modest pickup in the real [import] component.

MR. PARRY. That's an interesting development.

MR. TRUMAN. In general imports have been performing throughout the last several years at a lower level than we had anticipated. And those two things together plus the other factor, which [has been] important for a number of years, led us to put in a small adjustment [unintelligible].

MR. PARRY. Thank you.

MR. KEEHN. Mike, a curiosity question on productivity as depicted in Chart 14: Am I right that overall productivity includes manufacturing and services?

MR. PRELL. Yes.

MR. KEEHN. The question relates to my impression that on the manufacturing side productivity seems to have been pretty good over the [past] few years and, therefore, in an inflationary sense it has been a constructive thing. Am I right about that?

MR. PRELL. Yes, indeed. In the 1980s there was a distinct improvement in productivity performance in manufacturing. The residual has not shown that kind of improvement, and basically our expectation is that we will continue to see manufacturing do well in terms of gains in output per hour and that probably we will see the remainder of the economy improve its performance somewhat. I would caution, however, that it's not so clear that the developments we've been seeing recently--the restructuring--constitute a vastly different kind of event than we have seen in other cycles. So at this point I think one should be cautious in anticipating a really radical shift in productivity gains.

MR. SYRON. A question for Tom Simpson: In your discussion, you talked about the balance sheet restructurings of both households and corporations. This is not a well-defined question, but do we have some notion even in a generalized sense of how much more desire there might be to do that? I'm trying to get to how much intermediated versus nonintermediated funds are going to the open market in this area with some vague presumption of conditions in the market remaining about as they are now.

MR. SIMPSON. Well, it's really hard to pinpoint. In dealing with the corporate sector, we certainly hear a lot of stories about firms wanting to strengthen their balance sheets. And the announcements of reverse LBOs and so forth suggest that there still is more room to go in that area. What is going to constitute the new norm once all this adjustment occurs is an open question. Personally, I'm not so sure they will go back to the leveraging ratios of the late '70s or early '80s. The household sector is even a little more difficult to evaluate. We do hear a lot of stories about individuals straining under the weight of their debt burdens and holding the line and restraining themselves. But there again, I'm just not sure--

MR. KOHN. In terms of intermediation and [unintelligible] depositories, which is part of what I thought you were getting at, we have this securitization process for mortgages, which has been underway for a while but has certainly gotten going on consumer debts.

So, the relative contribution of depository institutions to the whole credit flow has been depressed by their own choice through this securitization process. Other intermediaries are taking it.

MR. SYRON. I was also trying to get at some of the cyclical aspects of it in the short and intermediate run, which I think Tom has answered as well, so--

MR. PRELL. Mr. Chairman, we've just received auto sales data. For those of you who want to be brought up to the very minute, there was some improvement in the last 10 days of January. On our seasonal adjustment factors auto sales were 6-1/4 million at an annual rate with almost 4 million in sales of light trucks. So we ended the month at 5.9 million autos sold and 3.6 million trucks sold; that's a little better picture than we saw in the first 20 days of January. The cars were close to the December rate; trucks were off a bit; you will recall that the year-end incentives distorted it. So, I think we're on a steady-as-you-go [course] in the motor vehicle market.

MR. HOENIG. Mike, I want to ask something relating to the single-family residential area because it's an important part of the projections as we come into 1992. Given the comments on restructuring of debt that have been made and some of the demographics, can you explain to me again why we're going to have such a strong residential recovery even without the fiscal stimulus which, if I understand it, was not part of this projection? [Your forecast] seems very optimistic to me.

MR. PRELL. Well, it's very difficult to get a precise fix on underlying longer-run trends. We know something about the demographic situation. It's certainly clear that the relevant population is growing more slowly than it was several years ago. It's also clear that if past patterns hold, that would favor single-family relative to multifamily construction because people are passing into years where home ownership rates typically rise very markedly. We think we have been below the longer-run trend recently and that we're going to move up relative to that trend--conceivably to around trend or a bit above it--in response to what is much enhanced affordability. We've had a very distinct improvement for people who want to buy houses, and the signs are that there is some response already in train here. We've raised our forecast since the last meeting despite no change, really, in our mortgage rate assumptions. It just appeared to us that people have been responding more than we had anticipated previously and that with perhaps a small degree of optimism we could carry that through the forecast period.

CHAIRMAN GREENSPAN. Tom.

MR. MELZER. Ted, I don't know quite what to make of this, but it seems as if your projection of consumer prices in the G-7 countries represents an extraordinary convergence of inflation rates and even of real output. Am I right in making that observation? And if so, what do you think the implications of that are for exchange rates and so forth?

MR. TRUMAN. Well, I think you're right in making that inference: there probably is some degree to which we have a natural convergence of these things at least on the inflation side. After we

put all this together, we noticed that several of the 1992 numbers on that chart are at 3.0 percent. I think that reflected a reluctance to put "2" [as the first] number. On the growth side, it seems to me that there is a convergence, but the movement is from different directions. Germany and Japan essentially are moving down and the weaker economies are moving up [in their respective growth rates]. In some sense that reflects the fact that a period in which we've had quite a lot of divergence in the experience and the needs of the different G-7 countries is coming to an end, though we end up with a forecast in which certainly for the United Kingdom and Canada growth still remains pretty weak relative to potential. As far as the exchange rates are concerned, to the extent that we do have both this convergence on the inflation side and less divergence in terms of certain short-run macroeconomic policy needs, it would seem to me that we're likely to have less shocks, if you want to put it that way, coming from abrupt shifts in policy over this period. I suppose the one set of question marks associated with this is that we're in a period, taking the two-year period as a whole, in which we have not only here but abroad--in Canada, the United Kingdom, France, and Japan--a lot of elections. If you put that all together, we could have some political shocks. In the case of the United Kingdom, I don't think we will see a fundamentally different policy even if the Tories should lose because Labor is as committed to staying in the ERM as the conservatives are and that is going to constrain monetary policy. Plus they think things are so bad that they would undertake once and for all to make exchange rate adjustments. It's uncertain what that may mean in terms of macro policy. And on the fiscal side they may move from a situation in which they have quite a lot of room to maneuver to one in which they really don't have that much anymore; but they're pretty much boxed in, even if there is a change in governments.

CHAIRMAN GREENSPAN. Further questions? If not, let me mention Mike Prell's insistence that any changes in your forecasts arrive by the end of this week. Who would like to start the tour de table?

MR. PARRY. I'd be happy to, Mr. Chairman. Economic weakness persists in the Twelfth District economy, unfortunately led by a worsening California economy. California continues to report declining employment in nearly all sectors. Weakness is most pronounced in construction and also in manufacturing. In 1991 construction employment fell in excess of 7 percent, and we actually had accelerating declines in the fourth quarter. Manufacturing showed a similar pattern, with employment declines of about 4.4 percent in 1991. I also have to point out that additional defense cuts are expected in 1992. Retail trade activity is also off sharply. Searching for a positive sign in the California economy, I was able to come up with one, and that is in real estate activity, at least residential, where median house prices actually have not fallen and resale activity has risen in several major markets. Even in Los Angeles, looking at year-over-year comparisons for single-family houses, the prices seem to be very similar to what they were a year ago. Throughout the rest of the District conditions are clearly mixed. Two of the largest of the remaining states, Arizona and Washington, are showing weakness. The state of Washington, which has had quite a few years of uninterrupted prosperity, actually showed a loss of employment in 1991. And Arizona has shown considerable

weakness in the last four months. Other states--Alaska, Hawaii, and Oregon--are relatively sluggish. The only two states in our District that have shown strong growth are Idaho and Utah; of course, both of them are quite small in terms of the number of residents.

Turning to the national outlook, we expect the economy to expand only slightly in the current quarter, which would mean we might see some further declines in the near term. In the quarters to follow, growth is expected to rise at around a 3 percent rate. Our major sources of strength come from inventories in the interest-sensitive sectors of the economy, although we would certainly subscribe to the Greenbook's expectations with regard to reduced interest sensitivity in most sectors. I do feel, however, that there is a rather large band of uncertainty encompassing both sides of this forecast. Nevertheless, the outlook for inflation continues to be encouraging. And consistent with a downward trend in underlying inflation, we expect to see a reduction in most major inflation measures this year compared to 1991. Thank you.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, our forecast is quite close to the staff forecast for 1992. Indeed, we probably are closer now than we have been in a while. Our outlook for both inflation and unemployment is just a little lower, but the differences aren't really worth talking about.

With regard to the District, in the period since the last meeting of the Committee, I think the District economy really has weakened. This seemed particularly true as we approached and then went through the year-end period. In some respects, I think the District just caught up with the conditions that were prevalent around the country. The employment situation is perhaps the most evident indicator of that. Total payroll employment in the District declined in December, and the District unemployment rate went up to 7-1/2 percent; that's the highest level we've had since May of 1986. Illinois really did stand out in that; its unemployment rate went up to 9.3 percent and that got a lot of attention. There are some special factors behind that; nonetheless, it was a very, very significant increase in the level of unemployment in Illinois. And that puts us, I believe, at the top of the industrial states. Announcements of employment reductions, closings, early retirement programs, and the like, are continuing at what seems to me to be a very disturbing rate. Since the year-end, I've been trying to look around pretty hard for better news and I have to admit it is a bit scarce. I will say that there are some categories in which there are signs, if not of improvement, at least of stabilization. The steel business is perhaps in that category. One large manufacturer in our area is clearly operating at a 72 to 73 percent rate, but its current order rate is a little higher, coming in at about 75 percent. So, that should mean their total production will go up a bit. And the forecast for shipments this year is a little higher than was the case last year. In the steel industry, though, the pricing is stable, which from their point of view means that it is just terrible. Their prices currently are generally at about the level that they were in 1980-81 on a nominal basis. On an inflation-adjusted basis that means they're about 30 percent under that level. The outlook for heavy trucks also is just a bit better; sales are expected to be some 5 to 6

percent higher this year compared to last year. But I will say that that improvement is very much a forecast for the second half of the year; there's an awful lot of focus in the District on the second half versus the first half. Machine tool orders increased in December; that was particularly true for metal cutting tools, which should mean that those industries will be producing at higher levels.

Also, I think there's something of a brighter note on the retail front. One specialty retailer I talked to said that in the early part of January their sales around the country were up some 14 to 18 percent. Another very major retailer in the area said they had a good January; their sales for the full month were 17 percent over last year. On a cautionary note, though, last January sales were very badly affected, of course, by the so-called CNN factor. And all the retailers say that discounting continues to be just very, very tough. In the automotive business, though, as Mike has said, the last 10 days were a little better. Still, for January as a whole those sales came in a bit lower than the earlier forecast. I think that means that the first-quarter production schedules are at further risk. But one manufacturer that I talked to said that they had seen some improvement in the order rate from dealers, which is something I've been looking at pretty carefully. And, indeed, last week they had a very significant increase in the order rate from their dealers. They're not quite sure why. If that is maintained, then their production schedules in the first quarter might be okay.

In the agricultural sector, the equipment business has hit a rough spot. One major manufacturer has had a decline in sales of major implements of some 24 percent over the last couple of months. There's a comparison issue there, but they still are down very significantly; the reason is supposedly that the farmers are looking at the ITC and are going to hold off until that gets clarified. I do think that for many of the businesses in our District, this ITC uncertainty is going to be something of wild card.

In an overall context, while I can't find people whose attitudes are particularly positive, nonetheless some of the very heavy depression that was rather pervasive when we last met has passed, and I do think our policy change in December had an important effect on that.

On the pricing front, the outlook continues to be positive. The competitive conditions speak for themselves: Price increases just don't stick; and wage increases, particularly in manufacturing, are modest and can be dealt with through productivity improvements. Therefore, I think the staff forecast on inflation is very realistic. Also, I think the restraint on credit extensions by banks is beginning to stabilize. As nonperforming loan problems begin to unwind here and capital ratios continue to improve, lending attitudes are getting just a bit more expansive. It hasn't shown up in the numbers yet, but my sense is that the lending officers are being encouraged to go out and find good loans, and I certainly would want to emphasize the "good" in that comment. Net, I think the risks continue to be on the down side in terms of overall economic activity, but I do think, though it's hard to give you statistical evidence of it, that there has been at least a mini-improvement on balance from the last meeting.

CHAIRMAN GREENSPAN. President Forrestal.

MR. ANGELL. Si, has the Caterpillar labor negotiation progressed?

MR. KEEHN. It has not; it has gotten worse. Caterpillar, of course, built up very large inventories going into the strike. And because of the low sales level they are still very much working off those inventories. And the union has an enormous strike fund. This is getting to be tougher; they are not talking, and it's difficult to see a constructive way out of this one.

MR. ANGELL. What are the union wage demands?

MR. KEEHN. It's not so much wages as it is the issue of [the industry] pattern. The UAW settled with Deere and is insisting on the same settlement out of Caterpillar. Caterpillar is saying they ship to different industries and face different competitive factors, and they cannot settle on the [basis of the] Deere package. Again, it's the pattern that is the ultimate issue here.

MR. ANGELL. It would seem, with farm sales down 24 percent, that maybe Deere made a mistake also.

MR. KEEHN. Well, Deere had a bad [strike] the last time and went into this one deciding they were going to find a way of settling.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, activity in the Atlanta District has softened since the last time we met, but I'm happy to say that there seems to have been quite a turnaround in expectations. Most of the contacts we've talked to expect an upturn, although a modest one, in the spring. On the manufacturing side, even though activity slowed in the last few months of 1991, a large number of firms that we surveyed recently indicated that they expect an increase in production and shipments as well as in orders over the next six months. We've had informal contacts with retailers, and they're suggesting a similar outlook. Retail sales were somewhat better in January; that [improvement] was concentrated in nondurables. Retailers continue to be very cautious about their inventory levels. One bright spot in the District that was picked up for the nation in Mike Prell's report is the sale of single-family homes. This has been true across the District generally and is concentrated in the lower to the mid-price range. And that obviously has implications for durable sales, which I mentioned. Another positive factor in the Atlanta District has been a rise in convention bookings as well as in the number of visitors and tourism. Foreign tourism in particular is expected to benefit from the weak dollar.

The agricultural sector is generally favorable, but the situation is really quite different for the energy sector. In December, for example, Louisiana operated 40 percent fewer rigs than a year earlier. The number for the country as a whole is 30 percent less. This is giving rise to continuing layoffs in the District in that industry. Banking contacts are reporting very weak loan demand, as was suggested a few minutes ago. Loan officers are out there looking for good credits; the problem is that they're not finding very many good credits. The banks also are reporting that they're not changing their underwriting standards at all, and some of them are

reporting that there has been really no change in the regulatory pressure that they had seen earlier on. So, in general, while things have softened, the attitudinal situation is considerably better than it was six or eight weeks ago.

With respect to the national outlook, we're reasonably close to the Greenbook in terms of the GDP forecast. Although we see a little more strength in the first half of '92 and somewhat less growth as time goes on, the GDP forecasts pretty much converge. Our outlook for inflation is somewhat less optimistic. We may indeed get the good results that the staff is forecasting in the Greenbook, but I think the risk on inflation is on the up side. My hunch is, although our forecast and the staff forecast are based on no fiscal change, that we're going to get fiscal stimulus probably above what the President has suggested. And that suggests to me that the GDP forecasts are probably on the low side; if we get that fiscal stimulus, the economy will probably do better. Having said that, I do think our decision today should be based on our assessment of what the situation is going to be ex fiscal policy. Thank you.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I don't have much to add to this very excellent presentation the staff gave us and the fine coverage in the Greenbook. Our projections really are not significantly different. We do expect a little more real growth and a little greater slowing in the rate of inflation. But the broad profile is pretty much the same, with some pickup in the rate of increase of the recovery in the second quarter--but only to a very moderate rate in comparison with what has happened in past recoveries--and continued deceleration in core inflation, even though we are projecting that the overall CPI will come in a tad higher this year than it did last year. Insofar as the risks of error are concerned, I guess a carefully reasoned analysis would say that they are about equal on both sides. Certainly, there are some downside risks: the heavy overhang of commercial real estate; the corporate restructuring; the balance sheet adjustments that are taking place; the restraint on credit. Also, all these temporary dislocations that have taken place as a result of declining rates of inflation could produce another year of lower-than-expected growth.

But on the other side of that, I think the substantial further easing in monetary policy we engineered in November-December could easily produce a more rapid recovery than we are expecting here, particularly if a fiscal package is enacted early in the year or relatively early in the year. For what it's worth, my instinct is that the upside risk is probably a little greater than the downside risk mainly because of the actions that we took in the fourth quarter. We engineered a very significant easing in policy; it has not at this point had a very positive effect upon the economy; the stock market really seems to think [it will] over the next several quarters. Moreover, we're seeing a decided change in the comments that we hear from our contacts around the District. There is not much hard evidence yet that things really have improved, but the outlook for the next six months or so is decidedly better than it has been over the several times we've made contacts; it's quite a shift away from what we heard [unintelligible]. It always seems to me that the pessimism is the greatest right at the bottom of a recession. So, since it

looks a little better now than it did a while back, I hope that means that we're beginning to come out of this a little faster than most people seem to think.

CHAIRMAN GREENSPAN. It could also mean we're not at the bottom of the recession!

MR. BLACK. I hope it doesn't get any worse than it is now. It would really be bad. It's the worst I've ever seen since the '30s and I don't know very much about that.

CHAIRMAN GREENSPAN. First Vice President Hendricks.

MR. HENDRICKS. Thank you, Mr. Chairman. At a January 24 meeting of the Fourth District round table, economists agreed that the economy will be flat again this quarter but will improve throughout the remainder of 1992. Similar to the staff forecast, the group of economists expects 6 percent growth in nominal GDP over the next four quarters, and that's about evenly divided between output and prices. They pointed out that structural changes in the economy, such as corrections in overcapacity in retail and banking and long-term adjustments in the automobile and computer industries, are restraining the recovery. With respect to our projections, they are very close to those included in the Greenbook.

Currently, activity in the District is mixed and has perhaps lost a little ground in terms of the momentum it enjoyed in recent months. Nonfarm payroll employment fell in January after three successive monthly increases. Our unemployment rate rose 1 point to 6.6 percent but is still, of course, below the national average. Construction contracts, retail sales, and manufacturing production all outperformed the nation through late 1991. Auto production remains weaker than expected, although the auto economists who participated in the round table still believe that production this year will be at least 10 percent higher than last year. [They base that assessment] on the strength of sales and inventories that they feel are a little better than they originally had expected. Auto suppliers note that orders softened late last year, but Goodyear has just announced a recall of 300 workers because of good demand for replacement tires. Steel operating rates at nearly 80 percent of capacity are expected to ease a little this quarter in the view of those economists because of the recent let-up in orders. The signals from capital goods producers are also mixed. Those sensitive to auto and truck production note easing in orders, but the industrial machinery and equipment producers report that orders are either flat or, in the case of machine tools, rising. The capital spending outlook for 1992 is also mixed. More durable goods producers plan either the same or higher levels of spending than those who plan cutbacks, but petroleum producers, retailers, and real estate developers will cut spending. Although the commercial real estate markets in the Fourth District are not as soft as in some other areas of the country, developers of shopping centers and office buildings are concerned about too much capacity. Inadequate financing and cash flow have put several projects on hold in Ohio, New York, and California.

It appears to us that we are perhaps at the threshold of an expanding economy. Of course, we thought that was the case last summer. We are encouraged by the absence of price pressures and by

the modest 2 percent increase in the price deflator again last quarter. And we expect continued moderate inflation in the months ahead. That concludes my report.

CHAIRMAN GREENSPAN. Thank you. President Syron.

MR. SYRON. Thank you, Mr. Chairman. In the First District we had thought that the economy was on the verge of rebounding but now it seems perhaps to be stalling a little again. The sector where that's coming from is the manufacturing sector. A significant amount of that has to do with defense, and it's probably a long-term structural adjustment. Defense is an extraordinarily important industry in Connecticut; on a per capita basis it dwarfs even California. So, everyone wants peace to break out as it affects someone else's factory; but we know we're going to have a lot of cuts there and it's causing a fair amount of uncertainty for the District. Also, the people who produce the capital spending more generally are finding that their customers are concerned. With respect to manufacturing in softer goods, several discount retailers have told us they've had calls from producers saying: "Can you take things from us now because we're starting to be concerned about cash pressures and our inventories are building a little more than we'd like?" For the retail sector, the post-Christmas period has been a little better than expected, as was the Christmas period. So, that is relatively good news. In the banking sector, loan demand for "acceptable" loans is still weak. Several banks have indicated that they are going to be more cautious as a result of the recent legislation in terms of prompt progressive intervention and capital standards. We are seeing the beginning of some improvement in nonperforming loans; the level of nonperforming loans has actually dropped slightly at the margin. And that is consistent with what has been talked about in other Districts. We have seen some pickup in residential construction in single-family homes even in New England; I'm not quite sure who is going to buy them, but I'm told that they are all contracted for before the [shovel] goes in the ground. Again, I'm not sure what the reason is, but the mood is generally improved somewhat as well. I think part of it has to do with our December cut [in rates]; it is being seen as a watershed event to some extent. But people are saying: "Well, it has to get better, and we expect it will get better in the spring."

As far as the nation goes, our own forecast would be quite similar to the Greenbook forecast, though I must confess not necessarily on the same policy assumption that's embedded in the Greenbook. I don't mean that as a criticism of the Greenbook; I realize the institutional constraints. But I think we do have to take into consideration that a forecast based on the "no change" approach to policy, which has become more of a standard assumption in the Greenbook, may have been biased toward optimism as we've gone through these periods. I realize looking immediately ahead that we do have this unknown in fiscal policy out there. I was very interested in Mike's comments that even the things that have been talked about now--the presumption that this [fiscal package] doesn't get "Christmas-treed" too badly--would not have a dramatic effect. At any rate, that's something that we can't anticipate very well at this point. The one place where our forecast does differ is with respect to the unemployment rate. For any given level of GDP, we would have a slightly higher unemployment rate forecast than what is reflected in the chart. I think that goes back to our own little model [at the

Bank] where we have the labor force increasing slightly more than is anticipated in the Greenbook forecast. We think that could add as much as a couple of tenths in some of the intermediate periods and, consistent with that, we'd be somewhat more optimistic on inflation.

To sum up, on balance we think that the risks still are on the down side. One reason has to do with the consumer and the necessity of forecasting that we're going to see a snapback in consumption to some extent. If that doesn't happen, I have a fear about what that would mean for inventory behavior and what that [implies in turn]. We've obviously made an enormous amount of progress on inflation and we don't want to give that up. But consistent with that, we've also seen this restructuring phenomenon that is going on, which will be very beneficial for productivity in the longer run. And it seems to me that the proper role of policy, as others have said, is to "facilitate" that restructuring phenomenon. I do have a concern that were we to see a significant further slowing in the economy, we'd see demands for all kinds of protectionism, not just in the international trade sense but in a slowing down of the restructuring process in many industries. That may be because I come from a District where a lot of people have been restructured out and I'm very sensitive to it. Thank you.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. In terms of the outlook, our view is similar to the Board staff's. We're somewhat more positive on real growth and right in the middle of the central tendency as far as inflation, as measured by the CPI, goes. But what I want to comment on are the assumptions. It's interesting how two people can look at the same thing in different ways. Dick was worried about an unchanged interest rate [assumption] and I'm worried about what I think is another policy assumption implicit in there! [Laughter] When we do our forecast further out--this would have very little impact on '92--our presumption is that at some point, not in the reasonably near future but in the course of this year, we'd get back to M1 growth of 4 to 5 percent. We don't run our projection solely on that; there's a lot of judgment implied. But implicit in the policy assumptions in the Greenbook and the Bluebook is an 11 percent plus growth rate in M1 for all of 1992. Now, I guess my view is that an unchanged interest rate is not necessarily an unchanged monetary policy. If we're pegging an interest rate and we have an economy that is picking up and there is greater demand for credit and associated with that transaction balances are created, we have to supply the reserves. So, my view is --though some things could occur in the short run to disturb this-- that over longer periods of time if we're fostering growth in reserves and narrow money at double-digit rates, that's going to come back to roost in terms of higher inflation. So, in terms of underlying assumptions looking further out, there are considerable differences. The other thing in this context that troubles me in general is that this can go on with an apparently benign policy as far as M2 is concerned because only 25 percent of M2 is comprised of the M1 component; 75 percent is in the non-M1 components. And special factors will hold the growth of those non-M1 components probably to zero in 1992. So, we can sit there with 10 percent M1 growth and have M2 growing at 2-1/2 percent. Enough about that now, but I think we had the same sort of problem between the middle of '88 and the middle of '89 in reverse in essence, where M2 looked as if it was growing

fast enough at a rate of about 4 percent. We were comfortable with that, but in fact what we were doing to maintain our pegged funds rate--which arguably was perhaps too high--at those levels was that we were pulling out reserves. M1 declined and we pulled out reserves over that one-year period at an annual rate of 3.2 percent. So, I think those are important considerations as we look ahead to tomorrow.

In terms of the District, I didn't go first today--that didn't do any good last time--but the numbers still look pretty good. Non-agricultural payrolls in the most recent period for which we have numbers were growing at 1.3 percent compared to 0.3 percent nationally, and we're seeing that growth both in [services and goods-producing industries], with particular strength in food and kindred products and in textiles. I continue to hear this anecdotal story about textile mills running flat out [in our District]; it's partly a delivery problem as I understand it. Inventories have been run down to the point where wholesalers and retailers can't wait for foreign deliveries so domestic mills are benefiting in the short run. As far as construction goes, residential construction has been particularly strong over the last year. Contracts have been growing at twice the national rate over that period. Nonresidential construction is off over the year and most recently, but it's off I would say modestly--about 4 percent over the course of the year--and there are no signs of further declines at least at the moment. I picked up the same thing Bob Black did on the anecdotal side. Over the last two or three weeks for the first time in many months, I have started to hear some positive comments from people in the housing area, from a couple of bankers talking about a pickup in loan demand both in the consumer and commercial areas, and also from the retailing side. A major national retailer based in St. Louis saw activity pick up in the week or two before Christmas and that pickup has been sustained throughout January. At the same time they point out that this is a very promotional period in terms of prices and that, as Si mentioned, last year is really a bad benchmark. But they're doing better than their plan. Anyway, District-wise, the story is really about the same as I laid out last time. At the moment things look pretty good.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. My assessment of the District economy is that it's just bumping along the bottom. I don't think there are any firm trends, up or down. But I, too, have picked up in recent weeks perhaps just a tad of improvement in sentiment. Some is from retailing, some from banking, and some from the housing area. If you didn't want to see it, I don't think you'd see it; it's not a big deal, just a little here and there. You would have to put your finger on the pulse; it's just a sense, and I think that's a positive sign.

As far as the nation goes, I think the Greenbook is about right. That forecast is the most likely outcome and I think it's well reasoned. Nonetheless, it could be wrong and we could relive what we went through last year. I just put my finger in the air and came up with my own assessment, which is that there's probably about a 60-65 percent chance that we will get an expansion along the lines the Greenbook sees. But I think there's maybe a 25 or 30 percent chance that we won't and that we could see a repeat of last year, with the balance [of risks] being that we could get a stronger expansion. So,

it's a profile that has the odds favoring an upswing but enough of a chance of a downturn that one can't dismiss it. I do think this is a time when we need some patience; we need to be very pragmatic about applying patience. We ought to wait a reasonable period and look for some indicators that the economy is picking up. If we don't see those signs after some reasonable period, we have to keep an open mind about how to proceed. But at this point I'd be willing to play the odds of a pickup.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. We think our District is growing somewhat more slowly; it might be described as flat at best. In the agricultural area, because of the subsidized grain shipments, the wheat price that we've talked about has gone up and that, of course, has been positive. But livestock prices, which had fallen sharply, have only come back slightly. And we're still projecting a slowdown in agricultural income, which has [adverse] effects on suppliers to that industry. Also, with natural gas prices being so weak, the energy industry, which is a very important resource in our District, is suffering. As someone said, the rig count for us is about the same as for the nation--about 33 percent less than it was a year ago--but very weak; and employment in that sector is very weak as well. In manufacturing, we are involved in the auto industry. Shifts have been eliminated and cutbacks in production schedules have caused unemployment to increase in that industry; layoffs of about 1,000 people in Kansas City were just announced recently. General aviation has also seen some modest falloff, but for us that is important. The construction industry has been positive, particularly in the residential area. Some significant gains have occurred there, and that has been the most positive note out of the District.

On the national economy, our projections are less robust than those in the Greenbook, partly because we have seen such a poor fourth quarter for the economy and we look at what impact that would have going forward. We see a slower increase in the first quarter, or perhaps no increase at all, and a pickup after that, putting our projections below the central tendency [unless] we assume that there will be some modest fiscal package, which would bring us back up toward the central tendency. With that we see unemployment in the same range as the staff projection and inflation without the fiscal stimulus probably being within the same range or lower. So, that is how we see the national economy as well as the District economy.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. The Eleventh District economy can be classified as flat to down slightly. As Tom [Hoenig] indicated, we're also suffering from the low natural gas prices and not too high oil prices. A lot of drilling activity is being shifted overseas. Also, in our major metropolitan areas, defense-related industries at least prospectively are losing employment, and that's getting a lot of attention. We continue to hear a lot about the potential loss of a major GM plant in our metropolitan area. The leading indicators that our staff looks at for Texas and the District, though, have been offering some promise recently. There has been improvement in some of the labor market indicators. The average workweek is up and initial claims for [un]employment are down locally. There is good news along

the border areas: The smaller towns are benefiting from a stronger Mexican economy than the U.S. economy. Our contacts, Beigebook and otherwise, have been mentioning being squeezed by their inability to pass on a lot of their rising costs. For the first time in a long time, we've heard complaints about higher minimum wages and the higher mandated benefits in health costs and so forth. I've been in Dallas a year now--this is my first anniversary--and in my [staff's] briefing yesterday I couldn't help but notice that we were at about the same place this year relative to the recession and hope for a recovery as we were a year ago. The main difference was that the staff seemed more pessimistic this time than they did a year ago. In the area of hope and better sentiment, the people I talked to reacted very favorably to our easing move in December. That seemed to give some hope. They're very skeptical about any benefits coming out of the fiscal side. They don't know what [the fiscal initiatives] will be, but they know they won't do any good and may do harm. I was at Texas A&M last week and I heard about an Aggie doctor who illustrated this fiscal package very well. He amputated a patient's leg, came in the next morning and said: "Well, I have some good news and some bad news. The bad news is I took the wrong leg; the good news is the other one is getting better." [Laughter]

CHAIRMAN GREENSPAN. President Stern, can you improve on this?

MR. STERN. I won't even try! For a long time, I've been reporting that the District economy is relatively steady, plodding ahead at a slow pace. That continues to be a reasonable description of the situation. Obviously, some sectors are doing better than others and some regions of the District are doing better, but none is really doing awfully. So, in that sense, we seem to be doing okay. On the positive side, as several people have already commented, recently almost wherever one goes, residential construction seems to be improving; that is underway. And as other people have commented, attitudes clearly have improved in the sense that while they always seem to me to be worse than justified by circumstances some of the intensity of the gloom seems to have lifted, if I can put it that way. So, slightly better attitudes at least seem to be emerging.

On the negative side, some manufacturers have commented--and I think this is implicit in the charts that Mike presented--that inventories are excessive upstream and that has started to affect them in the sense that orders have slowed and so forth. Although we're not a big textile district, our textile manufacturers are running pretty well full out, as Tom [Melzer also] commented. So, there is something going on at least in that area.

With regard to the national economy, I do think the stage is set for something like the Greenbook forecast. I don't have a very different view as to how things will turn out. I would reemphasize the point that has been made that it is by most comparisons a very conservative forecast, and it wouldn't be altogether shocking to me if the economy did somewhat better than that. The one thing that does trouble me a bit, looking at the national circumstances at the moment, is the state of the long-term bond market where clearly nothing favorable has been happening in recent weeks. Indeed, rates are at the levels they were before the discount rate cut back in December.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I have very little substantively to try to offer today, but I would like to put out one notion. I am struck by the very strong consensus that I read in the press--and indeed it seems to be here as well--that the economy is likely to be "flattish" in the first quarter, that it will be a little better or that a recovery of some magnitude will occur in the second quarter, and that the economy then will move on up from there. I share that view. What worries me is that I have a bit of the contrarian in me, and I ask myself: If we have this very strong consensus, it's probably wrong, but in what direction and how? Is it too strong or too weak? Again, I'm part of the consensus, but my suspicion is that we could very well see events prove to be on the stronger side. If we were going to have a collapse, it seems to me that it would likely have been evident in the fourth quarter and would be underway now, and I don't sense that it is going on now. And the longer that doesn't appear, it seems to me the less likely that it will. It's probably too soon to rule it out, but [more strength than is projected] would seem to me to be the way things are liable to go. We have some things going for us already that should help, maybe more than we know. The short-term rates and the monetary stimulus that's in the pipeline should help. The refinancing of homes is putting more spendable income into the pockets of people every day. And I wouldn't be a bit surprised if this little uptick in long rates doesn't accelerate that [development]; and it might accelerate home sales as well. I'd also bet that the white collar layoffs have seen their peak. I think most CEOs who felt the need to lay off workers probably wanted to be able to report it in their year-end statements and got it done in the fourth quarter. If there's anything to that, layoffs are going to decline and that should help confidence. The credit crunch may be beginning to ease and the bank crisis may be beginning to ease. We're hearing here today and we read that banks are looking for good loans. My suspicion is that if they look, they're going to find them along the way. Fourth-quarter earnings of banks were better; their stock prices are up; and the loan officers' survey says that nobody is tightening anymore. So, maybe we will begin to get some relief there, although I don't think it's going to be very dramatic very quickly. On balance, I'm with the consensus but if the consensus does prove to be wrong, I think it's going to be on the up side.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, I want to discuss for a minute this confidence issue. If the consumer is truly the key to this economy and if a lack of confidence is what is driving his behavior at the moment, I ask myself: What are the things that are going to change that? Now, my previous suggestion that we hire a behavioral psychologist was rejected by this Committee last time, so I was looking around for other solutions!

CHAIRMAN GREENSPAN. Couldn't afford it!

MR. LAWARE. We couldn't afford it; well, the Administrative governor put a veto on that!

MR. KELLEY. You already voted for the budget; it's too late!

MR. LAWARE. We've been told since November that the President's speech would lay down a program for the country that would inspire confidence. It was a letdown; it certainly didn't draw any "hazzahs" from the assembled throng and it certainly did not create a consensus that we are now on a high road. The corporate restructurings and the layoffs, which Governor Kelley referred to, have continued, and they increasingly involve Blue Chip companies that were considered above the storm. And I think that has further alarmed not only blue collar workers, the traditional layoff victims, but white collar workers as well. Congress is certainly musing around without much show of confidence-building leadership. The fiscal solutions involving massive cuts in defense spending seem to me to instill panic in the hearts not only of employees of defense industries but also their shareholders. And modest tax cuts don't sound to the recipients as if nirvana has arrived. Having said that, it is hard for me to believe that further monetary ease in the absence of some statesmanlike political leadership can really restore the economy to vigor. At the same time, it seems to me that previous monetary policy moves and the accumulated demand that has to be there in the economy should make something close to the staff Greenbook projections for GDP a realizable target without further monetary stimulus. In the pursuit of price stability, I don't think the modest growth rate outlined in the Greenbook is an undesirable outcome, although I must confess that the staff outlook for inflation is somewhat disappointing in the context of that slower growth rate. Mr. Chairman, that's all I have to say on the confidence issue today.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I don't have much to add. I like the Greenbook. I liked it last February as well. And I hope I never see it [repeated] again--not next February at least! I think the economy remains in a state of lethargy, although perhaps the intensity of the gloom is burning off. I think it's worthwhile to ask where we stand. We're in pretty good shape in the sense that we do have a lot of stimulus in the pipeline and we can see that working visibly and forcefully in financial markets--all the things we've mentioned in terms of the refinancings. Of course, we've been making this argument for some time now and someone is going to ask: When does this stimulus start to trickle out the other end of the pipeline? We have cut the fed funds rate 175 basis points in the last six months; 125 basis points of that has come in the last four months; our last move was six weeks ago. Sooner or later people are going to say: "Where's the beef here?" What real economic data do we have, even the forward-looking data like orders, that would suggest that we have found the appropriate monetary stance consistent with recovery? The housing market continues its modest rebound and we have exports as well. Of course, it's still pretty early in the lagged response cycle. However, so far we have relatively little to show for our actions. Those actions were certainly received as a credible move to realign short-term rates with lower inflation expectations but they have yet to produce much in the way of real economic stimulus. It's good that M2 is growing a bit more but it's still in the lower half of its range. When I look at the outlook for persistent slack in the economy, capacity utilization and labor, and the continued slow growth in M2 and credit, with significant sectors of the economy clearly sitting on the bench out of the recovery game--I mean by that state and local governments, commercial real estate, and consumers in the

sense that they lack the debt capacity for explosive spending--it's still difficult for me to conjure up much fear that an overly robust recovery will ignite inflation.

I guess there is some fear on the fiscal side, although I think that will tend to lead to chaos rather than effective stimulus. Nonetheless, we have had growth in M1 and reserves that has gone from high to very high. We also have a high long-term bond rate. Given the way the long bond has been reacting to statements on the screen, the evidence tends to suggest that the long bond rate would fall if we eased again. That's no reason to ease, necessarily. Despite that, the fact that the long bond rate hasn't come down more is clearly a concern. I think underlying that concern is primarily the fiscal situation. Despite a rigorously binding budget agreement, the deficit has continued to balloon even before one considers the fiscal package. And now we're moving to a fiscal bidding war where the first bid is a deficit of \$400 billion. If I were a long bond investor, certainly I could understand why I would be a little concerned. There is the supply side of that and also the artificial supply in the sense that dealers have been heavily shorting government securities as part of the process of issuing this record volume of corporate debt. And I suppose there may be the expectations of recovery as well. So, I think the long bond rate has to give one pause. It is consistent with the expectation of a cessation of progress on inflation once the recovery starts. It's interesting to note that many private forecasters as well as OMB and the Administration project a flattening out of the inflation rate once the recovery gets underway--a flattening out in the 3 plus percent range rather than the continued progress that the Greenbook shows. And this is despite very extended periods of slow growth in M2 and the persistence of slack in the economy. So, I think there's ample reason for caution. I, for one, don't want to see us go so far that a major tightening is inevitable once the recovery gets underway. And I'm certainly sobered by the realization that some on the Committee would suggest that we may have gone that far already.

So, I would agree with Ed Boehne that it's a time for patience. We're at a critical period here in the sense that we have a few weeks of relative quiet before the fiscal or political battle intensifies. I fear that will be even more unsettling for the markets and may tend to immobilize us. While it is a time for patience, I think it's also a time for vigilance. We should start to see some of this stimulus dribble out of the pipeline soon and we ought to start being concerned if we don't get some movement soon or if we should start to get some convincing negative news or significant signs of deterioration.

CHAIRMAN GREENSPAN. Vice Chairman.

MR. CORRIGAN. Speaking near the end, there's not much left to say in terms of the national economy. It's very hard to take serious exception to Mike's forecast at least for 1992; 1993 is obviously another question. I would agree, as many of you have said in one fashion or another, that attitudes at least have stopped getting worse. Whether they are better, it's hard to say; but one can [at least] say they are no worse. Even some of the most bearish major corporate CEOs now associate themselves with that. I also think one can make a pretty darn good argument that the stabilization of

attitudes, even if that's all it is, is fairly directly related to the change in monetary policy that was made at the end of December.

Now, in terms of the shaping of the future, I have managed to convince myself that we probably are a bit further along in this correction of the debt overhang [problem] than Tom Simpson was talking about than maybe is fully recognized. I also think we can now begin to make a case that the banking sector--and perhaps the financial sector more generally--looks a little better even if there still is a long way to go. And I do agree with several people who made the comment that banks are more [receptive to borrowers]. Just in terms of advertising space in the New York Times, we see a lot of full page ads now about loans, not deposits. If those two points are accurate even at the margin, I'd stipulate that one of the key assumptions of the chart show, to the effect that the credit crunch will ease "somewhat"--I think that was the word--in 1993, might be a bit pessimistic. I might be able to envision that [easing] at least in "somewhat" terms some time in 1992. But having said that, I agree also with John LaWare that the confidence factor is the wild card. Even if there are some straws in the wind that smell a little better and look a little better, the economy does remain vulnerable to shock. That's one of the reasons why I blow a little hot and cold about the level of the stock market. But I also think, as a number of people have said, that the source of particular uncertainty is political with a capital "P," bipartisan. I can't top Bob McTeer but I agree that the great [risk] on the fiscal side is that [the stimulus] will get overdone or that the process will get ugly, or both. If it gets ugly in a process sense, that certainly is not going to help confidence. If it gets ugly in a substantive sense, financial markets aren't going to like it. And that is a major risk.

Perhaps a bit longer term, I must also say that I take this Japan/U.S. thing as a symptom of what I perceive as a real rise in protectionism and some elements of neo-isolationism. This is a real concern even though it may not seem as imminent as the fiscal [actions]. And while it's even less imminent, the point that Bill McDonough made in his remarks at the opening of the meeting about this tension among the Europeans--with a quite different economic profile in Germany on the one hand than in most of the other countries, with its implications for exchange rates and interest rates and some other symptoms of a political stress point--can have important economic implications, though maybe not immediately. So, there's no shortage of things to worry about out there. But the risks as I see them are much better balanced today than I viewed them over much of the fourth quarter. I think we always run the risk of instant replay but for that reason I feel more comfortable with the kind of profile in Mike's forecast right now than I have for the last few months.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. It seems to me that the bond market continues to be a check in regard to our ability even to re-inflate. I have some question as to whether we can cause the growth path to be much more robust than is forecast. Probably we would have to demonstrate that we're re-inflating before we can alter some of these conditions that exist in people's confidence level. I don't think I've ever seen so much ill regard for our government among people. And even though we think that inflation is a monetary phenomenon, people out there have a

lack of confidence in government and what spills over from that somehow or other is that things won't be dealt with in a proper manner. Maybe that is what causes long bond prices to be at the same place they were 2-1/4 years ago. That's a rather sad commentary. Now, clearly, the housing market has been helped because the seven-year Treasury rate has come down quite substantially over the last 2-1/4 years even though the long rate has not. I sense, as many of you do, that there is some perking up, particularly in the housing market. Houses are selling; old houses are selling. And that does involve new activities. Certainly, a lot of refinancing is going on. As to whether the refinancing is being done in such a manner as to reduce the payments, the best sources that I have indicate that 70 percent of the refinancings are going to reducing the length of the maturity and keeping the payment [amounts] about the same.

Clearly, M2 looks a little better than it did a month ago. I agree that in the commercial banking system the capital positions of many of the banks are improving; and the stock market seems to be a plus. But I can't find any robust sector. I can't find any area, in any industry or any geographic region, that really is alive. I know, Tom, that you have those textile mills running at capacity; but as far as robust and entrepreneurial spirits being charged up, that doesn't seem to me to be really there. I think some additional mischief could occur on the international scene. Europe could be a little softer than the staff has [projected] in the Greenbook. I see very little prospects for the GATT round getting anywhere by April, as everyone is saying. And if that doesn't occur, I tend to share the feelings that have been expressed about how protectionism might slow us down. So, we have what I think is a recovery out there, but I certainly don't think it is a very robust one. If it is, I'll be mistaken. I'm somewhat more optimistic on the GDP deflator for this year, but only marginally so.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. I think that we're back to the problem of the law of averages. Listening to the comments around the table, on average, the Greenbook is correct. But with all respect to our staff, when I did a count I counted five who are more optimistic, five who are more pessimistic, and two who think you're about right. It means that on average you're right. I think about Mike Kelley's comment to the effect that the consensus is wrong; our dilemma is that we don't know in which direction it is wrong. One of the reasons that's true is that we have begun in the legislative and executive arenas to adopt pro-cyclical policies instead of the usual anti-cyclical policies. Now, if you'll excuse a witticism: In the current environment, pro-cyclical policies mean that when things are bad, act aggressively to make them worse. If you look at the particular legislation that has passed, I think the pro-cyclical nature is clear. Beginning with the banking legislation: Through regulatory fiat and through legislative policy we've adopted banking provisions that, when things start to deteriorate because they feed through into the capital environment, rapidly shrink loans. When things begin to turn around and we have rapidly rising capital, either through market values or through the ability of the banks to raise equity we will hopefully, sometime, have a rapidly rising ability for banks to make loans, but right now we're on the down side.

CHAIRMAN GREENSPAN. Sounds like the Banking Act of 1863.

MR. LINDSEY. It very well could be; my memory doesn't go back that far. Mr. Chairman, and unfortunately nor does my history.

MR. BOEHNE. You were on the wrong side of the war!

MR. LINDSEY. Yes, that's right; we were fighting you guys back then! [Laughter] In labor markets we also have adopted pro-cyclical policies. They were well intentioned, but they have the problem of being pro-cyclical. In particular, I point to plant closing legislation which requires substantial advance notice. I can understand the humanitarian reasons for doing so, but when the economy starts to turn down, or when we're in a down cycle, a company is forced to announce more plant closings, which has an adverse feed into psychology [and] the confidence factor. And if you look at what is happening on Capitol Hill, the other two potentially bad things that will happen if things continue to get worse--and they've already been mentioned--are a gross fiscal stimulus, which will push up long-term bond rates, and a revival of protectionism.

We have to think about how to interrupt this pro-cyclical policy. The keys have already been mentioned. The first is that the public knows that the political apparatus is not working well. One can see that in that the purpose of the politicians is to engender confidence. The President certainly billed his speech as one to engender confidence and the opposition appropriately called it "warmed over" and said that there was no confidence there. Further, if you think about why our December policy was apparently as successful as it was in building confidence--just about everyone commented on that--I think it was because it was decisive.

With all that as background, I think that on average the staff forecast is right. I don't know which way it is wrong, but I do know that it is wrong. I do know that the risks are high on both the up side and on the down side. And the proper policy call is that we should be as flexible as possible and should be prepared to take on the risks whether it turns out that we're wrong up or wrong down. In addition to being flexible, we should also learn the lesson of December and we should act decisively when we act. But in which direction that action should be, I share the Vice Chairman's view: I don't know. Thank you.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Thank you. Coming toward the end of this discussion, there's really not as much to say. Based on the Greenbook analysis and the comments that have been put forward describing what is going on in each of your Districts, it still seems to me that at best we can say the recovery is sluggish. We've been saying that for quite a while and I agree with Governor Angell in that I can't see where that source of light is that will lead us out of this. Some of the disappointing news that we're continuing to hear really confirms the hypothesis that we're seeing some structural changes. This is not just a cyclical move. The problem with that is that it may take us longer to come out of the recession than might have been the case in the past. I will say, on the positive side, that the positive signs we are seeing are very good for the long run. The balance sheet

restructuring certainly is good for the long term, as is the strengthening of the banking sector; and the fact that inflation does not seem to be as much of a concern in a broad variety of sectors is good for the long term. We're seeing some change in people's viewpoint toward savings. We've been saying for a long time that we need to have savings policies in this country, and I think we're starting to see some improvement there. And the easing that occurred in late December was about as positively received as we might have hoped. So, that was very helpful. I do think that a lot of the easing that has occurred over the last year and a half probably has been soaked up in the balance sheet restructuring. So, a lot of the easing that we may have thought was in the pipeline may be used up. I do agree that we're not yet seeing in the real economy the easing that occurred in late December. We certainly saw [mostly positive reactions], with the exception of the long bond situation. Certainly the stock market reacted very favorably. I'm concerned, as is Larry, about what might be happening on Capitol Hill to fix the situation. In view of the fact that I don't think the easing is fully reflected in the real economy, I don't feel quite the same pressure to ease that I was feeling in December. But like the Vice Chairman, I think we have to be quite vigilant over the next perhaps couple of weeks. In the next couple of weeks there may be a window before Congress starts doing all kinds of things. If there is a desire generally to ease, from a political perspective--though I hate to say it--it may be better to do it sooner than later. On the one hand, it's not expected before Congress gets going, and it may well strengthen the hand of those who wish to try to address the deficit situation. So, if we're thinking in terms of ease, I'd be inclined to urge that it be sooner rather than later. Nevertheless, having said that, I'm not feeling quite the same strong pressure that I was in late December.

CHAIRMAN GREENSPAN. Thank you. With that note I think it would probably be appropriate to adjourn until 9:00 a.m. tomorrow morning.

[Meeting recessed]

February 5, 1992--Morning Session

CHAIRMAN GREENSPAN. The next item on the agenda is the long-run ranges for the aggregates, and I will call on Don Kohn to brief us. I'm sorry, Don, could you hold up for a second? Wayne Angell would like to amend some of the remarks that he made yesterday, so perhaps the best time to do that would be right now. Governor, the floor is yours.

MR. ANGELL. Mr. Chairman, I don't know whether "amend" is exactly the right word because as I was talking yesterday and listening to myself it sounded very confusing to me. [Laughter]

MR. BLACK. You can imagine how the rest of us felt!

MR. ANGELL. I decided last night that the reason it was confusing was because I wasn't really willing to put the proper labels on what I think are our current circumstances. I don't think we can do the right job of selecting policy unless we understand more precisely the nature of the circumstances that we're in. Those circumstances are, I believe, that we are [involved] in a long-cycle event. And it's a long-cycle event about which we must understand the cause because we can't do the cure if we don't understand the cause. I think the cause of this long-cycle event was the very expansionist monetary polices of the 1970s that created double-digit inflation. That double-digit inflation began a debt cycle in the private sector, which in a sense was not sustainable unless the rate of inflation was to be increased continually. I believe it was not possible for the world's reserve currency to be subject to a continuation of that inflation. So, it was entirely proper that under the Volcker Federal Reserve that was headed off and brought back down.

But, ultimately, no more inflation means that the private sector--either corporations or households--does not wish to hold the debt as a ratio to their income that they did before. Now, during a long-cycle event it seems to me that the proper policy is one of price-level stability in order to get real stability to the event. As we've found during this period, to keep disinflation from turning into deflation we've had to provide reserves at a rate much [higher] than we ordinarily would think necessary, and we still have had a hard time keeping M2 and M3 growth where we wanted it. If it's the case that households and corporations are trying to reduce debt as a percentage of their cash flow and their income, then it seems to me that we have to admit something that central bankers never want to admit, and that is that the government has to become the debtor of last resort in such a circumstance. Because if we're going to force the growth of credit at a 3 percent rate or whatever even anemic rate may seem desirable, then someone has to be the owner on the other side because credit can't grow faster than debt grows. I think it's entirely responsible and important for the continuation of the creation of the private sector that those debt ratios be brought down. And under those circumstances I do not know how government debt can keep from going up. That raises the question for me as to what we say about this borrowing because it's the borrowing that causes the people out there to be so unhappy. The people are unhappy with their government because they don't understand how during this critical time we can have what they call "irresponsible borrowing."

Now, if that's the case, then I am somewhat admitting that Keynesian economics is really depression economics and I don't want to sound Keynesian; it's terrible for me to sound Keynesian, but I think we ought to be wise in regard to what the government does as it increases its debt. As defense spending comes down and as we have layoffs of highly skilled workers in the defense sector, it seems to me that it will be important for us to have [other] capital investment. It's not good to replace defense spending without employment compensation. That's a very bad tradeoff in regard to our getting done what we need to get done. So, I would much prefer to recognize the desirability of public sector spending on the infrastructure, that is, building highways and bridges and doing public sector spending that has the best multiplier in regard to the private sector. In other words, what I was trying to say yesterday and sounded so confused about is that I don't think monetary policy can in and of itself resolve this problem. I don't think monetary policy can do it [now] any more than it did in the Great Depression. So, Mr. Chairman, I wanted to revise and extend my remarks to recognize that this event is different. By that I do not mean that it has to be more severe; I do not mean that the outlook is necessarily worse than Mr. Prell has it. But I do believe there's a downside risk to the outcome that Mr. Prell has outlined. That is, if the debt contraction in households and in the business sector is to go on and if households ex ante wish to increase their savings all at the same time, then the paradox of thrift leads us to somewhat slower consumer sector spending than we have projected in front of us. And under those circumstances our job ought to be viewed somewhat differently and that is not that we can fix it but that we can keep it from getting worse. That would lead me to a stability orientation. Thank you for indulging me in that.

CHAIRMAN GREENSPAN. Thank you, governor. Let's now move on to Don Kohn.

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

MR. LINDSEY. Thank you. I'm going to be distributing a picture of what President Black and I will be proposing. Mr. Chairman, while that picture is going around the table, I'd like to begin with an apology. It had been my intent this morning to wear the Thomas Jefferson tie that Alan Murray made famous following the last FOMC meeting. But I got dressed in the dark because I didn't want to wake my wife, and it turned out that I pulled out my Adam Smith tie instead of my Thomas Jefferson tie. I was embarrassed, but Bob Black has reassured me that had Smith lived on this side of the Atlantic he no doubt would have chosen Virginia. And he also no doubt would have preferred the "Tunnel Option." With that aside--

CHAIRMAN GREENSPAN. The last time I spoke to him he didn't indicate that!

MR. LINDSEY. It's the "Invisible Tunnel."

MR. BLACK. He may have thought you weren't up-to-date on the issues.

MR. LINDSEY. [Statement and charts entitled "The Virginia Plan"--see Appendix.]

MR. BLACK. Shall I go ahead, Mr. Chairman?

CHAIRMAN GREENSPAN. Go right ahead.

MR. BLACK. I can't do what he said I would do, but actually he's given me a lot more credit for this than he should have. I had put this on the back burner; I had thought about it many times earlier. He surfaced the plan and sent it to me and asked for my suggestions and I made one or two suggestions, which he very graciously adopted. Then he sent me another version and I made one minor suggestion on that. So, the thought of giving me the credit for it is really misplaced. Since he has entitled it "The Virginia Plan," I wish very much that I could have Patrick Henry do the defense! There's little doubt that he and Thomas Jefferson and George Washington and George Mason would certainly have a favorite rate of growth of the money supply with the use of "tunnels," if anybody had ever brought that up. I do know that they would be a bit worried if they knew the "Virginia Plan" was being defended by somebody who was born in Kentucky. My only defense there would be that Kentucky was once a part of Virginia.

CHAIRMAN GREENSPAN. It was then.

MR. KELLEY. That's right.

MR. BLACK. Yes, it was then, that's right. I wish we could go back in time and I could speak at that time; but while I'm a Kentuckian by birth I'm a Virginian by choice--maybe that will give me a certain amount of credibility--and I also have two children who are native Virginians and I married a native Virginian. You kind of absorb some of this as you go along.

I think Governor Lindsey has already stated quite well the reasons for adopting the multi-year tunnel approach instead of the annual cones and basing this on the level of M2 at the end of 1990 originally. Now, we set the date on 1991, but it comes out to the same thing. Let me make three additional comments on this, mostly by way of elaboration. First, the upside insurance this would give us at this particular moment is really a compelling reason. The [beauty] of this tunnel is that it pretty much guarantees that we would get price stability over the long run--which I think should be the objective of monetary policy to the exclusion of all others--as long as we were willing to reduce the rate of growth in the money supply until we got it down to the rate at which the potential output of the economy could increase [over time]. Now, everything we know about monetary history tells us that we can stabilize price levels if we get [money supply growth] down over time to somewhere in the neighborhood of 3 percent or so. People differ on what the potential growth of the economy is, but I don't think there's any doubt that it would be greater if we had price stability than if we didn't. And this is essentially the message of the P\* model, which is one of the finest pieces of work I think we've done in the System. I wish I'd had a hand in that, but I certainly applaud the others of you who did.

I think a continuous unbroken tunnel would be a much more appropriate and powerful device for controlling the long-run rate of growth in M2 than the current cones because it would eliminate base drift. And base drift has really been the bane of our existence. Whatever base drift has brought us in the way of short-term flexibility in some years, in practice I think it has made it virtually impossible for us to control the long-run rate of trend growth of M2, with the result that we have [not] known and nobody else has known what the price level would be several years down the road. Consequently, I've concluded that no matter how strong our intentions are to reduce inflation--and for the last several years this group has had a stronger inclination in that direction than virtually at any time in the history of the System and I don't think that intention has ever been stronger than it is right now--I don't think we will achieve that goal. Despite our feelings on that and our best efforts, I don't think we will ever achieve that goal unless we do something about moving away from our present targeting procedures. And I think the tunnel would address this. Moreover, and I can't emphasize this point too much: I think this move to a tunnel would greatly increase the credibility of the System. We have said repeatedly that our intention over time is to bring down the rate of growth in the money supply to noninflationary levels. This would spell that out in a great deal more detail and yet it would be clear that we would have the necessary leeway in the short run to do what needs to be done. And if this did increase our credibility, it would greatly reduce the transitional cost of moving to price stability.

Second--and all of this is relevant to the comments that Don put in the Bluebook under the "tunnel option"--it's certainly true as the Bluebook suggests that we wouldn't want to adopt the tunnel option when the relationships between M2 and income and prices are going to fluctuate in the future. All we really have to guide us is past experience and, historically, we know that there have been variations in the short run extending sometimes more than a year but that in the long run there has been stability in that relationship. V2, by the best statistical measures that we have, has been constant and predictable over the long run. Consequently, this tunnel approach makes a great deal of sense to me. But the tunnel needs to be wide enough to accommodate a fair amount of these variations in V2 that we normally have over periods as long as one to several years. Maybe a 4-point spread, as Governor Lindsey suggested, would be the proper amount, but it's possible that the width should be greater than that. It's important to note in this regard that even a very wide tunnel would still constrain the trend growth of M2 over a long period of time sufficiently to ensure price stability.

And finally, the Bluebook may be right in suggesting that a substantial further easing of policy might be needed to get M2 up to the midpoint of Governor Lindsey's tunnel. But if we had a tunnel that extended our long-run trend objectives to 1993, I wouldn't feel compelled to move M2 up too rapidly from its present position near the bottom of the tunnel to the midpoint by the end of this year if it were clear that the recovery had resumed. In other words, this is not a ploy for ease. What I'm trying to do here is to suggest a long-run strategy that would give us the necessary flexibility in the short run. So, with regard to the width of the tunnel, it might be that it would be better for us to have a 5-percentage point tunnel if we wanted to make sure right now that we accommodate what is probably a

good projection on the part of the staff, which is that 3-1/2 percent M2 growth in 1992 would be consistent with a resumption of the recovery. But, again, even a fairly wide tunnel like that would be concerned with the course and control of M2 over a long period of time. And that to me is the beauty of the tunnel approach.

So, Mr. Chairman, like Governor Lindsey, I hope the Committee will give the "Virginia Plan" favorable consideration. I did not admit this to you, Larry, but as you were labeling this "The Virginia Plan" I thought to myself it really sounds more Hamiltonian than Jeffersonian. And then I thought with your background from New York you could send a "New York Plan." But in my case, although I spent right much time in New York, the first time I went to New York I crossed on the Staten Island Ferry prior to shipping overseas at the end of World War II and I didn't even see the Statue of Liberty. I was the only one who went out without seeing it and that was the main thing I was interested in seeing. So, I didn't think I could defend a New York Plan, but I do think this may be a little more Hamiltonian than Jeffersonian. And I hope the Committee will honor these distinguished forebears of ours who, other than an occasional glass of whiskey, probably would have liked nothing better than a slow, steady rate of growth in the money supply!

CHAIRMAN GREENSPAN. Well done, gentlemen. Let me raise a few issues on the other side of this. I don't think there's any question that we all hold the basic view that we wish to move toward price stability as a necessary condition for maximum long-term real growth. Also, I think that the monetary policies we set around this table, and the mechanisms we employ to achieve them, don't rest all that much on simplistic cones, tunnels, or whatever. Hopefully, we're looking at the issues in somewhat greater detail to understand the relationship between money and GDP. Having said that, I have been in and out of a position in favor of the "Tunnel Approach" over the years, and this is the original version of money supply growth notions. I think the key question we have to ask ourselves is: To what extent do we actually use the cones to operate policy?

We're obviously acutely aware of what other people see with respect to these data. And to the extent that the particular cones that we use--or even if we were to use tunnels--reflect our basic view of what we wish to be done, then indeed we would follow them. But the cone is a simplified version of  $P^*$ . Everything that's in the cone is obviously in  $P^*$  in a somewhat more detailed way. And we do use  $P^*$  as a guide and indeed have been using it, obviously, for the last several years as we try to move our way toward price stability. Indeed, it's that sort of process that suggests to us what the path of money supply should be. So, I think we have to ask ourselves several questions about this. Would our switching from cones to tunnels affect what we actually do here? Or are we trying to alter the perception of the market and other people? I submit it is the latter, not the former, that is crucial to this. And if that is in fact the case, then I think we are confronted with a very difficult problem here, which is that even though we may perceive the tunnel as being an endeavor to simplify  $P^*$  as the long-term goal, as a practical matter we are signaling a very sharp and immediate reduction in the funds rate to move M2 growth up [in the cone]. Were we to start something like this when we are at the midpoint of a range, it would be very easy to do. I don't think one can readily argue strenuously--with the exception of

a few minor issues I would raise--between the desirability of a cone and a tunnel. I think every person around this table has been on both sides of this in their monetary policy discussions. I'm most concerned that if we were to do this at this stage, it would look as though we were merely trying to hide the fact that we really want to move the money supply up sharply by dropping the funds rate. And in the context of what is happening on the fiscal side, I must tell you that I would be quite nervous about that perception being conveyed even if somebody as formidable as Bob Black, who certainly has no reputation as an inflationist in this country, were to come forward and defend this particular plan.

My basic impression at this stage is that were we to move from what we define as the bottom of the range and put the tunnel into position, we essentially would be saying that we are going to make a major push on the money supply and presumably on interest rates. Now, that clearly is not the basic view of either Governor Lindsey or President Black. My concern is that there's a degree of skepticism out there, which I find frankly to be very deep-seated. And while I personally would not mind discussing this in some detail--I might even vote for it if we were starting from the midpoint of the tunnel because most of the arguments you make are valid arguments and I think they make a great deal of sense--my concern is where we are at this particular point. The difficulty that we have mechanically is that we have chosen, for better or worse, to rebase on the grounds that there are structural problems in the relationship between M2 and gross domestic product that [cause that relationship to] veer off from time to time for several years. And that shows up in the P\* data; it would show up in the tunnel data. What our cones enable us to do is to reset all the past imbalances to square one. As I said to some of my colleagues, it's like pushing the odometer on the dashboard back to zero so you start from scratch. Now, in today's environment, we know there's base drift; we know that money growth is under where we probably would want it to be. And even though we start from square one, what we do as a consequence is to adjust to that fact [on the basis of] our judgments as to where we want it to be. I was also concerned that if we were to move the range up to, say, 3-1/2 to 7-1/2 percent or something like that instead of 2-1/2 to 6-1/2 percent to reflect the base drift or even more, that would create the same problem that starting at the bottom of the cone suggests.

The general [suggestion] that the other "Kohn" raised with respect to this issue is, namely, to stay where we are but to recognize fully that we have had base drift. And if indeed the depressing forces on M2 which we presume to be temporary start to ease and M2 starts to move into the upper [portion] of the cone, I don't think we should feel pressed to tighten policy to bring it back in; [rather we would] make an ad hoc adjustment in our procedures to recognize that this is not a bad level of M2 at which to be. So, I would conclude that I don't see any difference in philosophy between my view of money and that which Governor Lindsey and President Black expounded. In fact, were we in a particular range at this stage and changed to a [tunnel], it would not create the question of "What kind of game are they trying to pull?" I'm concerned about doing that at this time. I think the benefits that we would get from the tunnel, as Governor Lindsey outlined it, we could achieve just as readily if we are willing to operate in the upper [portion] of the cone, without creating for ourselves what I would consider to be a rather difficult

public relations problem. As much as we may think that we are doing things like this as a strictly analytical monetary policy position, I'm fearful that the rest of the world with its [high] degree of cynicism would not give us the benefit of the doubt. Would anyone else like to speak?

MR. BLACK. Mr. Chairman, could I say something in response to that?

CHAIRMAN GREENSPAN. Go ahead.

MR. BLACK. I don't hear anything you say that makes anything but sense, but my policy position now and I guess for the short run is that I'm going to argue that we not change the federal funds rate. I don't see any reason for doing that at this point. If we're concerned that [adopting the tunnel approach] would look like a tightening, then I think we could widen this tunnel, make it 5 percentage points, which would ensure that we would come within our targets. And on your last point, in a sense I think you're saying that it wouldn't be so bad to disregard the cone if the money supply were to go over it; and I certainly would want to do that myself if [that began to happen]. But I think that would be a bit more damaging to our credibility than if we had a tunnel [because with a tunnel] we would not be seen as disregarding our targets. People think that we don't pay a lot of attention to the targets. That's the only reason, really, why I want [a procedure] that we could live with and have the flexibility we need and not [unintelligible]. And I think with those two changes we could do it okay.

CHAIRMAN GREENSPAN. Governor Angell and then Governor Lindsey.

MR. ANGELL. Mr. Chairman, I really appreciated this discussion. It is exactly the right presentation. I side with you that the most critical question for us at this point in time is conveying what we are going to do in the short run. So, I agree with your position. I would, however, like to keep on tap this notion of the tunnel as possible for the long run as well as the short run. That is, we sometimes have [viewed] a yearly [target] as if it were the long run and then our FOMC meeting [decision] as the short run. It does seem to me that once we find ourselves at the middle of the desired tunnel, it might be good in terms of a track record for us to have [the tunnels] out there as we [draw] our cones to see whether or not we have cumulative base drift.

Bob, I was a little surprised that you were willing to accept a 4 percent growth path in your tunnel. I would have thought that you would have insisted on a growth path in the tunnel of either 2 percent or 3 percent, which is consistent with price level stability. Now, I find this tunnel arrangement puts us in an expansionist mode; I think it does exactly what you suggested, Mr. Chairman. If we had said we should have fostered growth of the money stock at 4 percent last year, not 4-1/2 percent, and if the tunnel from that should have been 3 not 4 percent, then we would have a long-run tracking guide that I think gives P\* its force but yet maintains a business as usual [approach] in regard to this year's cone.

MR. BLACK. Mr. Chairman, could I just say one thing in response to that, because I think Governor Angell has hit upon a very important point? When this was first done, Larry had it at 4-1/2 percent and I suggested that we cut it to 4 percent. That was done and he carried the 4 percent rate on out into 1993. I would not want 4 percent in 1993; I would want to bend it down to 3-1/2 percent or something of that sort. There's a sentence in the letter that he sent me in which it appeared, if someone read it carelessly, that he might be committing himself to 4 percent forever; I don't think that was his intention. So, I suggested that we make it appear that we want to bend it down. What surprised you is not the way I had suggested. So, I'm really where you thought I would be; it's just that we didn't end up changing that particular thing.

CHAIRMAN GREENSPAN. Could I just ask you a quick question? If we were to adopt this and the money supply were way out of these ranges by the end of this year for reasons that are fully technical, would you feel that we would be required to push back into that tunnel over a particular period of time or [would we] stay outside for a year, or what?

MR. BLACK. I would say if [the reason for such growth] is purely technical, it would be permissible to go outside. I have not been as disturbed about the low rate of growth in money we've had recently as I would have been had I not felt that there were explanations for it. If we have good reasons for why it's growing unusually fast, I think we should state those to the public and use them as justification for staying outside [the tunnel] but say, that if we get into a more normal pattern of money growth, we will definitely get [money growth] back into the [tunnel].

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I understand very much your sentiments. Let me say that, looking at the picture, I forgot the old adage that a picture is worth a thousand words. Regrettably, the picture that I have in front of you, which from my point of view is for presentation purposes, is in error. It was based upon preadjusted M2. Am I correct in saying that we had 3.1 percent growth last year?

MR. KOHN. That's correct.

MR. LINDSEY. Actually, therefore, this box should be substantially closer to the middle of the target range, i.e., 0.6 percentage point closer. Further, if we adopt President Black's suggestion, with which I agree completely, the tunnel would be widened to 2-1/2 percentage points on either side and we would be a full 1.1 percentage point above the bottom end of the target range. That wouldn't be close by any measure. So, the picture as presented--which by the way is not even to scale but is illustrative--actually should show our starting point as somewhere very close to the middle of the bottom half of the target range. That's the only correction I have in that presentation.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. I have a question of clarification. It seems to me that the initial starting point is an important issue and that it

ought to be based upon some concept of a steady state velocity. Did you choose the fourth quarter of '90 with the thought in mind that we were in effect in a period when we were at a steady state velocity? Is that why you chose it?

MR. LINDSEY. Probably, and I would be happy to be corrected by President Black on this. We were in the middle of this period of uncertainty. If I were to select a period of more stable velocity, I probably would have to go back further; and if I were to go back further, I'd be incorporating more base drift in there. I would be incorporating so much base drift that the picture wouldn't look very sensible. So, I will admit to arbitrariness in the selection. I was basing it, really, on the statement of this Committee last quarter which said it was our [objective] to move back toward the middle of our 1991 target range. So, five months ago we were willing to say that we should be where that middle line is.

MR. PARRY. I'm not sure how to accomplish this, but it would seem to me that if one does see value in  $P^*$ , which of course uses steady state velocity as an important component, one would want to figure some way to get a greater symmetry between the two procedures.

MR. CORRIGAN. Dick Syron.

MR. SYRON. I think it's very difficult because it's very hard to deny the intellectual consistency of this approach; in fact, it is completely intellectually consistent with what we say we're doing, which inevitably in discussing it leads one back to pragmatism. My concern is that it may be a little more consistent than the consistency of velocity allows us to be over time. I admit in making that argument a continuing analogy: Hancock and Revere were considered sort of rogues and not the intellectuals that Jefferson and Hamilton were, so I'm not going to make their argument. My concern is that I just don't have confidence in the stability of these relationships in a multi-year process. That would lead us to having to have the tunnel be quite wide if we wanted to have any confidence that we were going to stick with it over time. And if the tunnel has to be that wide and also if we need to have the possibility of bending the tunnel, one comes back to the issue that the Chairman raised of either a very wide tunnel or a bent tunnel. Bent tunnels are almost cones in a sense, and that leads us back to this problem of saying that people could misinterpret what we're trying to do. Obviously some will make a fairly mechanical calculation and see that we really would have to drop interest rates--as is implied on page 15 in the Bluebook by extension--very, very dramatically if we wanted to come back to the midpoint without bending the tunnels. So, my own view is that this [approach] ultimately is tied to the issue of how flexible we want to be in the intermediate period. That's what we're talking about; all these are subsets of that. Given the concerns that we have about velocity's erratic behavior and given the many structural changes that people have been talking about, I don't know that this is the time to make a change. I prefer for the longer term to focus on  $P^*$ , which I think is another way of doing it and avoids some of these problems. But having said all that, I can't deny that intellectually this is completely consistent and in that sense would seem to be the way to proceed. I just am afraid that practicalities both in perception and measurement preclude it, in my own view, at this time.

CHAIRMAN GREENSPAN. Vice Chairman.

MR. CORRIGAN. In the past 13 years or so I've been around this track more than once, too. I can't deny the neatness [of this tunnel idea], but I have to ask myself the question: Are we dealing here with form or substance? And if we're dealing with substance, it has to follow that the adoption of the tunnels would, in fact, mean that policy in some sense would be different. If we're dealing with form, we're saying that policy would be the same but somehow or other the form would make a difference in terms of perceptions about policy --the so-called credibility effect. I have to say that, despite the neatness, I think it's much more form than it is substance. For example--and I can't allow for compounding, so Don Kohn can correct me if I'm wrong--I think it's about correct to say that had the Committee at the end of 1986 adopted a policy of a five-year cone from then to the end of 1991, policy wouldn't have been any different than it has been in one sense. I think we would have been within the cone each and every year. If we put ourselves back to that position--if we had had the cone and we were in it every year and M2 growth for the five-year period averaged 4 percent--would we have felt back then that we would have achieved price stability or have been much closer to it than we are right now? I think a lot of people would have said "yes" to both of those questions; but I don't think the outcome would have been any different either in terms of the execution of policy. I am very skeptical--I always have been--of this so-called credibility argument. The people out there setting wages and prices in the trenches wouldn't know a cone or a tunnel if they were in it. What they react to is demand and supply in the marketplace. And what we are ultimately trying to influence are those considerations. So, while I do think [the tunnel concept] is neat, I don't think there is a great deal of substance, defined the way I did define it--meaning that the actual execution of policy would have been different than otherwise.

I have a lot of sympathy with the argument that Dick Syron just made that at this juncture, not only for the reasons the Chairman cited but for the other one that Dick hinted at, this could end up as somewhat of a bear trap. Right now, I'm not even sure I know what the algebraic sign of the interest elasticity of demand for M2 is. In other words, I could make a pretty decent argument that if we want to accelerate M2 growth, we better raise interest rates. Now, you may laugh, but I don't think you can just reject that out of hand. And if we're not even sure what the algebraic sign is, why do we want to get ourselves trapped into a more mechanistic approach? In addition, there's the concern that the Chairman raised about what it might imply regardless of how we fine-tune the beginning point. So, like others, I have been around this debate more times than I'd like to count. I can't deny the neatness, but I would be reluctant to bet the ranch on the tunnel option at this juncture.

CHAIRMAN GREENSPAN. Anybody else?

MR. MULLINS. I agree with the Chairman that the best time to switch is some year in which we end up at the midpoint and then we could click right into a tunnel approach. One difficulty is that we haven't hit the midpoint or been close to the midpoint in five years; we've been consistently under the midpoint and we're projected to be under again this year. Philosophically, I like this approach, and I

agree that a lot of it turns on this issue of credibility. I agree with Jerry that for UAW and Caterpillar the cone versus the tunnel will not be a major issue in their negotiations. I do think the credibility issue is more important in the capital markets, where I believe bond market participants and the like might look at it. One thing that bothers me about continuing with the current approach, even though I can understand the arguments for it, is the sense in the Bluebook that we're setting a policy based upon our projection of what we expect to happen--of what is pretty much achievable based upon our rigorously accurate forecasting abilities in these areas. We see what is going to happen and we say: Well, we should set the target there. Whereas I like the idea of forcing us to think about a long-term objective and then achieving it. Of course, in part this is a little different perspective. Despite the imperfections in M2, as I read it M2 grew a little over 3 percent last year as did nominal GDP. And I tend to think that M2 will come back this year because a lot of these factors will open up. As Jerry said yesterday, the banking system and some of the credit crunch issues are opening up and I think the RTC is near the end of the road; many of those institutions have already been squeezed. I think one would expect the bulk of the yield curve effect to come relatively early when the yield curve switches. So, I wouldn't be surprised to see a catch-up. The way the Bluebook puts it is, on page 18: "The tunnel approach in 1992 would be appropriate if last year's shortfall in M2 was seen as associated with an undesirable shortfall of income"--and I would define a recession as an undesirable shortfall of income--"or transitory shifts in the demand for money." I have a feeling that we're going to get some catch-up on that. I do agree with the general sentiment that there are advantages to flexibility. Those in decision-making positions always will prefer flexibility to being bound. And I do think there is a problem in how people would interpret this at the current time. But more generally I would agree philosophically with the notion, especially once we get out of this period in which I think we have some temporary problems with M2, of trying to put us under a bit more pressure and committing to some longer-term ranges.

CHAIRMAN GREENSPAN. Anybody else?

MR. PARRY. [What about] questions of Don?

MR. KOHN. I was hoping you had forgotten me!

MR. PARRY. Don, the Bluebook indicates that the growth of M2 would be 3-1/2 percent, assuming that there is a downward shift in the demand for money of similar magnitude to that experienced in 1991. If there were not such a downward shift and we had a continuation of the experience of 1991, what would be the model's forecast of M2 growth?

MR. KOHN. Well, the standard model would have it something close to 6 percent with a 5 percent GDP; that's because it would still be getting some push from interest rates early in the year. Our yield curve model, however, has been doing a bit better these past few years, although it has been missing; it would have [M2] growth more on the order of 4 percent. So, I would tend to split the difference in the models and tell you something like 5 percent on M2 to get 5 percent GDP.

MR. PARRY. Now, the tough question: At the beginning of 1991 you had some feelings about the probabilities of these forces continuing in 1991. You obviously in this Bluebook have some convictions about that as well. How strong are they this time? Governor Mullins indicated he thought that these effects may not be as strong as you think they are.

MR. KOHN. Well, as I indicated in my briefing, I think 3-1/2 percent growth is our best shot.

MR. PARRY. Right.

MR. KOHN. But if there were a risk to this, I think it might be that we could get a little more M2 growth or something like the FOMC [members' forecasts of] GDP, which is higher than the Greenbook GDP. And it would be because of the fact, as Governor Mullins mentioned, that [the effects of] some of the initial shifts in the yield curve may be wearing out and so forth. I guess to some extent we're perhaps a little gun-shy on this because those are arguments we've been using for the last six months about why banks in response would have higher--

CHAIRMAN GREENSPAN. Not necessarily.

MR. KOHN. It's true that velocity was unchanged in 1991. But it took an incredible decline in short-term interest rates to keep it unchanged. And all our past relationships in models and charts and whatnot would suggest that that would give you a huge decline in velocity--a lot of M for a little bit of GDP--and we didn't get that. Now, some of that may unwind a bit this year, but our best guess is that the credit for the expansion in the staff forecast, which I think is an entirely credible one, would basically come from outside depository institutions. Most of it is going to come through the capital markets. So, I don't see loan demand picking up at banks or thrifts; they're still on the securitization route. Certainly, marginal banks and thrifts under the new banking law are under tremendous pressure--even more pressure than they were before--to downsize to get their capital up. So, I don't see those credit conditions deteriorating; I also don't see them snapping back a lot. And I think there are still a lot of portfolio shifts coming that we haven't seen yet. A lot of small time deposits [that depository institutions] put on a couple of years ago are just maturing.

MR. PARRY. This 3-1/2 percent certainly would be something that one could use to support a recommendation of alternative II, if one had considerable certainty. To the extent that one moved more toward the kinds of comments that Governor Mullins made, one would tend to look more favorably on alternative I or even conceivably alternative III.

CHAIRMAN GREENSPAN. One of the problems that the current period is creating with respect to the money supply is that we are going through this extraordinary turmoil with the virtual dissolution of a big chunk of the savings and loan industry. We have all sorts of abnormal aspects with respect to holdings of liquidity. It strikes me that our major focus at this stage has to be to understand the very short run of where we want to be on money supply, largely because we know so little about what is going on. The "Virginia Plan" and all

the [other] tunnel-type plans presuppose precisely the opposite: That we are feeling sufficiently comfortable with respect to these relationships that we can project further out and make available to the public a plan to which we intend to adhere. I wish we were under those conditions. Were we in that position, I would feel quite comfortable about locking in longer-term commitments in a sense to bind us so that we don't get off a particular track.

My difficulty, knowing all of the technical problems that are associated with the relationships between money on the one hand--and liquidity for which it is a proxy--and gross domestic product, is that our state of knowledge in that sequence at this stage has not been so poor in many years. Also, I would be very hesitant to lock into a tunnel because I'm fearful that we might find that all of a sudden [relationships have gotten] back to some form of normal [at a time when] we are outside the tunnel. It would then take us an awfully long time to work our way back unless we took the whole tunnel and changed it up or down, which would be the worst of all possibilities. I don't know how we could find our way back, whereas the procedures we have at the moment at least enable us to start from scratch in early February. Despite all of our intellectual, analytical problems, which may have been totally unresolvable with respect to policy in the previous year and created a base drift, at least in a sense we can always start from scratch and struggle from where we are rather than try at that stage to work our way back and absorb mistakes that we made analytically two years earlier or something. It creates major problems if we are wrong. Obviously, if we are not and we can stay within the tunnel, it is very effective. But I ask myself the question: What do we do if we're wrong? And I say if we're wrong and we have cones, we can adjust far more readily than we can if we have a tunnel. I would be very hesitant to go to a tunnel unless we felt confident that [money] were not going to veer substantially outside the ranges of a tunnel. And at this stage I frankly can't feel secure in that respect, knowing our terrible difficulties in trying to forecast M2 on the basis of all our previous models.

MR. PARRY. The trouble is that when we're wrong we are sometimes reluctant to make the change in that new year to compensate for that wrong.

CHAIRMAN GREENSPAN. That is a problem and that's the advantage of this [tunnel concept]. But I should certainly think in the context of what Jerry Corrigan was saying--namely form versus substance--that if we have enough understanding to know the difference, we would make certain our policy is formulated on the basis of substance and not on the position of where a dot is on some particular chart that we built.

MR. PARRY. We came in with less [growth] in nominal terms than was expected. We saw real growth that was significantly less than forecast in July, but there's probably not going to be much discussion about that history and its implications for what we might want to do in 1992.

CHAIRMAN GREENSPAN. Well, the question is: Why isn't there? Well, let me put it this way: What is it you want to put on the table that the rest of us--

MR. PARRY. No, I'm not--

CHAIRMAN GREENSPAN. I think we're all acutely aware of that whole episode.

MR. PARRY. But again: Does it affect how we construct targets for 1992?

CHAIRMAN GREENSPAN. Yes. That's my view.

MR. MULLINS. My view on that is that there's a strong intellectual case for moving the cone up. However, I wouldn't support that case because it would send the wrong signal. So, I think the way to handle it is to do what the Chairman suggests, which is to recognize an intention to be at the upper end of the cone next year. But this is the difficulty; it gives us flexibility but it's more [in the nature of] hypothetical flexibility.

MR. PARRY. In the Bluebook the implications were that we had to reduce interest rates by a fair amount--did you say 3/4 of a percentage point?--to achieve that. So, that is the issue [unintelligible] discussion that [unintelligible] relying on what happened last year.

CHAIRMAN GREENSPAN. That's real substance!

MR. PARRY. That's real substance!

CHAIRMAN GREENSPAN. That's real policy!

MR. BLACK. But no matter what form we select, we're always going to have serious doubts about how much we need to move the federal funds rate.

CHAIRMAN GREENSPAN. Oh, I believe that! [Laughter]

MR. BLACK. We're never going to know the answer to that!

CHAIRMAN GREENSPAN. Nobody is saying that either one of these [approaches] is going to solve that.

MR. BLACK. Well, that's the really difficult issue and the reason I wish we could develop some other control mechanism, but I'll be darned if I know what else we can do. Most of M2 is not reservable and, given the market's proclivity for designing new instruments that would avoid any reserve requirements we put on existing instruments--if indeed we did--unless we paid interest rates on the reserves, which is a political problem.... That would certainly make it legally controllable.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I wanted to ask Don a question; are we still in that mode?

CHAIRMAN GREENSPAN. Yes.

MR. MELZER. Don, what M2 growth would you consider consistent with price stability based on what we think longer-term relationships are? Is it the 3-1/4 percent in strategy II?

MR. KOHN. Right.

MR. MELZER. In the out years is that--

MR. KOHN. That largely reflects some remaining--questionable in Jerry's terms--interest rate elasticity. That is, nominal interest rates are coming down so that you'd have to get a little extra [money growth]. If you believe the P\* model and the assumption of a constant P\* and the economy is growing at 2-1/4 percent--our current estimate of what the capacity of the economy is--presumably M2 over a long period of time would have to grow something on that order as well.

MR. MELZER. Well, what if [unintelligible] will not accept zero measured inflation?

MR. KOHN. That would give you more like 3 or 3-1/4 percent, if you thought 1 percent measured inflation were equivalent to price stability.

MR. MELZER. I have this view that, if we adjust our cones over the years, I don't want to get into a position where we need to move them back up if we can avoid it. Ideally, in a perfect world we'd like to ratchet those things down gradually, getting to a cone that's consistent in the long run with price stability. If we missed our cone, we'd explain why; but I don't envision a world in which we're juggling these things around. And I was trying to get some feel for how much further we have to go; probably we'd have to ratchet it down another percentage point, maybe a little more.

MR. KOHN. Yes, I think you're right about the price level and the measurement problems. So, I would say a range of about 1 to 5 percent would probably do it for you. We used to worry about what would happen as we approached price stability and nominal interest rates fell and we'd have this surge into M2 [assets] so that in order to keep the economy from plummeting at that point we'd have to pump in some more liquidity to meet that demand. But we've had our decline in nominal interest rates without a surge in M2, so perhaps this reentry problem isn't so bad unless long-term rates come down and we end up with 4 or 5 percent long-term rates with this thing. Then, all of a sudden those bond funds won't look so attractive relative to a 2 percent OCD or NOW account rate and we could get a surge of funds back into M2. So, there might be complications as we approach price stability, but I think your sense of around 3 percent in a steady state is probably [right].

MR. MULLINS. Do we have studies on the drift problem, the measurement problem, with zero inflation? You mentioned 1 percent.

MR. KOHN. There have been studies. I heard Bob Gordon give a paper at the Tokyo Conference--Dick Syron and Ed Boehne were there--and his view was that something between 3/4 and 1-1/4 percent, given his sense of distortions, was about right.

MR. MULLINS. At some time it might be useful to explore that issue in more detail because we are getting within shouting distance.

MR. PRELL. Governor Mullins, as you know, we distributed to all of the FOMC members a paper by Dave Stockton and colleagues which included a discussion of that issue, and there's further work being done. But we do have something that has gone out to the Committee.

MR. CORRIGAN. [Unintelligible] very imperfect. The technical data are interesting both in the context of Dave Mullins's question and Tom Melzer's last question. If you look at the actual targets for M2 going all the way back to '83, once we got out of the recession, they have come down from 6 to 9 percent to 4 to 8 percent, to 3 to 7 percent, and to 2-1/2 to 6-1/2 percent. But if you look at the actual growth rates, in the first part of the period we had a base drift on the high side and in the second part a base drift on the low side. I think for that period as a whole we probably end up about having washed it all out.

MR. ANGELL. You'd end up with an historical tunnel.

MR. CORRIGAN. That's right.

CHAIRMAN GREENSPAN. I guess we've proceeded as far as we're going to go on questions. It would now be useful to have each member and other presidents state very simply of these various alternatives where they would like us to come out. Who would like to start?

MR. FORRESTAL. I would start on the tunnel, Mr. Chairman, by confessing to Mr. Lindsey and Mr. Black that I have spent very little time in Virginia. I only pass through occasionally, so I had no bias one way or the other. But I think the Chairman's points were well taken. The other thing I would add, Mr. Chairman, is something you didn't mention. It seems to me that to introduce this tunnel proposal at the time of the Humphrey-Hawkins report would raise an awful lot of pressure and would be counterproductive in the present environment.

On the targets themselves, I would be very much in favor of keeping the targets that we established last July. To change them in either direction would send the wrong signal. To bring them down, which has obvious implications for price stability, is desirable in a theoretical sense but would seem to me to lead to the interpretation among market participants that we intend to moderate growth. And in this environment that would not be very appropriate. On the other hand, of course, raising them would give rise to the interpretation that we've given up on our fight against inflation or at least are moderating that attack. And that, too, would be the wrong signal to send. I think stability in the targets is what is called for now, so I would like to keep both M2 and M3 where they were.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Basically, I agree with what Bob Forrestal said. If you just took the staff forecast of M2 and M3, you could make an analytic case for reducing the ranges, particularly for M3. But I don't think that would be a very wise development at this time. So, my preference would be to leave the money and debt ranges at the tentative levels that we set in July. I must admit that I would be

interested in talking about this subject of the tunnels again in July, particularly after we've had an opportunity to look at some of the more technical issues like the base, etc. But at present I prefer to stick with the cone.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, the one time I dissented on anything since you've been here was when we established the tentative ranges in July of last year. But we missed so badly because of base drift, by virtue of this faulty procedure we use, that I think it would be a mistake to do anything other than alternative I. So, to show my graciousness, I would argue that we ought to stick with alternative I.

CHAIRMAN GREENSPAN. I wasn't aware you'd lost anything, frankly. President Hoenig.

MR. HOENIG. Given the circumstances that we have today, I would not be in favor of the tunnels. I think what we have now does give us the flexibility we need to move toward price stability, and that's what should be our focus. As for the alternatives here, I am in favor of alternative I for the reasons that have been given. That gives us the flexibility we need to continue to move toward price stability, and to adopt either of the other alternatives I think would give an incorrect signal at this time.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Alternative I for all the cogent reasons given.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I prefer alternative I; I could accept alternative II. First of all, I think alternative I is consistent with strategy II, which I believe in and I guess [other] people around the table also do. I just wanted to make one other point in connection with this. I think M2 is probably the best indicator we have of concurrent economic activity. It gives us some sense of how we're doing with respect to our goals. I have some problem calling it a target. I don't want to get into a semantic debate and I wouldn't suggest we change how we describe it, but in my view a good target is not only something that relates to our goals but is also directly controllable by our actions. As I mentioned yesterday, the component [of M2] we do control is only 25 percent of the total and our ability to indirectly influence [M2] through our influence on interest rates is questionable; I think the evidence that we've seen here recently calls that into question. This isn't a proposal but I urge people not to lose sight of things like reserves, the base, and narrow money that we do directly influence because I think they give us some indication of the thrust of monetary policy actions, which I don't think M2 really gives us. In that connection, I get somewhat troubled when I hear suggestions that we ought set as our longer-term goal somehow getting M2 into the upper end of the range that we're setting because if that happens under circumstances where we're getting no growth in non-M1 components of M2, we're talking about 25 to 30 percent M1 growth. One can scoff at M1, but I feel very strongly that if we put that kind of stimulus into the system over a period of 6 to 12 months,

we will have big problems. Now, if we get into the upper end under different circumstances where M1 is much more controlled and some of those other components are growing, that's a different story. Anyway, I would urge that we not lose sight of those [measures]; I think we need to pay attention to them. I wouldn't advocate a target but we may even be at a point in time when we would want to monitor consciously or explicitly the behavior of a narrower [measure] that reflects the thrust of our objectives.

CHAIRMAN GREENSPAN. Would you and Si be supportive of proposing reserves across the board on the M2 components?

SPEAKER(?). Good question.

MR. MELZER. I don't know about the politics of that, Alan, but that's something we ought to think about in terms of the longer-term influence of monetary policy--possibly reducing reserve requirements and spreading them more broadly over broader classes of deposits.

SPEAKER(?). That's a good idea.

MR. KOHN. We have a letter from Chairman Neil on that issue and I'm sure you'll be asked to address it at your Humphrey-Hawkins testimony.

CHAIRMAN GREENSPAN. First Vice President Hendricks.

MR. HENDRICKS. Thank you, Mr. Chairman. We continue to advocate a policy to achieve price stability, and the recent slowdown in inflation suggests that we're on track. To continue a gradual approach to that objective we would expect some downward shift in the M2 band in 1992. But we really don't know how long it will take or how big it will be. Ideally, in the year ahead we would prefer an M2 target range of 1-1/2 to 5-1/2 percent because that range corresponds more or less to our desired M2 growth by year-end, if conditions warrant. The ranges are wide enough to accommodate some makeup from last year's shortfall. As a practical matter, we could live with the ranges expressed in alternative II. We'd inch down the ranges and remind markets of our [intent] to achieve price stability over a reasonable period of time. Recognizing our recent progress in reducing the M2 growth trend, lowering the target range to center on a 4 percent midpoint would in our opinion enhance the credibility of our commitment to our long-term objective of reducing inflation.

With respect to the tunnel approach, we were prepared to comment on it. As a matter of fact, we prepared an "Ohio Plan" handout. But as I listened to the discussion, I found that all the questions were answered and all the comments were made, so our plan wouldn't add much to the discussion. But we are interested in seeing a different approach at least kept on the table.

MR. LINDSEY. You know, Ohio has been part of Virginia, too!

CHAIRMAN GREENSPAN. Vice Chairman.

MR. CORRIGAN. I favor the alternative I tentative ranges from last year. I would certainly tolerate growth in the upper half

of the range if it could materialize in a context of developments in inflation and economic activity that are otherwise satisfactory.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. On a long-run basis, alternative II is clearly my preference. Real GDP between 1991 and 1996 grows at a 2.6 percent percent average annual rate under alternative II, which is just 0.2 percentage point lower than the 2.8 percent path under alternative I. Now, I know we don't have clear insight that these are accurate paths. I guess Don Kohn doesn't claim clear insight that these are accurate out [that far], but I do think this expresses exactly what we know to be the long-run relationship between monetary policy and economic growth. So, if I could end up in 1996 with zero inflation.... While we have 3/4 of a percent in the Bluebook table, clearly that falls within my notion of what zero inflation would be; I would guess that 3/4 to 1-1/2 percent would probably be real zero inflation if we measured properly. So, I have a clear preference for alternative II. I would admit, Mr. Chairman, that politically I think February 1992 is not a good time for you in your Humphrey-Hawkins report to announce this. Even though it would be a wonderful economic presentation and education, I think it would not be desirable for you to do that. And I can't imagine your wanting to do that. So, I will accommodate myself to one more year of begrudgingly voting for and accepting alternative I. But I do want us to be [where alternative II takes us]. And I do agree with Bill Hendricks and Tom Melzer that we must keep our vision on price level stability. Indeed, in the circumstances that we're in, that clear commitment to price level stability in the Humphrey-Hawkins report will do more to keep long-term rates down and I believe will give us a better growth path than we would get if we appear to be willing to re-inflate.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. On the narrow issue, I would favor alternative I, and I would also favor and support the Vice Chairman's comments on being willing to tolerate growth in the upper end of the ranges under satisfactory economic and inflation circumstances. More generally, I think we're moving into new territory where considering these issues will be different than it was when we had ranges of 6 to 9 percent. We're nearing the end of a long and successful journey of ratcheting down these ranges and we're approaching a steady state. And I think we need to revisit the issue of how we operate in a steady state and what it is. But I support alternative I for next year.

CHAIRMAN GREENSPAN. Let me just ask President Hoenig something. You indicated a preference for alternative I. Would you associate that with these remarks about tolerating the upper end of the range for that?

MR. HOENIG. Yes.

MR. ANGELL. Mr. Chairman, I didn't; I would not.

CHAIRMAN GREENSPAN. That's clear and I did not ask you! [Laughter] President Syron.

MR. SYRON. Mr. Chairman, I also would be in favor of alternative I because, like everyone else, I have no confidence in what is going to happen in the future to return M2 growth to its "normal path." Since you asked specifically, I would be much more willing to be close to the edge at the upper side than the low side. In fact, I think that may be necessary and be consistent with what we have in the economy. So, given my own guess on what is going to happen to velocity, I would hope that we're at or toward the upper part of the range. It is essential that all this be taken in the context of continued progress toward price stability. As an add-on comment, I don't agree with Tom Melzer's enthusiasm for M1 and in that regard I would be enthusiastic about doing something to impose reserve requirements more broadly across the components of M2.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I, too, favor alternative I. On the question of where M2 ought to be within the range, I'm a little more conservative than some. M2 growth over the last 5 years has averaged a little over 4 percent, if I read those revised data [correctly]. If that's right, it seems to me that we ought to be careful about letting it veer very far from that on the up side lest we risk compromising what we have already put in place in terms of progress [toward] price stability. I don't think that's going to dissipate very quickly, but I believe we need to be sensitive to that. Clearly, there are some circumstances under which I would find more rapid M2 growth acceptable, but I'm urging a bit of caution at this point. Just to state the obvious, we always, so far as I know, accept a wide range of incoming information before deciding those kinds of questions. And as long as we continue to follow that policy, I guess I won't be troubled.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I would be in favor of alternative I. For the reasons we've articulated today and in any number of other meetings it seems to me that the [historical] relationships have broken down. As a consequence, to make a change would imply a greater degree of confidence in the aggregates than we currently have, at least in an operative sense. Moreover, if we were to make a change, either up or down, it would convey a policy message that I think at this particular point would be very inappropriate. So, I would be in favor of alternative I.

As to where we might end up in the range, it's awfully early in the year to try to determine that. It does seem to me that in an operative sense we are really driving policy off a different measurement anyway. And I'd like to see how the economy seems to be developing as we get further into the year before trying to determine just where in the range M2 might properly be.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I share President Black's good grace, and I concur with the obvious consensus for alternative I. With regard to where we end up in that range, I'd like to avoid a normative statement and make a positive statement. If we do not get the velocity shock, if the staff forecast of inflation is correct, and if in fact the economy has resumed growth as we think it might have

because of the money in the pipeline, then two meetings from now with 2.8 percent real economic growth we will not only be in the upper half of the target range, we will be at the very top of the target range. And I would be very interested in what the Committee decides in May should that come to pass. Thank you.

MR. CORRIGAN. Governor LaWare.

MR. LAWARE. Well, Mr. Chairman, I have a strong personal preference for alternative II. I think we have a precious opportunity here to press the attack on inflation, and the inflationary trend under alternative II is much more appealing to me than the rather slow progress under alternative I. I understand the pain in the growth rate [of the economy] and the unemployment figures that are consistent with that. And I understand the institutional risks that are probably inherent in making a change of that kind at this point in time. I believe that alternative II gives us enough range and enough flexibility to pursue an intelligent monetary policy that would not overly inhibit the growth of the economy. I'm just afraid that if we don't press the attack now, [inflation] may get away from us in the final analysis. Having said all of that, in order to clear my conscience, I am prepared to vote for alternative I. But, like Governor Angell, I would be very unhappy if the actual growth in M2 were anywhere near the top of the cone.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. I basically agree with Governor LaWare. My real preference would be for alternative II but, for reasons that Governor Angell mentioned and those that Governor LaWare called "institutional risks," as a practical matter I would opt for alternative I right now. But I, too, would like us to try to stay as close to the middle of the target range as we can. I think any inflection point in the growth of money supply is a shock to the system, and I don't see any point in going above or below [the midpoint] right now. I think we should always be moving asymptotically, if that is the word, toward the middle of the range.

MR. KELLEY. You didn't learn that last week at A&M did you?

MR. BLACK. I guess it's a Boston thing!

MR. MCTEER. On the tunnel, I don't know what Sam Houston would think of the tunnel, but I have more sympathy for it than most of the people [who have spoken], especially if it were bent down at the end of next year to 3-1/2 percent. It would give us a tunnel that's very much like the tunnel that connects these two buildings, which works very well. It would eliminate base drift, and I don't believe it would be received badly by the financial markets. I think it would do two things that would be favored: One, it would indicate our willingness to speed up the rate of growth of money in the short run, which I think is needed; and, two, it would cap the rate of growth in the long run, which I think is needed. So, I hope we will revisit this issue soon.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I think this discussion has bracketed the situation very well. The higher ranges are simply a non-starter. The lower ranges are where we want to go but probably are not desirable now, which leaves us with the same ranges, those of alternative I. And that's certainly what I would support. As far as going into the upper part of the ranges, without enthusiasm I could support that for what I hope would be a fairly brief period of time. But I'm not enthusiastic about it or lusting after that.

As for the tunnel versus the cone approach, I have a lot of sympathy with the tunnel idea. But I concur with your suggestion that this probably is not a good time to adopt it. I'd like to see it stay on the table; I'd like to see us watch it closely and look at some different ways to do it and have it be a continuing part of the dialogue.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. As the native Virginian, it seems to me that elements of the Virginia Plan--

CHAIRMAN GREENSPAN. These two carpetbaggers!

MS. PHILLIPS. Right, these carpetbaggers. I do have sympathy for the tunnel plan, and I'd like to see it continue to be discussed and kept on the table because I think it is better for the long run. As a person who has not spent as much time on monetary policy matters as on other policy matters, I've noticed a tendency that whenever the time is inappropriate to make a change that's when it's on the table and is brought forward. If we were at the midpoint of the range, it probably would not be as much of an issue. I think it's very difficult to make policy changes when you're at the middle; there's just not an incentive to do it. I do understand the politics of the situation, so, like several others who have spoken, I'd like to see the tunnel plan remain on the table for discussion, particularly for looking at the long-range policy implications.

I could support alternative I. Maybe I'm not even as optimistic as some; I'd like to see us get to the middle of the cone but I certainly could tolerate going to the upper parts of the ranges. If growth does get to the upper part of the range, I'd be willing to bet that there will be a discussion then for tightening. So, it will be interesting to follow this discussion as we move into the year.

SPEAKER(?). I hope so.

MR. CORRIGAN. Mr. Chairman, I wonder if it might be a good idea for Governor LaWare to repeat briefly what he said when you were out of the room.

CHAIRMAN GREENSPAN. Sure.

MR. MULLINS. I took notes.

CHAIRMAN GREENSPAN. He said he preferred alternative II, but--

MR. LAWARE. I said I personally preferred alternative II because I thought we had a precious opportunity right now to pursue the attack on inflation. And the [Bluebook] trend line under alternative II in winning that fight against inflation sooner rather than later was very appealing to me. I was afraid that if we stuck with alternative I, the inflation objective might escape us. I'm well aware of the pain involved with regard to the [economic] growth rate and the unemployment numbers. But it seems to me that the long-term public policy interest might better be served by pursuing alternative II. At the same time, I think there are significant institutional risks in making that kind of change at this time, even though the ranges [of alternative II] probably give us enough flexibility to do whatever we want to do with monetary policy. So, I would vote for alternative I, but like Governor Angell, I would prefer to stay toward the lower part of the range described rather than allow a drift up to the top.

CHAIRMAN GREENSPAN. Well, let me make the following proposal. First of all, there is obviously sufficient interest in pursuing the tunnel proposal to keep it on the table and keep it on the agenda. We will look at it. That would essentially [address] Governor Phillips' concern, on which I think she is quite right: namely, that when things are easy and normal and you don't think there's a problem, then you don't spend any time on it. But let's make sure that we do and do that readily by putting it on the agenda the next time this issue comes up, and keep it there until we lose interest in it or decide to use it. Let's keep it in a context where it can be an alternative.

Secondly, it's clear that we have a large majority of the voting members in favor of alternative I, with a majority willing to accept--should it occur as a result of market forces--growth in the upper end of the range. But in our official statements relative to this, I think it's important that we insert in our [explanation] that we do not wish to lose the gains that we have achieved with respect to price stability and that our actions with respect to monetary policy over the long run will be very sensitive to that particular [issue]. What that implies in actual action is that we might accept [growth in] the upper portion of the cone, but with some reluctance, and certainly not as a permanent phenomenon. So, what I would like to put on the table for a vote at this point is alternative I with language in the Humphrey-Hawkins report somewhat similar to the way Jerry put it, but including immediately thereafter a comment that the gains in price stability have been extremely valuable to this economy and that it's certainly our strong desire--or some [wording] even much more formidable than that--to make certain that those gains not be dissipated. I won't give you exact language but in rough form would ask if that is acceptable to the Committee to vote on.

MR. ANGELL. I have a question, Mr. Chairman. Isn't there some danger in that? I agree that the majority of the voting members would accept the upper part of the range. But if we said that in the Humphrey-Hawkins report, doesn't that then put us in the position of appearing to have [that as the] actual desired range? Suppose money growth is weaker than we anticipate. Even though we might end up, let's say, cutting the fed funds rate one or two times, we might still have weak growth. Would that not then cause our critics in Congress

to say to us: You really acted as if you wanted to be in the upper end and then you didn't [even] get to the middle.

CHAIRMAN GREENSPAN. Well, I think we would be subject to that [criticism] no matter what we did. But the language that Don or the Vice Chairman used I don't think puts us into that position. We're not saying we're going to force [money growth] into the upper part of the range; but if market forces were to do that, we would not be acting strenuously to push it down.

MR. MELZER. There would be no reason for people to presume that we would be anyway if growth were in the range. Isn't that right?

CHAIRMAN GREENSPAN. Well, I would hope so, but one doesn't know. There's another alternative. We can leave it out of the official text and I could use that in the questions and answers--

MR. ANGELL. I would prefer that.

MR. CORRIGAN. I would, too.

SPEAKER(?). Yes.

CHAIRMAN GREENSPAN. Okay. Why don't we leave it out then and I will, if the issue surfaces, find appropriate language in the Q&A portion of the Humphrey-Hawkins testimony to put that on the table.

MR. PARRY. In your statement about the ultimate objective of price stability or something close to it, would it be well to underline the fact that in subsequent years this would most likely require further declines in our targets?

CHAIRMAN GREENSPAN. If that comes up in the Q&A, I would answer in the affirmative; I have in the past.

MR. PARRY. I'm thinking of a conditioning for what might become--

CHAIRMAN GREENSPAN. Yes, I suspect it has been true of all of us when that issue has come up. We've all indicated that the particular range we're in at the moment is not necessarily by any means our view of [the range that is consistent with] price stability. Okay, could somebody move this?

MR. SYRON. So moved.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

MR. BERNARD. The directive would read--I'm reading from page 24 of the Bluebook--: "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 2-1/2 to 6-1/2 percent and 1 to 5 percent,

respectively, measured from the fourth quarter of 1991 to the fourth quarter of 1992. The monitoring range for growth of total domestic nonfinancial debt was set at 4-1/2 to 8-1/2 percent for the year. With regard to M3, the Committee anticipated that the ongoing restructuring of depository institutions would continue to depress growth of this aggregate relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
First Vice President Hendricks	No
President Hoenig	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President Melzer	Yes
Governor Mullins	Yes
Governor Phillips	Yes
President Syron	Yes

CHAIRMAN GREENSPAN. Okay, I think coffee is outside. Let us adjourn [temporarily].

[Coffee break]

CHAIRMAN GREENSPAN. Bill, you asked for the floor.

MR. HENDRICKS. Thank you, Mr. Chairman. Since the vote and during the recess, I've been thinking about the presentational difficulties that you might have and that, from your view, unanimity on the 1992 targets is the desirable thing. We're willing to support the present targets, and I would therefore request that my vote be changed.

CHAIRMAN GREENSPAN. Thank you. I think it is important that we have unanimity where we can in this particular period, with the turmoil and politics going on and swirling around us. A perceived division within this FOMC is something we should try to avoid if we at all can. This would be helpful and I will declare the vote unanimous. Let's move now to Don Kohn.

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

CHAIRMAN GREENSPAN. Thank you. Questions for Don?

MR. ANGELL. Don, I guess this is a question for Ted Truman as well as for you. When we look at the real exchange value of the dollar, I presume we do not make any attempts to adjust for differences in the measurement of inflation in the United States versus that in the other G-7 countries. If most of us tend to believe that we might be as much as 1 percentage point off on our measurement

of inflation, over a period of time that 1 percentage point compounded could give us quite a distortion in terms of the real exchange value of the dollar.

MR. TRUMAN. Well, I think there are two factors. One is the question as to relative distortion that you want to focus on. I guess a priori my view would be that in some sense the relative distortion would be larger in the major industrial countries abroad than it is here. We probably spend more time purifying our CPI than do some of the other industrial countries, which biases [their estimates] in the other direction. Moreover, just in the short run, we have a phenomenon because what we use here are consumer price indexes. There are cases for using other price indexes. It's like everything else: There's nothing perfect. It depends on what you are trying to prove. Certainly, in the short run, we have had a situation where there have been a number of shocks to the consumer price level abroad. These are the result in the last couple of years of excise tax increases and things like that: for example, [goods and services] tax in Canada, the [value added] tax in the United Kingdom, etc. So, the foreign price level, in a truly competitive sense, is probably somewhat inflated relative to the CPI measures. And that goes back for the last couple of years.

MR. ANGELL. It seems to me that in places like Japan, by using rents as the equivalent to owner-occupied homes and then having rent control, they underestimate their rate of inflation.

MR. TRUMAN. I think that's a possibility. We looked at it a couple of months ago [and] we were not convinced that it was as understated as you suspect it may be.

MR. ANGELL. All right.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I wanted to ask you a question. Do you think that there is in the market and the Congress a tradeoff between what we do and their enthusiasm for fiscal policy?

CHAIRMAN GREENSPAN. I think there's some. There's a view in the market that if it is perceived that the Fed is shut down and won't be doing anything more, that will induce increased fiscal activity, so to speak, on the Hill. I don't know whether it's true; it's hard to judge. It's probably true in part. How important it is, I really don't know. A number of people believe that in the market; I think that is a fact.

MR. PARRY. If rates were cut 50 basis points, would it alter the dialogue, the momentum, etc?

CHAIRMAN GREENSPAN. I'm not sure. I think there's something to it, but I would not want to move policy on the presumption that it might create a more balanced fiscal policy. I frankly doubt it. Any further questions for Don?

Well, why don't I get started. I think the issue of the extent of monetary policy [easing still] in the pipeline can be looked at in a somewhat different way. And it, too, suggests some effects

but it is by no means complete. If we judge that the major problem confronting us is the balance sheet strain created by the rise in debt and, in certain instances, by a fall on the asset side of both household and business balance sheets, the business balance sheets obviously would have to fall in value in substantial part because of [declines in] real estate. Any decline in values on the asset side of the household sector is rather [questionable]. Obviously, there's a belief that residential real estate values have fallen, but that's very hard to prove. I think it is the case that equities have declined some as debt has eaten into the value of real estate, but it's not by any means obvious that it's on the asset side.

What I think is essentially the case here is that the debt overhang is creating a diversion of disposable personal income on the one hand and corporate cash flows on the other more toward repairing balance sheet relationships rather than consumption and investment expenditures. And this may be showing up in some increase in the saving rate, but that remains to be seen. Obviously, in the month of December the [published] saving rate at 5.8 percent is a very weak statistic, and the range of error is considerable. Nonetheless, it is consistent with the employment of disposable income for the reduction of debt and, therefore, an increase in the net equity of households-- meaning saving rather than consumption expenditures.

This implies, as we've discussed before, that [households and businesses] need to repair these balance sheets as a necessary condition to initiate expansion. The evidence clearly suggests that that is underway. We are looking at a very significant amount of corporate equity de-leveraging in a number of corporate balance sheets. We are looking at a very high level of corporate debt issuance, in part to refinance high interest debt but also presumably to pay off short-term liabilities and improve the liquidity position of the corporate balance sheets. Now, clearly, the decline in interest rates is showing up in the various [ratios of] interest costs to cash flow both in the business and in the household sectors. And in that sense the debt burden is moving down. So, one can clearly see the impact of the combination of Federal Reserve policy on the short end and decreasing inflation expectations on the long end beginning to repair balance sheets in precisely the way one would presume that markets trying to repair themselves would function. The question is: How far has this gone? I think the answer is that we don't really know; it has gone part way, but there's no evidence that we're anywhere near the point where a significant easing in [strains on] balance sheets has occurred enough to restore the normal recovery forces in the economy.

At this point, all the evidence suggests that output is essentially flat. The weekly data that we have on industrial production suggest that there was a decline in January but probably no further follow-through in February. Indeed, it's possible that February may be moving back. What one can say in general is that while the balance sheets apparently are being repaired, the economy is on hold; and there is no real evidence to suggest that that's about to change quickly. I think the inflationary forces continue to recede, and I would be not surprised to find that actual price data come in under the Greenbook [forecast]. I hope that is, in fact, the case. I suspect that if we have any surprises in that area, that's probably where they are going to come out.

This leads me basically to the obvious question of some evidence of improvement in confidence, which a number of you mentioned yesterday. And that strikes me as probably a reflection of previous Federal Reserve actions, because we're not picking it up in any of the general surveys. We're getting it largely from more sophisticated people who would be responding to the type of things we might be doing. We are seeing evidence--at the moment mainly anecdotal but to some extent real--in residential housing: in housing sales and in starts and permits. And that appears to be creating some positive elements. But for the moment we are reaching if in fact we are stipulating that the economy has turned up. There is no evidence of which I am aware that supports that view.

Nonetheless, it's my personal view that we probably have done enough to put the economy on track eventually. But I'm willing to acknowledge that we may not have. Since I think the probability that we would want to move interest rates higher or tighten in the intermeeting period approaches zero and that there is at least a non-negative probability that we might want to ease during the period. I would conclude--if that's the view of the Committee--that something like alternative B, with normal asymmetric language toward ease is appropriate, without specifying a presumption that any action is contemplated during the period other than what one would assume under the normal procedures with asymmetric language. I put that on the table for your reactions and would be curious to get the judgments of other members. President Syron.

MR. SYRON. Mr. Chairman, I guess my longer-term objective here is to have to vote for tighter policy as soon as possible. And that has something to do with how we behave in the interim period. I'm inclined to agree that we have put a lot of stimulus in the pipeline and that it's more likely that we're going to see an upturn than a further slide. But I am concerned about [specifying] an asymmetry of risks or costs [and] being wrong on one side or the other. We [are not sure] about the forecast, anyone's forecast. That raises, of course, the issue of risks and insurance and how long one waits. I think we're going to have to wait a while to see data that are really conclusive in one direction or the other. I do think, and Governor Phillips raised this point yesterday, that we may be in a situation--I don't want to use the term "window"--where it's easier for us to make a change now than it may be later as we come closer to a season that may be seen as more political and also as we get into the midst of all this fiscal policy business. Those things would argue for ease because I think we are in the midst of this long cycle that we've talked about, and our role is to facilitate lending. The best thing we can do to facilitate the long cycle adjustment is to have a stronger economy.

Where all this leaves me at the end of the day is that I would favor easing sooner rather than later. But I am aware of the time in which we operate and I think we are in a period in which there's a great deal of concern about confidence in the government as a whole. That point is very well taken. And in that environment, it's nice to see one organization that has some element of stability. So, to tell you the truth, while I would prefer to ease now, short of that, which we won't get [consensus on], I prefer strong asymmetry. In this business of nuances, I'd find acceptable what you suggest but would prefer the other side.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, given the prospect of a moderate upturn at least incorporated in most of our expectations, I would prefer alternative B. I do think, though, that the uncertainties are as you indicated, and that would lead me to be very supportive of asymmetry to provide for significant further ease. Two points with regard to that: It would be my view that if we were to ease, it probably should be of some significance because public visibility for the event would probably be desirable; secondly, my own feeling is that it probably would be desirable for that ease to come sooner rather than later.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I think the appropriate course for monetary policy at the moment is to stay where we are. As has been indicated several times around this table over the past day or two, there is a good deal of stimulus in the pipeline. And as we look back at our history, we certainly have made the mistake of overdoing it on either side of the equation over time, and I hope we won't repeat that mistake. I think what we need at this time, as other people have said, is some patience to let our policy feed its way through to the economy. So, I would support your recommendation of no change at the moment and, therefore, I would support alternative B. I must say that before the meeting I was more inclined toward a symmetric directive but, having reflected on it overnight, I think the uncertainties in the forecast are such that we ought to be in a position--you ought to be in a position--to move rapidly in the event that incoming data indicate that that's the appropriate course of action. So, I, too, would support an asymmetric directive.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I think this is a time for patience and watchful waiting. On the question of symmetry or asymmetry, if I were voting, I could accept either. I agree with your logic that the chances of tightening are essentially nil and that there is some chance for easing. So, there is something to be said for asymmetry and I would support it.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. I, too, am inclined to follow your recommendation. First of all, I'd start by saying that there is a lot [of stimulus] in the pipeline and we should be patient. However, as I mentioned yesterday, our projections are that the real economy might actually grow more slowly than what is in the Greenbook forecast, and that gives me some pause. I also am concerned about the growth of M2, which I think has been erratic and too slow. So, I am inclined to go with "B" asymmetric toward ease, but I would wait until we have some more information on the real economy and on M2 before I would charge forward.

CHAIRMAN GREENSPAN. First Vice President Hendricks.

MR. HENDRICKS. We've had several years of moderate growth and our view is that the inflation trend appears to be a decline to 3

percent and that it may be getting down even beyond that. We see the basic thrust of policy as being consistent with that outlook: that is, 3 percent inflation in '92 and 2 percent, perhaps, in '93. Therefore, we feel that the FOMC does have some room for further easing if the policy action that was adopted in December does not stimulate growth in money and credit. M2 seems to have been particularly erratic over the past month or so, making it difficult to judge just what sort of growth track we're really on. For the year we'd like growth in M2 of 3-1/2 percent or so and we would not like to see any significant shortfall from that path this quarter. Consequently, we would like to see further easing in policy should the incoming data suggest that M2 is weakening from current levels. Our position for now, however, is in line with the Greenbook projection and your suggestion, Mr. Chairman. We would support alternative B with asymmetry toward ease.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I would prefer "B" symmetric, but I have absolutely no problem with what you recommended. If there were a presumption of another easing step in the asymmetry, I'd have a lot of trouble with that. I agree with you that I don't think we can do anything with our policy that is going to affect what we get in fiscal policy. The politicians are going to have to be seen to be doing something, and they can't just stipulate that the Fed has taken care of it and they don't have to do anything. So, I agree with your analysis on that.

The only other thing I would suggest--perhaps this is partly tongue in cheek but not totally--is that we ought to get an alternative C back in the Bluebook. We have recognized all along that we were probably going to overshoot on the way down here. There's a statement in the Bluebook that was music to my ears about unsustainably low real short-term interest rates. Now, they can become sustainable, I know, through two courses. But, at any rate, I think we ought to get used to looking at an alternative C because there could be circumstances where we're going to get some rope back, and it might be better to move on that sooner in small steps rather than later and not let too much build up. I have no problem with alternative C not being in there for this meeting.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, my personal preference would have been to have symmetric language with "B" for two reasons. First of all, I have strong reservations about whether further ease in monetary policy is going to affect the outcome significantly. And secondly, symmetric language would tend to enforce a posture of patience on us more rigidly. On the other hand, I accept the argument that we need a safety valve of some kind here that can be used in the event that circumstances change dramatically from what they are now. Consequently, I can support your recommendation of "B," asymmetric.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, to state the obvious, this is a very difficult period to try to assess both the current as well as the

prospective environment. There may have been at least a mini-improvement in the balance from the last meeting but, as I said yesterday, I still think the risks are very much on the down side at this point. And the policy directive should reflect that risk. I think it's perhaps too soon to ease again; moreover, we don't have a credible basis on which we could make that kind of change. But if the incoming data begin to show further deterioration, I'd move and I'd move quickly. Therefore, I'd be in favor of your recommendation for alternative B with asymmetric language toward ease.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I would support your recommendation.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. I agree with you, Mr. Chairman. I might point out that Friday we will get the unemployment report and if we get a surprise on that on the down side you could, of course, schedule a conference call to decide what to do and where to go from there.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. I would support your recommendation, Mr. Chairman.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Mr. Chairman, I can certainly support your recommendation. But I would like to indicate my strong preference, if easing does appear to be appropriate, that we time it with more forward-looking indicators and avoid creating the impression that monetary policy is tied to the real economy. If that [latter] impression is developed, then the bond market will anticipate, rightly or wrongly, that a rebound in growth means we're going to tighten. Whereas if the monetary aggregates--and I might even mention commodity prices--were to indicate the desirability of having a lower fed funds rate, it would be clear that any easing that we do would really not be easing in the sense that money growth was below target and we were trying to keep monetary policy neutral by not pegging the fed funds rate high.

CHAIRMAN GREENSPAN. Vice Chairman.

MR. CORRIGAN. "B," asymmetric.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I am in concurrence with your view. The one thing we all know is that we don't know. And given that the uncertainties are high, we [ought] to go to the normal kind of analysis, which is a loss function. I think the loss function is much greater on the down side than on the up side. Secondly, [we need to ask]: "How easily can we correct policy?" Again, it's much easier to correct policy if we are surprised on the up side than if we're surprised on the down side. So, I think you selected exactly the right course of action.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I support your recommendation.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I'm clearly for "B." And I will support asymmetry as well because if there's a move in this period, very clearly it's going to be on the easing side rather than on the tightening side. But I must say that I don't share the presumption that we will ease that seems to be implied in conversations speculating on how the timing will work.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I support "B," asymmetric. And if we do get evidence of deterioration or if we don't get some movement pretty soon, I would favor seriously considering moving [toward ease].

CHAIRMAN GREENSPAN. On the table is alternative "B," asymmetric. Would you read it, please?

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

CHAIRMAN GREENSPAN. Let me just ask the question here whether in this context "somewhat" or "slightly" is the appropriate word. I would ask Don to refresh me on this.

MR. KOHN. I thought as Norm was reading that the "slightly" did tend to capture the sense that it wasn't an unusually strong--

CHAIRMAN GREENSPAN. You said it did?

MR. KOHN. It did capture the sense. And perhaps if in your judgment, Mr. Chairman, more than one move became necessary over the intermeeting period, which is a long intermeeting period, I believe a consultation with the rest of the Committee would be appropriate.

CHAIRMAN GREENSPAN. I would certainly think that is correct. I feel comfortable with the word "slightly" frankly, but I wanted to make sure that that's appropriate.

MR. ANGELL. Preferred.

CHAIRMAN GREENSPAN. Okay. Call the roll.

MR. BERNARD.

Chairman Greenspan

Yes

Vice Chairman Corrigan	Yes
Governor Angell	Yes
First Vice President Hendricks	Yes
President Hoenig	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President Melzer	Yes
Governor Mullins	Yes
Governor Phillips	Yes
President Syron	Yes

CHAIRMAN GREENSPAN. Okay. As been mentioned, our next meeting is March 31st, which is--

MR. BERNARD. Eight weeks.

CHAIRMAN GREENSPAN. It's outside the March 20th deadline. I don't know what significance that has! [Laughter]

MR. MULLINS. About right.

CHAIRMAN GREENSPAN. We now adjourn for lunch.

MR. PRELL. Mr. Chairman, may I remind you about the updates of anyone's forecast?

CHAIRMAN GREENSPAN. I thought we did that yesterday.

MR. PRELL. Yes, and I wanted to raise the question about fiscal policy assumptions. There seems to be some confusion about what has been asked for.

CHAIRMAN GREENSPAN. Oh yes, my apology. There's an interesting question about the basic assumptions implicit in the forecasts of the Committee members and other presidents with respect to fiscal policy. I would suggest that we each make our own assumption. In a sense make it an endogenous calculation, rather than have an imposed external presumption, because I'm not sure that's very helpful and I'm not sure that we want to have an official position as such. So, I would assume that each of you is making a forecast in the context of how you believe the politics of what is going on may--

MR. CORRIGAN. We're allowed to do that!

MR. PRELL. We won't anticipate any particular indication of what you are specifically assuming. So it's [unintelligible].

CHAIRMAN GREENSPAN. Okay, we'll adjourn for lunch.

END OF MEETING