Federal Open Market Committee
Conference Call

October 15, 1998

A consultation of the Federal Open Market Committee was held by telephone on Thursday, October 15, 1998, at 12:30 a.m. Locations of participants other than those at the Board of Governors in Washington are indicated in parentheses.

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman (New York)
Mr. Ferguson
Mr. Gramlich
Mr. Hoenig (Kansas City)
Mr. Kelley
Ms. Minehan (Boston)
Mr. Poole (St. Louis)
Ms. Rivlin

Messrs. Boehne (Philadelphia), McTeer (Dallas), and Stern (Minneapolis), Alternate Members of the Federal Open Market Committee

Messrs. Guynn (Atlanta), and Parry (San Francisco), Presidents of the Federal Reserve Banks of Atlanta, and San Francisco respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Prell, Economist
Mr. Truman, Economist

Mr. Varvel (Richmond) First Vice President, Federal Reserve Bank of Richmond

Transcript of Federal Open Market Committee Conference Call of
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MR. BERNARD. All the Reserve Banks are on the line, Mr. Chairman. For those at the Reserve Banks, let me mention that all the Board members are present here at the Board.

CHAIRMAN GREENSPAN. Good afternoon, everyone. This is first an information meeting, but it is conceivable that we will conclude the meeting by taking an action, depending on what evolves during our discussion. Let me begin by calling on Mike Prell to bring us up to date on what is going on in the economy. Mike.

MR. PRELL. Thank you. There have been some significant developments since we prepared the last forecast, but what we have on balance is more a matter of uncertainties at this point than clear-cut changes in the outlook. We have had some weaker economic indicators at the margin for the third quarter than we had anticipated. The employment report for September was on the weak side. We have no special story. It may simply be statistical noise, but employment growth was discernibly weaker than recent trends and below our expectations. Tomorrow, we will be publishing industrial production for September. We anticipated some modest growth in production, and instead we will report a significant decline for the month.

In the consumer sector, this may be too fine a reading, but around the edges the picture looks a little weaker than we had anticipated. Nonauto retail sales for August and September were quite subdued. Even allowing for the strength we have seen in the sales of motor vehicles, consumer expenditures look to have been marginally weaker than the 3½ percent growth rate that we had in the September meeting Greenbook. Of course, we have seen some slippage in the indicators for consumer sentiment. The stock market has dropped even more than we

anticipated, though at this point I think it is still much in line with the level we had predicted as the average for the fourth quarter. But to date the market has had a more negative tone and that may be taking some toll on sentiment.

On the inflation side, the wage news has been good. Average hourly earnings in September are giving us still greater confidence that we are on the right track in our forecast of a leveling out in wage inflation and possibly some deceleration in coming months. With regard to the price news, the PPI this morning was much worse than we anticipated. Basically, the entire surprise was in the motor vehicles area, which accounted for almost all of the rise in the core PPI. We have found it very difficult to guess what the changes in motor vehicle prices will be in September when there is a model change occurring. I guess I would interpret that figure as suggesting a little less favorable trend in producer prices for finished goods than we had in mind previously. But basically we see that PPI number for finished goods and the fact that prices of crude and intermediate materials were down as not calling for any fundamental change in our assessment of the underlying price trends in the economy. Indeed, at this point a relatively low capacity utilization rate suggests that the goods market is quite comfortable.

Looking ahead, certainly we have heard negative reports about the manufacturing sector that suggest that there is some greater weakness than we might have anticipated. We do not hear very much yet that indicates that there is any greater erosion in capital spending plans than we had anticipated would be occurring, but that is clearly a question mark. I think where the greatest uncertainty arises and leads to a bias perhaps in the risks to the economy going forward is that private financing conditions have deteriorated further, particularly in the lower quality area. That has occurred despite the easing of the funds rate and despite the decline in Treasury rates, which

we had not foreseen. I think our sense is that the tenor of the markets is much more adverse to private borrowers than we had anticipated. If this were to persist for very much longer, I believe there would be a risk of undermining the momentum of private demand beyond what we had forecast previously, and thus a softer economic outlook as we move into the first half of 1999. But we were very uncertain in our assessment last time of what the dimensions of the risk spreads would be, how soon they would narrow, how soon access to markets would be restored, and we are no less uncertain at this point. Clearly, that is a much more negative element of the economic picture at this juncture.

Mr. Chairman, I think that is about all I can contribute at this point unless there are any questions.

CHAIRMAN GREENSPAN. Let us first move to Ted Truman. Do you have any remarks you wish to make?

MR. TRUMAN. I would note that, of course, we have no new real data on the external sector. New trade data are coming out next week for August, which seems like a long time ago. The dollar has weakened, particularly against the yen. The positive news is that the weakness has also pulled up some of the other Asian currencies. I do not have a ready explanation for the dollar's weakness against the yen. It has weakened slightly against the European currencies.

With regard to foreign economic activity, I would say that the information that has come in over the last few weeks has been consistent with what we were saying. That implies some sense of a catch-up, if I may put it that way, with the somewhat weaker outlook that we had in the September Greenbook. There are nonetheless some small positive factors in my view. The fact that the IMF legislation is likely to be enacted means that there is one less shoe to drop. We

got through the Brazilian elections. The Japanese have passed some banking bills, but no one knows quite how they are going to implement those bills. And I think the recent international meetings in Washington were somewhat of a reality check for our European friends.

On the other hand, it is pretty clear that globally there is an increase in financial stresses. When we look at certain indicators of the kind that we look at for the U.S. economy--they are not as available abroad--they all show the same kinds of effects. Although Brazil is through its elections, it is not through the new economic program. There is a question about the implications of the German elections. The international policy complexion of the new government leaves some big question marks at this point. But I don't think anything has basically changed in our outlook. We had a weak outlook, and I think the downside risks are still there.

CHAIRMAN GREENSPAN. Don Kohn, would you like to add anything?

MR. KOHN. Just to say that I think Mike Prell highlighted the key issue here, namely what is going on in credit markets, as I think President McDonough will be commenting on in a few minutes. There certainly has been more volatility, less liquidity, and less willingness to take risks even since the Committee meeting only 2½ weeks ago. The extent of the spillover into the commercial banking sector is uncertain. We don't collect data often enough to know whether bank spreads have risen, but we have had confirming data from other sources of the tightening of lending terms and conditions. Our Senior Loan Officers Survey for the period through the end of September provides evidence that some tightening has occurred, particularly for loans to larger businesses. I think what has happened here is that the banks have become increasingly reliant on the securities markets to syndicate their loans and to manage their portfolios. As deterioration occurs in securities markets, it inevitably spills over into the banking sector, perhaps even more quickly than it might have 10 or 20 years ago.

In my view it is reasonable from a policy perspective to anticipate that financial conditions are likely to settle down over time in this country. We have seen some rather extreme movements in financial markets and an extreme lack of liquidity. But after financial conditions settle down, they are likely to be noticeably tighter than they were a month or two ago, and maybe even tighter than we thought they would be a week or two ago. Although they will settle down, I'm reasonably certain that lending terms and financial conditions will look tighter to a lot of borrowers, at least for a while.

CHAIRMAN GREENSPAN. Any questions for the three gentlemen?

MR. POOLE. This is Bill Poole.

CHAIRMAN GREENSPAN. Yes.

MR. POOLE. I was still on the highway, so I did not hear the PPI report. Can you give me that number?

MR. PRELL. The PPI for September was up 0.3 percent and its core component was up 0.4 percent.

MR. POOLE. Thank you.

CHAIRMAN GREENSPAN. Any further questions? Let us move on and I would like to call on the Vice Chair to bring us up to date on what he sees in the financial markets around the world and especially in New York, which is of particular interest. Bill.

VICE CHAIRMAN MCDONOUGH. Thank you, Mr. Chairman. What we are seeing here in the financial markets in the United States, which certainly reflect financial conditions elsewhere, is a very dramatic increase in risk spreads. Let me give you some examples.

The spread between the on-the-run 30-year Treasury bond and the most recently issued Treasury bond before it, which normally runs at about 4 or 5 basis points, moved up after the

Russian debacle to about 12 basis points. Then, in the middle of September it moved up some more and it is now at about 27 basis points. Again, that compares with the usual 4 to 5 basis points. The interest rate volatility measures remain unusually high. The actual volatility on the long bond has moved up to about 23 basis points. It usually runs at about 5. The implied volatility has moved up from its usual level of about 8 to 14.

The quality spread that we tend to look at the most is that between U.S. Treasuries and the fixed-interest part of a swap. So it involves looking at prime bank rates, if you will, compared to U.S. Treasuries. The two-year, which normally runs at about 35 basis points, is now over 70. The 10-year, which is I think the most significant, normally runs at about 50 basis points and is now approximately 95. The spread between Treasuries and 10-year investment grade securities--Ford Motor Company would be a typical example--usually runs at about 75 basis points; it is now 124. If we look at the Merrill Lynch bond index for BBB securities, which is an indication of the rate for medium-sized companies in the capital markets, the normal spread between those BBBs and Treasuries is usually about 3.2 percentage points and it is now at about 6.3 percentage points. This is an indication, I believe, not only that the spread is very broad, but that no financial officer who is not smoking pot would actually try to issue in this kind of market. We have the very unusual situation of Treasuries yielding more than municipal bonds. So, we are observing a concern for quality in the municipal market as well.

For the mortgage-backed security spread, which of course has a close relationship to the construction industry, especially the home construction sector, the normal relationship with Treasuries is about 110 basis points. A week ago it was up to about 195, and it has now backed off to about 170.

An indication that financial market participants are particularly concerned about the quality of financial securities firms shows up in the relationship between the S&P 500 and the stock indexes for money center banks and investment banks. If we go back to the end of October 1997, the S&P 500 is up a little, not a whole lot, from its level at that time. It is now about 102 percent of its level then. The money center bank index has declined to just under 80 percent of its year-ago level, and the number for investment banks is down to about 75 percent. We are not, of course, in the business of having to worry about those institutions and their shareholders in the management of our affairs, but this is an additional indication of the run into quality and the tremendous risk aversion we are seeing.

Just a word about the clearing systems: We have had to keep fed wire open late for the last several days because of requests from the securities firms and the banks--Chase and BONY--that clear for them, largely as hedge fund positions are unwound. That is something that is a normal part of our business, but I think it is another indication of some hiccups in financial markets. Depository Trust Corporation has been concerned about the availability of liquidity to some of their participants, especially the smaller ones. At the clearing corporations, the clearings seem to have been going reasonably well, and CHIPS has been functioning quite well.

Generally speaking, Mr. Chairman, what we are seeing in the financial markets here is a very significant run into high quality instruments of the kind that has not been seen for a very long time even by people like me who have been around for a long while. Even in the most liquid market of the world, the U.S. Treasury market, there is an incredible broadening of spreads between on-the-run securities and the most recent off-the-run securities, and between mortgage-backed obligations and Treasuries. In general, we are seeing a run to quality and a rather serious drying up of liquidity. Not to be an alarmist, the important thing I think is that with the exception

of having to keep fed wire open, the payments and clearing systems seem to be functioning okay. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Any other comments?

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

CHAIRMAN GREENSPAN. Yes, Bob.

MR. PARRY. Mr. Chairman, I have two questions. One, we have seen some spillover from LTCM to D.E. Shaw and others. Bill, is there anything else related to that? Secondly, it is my understanding that in some instances LTCM has been one to two days late on margin calls and this, of course, would raise the possibility that somebody would take legal action against LTCM because it was in default on a particular loan. Do you have any comments on either of these points?

CHAIRMAN GREENSPAN. Bill McDonough.

VICE CHAIRMAN MCDONOUGH. The Ellington Capital Management firm was late on margin calls and that is one of the reasons that its positions have had to be unwound.

MR. PARRY. I see.

VICE CHAIRMAN MCDONOUGH. The other firm that Solomon Brothers cleared out, MKP Capital, had also been late on some margin calls. We have not been hearing anything on LTCM. There was a short period, a few days of teething problems, when the five firms comprising the oversight committee sent their people to LTCM to begin the process of managing the firm rather differently. But there does seem to have been a greater relaxation in the market about LTCM and a feeling that the firms that recapitalized it have the staying power and the willingness to unwind its positions on an orderly basis so they do not just move the market against themselves.

MR. PARRY. Thank you. Do we know anything beyond either the incident involving B&A and Shaw and what I guess has affected a couple of other banks? Is there anything else in that area?

VICE CHAIRMAN MCDONOUGH. I believe there probably are some skeletons still rattling around closets that have not been revealed yet. We do not know. Even the darkest rumors do not suggest anything of the size or shape or potential magnitude of LTCM. I think it is a reasonable assumption that we would hear about it if it were there. But that is an assumption; it is not a certainty. I think we can safely assume that there will be some other banks that will have to report some losses based on dealing with people who with hindsight they wish they had not been dealing with.

MR. PARRY. Thank you.

MR. HOENIG. Bill, this is Tom Hoenig. Just a clarification on the spreads: I realize they have widened and I understand that the junk bond side of the market has dried up. The spreads on investment grade corporates have increased, but it seems to me that has not occurred so much because corporate rates have risen as a result of perceived unusual risks. Rather, the reason is that the flight into Treasuries has lowered rates on Treasuries, thus causing the spreads to widen. Is there a perception of unusual risks in the investment grade corporate obligations? I know there is such a perception with regard to junk bond securities.

VICE CHAIRMAN MCDONOUGH. In a run to quality, Tom, I think we always have a certain irrational quotient involved. So, if you were to ask the people racing into Treasuries, and especially into on-the-run Treasuries, whether they are more worried about the Ford Motor Company than they were two months ago, they would say "of course not." On the other hand, their behavior suggests that they have that concern. The other aspect to it, by the way, is that we

think the spreads would probably be wider were it not for a general view in the market that the high quality credits will not be issuing new obligations. So, if we look at the AAs, their nominal rates have actually come down some. It is the spread that has increased substantially. But the view in the Street here is that the reason the nominal rates have come down is the expectation that there will be a reduction in supply, if only in the absence of new issues reaching the market. Firms simply will not be issuing new obligations and securities that mature will not be replaced.

MR. HOENIG. Thank you.

CHAIRMAN GREENSPAN. The very substantial reduction in new issuance, which I gather is much across the board, clearly is a crucial factor. Obviously, the junk bond issuance has completely dried up, but even investment grade issuance has come down very markedly. There has been a fairly dramatic shift from the securities markets into the commercial banking markets, and that is an indication that the degree of liquidity in the overall financial system is clearly under stress.

MR. PRELL. Mr. Chairman, if I might just supplement that with one other observation: I am told that to date the rating agencies have not put very many companies on their watch lists for potential downgradings. This suggests that they have not at least to this point perceived, given their economic outlook, that the default risks for these firms have increased greatly.

MS. MINEHAN. Could the last speaker talk into the microphone a little more directly because your voice keeps breaking up?

CHAIRMAN GREENSPAN. That was Mike Prell.

MS. MINEHAN. It was Mike, I am sorry.

CHAIRMAN GREENSPAN. Unless you are by chance blocking your microphone, the breakup in his voice may have to do with the transmission.

MS. MINEHAN. I can't hear you clearly either, Mr. Chairman. Maybe it's our connection here in Boston.

CHAIRMAN GREENSPAN. I can hear you perfectly well. Cathy, is my voice still breaking up?

MS. MINEHAN. Yes, it is still breaking up. Maybe it's only our Bank.

MR. PARRY. That must be Boston because I can hear the Chairman here in San Francisco.

MS. MINEHAN. Okay, we will have to check our telephone line.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, this is Bill again, if I could comment. The rating agencies have, from what we are hearing around town, an extremely high anxiety level about the financial services firms. I would not be surprised if we got some additional downgrades or putting on watch of securities firms and perhaps banks, more likely securities firms. Obviously, the rating agencies have to do what they have to do, but in an already very illiquid market that would not be helpful.

MS. MINEHAN. Bill, could I ask a question that is a follow-on to Bob Parry's? We have heard a lot of nervous talk from people, particularly toward the end of last week. But this morning I got a couple of calls that suggested, with the Shaw situation having been more or less taken care of the way it was, concerns were easing and that markets seem to have been a lot quieter and more stable over the last couple of days, at least to people directly in the markets. Have you seen that?

VICE CHAIRMAN MCDONOUGH. Sandy Krieger and Dino Kos are shaking their heads with enormous negative vigor. I have not seen that nor have they and, of course, they are right on the Desk all day long.

MS. MINEHAN. Okay.

CHAIRMAN GREENSPAN. But in fact there has been a slight narrowing in some of the spreads, even though that is grasping for straws I must admit. Other comments from Presidents or Governors?

MR. BOEHNE. Mr. Chairman, this is Ed Boehne. I would like to shift the focus of the discussion from the financial sector to what is going on in the real economy, at least what I have been able to pick up in this District. I have made several forays into the District since the last Committee meeting and have taken a lot of phone calls and attended other meetings here in Philadelphia. My sense is that business sentiment is eroding. I do not see a dramatic erosion at this point, but I think it is a clear erosion and it shows up in a greater sense of uncertainty about the future on the part of business people. That uncertainty gets translated at a minimum into caution and, in a number of cases, also apprehension about the future. I have a sense that sentiment in the nonfinancial business sector, while it is holding up reasonably well compared to that in the financial sector, nonetheless is vulnerable to fairly significant deterioration. I have the sense that people are watching and wondering if this unsettlement is going to pass or whether it is going to get worse, and there's a feeling that it might go either way. But I think the tilt is more that conditions could deteriorate, and I believe business sentiment could shift fairly noticeably.

Contrary to what I was picking up before the last FOMC meeting, I also have been hearing that some of the mid-size and smaller banks in the District are beginning and in some cases more than beginning--they are well along--the process of reviewing their credits and their lending standards. I'm told that there has been some tightening up. I had not picked up much of that earlier among the smaller and medium size banks. I'm also hearing stories that some of the middle size business firms in the District that previously had access to the capital markets no

longer have such access and are turning to the banks. While the banks certainly like to have them as customers, they are beginning to wonder whether they should want them now if the capital markets do not.

Some businesses are also telling me, and these are relatively new comments, that they are falling short of their budgeted sales, though they are still making money. How that is translating into capital spending is difficult to quantify. The sense that I'm getting is that, while there has not been a wholesale or even something approaching a wholesale cancellation of capital projects, the decisionmaking process may be stretched out some. In other words, if people have not made a final decision or they have not made a final commitment, there is a tendency to wait and see. I talked to a person this morning who is heavily into real estate, and he says the same kind of thing is happening in his business--industrial parks and that sort of thing. Where there has not been a signing on the bottom line there is some tendency to delay, to wait and see for a few weeks.

My sense is that some precariousness is developing. While business is still good, while sentiment is still at high levels, there clearly is a vulnerability to the downside that could escalate and move fairly quickly. Perhaps getting ahead of myself, I think we have a window of opportunity here with monetary policy to take some action that I think could keep us on the curve. If we do not do something promptly, I think we're going to slip behind the curve, and I don't think we will get the same bang for an action taken later that we would get for taking it fairly promptly.

CHAIRMAN GREENSPAN. Other comments?

MR. STERN. Mr. Chairman, this is Gary Stern. Just as a coincidence, we had a meeting of our Advisory Council on Small Business, Agriculture, and Labor yesterday and a directors' meeting this morning. I think much of what we have been discussing was evident at those

meetings in the sense that there clearly is some anxiety about the overall situation including a good deal of concern about consumer confidence, given the developments in financial markets. It would be remarkable if that were not the case! I do not sense that these anxieties have changed much in the two and a half weeks since the FOMC meeting. I can't be very precise about the level of these anxieties, but they certainly have been around for some time.

What has been a bit surprising to me is that there do not seem to be any changes in the economic fundamentals that people have reported. I'm not referring only to the persistence of tight labor markets and squeezes on earnings, but a number of people in construction, for example, commented that they are booked up through 1999. Obviously, they are confident and optimistic at the moment, but the clear implication was that they did not seem to think that cancellations were likely or that material adverse changes were just around the corner. So, despite some well recognized concerns and anxieties, the fundamentals, at least around here, seem to be pretty much in place. That is not to say, obviously, that things can't change, but I was struck if anything by what I took to be less concern among our contacts about their own business prospects than I might have expected. At the same time there was a good deal of concern about the global situation, but that is a different matter.

MR. MCTEER. Mr. Chairman, this is Bob McTeer.

CHAIRMAN GREENSPAN. Yes, Bob.

MR. MCTEER. Regarding the issue of fundamentals in the District, in the last two days I made a speech in Austin and two in Houston, to different kinds of groups. I also attended our San Antonio and our Dallas board meetings, and I have a report this morning from our Houston board meeting. In all cases people are not interested in what is going on in the real economy because everybody assumes, and I think probably correctly, that what is going on in financial

markets is going to break the link between our recent and present situation in the real economy and that in the future. There is a great increase of anxiety and pessimism in our region. I don't think that just looking at the fundamentals gets at the problem. It is all about troubled financial markets right now.

MR. HOENIG. Mr. Chairman, this is Tom Hoenig. We had a board meeting and I have done some traveling throughout the District recently. I don't have much that is different to add to our discussion, maybe just something on the edges. Basically, people in this region are aware of the turmoil in the financial markets, and there is a sense of concern about what it might imply for the future. I did get a sense and specific comments to the effect that, as things have settled down and the fundamentals have remained reasonably good in the District, people were more concerned in August and early September than they are today. Things have not fallen apart on them thus far, and they tend to the view that that does not necessarily have to happen.

The outlook for regional investments is a mixed bag, and it does not provide a lot of help for the analysis of national trends. Our contacts in the energy sector and in some areas of manufacturing are saying that they are pulling back on their investment plans. If the cash flows on the energy side remain weak or weaken further this quarter, they indicate that there will be some additional pullback. There are a couple of areas of strength, though. One is heavy construction--road construction and so forth--where there is a tremendous backlog because of large fiscal expenditures on highways and other public projects. In some of the service industries, it is full speed ahead even with the current uncertainties.

I want to share one anecdote. It involves a major firm that is constructing an office building, partly for its own use. They were working with a major investment banking firm to arrange the financing, and they had secured a pricing that was 100 basis points over some

base rate. Because of this financial turmoil the investment bankers came back and said the interest cost would be 300 basis points above the base rate. In the meantime the base rate went down 100 basis points, so the net interest cost was up by 200 basis points. But that still worked out to a rate of 7½ percent and the rate on their old mortgage was 8½ percent. So they decided to go ahead full speed on that project. We have these widening spreads, but the question is what kind of impact they are having on the real economy. I would not draw a conclusion necessarily from that anecdote other than to give it to you.

As far as consumers go, a lot of consumer lending is still going on, and our area lenders are very much involved with equity lending at an equity to debt ratio of up to 130 percent.

In sum, there is concern about the future in our region, and we sense a great deal of the uncertainty that others here have talked about. However, the fundamentals remain reasonably good. The outlook is prospectively somewhat mixed in our region, but still generally favorable on balance.

MS. MINEHAN. This is Cathy Minehan, Mr. Chairman. Let me just follow up on Tom Hoenig's comments because, as we see things here in the First District, there is some similarity. On the downside, our large manufacturers--Gillette, Polaroid, and Raytheon--are all issuing negative notices about their current quarter earnings and planned layoffs. In the financial services industry, we have reports of some layoffs and branch closings, in Asia largely, by the Bank of Boston and of some small layoffs by Fidelity. There is an enormous amount of fear, obviously reflecting the Wall Street related concerns here in the financial community. That kind of fear tends to build on itself and it seems to be spreading beyond the financial sector, certainly through the media locally. So we are beginning to hear increasingly from nonfinancial companies about their concerns over, not just the present, but the future as well.

On the other hand, just looking at the financial markets and talking to a couple of our directors, for those organizations that have cash from whatever sources, business is very good this year. A large insurance company, for example, is finding not only that the life insurance business remains very good but that opportunities for investment abound. They have some internal cash generation, and do not have to finance themselves heavily in outside markets. So they are finding the spreads currently on corporate bonds and mortgages to be great bargains, bargains that they have not run into in a long time.

We are seeing a very strong residential real estate market here. To be sure, confidence is down, at least according to our early Beigebook calls, and conditions in the mortgage-backed securities market certainly will affect housing activity eventually. But we have not seen it happen yet. We do have indications that whatever speculative commercial construction was being contemplated likely has been set aside, but the overall economics of commercial real estate remain very good. With no new construction coming on line and with low vacancy rates and high rents, we are seeing a good deal of support for that sector as an ongoing business.

In sum, I would echo what Tom Hoenig is saying. There is a lot of fear and uncertainty, but there is some strength in our regional economy as well. We are not seeing a feedback from the financial markets; in fact, we are seeing some reasons why there might be a bit of impetus to growth from some of the current developments.

MR. GUYNN. Mr. Chairman, this is Jack Guynn. My own regional evaluation is probably closest to Gary Stern's than to that of others who have spoken so far. I, too, do not see and do not sense any fundamental change in our regional economy since the last FOMC meeting. We had a directors' meeting and we made a number of special inquiries on a couple of subjects that we all agree, I think, may be pivotal to developments in the period ahead. Clearly, there is

enormous uncertainty and uneasiness. I get the impression that that it is fed more by the steady drumbeat of negative commentary than by any deterioration in fundamentals.

When we ask about investment spending plans--and we've made calls to a number of our key contacts over the last week--not surprisingly what we find is that there has been a fairly decided pullback in export-sensitive industries and companies. The pulp paper division of Georgia Pacific has scaled back and is now probably going to cancel a major project. Steel producers clearly have no plans to expand.

On the other hand, a major company here in Atlanta, Lucent Technology, is going full speed ahead with a $350 million expenditure for a plant north of Atlanta. That investment is driven by the same fundamental that we have been hearing about for several years. That is, Lucent has been subject to a strike threat and wants to substitute capital for labor.

We also talked to some bankers in the region in an effort to get some sense of the availability of credit. Our supervision and regulation people talked to five or six of the major banks that lend in Latin America, and the latter confirm the story that we all have been hearing, namely that there has been a substantial pullback in credit even to the most creditworthy borrowers in Latin America. Bill Estes was telling me this morning that some of the top tier borrowers are paying double and triple the rates that they were paying before everything began to come unglued. There is even some pullback in trade lines to Latin America.

By way of contrast, calls to the major regional banks in the Southeast suggest that they clearly are looking much more carefully at their lending. We would characterize what we see happening as a responsible slowdown in lending to some borrowers where the lending standards may have been overly complacent. It's the kind of responsible behavior that one would expect given the turn of events. It means some additional stress-testing, looking ahead to an economic

situation that might not be so favorable, but certainly nothing close to any rationing of credit to legitimate borrowers.

Finally, I should add that the manufacturing survey we just released yesterday, which involves investment spending reports that we collected in September, shows no clear new pattern. Such spending has been very heady in this region for several years. We saw some slowing early on, but compared to a month or two ago, there is no apparent new trend toward any reduction in investment spending plans. So again, we do not see a lot of change other than the continuing uneasiness and uncertainty that we've all been talking about and that certainly continues to be true here in our region. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Thank you. Anybody else?

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

CHAIRMAN GREENSPAN. Yes, Bob.

MR. PARRY. We recently have had an advisory council meeting and a meeting of our board of directors, and I would have to say that, as I see them, the numbers relating to the performance of the District economy have not changed at all. However, there has been a definite increase in uncertainty and concern, particularly about financial prospects. We also heard reports that, for example, in the commercial real estate area some deals were being delayed but eventually getting done. I guess at this point I can not point to any specific changes that would indicate that economic prospects have weakened, although with all of the concerns expressed about financial developments, I would have to believe that there's going to be an impact on investment decisions.

MR. VARVEL. Mr. Chairman, this is Walter Varvel in Richmond. Al Broaddus could not participate on this call, but I visited with him this morning, so my comments will reflect his views.

We had a joint board meeting last week of our Richmond and Baltimore directors. I think it would be fair to say that our situation is very similar to that of several who have commented previously, Bob Parry's and Jack Guynn's comments in particular. We don't see a significant change in fundamental economic conditions within the District. However, there is increased uneasiness being reported by some of our directors. Others remain very optimistic and upbeat. One of our economists participated in a meeting yesterday of the Virginia Governor's Advisory Board, and we did pick up some information about reductions in capital spending plans. The chief economist for Mobile noted that they have cut their spending plans for next year, and they expect that to be the case throughout the oil industry. Also, a spokesman for Norfolk & Southern Railroad said that they have cut their capital budget, and their spending plans are now based on an assumption of zero growth in GDP over the next two to three years. Finally, we just completed a survey of our manufacturing and service sectors, and it provides some indications of a weakening in business sentiment and modest reductions in capital spending plans. Thank you.

MR. MOSKOW. Mr. Chairman, I have just a couple of things to add; my comments are very similar to those of my colleagues. There is no real sense of a fundamental change in business conditions in our District, but there is clearly a lot of increased concern, a lot of increased uncertainty.

Looking at some District industries, the automobile industry still seems to be going strong, although operating with very high sales incentives. GM seemed to recover better than expected from its strike. The steel industry is in the doldrums at this point. We just published

our survey of Midwest manufacturers, which covered developments in August. We found strength in the auto and steel industries, but we think that mostly reflects recovery from the GM strike. On the other hand, the machinery and natural resources areas showed some slowing in August.

Business people we've been talking to are starting to focus on their budgets for next year. The general comment is that they are all planning lower levels of capital spending, hiring, and expenses for 1999 than they had for 1998. In other words, they went into 1998 with the view that it would be a very bullish year, whereas they are approaching 1999 with a lot more concern. While we are seeing a lot of concern, the labor markets are still very tight and there are still many areas of strength in our District economy.

CHAIRMAN GREENSPAN. Any Board members want to comment?

MS. RIVLIN. This is Alice. I would certainly concur with most of what I have heard around this table.

MR. GUYNN. We can not hear you, Alice!

MS. RIVLIN. I will get closer to the mike and shout! Everything I have heard around this table, if it can be called a table, confirms what I thought I knew, namely that the world is very weak and getting weaker. We see enormous risk aversion in financial markets all over the world. But here in the United States we have general strength in the domestic economy, especially in the consumer sector. At the same time, there is a great deal of anxiety and some evidence of a pullback from economic activities that were going on or were expected to be going on in the next few months.

It seems to me that these developments give us an enormous chance to get ahead of the curve, as Ed Boehne suggested early in the conversation, and to do what we can to keep a good

thing going in this country. What worries me most and I think worries other people most is that the real weakness in the world economy is eventually going to affect our own economy. I think we should get ahead of that by taking action as expeditiously as we can to make sure that the U.S. economy stays strong. Now, we can wait until our next meeting, but that would involve a long wait. The risk of waiting in my view is that we may be forced into a reactive position. The beauty of doing something right now is that nothing much is happening. We can look ahead as we did before to see likely weakening in the U.S. economy and decide what to do about it later, but I think we should make a prompt downward rate move. If we wait to see what is going to happen in the next week or two, we might find ourselves reacting to either a sharp drop in the stock market as earnings come in more gloomy or to a catastrophe on the international scene if Brazil or something else goes wrong. So this seems to me a good moment to make our move.

MR. KELLEY. Mr. Chairman, this is Mike Kelley. I agree with a great deal but perhaps not everything that Alice Rivlin just said. Her analysis of the situation and that of others who have spoken all seem to go in the same direction. That is, as each day passes the economy is slowing a little more. It certainly seems more and more likely that our policy is on an easing path and that we have further to go. But I have a concern in that we eased just 16 days ago and that was the first move we made in a very long time. To move again so soon would very clearly not be a business-as-usual thing to do. If we do it, I think we are going to have to very careful about the message that we send. We have discussed the economy, so I will not go over that again. We have three vectors here, two of which look pretty much the same as they did two weeks ago. The latter are the real economy in the United States and the real economy around the world. Some weakening clearly is occurring. The delta, to the extent that there has been one in the last two weeks, is clearly downward. The dynamics are in the credit and capital markets. As Alice Rivlin

and others have suggested, if those markets should implode--maybe that is too dramatic a word, but if they should deteriorate badly--they could very easily and promptly take the real economy with them, and we could find ourselves very quickly behind the curve.

If the Committee judges that a substantial deterioration of that kind is a strong or imminent possibility, then I think we should act, and I would certainly support that action even though it obviously is not business-as-usual. But if this situation does not reach that level of urgency, then I think we should be very careful about our timing. I would be concerned that if it is not a situation of substantial deterioration or perhaps does not appear to be, then a move right now would run the risk of making it seem as if the Fed believes that it got it wrong the first time and we feel the need to act very quickly to correct our error. If that were the perception, I think the market could rightly conclude that the situation as seen by the Fed must be far worse than we thought it was in late September and that there is some kind of policy panic or disarray at the Fed.

I see two major problems if that should be what is perceived. Number one, I do not believe we got it wrong the first time, and I think it would be very destructive and quite unnecessary to convey that impression today. Secondly, I would be concerned that such a perception could induce the very type of financial market panic that we are seeking to prevent in the first place. If we do make a judgment that the credit and financial markets are such that the situation is dangerous and action is required, I will support that judgment. Under those circumstances, if that is where we are, I think we probably should consider moving more strongly than our usual 25 basis points in the federal funds rate. I also think we should give very careful consideration to what we say in our press release. We should basically acknowledge the risks that

we see for the economy and make sure that those risks are what the market sees us acting upon and not those that I mentioned a minute ago. Thank you.

MR. MEYER. This is Larry Meyer. Let me reinforce two themes that I think we have heard mentioned several times. While there may be some erosion on the margin in terms of the very near-term outlook, there is not very much change in terms of the traditional ingredients that go into our forecast, say for 1999, and no basis there for a material change in policy. On the other hand, we have to contrast developments in the real economy and those in the financial markets. There is a tension between them. It may be that recent developments have increased our perception of a wider deterioration in the functioning in the financial markets that goes beyond simply the widening of risk spreads but now includes indications of illiquidity--market participants not standing behind the bid-ask spreads as wide as they are. It is very difficult to translate all that into a revised forecast, but it adds a higher degree of uncertainty and reinforces the sense of downside risks.

With reference to other forecasts, I must say that for the first time I see a meaningful shift in forecasts for 1999 after a long period of little change. I think we are going to see those forecasts converge down to something closer to the Greenbook, not to the Greenbook level but toward it.

My sense is that one of the problems is that we may not have conveyed as well as we might have liked the message that we wanted to send at the last meeting. That message I thought was that we had a flexible policy, we recognized a significant change in the economic outlook, and we responded accordingly. I think our action was taken as something done grudgingly, and I believe we might reduce some of that uncertainty in the markets by taking a further action at this point. Were we to do so, and since it would involve an intermeeting move, I would think that 25

basis points would be the right way to do it. To me, if the story is that we feel we need to have a lower federal funds rate in the first half of next year, it probably would be good to get there a little faster than on the pace we might otherwise be on. In addition, given the downside risks, I would say that if I picked a number that I would like for the GDP growth rate next year, I would snug it up a little closer to trend than I otherwise would because of the prevailing sense of downside risks and discontinuities.

MR. FERGUSON. This is Roger Ferguson speaking. I would like to echo and respond to some of what I have heard on the policy issue. Mike Kelley is concerned about sending a message of panic or disarray in policymaking. On the other hand, I am actually more concerned about being perceived as being inactive in the face of what I think are going to be potentially rapidly moving changes going forward. I have been struck by some of what Bill McDonough had to say and what Larry Meyer had to say as well. The financial markets do seem to be showing signs of a great deal of fear and uncertainty. They seem actually to have gone beyond a state of concern and uncertainty and to have seized up in important ways. There are counterparties that no longer seem to be standing on the other side of important trades. I am fairly certain that the result will inevitably be some impact on the real economy. The sense of financial foreboding that I have heard, while it has not yet translated into an impact on the real economy, will in my view have such an impact at some point, perhaps not in the next week or two but certainly in the next quarter or two. We all know that the policy actions that we take require some time to work their way through the economy. Additionally, in a period of great uncertainty, I think it is important for us to be shown in a leadership role and one in which we are prepared to be as flexible and as vigilant as the markets and circumstances in the real economy require. Therefore, in terms of what has brought us here today and what is different, I conclude

that what is different is that the markets have not moved to support the kind of investment or the kind of consumption expenditure that we need to maintain growth as close as possible to trend. I think it is our obligation to be pushing publicly against the significant downside risk that I believe we face.

I am mindful, as Mike Kelley indicated, that we are involved in an intermeeting discussion. Therefore, any action that we may take should in my view be on the order a 25 basis point move. It should not be larger because we will get more impact out of 25 basis points in my opinion than from anything else. So, having heard where we are now and sharing the sense that adverse financial conditions have not yet hit the real economy but are likely to do so, my inclination would be to take advantage of this period of quiescence to indicate that we are vigilant, forward-looking, and responsible.

MR. GRAMLICH. This is Ned Gramlich. First on the real economy, let me focus on the Greenbook forecast. You will recall that two weeks ago it was already weak, and that was despite the assumption of a 75 basis point reduction in the federal funds rate. Now, according to Mike Prell, whose view is supported by other comments we have heard, it is weaker still. So, I think that we could easily justify a 50 basis point reduction in the funds rate. The next question is whether we should reduce the rate at the next meeting or now. I guess I agree with a lot of others, why not now? From the standpoint of the real economy, it probably doesn't matter too much; four weeks is not that long a period when we consider all the lags in the real economy. But for the financial markets, four weeks could be a long time, especially for one key currency market, the real. So I come out in favor of doing something now. I guess 25 basis points is okay, though I could also defend 50.

There are two basic arguments against reducing the rate. One is the uncertainty argument and one is the panic argument. With regard to the first, it seems to me that the uncertainty that we had even two weeks ago is being largely resolved in the direction we did not want it to be. I think we are lot more certain, maybe sadder but wiser, about the outlook now than we were two weeks ago. On the panic argument, frankly there is panic already.

I think Larry Meyer is right that our message was a bit misinterpreted and that some reinforcement of that message may be a good idea. If we move the rate down today my guess is that our action would be calming, not panic-inducing. Thank you.

MR. POOLE. Mr. Chairman, this is Bill Poole. As I read the discussion, everybody has a sense of concern about current conditions. Personally, I would feel a lot better about moving between meetings, given past practice, if there were a sense of urgency that was a step up from a sense of concern. We are going to be sending a message by acting between meetings, and I am a little concerned about how that message is going to be interpreted.

I have two questions and would appreciate some comments on both. First, do we want to ease policy on a day when we have received bad PPI news? Secondly, is there any chance that action today could be viewed, by some anyway, as an effort to help bail out the hedge funds?

CHAIRMAN GREENSPAN. Let me respond to that, Bill. First of all, the latest PPI number is clearly a significant aberration, and I think the markets understood that. When the number first came out at 8:30 this morning, the bond market dropped ½ point. As soon as it became clear what was causing the PPI to rise, the market came all the way back. I don't think the PPI is an issue. Indeed, there is a certain perversely positive benefit to responding when the numbers do not appear to be immediately supportive of a policy change because that does imply

that we are looking at a broader, more forward-looking picture. So today's PPI number is not something I would be particularly concerned about.

What I think we have to focus on here is the issue of where we think the funds rate should be at this point, knowing what we know about the future and disregarding the fact that we are at 5¼ percent, if I may put it that way. I think it is probably too soon for the type of financial constrictions that have been occurring in quite a virulent manner in the last couple of weeks to have worked their way through balance sheets and into capital investment decisions. I have been trying to get a sense from a number of different contacts regarding what is going on in the real economy. The judgments that I am hearing from most of you that nothing much has changed in the economy strikes me as about right. That is, there is very little evidence that I can detect of an underlying deterioration in the economy, and indeed were we to see that, I would suggest that we are right on the edge of a recession. When we see developments of that nature, it usually is a signal that the system is breaking down. That is one of the reasons why we often have difficulty forecasting recessions. I do not sense anything out there that reminds me of that, and I do think that the perception of a continuing reasonably good economy is a fairly objective observation.

However, if we look at past history and at what happens when profit margins are under some pressure and financing conditions deteriorate even half as much as they have so far, the presumption that the capital goods markets can hold strikes me as rather unlikely. We have maintained a somewhat higher federal funds rate than we otherwise would have in the last year or two, largely I suspect because we were seeing a quite pronounced stock market wealth effect on the economy. Because of that effect, we felt the need for a tighter policy than would ordinarily have been the case. We purposely allowed the real federal funds rate to rise as inflation expectations fell largely because that seemed to be the appropriate policy posture to take. But if

we start where we are now and look forward, taking account of current financial conditions and the developing weakening in profit margins, a funds rate in the area of 4½ to 5 percent seems close to where we want it to be at this stage. But clearly, to start moving at a more dramatic pace than we need to raises the risk, I think, that Mike Kelley quite appropriately brought up.

My own impression at this stage is pretty much what Ed Boehne and Alice Rivlin mentioned, namely that we have a window in which to adjust the funds rate downward without being perceived as moving in response to very strong pressures that are working against us in the economy. If we move the funds rate lower, and frankly I would be inclined to lower it today, that does not put us in a position where, if the move proves wrong, there is something that would prevent us from moving back. If in what I would at this point consider to be a relatively low probability the financial markets were to return to what we perceived of as normal two months ago, and if the economy started to strengthen again and the stock market to move higher, there is nothing that would prevent us from reversing our move. At 5 percent, for example, if we were to move the funds rate ¼ percentage point lower today, we would not be that far out of position in terms of a real funds rate to address the low probability of an upturn in the economy.

At this stage, after 50 years of looking at the economy on almost a daily basis, I must say that I have never seen anything like the current situation. Certainly, based on all the historic annals I have read, and I have done a good deal of reading in economic history, it would be an extremely rare event for this type of financial environment to emerge and eventually to recede without having any impact on the economy. Indeed, I do not remember any occasion when that occurred in the past.

In conclusion, I would be inclined at this stage to move the funds rate down by 25 basis points. There is an inclination on the part of a number of Board members to accept the

outstanding requests of Reserve Banks that want to reduce the discount rate by 50 basis points. As you know, at least those of you who have been around for a while, the convention in this Committee is not to vote on policy adjustments during intermeeting periods. The reason is that our directives in essence give the Chairman of the Committee, in consultation when feasible with the Committee members, the authority to request the Desk to move the federal funds rate. I would be inclined to reduce the rate by 25 basis points and would like to put such an action on the table, not for a vote but to hear whatever objections there may be against it. Unless I hear strong objections, I would request the Desk to move the rate down 25 basis points, and having done that I would call a meeting of the Federal Reserve Board to request approval of a reduction of 50 basis point in the discount rate. So, I very much would like to hear responses to that funds rate proposal if I may.

MR. BOEHNE. Mr. Chairman, this is Ed Boehne. I agree with your recommendation to lower the funds rate by 25 basis points. I think that the risks are on the downside and that we need to stay on or ahead of the curve. I also think that our last move was misinterpreted. Therefore, I think your proposal is a good idea.

Although it is not something for the Federal Open Market Committee to decide, I would like to express the view that a 50 basis point reduction of the discount rate in conjunction with a 25 basis point drop in the funds rate is extraordinarily unusual. I do not recall that happening before. It may be confusing to the public. I guess I would ask the Board to reconsider. I agree that we should move the discount rate down. It just seems to me that it might make more sense to reduce it by the same amount as the funds rate because the message we are sending is that we are open to further declines.

In sum, I am for the 25 basis point drop in the funds rate, and it seems to me that a 25 basis point drop in the discount rate would be more consistent with that. I would just ask the Board to take that into account.

MR. MCTEER. Mr. Chairman, Bob McTeer.

CHAIRMAN GREENSPAN. Please hold for a moment, Bob. Don Kohn wants to respond to Ed Boehne's comments.

MR. KOHN. President Boehne, you are correct in that most of the time the discount rate and the funds rate are moved by the same amount. But actually in 1990 and 1991 there were five instances in which the funds rate was moved down by 25 basis points and the discount rate by 50 basis points. So in that easing environment such a disparity was not unusual.

CHAIRMAN GREENSPAN. Bob McTeer is next.

MR. MCTEER. Thank you. As you might expect, I would prefer 50 basis points today rather than 25 on the fed funds rate. We have a Texas country swing band down here whose name is "Asleep at the Wheel." I would hate for the financial markets to give us that label as well. I realize that I am in the minority, but I thought I should express that view.

On the question of the discount rate, I think it is easily explained that we did 25 basis points on the fed funds rate last time, 25 basis points more this time, and 50 basis points on the discount rate is simply a catch-up. I would strongly agree with your 50 basis points on the discount rate.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, Bill McDonough here.

CHAIRMAN GREENSPAN. Yes, Bill.

VICE CHAIRMAN MCDONOUGH. I noticed that you really asked only if people strongly disagreed with what you plan to do. I do not strongly disagree at all. I think it would be

a great idea if we just told you that we think that, as usual, you are doing a fabulous job and allow you and the other Board members to meet promptly to approve a reduction in the discount rate.

CHAIRMAN GREENSPAN. You have rendered the rest of your colleagues to silence! [Laughter]

MS. MINEHAN. Mr. Chairman, I don't have any objection to the 25 basis point reduction in the fed funds rate. I do think that Governor Kelley's cautionary comments apply with particular force if we move both the discount rate and the fed funds rate on the same day just a couple of weeks after our earlier action and in the face of a lot of panic in the financial markets but evidently not much change in the real economy. While it may not happen, I think the combined moves have the potential of feeding rather than assuaging the panic in financial markets. I realize that it is not my job to make a decision on the discount rate, but I am concerned about the proposal.

CHAIRMAN GREENSPAN. Are you saying that you think the discount rate should not be changed at all?

MS. MINEHAN. I could agree with not changing it at all because we have had discount rates and fed funds rates at the same level many times in the past. I could support reducing the discount rate by the same amount as the fed funds rate.

MR. PARRY. Mr. Chairman, this is Bob Parry. I would not object to your recommendation with regard to the funds rate. With regard to the discount rate, we at our Bank have been recommending to our directors that they request a reduction in the discount rate, which as you know they have done. So I could not very well object to a cut in the discount rate either.

MR. POOLE. Mr. Chairman, this is Bill Poole. I would like to associate myself with Cathy Minehan's position. Thank you.

MR. GUYNN. Mr. Chairman, this is Jack Guynn. I would as well. If I had a vote and if the Committee were voting, I certainly would not dissent. But as Mike Kelley suggested I would prefer to hold off taking action until the next FOMC meeting. As other presidents have noted, we do not have an official say in setting the discount rate. Nevertheless, I think a 50 basis point reduction in that rate on top of the 25 basis point cut in the fed funds rate clearly would be a terribly strong intermeeting action--and one that I would prefer not to see us do. Thank you.

MR. STERN. Mr. Chairman, this is Gary Stern. I think we have an opportunity to reduce the funds rate and we should do so. It is possible that the move could be misconstrued by the market, but it is also possible that we would be perceived as moving decisively. I am willing to take the risk that the market will get it right.

As far as the discount rate is concerned, for what it is worth I would prefer a 1/4 point reduction, but this is not a big issue with me.

MR. MOSKOW. Mr. Chairman, this is Mike Moskow. I, too, would prefer the 25 basis point reduction in the discount rate. I would support the proposed reduction in the fed funds rate.

MR. HOENIG. Mr. Chairman, this is Tom Hoenig. I would not object to the 25 basis point reduction in the fed funds rate. I am uneasy about making this move this soon after our late September action. I don't think there has been enough change since the September meeting to warrant the rate cut, but I certainly understand that it is in some ways an insurance action and I would not object.

If I may express an opinion on the discount rate, I would much prefer a ¼ point reduction so that it comes in the same as the reduction in the funds rate. That combination does not sound

quite as alarmist as one involving a larger discount rate. With reference to the earlier period that you mentioned, Don, I think those actions might have been justified during a more difficult period for the economy. In any event, the discount rate is someone else's call to make.

MR. VARVEL. Mr. Chairman, this is Walter Varvel in Richmond. We have similar views. We would prefer to see a reduction at the next regular meeting. Taking the unusual action in an intermeeting period might send the message of a sense of urgency that could cause the markets to expect further or greater rate reductions in the near term than we might contemplate at this point.

CHAIRMAN GREENSPAN. Others?

MR. JORDAN. Mr. Chairman, this is Jerry Jordan. I think most people know my position on policy, namely that it is too expansionary at this point. With regard to the discount rate, its only economic significance is the message. So the question is what message we want to send with the discount rate. There is real significance to what we do on the funds rate. I don't think a ¼ point reduction is going to do a lot of damage or help a lot either. But I think the real question that must be carefully considered about the discount rate, whether the change is ¼ or ½ point, is the statement that is made about policy now and the statement that will have to be made in a subsequent period when the rate has to be raised again.

CHAIRMAN GREENSPAN. Do any of the Board members have comments? Governor Rivlin.

MS. RIVLIN. I would agree with the Chairman. I believe we want to send a strong signal. I don't think we should worry about the panic factor. I suggested 50 basis points on the discount rate because I thought it would give a stronger signal. Indeed, if we were only going to do 25 on the discount rate, I would be inclined to move the fed funds rate by perhaps 50 basis

points because I think the point is to communicate the message that we are in the action here, and we are doing something major.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, Bill McDonough. I fully agree with Alice.

MR. KELLEY. Mr. Chairman, this is Mike Kelley. After the discussion that we have had here this afternoon, I concur with the recommendation of a 25 basis point reduction in the funds rate today. I also think that we should lower the discount rate and that the Board members should discuss a little further whether the reduction should be 25 or 50 basis points.

CHAIRMAN GREENSPAN. We will do that later. Governor Meyer.

MR. MEYER. I agree with the 25 basis point move in the funds rate. In general I think the discount rate should be moved in line with the funds rate. I do not think of the discount rate as anything other than complementing policy. And since we recently narrowed the spread between the two rates to 25 basis points from 50 basis points, it is very easy to justify a 50 basis point move on the discount rate. I guess that's where I would be.

MR. FERGUSON. Mr. Chairman, I concur with your recommendation of a 25 basis point reduction in the funds rate. I think we are being preemptive and forward-looking here. I believe we should take advantage of this window of opportunity to make that change so that we do not appear to be in a panic and reactive. It will take some time before we see the effect in the real economy.

With respect to the discount rate, I think we should try to keep it at a certain level below the current funds rate. Therefore, I think a 50 basis point move would be appropriate, but I will suspend judgment and participate in the further discussion of that issue by the Board.

MR. GRAMLICH. I think a 25 basis point cut in the funds rate is fine. I have this quaint notion that the discount rate should be above the funds rate, so my position on that is the smaller the change in the discount rate the better. So I prefer 0, 25, and 50 in that order for the discount rate.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, could I take the liberty as Vice Chairman of the Committee to thank you for the courtesy that you have shown your fellow members of the FOMC and the other Reserve Bank presidents by having this meeting.

CHAIRMAN GREENSPAN. Thank you.

MR. MOSKOW. Mr. Chairman, just one question. Could you give us some idea as to what the timing would be on an announcement of all this?

CHAIRMAN GREENSPAN. Yes. I think we should just read the proposed statement first, just as it relates to the federal funds rate. Don Kohn, would you read this and then tell us what you recommend on the timing? We have to go into a Board Meeting to discuss the discount rate. I don't want to presume where we will come out. We will obviously make the announcement after the Board meeting.

MR. KOHN. This is a draft, Mr. Chairman. Obviously we can fine-tune it after the discussion, but the heart of it would be "The Federal Reserve today announced the following policy actions: The Board of Governors approved a reduction in the discount rate from 5 to either 4¾ or 4½ percent, depending on what the Board decides. The federal funds rate is expected to fall 25 basis points from around 5¼ percent to around 5 percent." There are then two explanatory sentences: "Growing caution by lenders and unsettled conditions in financial markets more generally are likely to be restraining spending and damping inflation pressures in the future.

Against this backdrop, prompt easing of the stance of monetary policy was judged to be warranted to sustain economic growth in the context of continued low inflation."

CHAIRMAN GREENSPAN. We can close the FOMC meeting with a decision that the Desk will be requested to lower the funds rate by 25 basis points. We will immediately go into a Board meeting and hopefully make a reasonably quick decision. Don Kohn, what is the appropriate time for release?

MR. KOHN. I think for the discount rate there is no set time. I believe we should get the announcement out as quickly as possible once there is agreement on the action and the wording. So I think perhaps an hour from now is feasible or even less if possible. We are not constrained by the practice followed after regularly scheduled FOMC meetings where the release time is set for 2:15 p.m. We will try to move through the process of preparing the press release as rapidly as possible. I would expect it to be out within the hour.

CHAIRMAN GREENSPAN. Thank you very much, everybody. We will get to work as quickly as we can on the discount rate issue.

END OF SESSION

Secretary's Note: The Board of Governors voted to approve a ¼ percentage point reduction in the discount rate, and the statement announcing both actions was released to the press at about 3:15 p.m. on the date of this conference call meeting.