

Meeting of the Federal Open Market Committee

November 13, 1990

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, November 13, 1990, at 1:30 p.m.

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

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

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

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

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

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

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

A third option would be to maintain current reserve conditions, even following passage of a fiscal package like the one proposed. Such a choice would be based on the notion that the proposed fiscal policy, perhaps in light of its time profile, and current conditions more generally, were not likely to result in weakness in the economy over coming quarters beyond that needed to contain inflation. The lack of policy action might be seen by some as a failure to follow through on a promised policy ease, and in any case would disappoint market expectations slightly. Once it became clear that policy was not going to ease following the budget accord, short-term rates would back up a little and bond yields also might rise. The longer-term response of bond markets might be more favorable, however, reflecting a continuing sluggish economy and damped inflation expectations.

Mr. Coyne, Assistant to the Board, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and
Statistics, Board of Governors
Mr. Slifman, Associate Director, Division of Research
and Statistics, Board of Governors
Mr. Madigan, Assistant Director, Division of Monetary
Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of
Monetary Affairs, Board of Governors

Mr. Guynn, First Vice President, Federal Reserve Bank of
Atlanta

Messrs. Balbach, Beebe, Broaddus, T. Davis, Ms. Munnell,
and Mr. Scheld, Senior Vice Presidents, Federal Reserve
Banks of St. Louis, San Francisco, Richmond,
Kansas City, Boston, and Chicago, respectively

Ms. Lovett and Mr. Meyer, Vice Presidents, Federal
Reserve Banks of New York and Philadelphia,
respectively

Transcript of Federal Open Market Committee Meeting of
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CHAIRMAN GREENSPAN. Would somebody like to move approval of the minutes?

MS. SEGER. I'll move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. No objections. Mr. Cross, foreign currency operations, please.

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

MR. HOSKINS. I have two questions. One has to do with the warehousing arrangement. Sam, I didn't catch what you said in terms of our exposure now and where our ceiling is. And, is it advisable to consider lowering it?

MR. CROSS. We now have \$4-1/2 billion warehoused.

MR. HOSKINS. And limits?

MR. CROSS. The limit is \$10 billion.

MR. TRUMAN. The [current] limit is \$10 billion and the [potential] limit actually voted by the Committee is \$15 billion.

MR. HOSKINS. So, we have a \$15 billion limit but we're currently at \$4-1/2 billion. I'm wondering if we should consider bringing the limit more in line with the outstandings, especially since it has attracted some attention.

MR. CROSS. Well, there is an occasion to reexamine these limits, which comes up in February. I'm sure we can look at it at that time.

MR. HOSKINS. My second question has to do with the swap arrangements. I've brought this up before. Most of the countries on the list are industrialized countries with AA ratings for their debt and an exchangeable currency. There's one exception, and that's Mexico. My view on Mexico has been that it doesn't meet the goals of why that swap arrangement was originally set up. In a sense it's more like foreign aid or a loan to Mexico by the Federal Reserve and that's more or less outside the goals of swap arrangements. Mexico is a different [type of] country than the other ones.

MR. CROSS. But we do, of course, have very close ties with the Mexicans for many, many reasons. And we've had the swap line outstanding with them for decades. At times it has been regarded as useful for the Federal Reserve to be in a position to provide some financing during a period when Mexico was working to try to get its situation under control. We have participated with the Treasury and it has been very helpful to be in a position to be able to provide in effect a measure of confidence about what Mexico was trying to do, which we were very much supporting. But never did we do anything that caused really great exposure for us.

MR. BOEHNE. In the current market environment, do you sense that the exchange market would react differently to a change in the funds rate versus a change in the discount rate?

MR. CROSS. I would think that most market participants expect that there will be some change in the federal funds rate looking ahead over the next few days or so; at least there seems to be a general expectation of a very modest change and a [possibility] for another one. The latter is a much smaller expectation but some people in the market are thinking about a further step maybe by the end of the year. Even though they are expecting such a move to take place, that doesn't mean it would not have any impact in the exchange market; I think much will depend on how and when [a move is made] and the circumstances and so forth, and whether the market gets the idea--looking further into the future--that we're on a particular path in a particular direction. So, even though most people in the market expect that there will be a modest change in the federal funds rate, I don't think one can conclude that that wouldn't have any effect. It might not have any immediate effect, but it certainly goes into their thinking about what they're looking for over a longer period. My own feeling would be that a discount rate move would be regarded as a more significant step and one that I don't think they really are anticipating at this point.

CHAIRMAN GREENSPAN. Any further questions for Sam? If not, would somebody like to move to approve the one-year extension of the swap lines?

VICE CHAIRMAN CORRIGAN. Move it.

MR. ANGELL. Second.

CHAIRMAN GREENSPAN. There is a second. Without objection. Peter Sternlight, domestic operations.

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

CHAIRMAN GREENSPAN. Questions for Peter?

MR. HOSKINS. This is just a hypothetical question. If the funds rate were to come down, do you see any problem with the discount rate--with the spread being narrowed? I know you're not using it as the fulcrum anymore.

MR. STERNLIGHT. At some point I think there could be, but I don't think a modest further move of the funds rate would cause difficulty in that regard.

MR. PARRY. What is the nature of that problem?

MR. KOHN. It would be more a problem if we were trying to judge the adjustment borrowing--

MR. HOSKINS. Yes.

MR. KOHN. We have operated before with the funds rate below the discount rate.

MR. HOSKINS. It seems to me in the current environment--the way we're tending to operate by pegging the funds rate--that we probably could go ahead and operate with a penalty discount rate. Is that right?

MR. PARRY. Right.

MR. STERNLIGHT. I think that's right.

MR. HOSKINS. I had one other question, the perennial one. Given all these changes that have gone on and the consideration of potentially reducing reserve requirements as well, are we going to have a collateral problem soon?

MR. STERNLIGHT. The dewarehousing that Sam referred to and that I noted relieves the immediate concern. I think we could still run into a problem early next year. We came close on some days in the recent period--closer than we had expected because of the very slow growth of money and, hence, reserve requirements. But the dewarehousing gave us some more breathing space. I don't really look for a very tight squeeze again until maybe February.

MR. KOHN. Our projections, President Hoskins, actually have us squeezing through February with a little breathing room; I'm not sure about Peter's. It is the case after the dewarehousing--and obviously depending on what happens to the dollar and the reserve requirements and what not--that if reserve requirements were reduced as a policy move, something would have to be done about using the foreign currency holdings. We don't have enough space to move.

CHAIRMAN GREENSPAN. Si.

MR. KEEHN. In the Bluebook there is a comment about the Japanese banks borrowing overnight and about the fact that [such borrowing] apparently doesn't have an impact on the domestic rate. I'm not quite clear how that works.

MR. STERNLIGHT. I think the comment was that there has traditionally been a little premium paid by Japanese banks borrowing in the fed funds market and that has tended to increase in the recent period.

MR. KEEHN. A premium.

MR. STERNLIGHT. There are various reasons for it; some of it is the market perception of the Japanese banks and some is that those banks seem to be concentrating more of their funding in the overnight market.

CHAIRMAN GREENSPAN. I can understand why the spread has opened up, but what I can't understand is why the spread existed in the first place. What is there about the risk on overnight funds, versus, say, a year and a half ago, of a major Japanese bank? Why is it any more than for an American institution?

MR. STERNLIGHT. I think it's just the reluctance of some participants in the market to extend their range of contacts. The sellers in the funds market are typically the smaller regional banks

that are not used to dealing in the international markets. They just have had a preference for selling their funds to their traditional correspondents. To get them to reach out and sell to any foreign banks has taken a bit of a step-up in rates.

VICE CHAIRMAN CORRIGAN. The Japanese banks have always paid up in London too.

CHAIRMAN GREENSPAN. That's even more bizarre.

MR. KOHN. And they used to pay up more, even before, at the end of the quarter on the statement dates; the spread would widen for a day or two and then come back down. So, it's clear that people, rational or not, were having trouble showing that [borrowing] on their balance sheets.

CHAIRMAN GREENSPAN. More trouble spelling some of the names!

MR. STERNLIGHT. There has been a tendency for all of the foreign banks to pay up a little, although the increases recently have been more or less confined to the Japanese banks. The European banks have not seen a step-up in premium.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Peter, again this is a hypothetical question. If you had been able to meet the demand for reserves that would have achieved the target funds rate, would that have substantially affected the growth rate of reserves over this period? I'm not sure you can answer that.

MR. STERNLIGHT. I just don't know whether it would have had that much short-run impact.

MR. KOHN. My view would be that it would not, because the difference in interest rates, in effect the fed funds rate, is very minor and, therefore, the demand for required reserves would be affected by a very, very small amount. I'd be skeptical, as Peter is.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Peter, there has been a lot of discussion concerning the Japanese and other foreign investors pulling back from their investments, particularly indirect investments, in the United States. I'm not sure what the order of magnitude of those flows has been but if they have been substantial, why aren't we seeing some upward pressure on interest rates as a result of that?

MR. STERNLIGHT. Well, I think there has been a pulling back by the Japanese but what impact that would have has been offset, because in a soft economy other demands for credit have been lightened. And there is this quality differential factor as well, where Treasuries have been in demand because they are seen as the premier type of investment as against virtually any other kind of investment.

MR. TRUMAN. President Forrestal, you probably have seen it, but you've seen it more in the exchange rates than in the interest rates.

MR. FORRESTAL. Well, it goes to the question of the financing of the deficit, and we've talked about--

MR. TRUMAN. Although Japan is still running a current account surplus, it is a lot smaller, so there's less financing going to come, net, from that country anyhow. So, some of that is going to come out in various pieces. But to the extent you have some [unintelligible] factors, you're going to find it both in interest rates--and there may be special reasons why you don't see it in the Treasury bill market--and also in the foreign exchange markets.

VICE CHAIRMAN CORRIGAN. One of the related things going on too, Bob, is a very clear widening out of spreads even on standbys and things like that. In other words, one manifestation of all of this concern about credit quality is that for a given structure of interest rates, spreads and fees even on standbys are actually widening--and perhaps by a lot. Some of that I think is directly related to this general concern about credit quality, but some of it also is directly related to the fact that the Japanese banks' profile--not just here in the United States but in Europe including Britain--really has changed.

MR. MULLINS. As a factual basis: In the recent refunding, how did the foreign demand hold up and also how did individual purchases hold up?

MR. STERNLIGHT. Foreign demand was on the light side. It had been on the light side in August also, as you may recall. The Japanese dealers were there but it was not altogether clear how much was really going back home to Japanese investors. To some extent I think they put in an appearance and then just turned the stuff over in the U.S. market. They were not very big participants; they were moderate size participants.

MR. MULLINS. What percentage appearance did they put in would you say?

MR. STERNLIGHT. In the 3-year note it turned out to be very little because they were bidding but other people outbid them, so they only got around 5 percent. In the 10- and 30-year issues my recollection is that it was more in the 15 to 20 percent range.

MR. CROSS. I got the impression from the Japanese that they took about 2/3rds as much this time as they had in some earlier periods.

MR. STERNLIGHT. That sounds about right.

MR. MULLINS. And the individuals?

MR. STERNLIGHT. Individuals were about normal, I'd say.

MR. KOHN. I think their participation was down from the previous couple of auctions but still pretty high given that [market] rates had come down closer to the deposit rates.

MR. MULLINS. I have a question also on the collateral issue. If we had a major problem with a large banking institution, would that affect our collateral [against Federal Reserve notes]?

MR. STERNLIGHT. Yes, it would if we were making big discount window loans. What they put up as collateral might or might not be countable in backing currency. It would depend on what--

MR. MULLINS. And barring that, we get through February before we bottom out again?

MR. KOHN. Maybe. It's close, but it looks as if we have a much better chance than we did before the [dewarehousing].

MR. MULLINS. Thank you.

MR. BLACK. Well, at some point that law has to be changed, it seems to me. This is probably not the time to do it.

MR. BOEHNE. It never is.

MR. BLACK. We really ought to get rid of that; it's a fiction [unintelligible] reserve requirement rather than some notes and deposits.

MR. LAWARE. How big would the discount window borrowing have to be in order to create a problem? Assuming, let's say, that all or rather a quarter of the collateral wasn't as nice as you'd like to see--

MR. STERNLIGHT. Well, there is a fairly tight spot in February, as Don noted, so we wouldn't have to get any really major borrowing.

MR. SYRON. A billion dollars would do it?

MR. STERNLIGHT. It might.

MR. KELLEY. I'm glad you amended your question to say 1/4.

CHAIRMAN GREENSPAN. That's interesting. Any further questions?

MR. GUFFEY. Just a follow up. We have the authority to back currency with foreign assets, right?

MR. STERNLIGHT. Legal authority, yes.

MR. GUFFEY. Does any additional action need to be taken in order to implement that?

MR. KOHN. Yes, by the Board.

MR. TRUMAN. The Board [unintelligible] required authority. There was some in place because your Bank and a couple of others used it as I remember. The Board declared that it would not do so.

CHAIRMAN GREENSPAN. Yes, but didn't that come up just because of Mexico?

MR. TRUMAN. No, it came up because we were using Swiss francs.

CHAIRMAN GREENSPAN. Swiss francs?

MR. TRUMAN. Yes.

CHAIRMAN GREENSPAN. That soft currency!

MR. TRUMAN. It is true that during that period there were problems with the Mexican peso, but in the particular cases in which [foreign currencies] were used we were using Swiss francs. The Board said at the time that it would not do so again except under a determination of unusual and exigent circumstances. So, there's an S letter out governing the use of collateral and that would have to be changed.

CHAIRMAN GREENSPAN. Maybe we should go back to the gold backing.

MR. TRUMAN. The greenback would go to a premium then.

MR. ANGELL. You want to devalue also?

CHAIRMAN GREENSPAN. Well, this is so bizarre--the silliness of this. Any further comments for Peter?

MS. SEGER. May I just ask one question?

CHAIRMAN GREENSPAN. Go ahead.

MS. SEGER. When you alluded to the pressure being put on mutual funds to improve the quality of their--

MR. STERNLIGHT. Yes, the money funds.

MS. SEGER. I figured you meant bank CDs and commercial paper. Is that correct?

MR. STERNLIGHT. Yes.

MS. SEGER. I guess I didn't realize that the SEC has the authority to manage accounts. I thought that the primary purpose of the securities laws required--well, that it was not to tell the managers what to put in their portfolios.

MR. STERNLIGHT. I think this would involve a rule that would dictate the accounting practices that they follow. In order to continue accounting for investments in the fund, keeping the unit value at \$1 or whatever, they would have to follow certain accounting rules. And the rule that was being proposed would have set a very stringent standard as to what proportion of their assets could be in less than the top rated forms of commercial paper or bank deposits.

MR. PRELL. You recall they also have regulated the maturities, in essence for the same purpose.

MR. STERNLIGHT. That's right.

MR. PRELL. So, they played a very active role in this field.

MR. MULLINS. But this is for money market mutual funds that don't want to mark to market and that want to be allowed to use that cost plus basis and keep the unit values. The rule is no more than 5 percent A-2/P-2 paper and the maturity has been shortened to 90 days.

MS. SEGER. But still, they will come back up and make financing problems for the issuers of those--

MR. MULLINS. Yes.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Mr. Chairman, I agree that the problem you were referring to is ludicrous, but I do believe that we need to make up our mind by the next meeting about what we're going to do. It would be better for us to deal with it before there's a crisis. I would like to suggest, Mr. Chairman, that the Committee be open to your recommendations at our next meeting as to what--

CHAIRMAN GREENSPAN. Well, I'll put it this way: One percent gold is better than 40 percent something else at least, because you've got--

MR. ANGELL. Well, I wasn't really thinking about gold. I was thinking about our collateral problem. I believe that we ought not to wait until we need to make a loan and then at that time have to deal with this. It would be far better for us to make up our mind ahead of time than to wait until we need to make a discount window loan. The time we need to make a discount window loan is going to be the worst time to make the changes.

CHAIRMAN GREENSPAN. You want at least \$20 billion in discount loans?

MR. ANGELL. Well, I wasn't thinking of anything quite that large, but--

CHAIRMAN GREENSPAN. I think this issue is getting to the point that the logic of it makes no sense. This is really an extension of the original statutes in which we had backing for the currency for the legitimate purpose of its convertibility; that has ceased to--

MR. ANGELL. It's the law. We would either have to send the letter back to Congress and say we don't mean to do it anymore or we'd have to get rid of some foreign currency holdings. Or we have another suggestion--

CHAIRMAN GREENSPAN. That's one of the options. If there are no further questions for Peter, may I have a motion to ratify the transactions at the Desk?

MR. SYRON. So move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. At this time Don Kohn would like to address another anachronism at the end of our directive.

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

MR. ANGELL. Mr. Chairman, since we have some policy considerations ahead of us, I would support waiting until that is done before we deal with this issue.

CHAIRMAN GREENSPAN. That's the reason we decided to do it before [the policy discussion], because we ran into that problem the last time. We decided for exactly the opposite reason that we would make a decision [about this issue first]. I'm not quite sure what it is we're going to say later that comes to grips with any of the options that Don has raised. Do you have an idea?

MR. ANGELL. Well, it does seem to me that there might be one alternative that would get us a little more volatility in the fed funds rate. And if we did have more volatility in the fed funds rate, then the 4 percent range specified could be a clear indication of what we were doing. Now, it may be unlikely that there will be a majority who would wish to do that.

CHAIRMAN GREENSPAN. I think that happens to be true. But I'm not sure that that solves the problem because you're talking substance and we're talking public relations. The issue that you're raising, which is a substantive operational question, is something we've been struggling with and have not been able to find a consensus here that would enable us to function in that context. We had put it aside temporarily hoping we'd find an opportunity to address that issue. But pending [a resolution of] that substantive question, we have this anachronism that is in the directive, which is on the table for us to address. The question is: What option do we choose? One option is to do nothing. And it may well be that we should do nothing until we come to grips with the fundamental question. That's clearly an option, but I do think we at least ought to make that judgment explicitly if in fact that's the option the Committee chooses to adopt. President Parry.

MR. PARRY. Mr. Chairman, since you characterized the sentence as an anachronism, why don't we choose the environmentally sensitive solution and eliminate it?

CHAIRMAN GREENSPAN. [Unintelligible] I'm not sure we'd have that much trouble explaining it.

MR. PARRY. I don't think so either.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I think that Don gave us a good solution to the problem, and I certainly agree with Bob Parry that the

final option is the best one. We certainly don't want to lock ourselves into the pre-1979 procedures where we have a very narrow range and have all the problems attendant to that. When you look at the third and fourth options, we have all these difficulties writing what we want in the directive now, and I can't imagine this group being able to sit around the table and come up with an alternative that we would agree on for the language there. So, this kicks me back toward the final option. If we're not willing to do anything in the way of adopting a new one, then I think what we have now is better than any of the alternatives other than dropping it.

CHAIRMAN GREENSPAN. Do you mean option one?

MR. BLACK. Yes, go back to option one if we don't go to five, but I much prefer five. I've always been opposed to any limits of any sort because my predilections are to try to control things with some kind of a reserve measure. That necessitates a wider range over which the federal funds rate can move than we've been willing to tolerate in the past.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. In the interest of truth in labeling, given the way we've been operating, it would probably be a good idea to get rid of it because that is a straight-forward, honest interpretation of what we're trying to do. However, the issue that Wayne raised--and you correctly identified it as substantive--is an important one. I have asked Peter before and maybe we should ask him again, in moving toward the substantive area: Would you want some more variability in the funds rate than we have now?

MR. STERNLIGHT. Well, I would welcome some greater day-to-day flexibility in the funds rate. I don't know whether it has an awful lot to do with this.

MR. HOSKINS. Would getting rid of this sentence do anything to your operation in terms of how people might interpret what goes on in the funds market?

MR. STERNLIGHT. I don't think that would be detrimental. If you went for a substantial narrowing, I think that would.

MR. HOSKINS. We've been on that road.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. I have a fair amount of sympathy for what Bob Parry said because I think it's somewhat consistent with the discussion we had earlier in the day. We ought to say what we're doing when it's possible and do what we say. If this is something that we're really not paying much attention to and it's hard to think that we are--and this is separate from the substantive point--I really wonder why we have it there. That was a very effective rhetorical question that Lee asked--whether the 4 percent range was really affecting Peter very much now. So, I'm sort of driven to the polar extremes: just to drop it out of the directive completely or to go to something that leaves it in there and then also add something like the sentence in the fourth suggestion--the sentence on what's happening in

the real economy and the statement that the Chairman has a great deal of discretion, which is what I think should be the case. So, in the interest of simplicity, I'd come out in favor of just dropping it.

MR. HOSKINS. Or, following those up, we could go to saying explicitly what funds rate we are targeting.

MS. SEGER. They figure that out.

MR. SYRON. That's another sensitive question, but I think it's worth--

CHAIRMAN GREENSPAN. That's a substantive question, which I suspect would not enjoy this Committee's support. I hope not, anyway.

MR. HOSKINS. I think the interest in the Committee would be to provide more information, though maybe not necessarily that piece of information.

CHAIRMAN GREENSPAN. In our previous discussions there has been a very significant amount of discussion in which we've extolled the advantages of having certain flexibilities in our operating procedures. Peter feels extremely restricted at this moment for reasons that I think are fairly clear. What we're failing to do is to find the means to do it. I don't think there's a lack of interest in trying to go in that direction. It's an issue of [finding] an operational procedure that is objective and that we can function with. And I think we're still looking. But literally trying to lock in on a funds rate probably will give us real problems in any event. President Melzer.

MR. MELZER. I'd favor dropping it. I would just observe, in thinking back to that memo Ann-Marie Meulendyke did 3 or 4 years ago, that it's interesting that we have had different operating regimes, but if oriented toward the funds rate there used to be a constraint associated with reserves or aggregates--I don't remember specifically. Of course, the irony of this one is that, in effect, we have an operating regime that practically targets the funds rate and our constraint is the funds rate. And a point that falls down the road is that if we're going to have an operating regime and a constraint, the constraint really ought to be oriented toward reserves or something behaving drastically differently from what we expected. That would be a sensible restraint in the current operating regime.

MR. ANGELL. If we are willing to admit we're targeting the fed funds rate.

MR. MELZER. Yes. I would just eliminate the sentence.

MR. BLACK. Well, when Roger used to say we were targeting the federal funds rate, Chairman Volcker used to say: "That's what you always say, Roger." He always used those exact words.

VICE CHAIRMAN CORRIGAN. And nothing changes.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I agree that the two options that have been mentioned most here are the two best ones: either to do nothing or to delete the sentence. It is an anachronism now; it has been an anachronism for a long time. I don't see any compulsion to do anything about it right now, given the fragilities that we're all intensely aware of and have been discussing and given the fact that the Fed is in many ways at the center of the scrutiny and the concern about the fragilities. I've heard no hue and cry on the part of anybody to do anything about this issue. I would suggest that in this environment we leave it alone, although I could support deleting it if we were going to do anything at all.

MR. BLACK. Mike, the absence of objections might be because some of us have been objecting for so many years with so little success that we just finally quit out of a sense of futility. But I see renewed hope, based on what the Chairman said about that. And I think it is tied into Governor Angell's point that it's really closely related to what our new procedures turn out to be, if indeed we adopt new procedures.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Because the sentence really is no longer operative, as we discussed, I would very, very strongly favor eliminating it altogether. There is another option if we feel we can't do that: Sort of coupling the third and fourth alternatives with the word "and" may cover all the circumstances--and indeed are the circumstances under which we would want a consultation. But I prefer dropping it altogether.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. If you have the leeway to call for consultation any time you wish in any case, I don't see that we need the sentence at all. On the other hand--I'm learning, Bob, about what economists mean by "on the other hand"--if it is necessary to say something it seems to me that we could use option 4 with one word change. We could say: "The Chairman may call for Committee consultation if economic and financial developments appear to be diverging significantly from Committee expectations." Significantly is a qualitative word rather than a quantitative word; substantially is quantitative. And that gives you complete flexibility to determine that some trend line is significant or not significant and doesn't in any way inhibit you; and at the same time it does say something if we feel compelled to say something. But I could vote for eliminating it completely.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. I think, too, that it has been anachronistic and irrelevant for a long period of time, and my preference would be to eliminate it. But as Governor LaWare just said, if there's a particular reason to preserve in the record your discretion to have a consultation, then I think we could fashion language that doesn't really tie it to any particular economic situation but just gives you broader authority to call a consultation whenever you feel like it. For example, "The Chairman reserves the right to call for Committee consultation when in his judgment conditions warrant such consultation" or something like that.

CHAIRMAN GREENSPAN. That's very implicit in the current directive.

MR. FORRESTAL. Well, that's right. It is implicit and that's why I favor doing away with the sentence. But if anyone felt they wanted to have language, I would prefer broad language like that rather than tying it to the funds rate or to economic conditions. But you're right, it is implicit.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I think this discussion shows that we really don't want to face up to the major issues that confront us, because it strikes me as being clearly a minor issue on our agenda today. It's also full of irony because if you look at the operational paragraph, it's the only reference to the federal funds rate yet we essentially peg the federal funds rate and we are [talking about] eliminating that reference. I don't think it makes a lot of difference whether we keep it or not. I would think that the most accurate sentence to put in would be what John LaWare just suggested because that does explicitly keep in [language regarding the Chairman's] discretion to call for Committee consultation and it does refer to what we've been using all along, and that is a fairly wide range of economic and financial variables. But I'm prepared to support practically anything because I don't think it makes a lot of difference.

MR. ANGELL. Mr. Chairman, I'm sorry I brought it up.

CHAIRMAN GREENSPAN. At least we find out what the Committee has to say. It has been moved and seconded to eliminate that sentence from the directive. Are there any comments?

MR. BOEHNE. I'd like to make one comment. I wonder if there might be some merit in making this effective at some future date, such as the beginning of 1991, so that it takes away from it having any immediate significance.

CHAIRMAN GREENSPAN. The trouble with that is that if we make an explicit statement that we're leaving it in until the next year we're saying it has some meaning.

MR. BOEHNE. Yes, but here it is November and we're talking about doing it January 1st.

MR. MELZER. They're going to be suspicious that we have something else in the works.

MR. KELLEY. That's why you leave it alone.

VICE CHAIRMAN CORRIGAN. That's the problem. I couldn't care less what it says because I know what we're going to do anyway. But I think there is a problem in that--

CHAIRMAN GREENSPAN. We're about to change.

VICE CHAIRMAN CORRIGAN. That's right. The worst interpretation would be if we take it out and it leaves the impression

that the Committee has decided that it will no longer make any intermeeting adjustments in policy, and--

MR. SYRON. Cuts back [unintelligible] on phone calls.

CHAIRMAN GREENSPAN. This will not appear in the policy record until six weeks after this meeting.

MR. KOHN. It will be published the Friday after the December meeting--about the 21st.

MS. SEGER. They'll all be on Christmas vacation so they won't notice!

CHAIRMAN GREENSPAN. We will have minutes at that point and I assume the minutes will explicitly state the purpose of what is being done. I don't think it should create a problem unless I'm missing something.

MR. ANGELL. Well, all the "somewhats" and "slights" and "mights" in the operational paragraph imply that we might do something.

CHAIRMAN GREENSPAN. Look, we have a motion and it has been seconded. Is there any further comment?

MS. SEGER. Can I just ask one question? I think you said we've had this exact sentence since 1982. How many times in that 8-year plus period has the fed funds rate deviated more than 4 percentage points between meetings? It cannot be often.

MR. KOHN. I doubt there were any such instances.

MS. SEGER. I can't think of one myself.

MR. KOHN. Since the end of 1982, when we went off the nonborrowed reserve--

CHAIRMAN GREENSPAN. I would suggest that the motive here is to save money--for example, on the ink that is used on the paragraph. Any further comments? If not, will the Secretary call the roll.

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

CHAIRMAN GREENSPAN. It is removed.

MR. BLACK. That was enthusiastic! It suggests, Mr. Chairman, that if we want enthusiasm on the part of the Committee that we should discuss insignificant items.

CHAIRMAN GREENSPAN. [We move to] the substance, ladies and gentlemen. Messrs. Prell and Truman are now on the agenda.

MR. PRELL. Thank you, Mr. Chairman. I'll try to sustain the level of interest here! [Statement--see Appendix.]

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

CHAIRMAN GREENSPAN. Thank you. Questions for either gentleman?

MR. SYRON. At the risk of repeating David's question at the last meeting--I'm going to make an assumption sort of going forward--let me ask this question. On the basis of having made a forecast that to me is a little optimistic given no change in policy--and you qualified that in what you said, Mike--I'd be interested in your reaction as to which way you think the risks are of not coming out on your forecast. You mentioned, and I'm particularly interested in, the snapback issue. Given the continued expectation of problems on the credit flow side, I have a little question about the mechanism by which we get a snapback without a change of policy in two quarters.

MR. PRELL. Well, the major mechanism is the drop in oil prices that we have assumed. On top of that we get some impetus over time coming from the recent decline in the dollar showing up in the stronger export growth and the retardation of import expansion. So, that's the major impetus to defining final demand as we look out into the latter half of 1991. As to the risks: Obviously, they're manyfold and very substantial. If I had to characterize them for the very near term, I'd put a small interval around the minus 2 percent and say that is what we think is the most likely result. My judgment would be that the tail [of the probability distribution] is probably a bit longer and a bit thicker going to the down side but that we have a significant [mass] of the probability around this moderate drop--I don't know if a drop is ever moderate--of 2 percent or something close to the magnitude that we have in the fourth quarter.

MR. SYRON. There is never an awful lot of comfort in these things, but are you much more uncomfortable in terms of your distribution about how long it takes to come back--whether it's two quarters, three quarters, etc?

MR. PRELL. Well, we're sort of captives of our key assumptions. And oil, given the movement we have forecast, is a quite powerful influence. So the broad contours here seem right to me in light of that assumption. Now, as to how one might want to alter that in light of one's geo-political-military assessments, obviously, there's a tremendous range of possibilities. I think there is a lot of sense to assuming that at some point over the next 6 to 9 months we will have a significantly lower oil price either after military conflict or in the absence of military conflict. But the timing of that and what might happen in between is hard to say. So, that obviously complicates things. As to the credit picture, as we've said all along, this is just very hard to translate into GNP points. We

are not able to point to very clear-cut real impacts at this juncture that we can say are obviously attributable to the credit situation. For example, in nonresidential construction, which is where everyone thought the most direct hit would be, it isn't really obvious there yet. We can see the contracts and permits data suggesting some weakening, but there seems to be a pretty long pipeline and there isn't a sign of an enormous drop right now. We're predicting that we will see some significant weakness in construction put-in-place in the next two months' reports. But this is hard to predict.

CHAIRMAN GREENSPAN. We may be seeing it in declines in some of the prefabricated manufacturing elements that go into the inventory data prior to going into the value put-in-place figures. The SIC 344 --that whole metal fabrication area which precedes the value put-in-place--is beginning to become quite weak. So, we may be seeing it on the edges.

MR. PRELL. Well, I think the evidence is mixed in this area. Last week at a meeting of business economists, a steel company economist indicated specifically that the steel fabrication for structures seemed to be holding up quite well up through the first part of next year.

CHAIRMAN GREENSPAN. Are they talking about the orders for steel structures?

MR. PRELL. This is just what they had booked through the first quarter of next year. Now, there's always a vulnerability to some shift in this; and one company's perspective may be different from another's. We're expecting a significant change in the tenor of these things. Also, based on anecdotal information that has come in, there are some areas such as steel and chemicals where perhaps there has been a bit of inventory building, and we could see production fall off very noticeably in the coming months. Certainly, we have a distinct change in the tenor of things happening right now in this forecast. And it's a judgment call; it's not something that we can substantiate by pointing to clear leading indicators in the data, particularly with regard to the timing and magnitude.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Mike, do you make much of the divergence between the payroll and the household employment data? The household data have been quite a bit weaker for some time now and I'm wondering whether, as we come to understand the recent pattern of the economy better, that isn't telling us something.

MR. PRELL. Well, both of them look weak over the last two months and that's the key inference that we're drawing--that there is weakness in labor demand. There have been these divergences over time, which have not been fully explained. But both series for employment show weakness recently, and that's one of the reasons we're putting considerable weight on that information.

MR. ANGELL. Mike, on the personal saving rate, how much of that oil tax hike was absorbed by the personal saving rate?

MR. PRELL. The personal saving rate has come down and has done so in circumstances where real disposable income has been significantly eroded by the energy price increases. Basically, in the very short run, if these data hold up, what we've observed is that people have not adjusted their spending patterns very rapidly in the face of this decline in their incomes. We're expecting that this adjustment will occur and that we'll see some movement back up in the saving rate, particularly because of the general financial environment. All that we know about consumer sentiment suggests that people are not necessarily going to want to diminish their financial wealth. They've already experienced rather weak real estate values and the stock market hasn't gone up, so their wealth positions just have not been improving recently.

MR. ANGELL. Our analytics tell us that consumer spending should be weak. And consumer sentiment looks like it's in a free fall. But the data we have don't yet show it, is that right?.

MR. PRELL. I think that's a fair characterization.

MR. HOSKINS. Just a follow up on Dick's question again, because I'm not sure I have your orders of magnitude right. One concern that I have is that there's still a reasonable chance that the fourth quarter may not even turn out down. But if I listened to you correctly you're pretty confident--meaning 80-90 percent probability--that we're going to have a negative?

MR. PRELL. 77 percent! [Laughter.]

MR. HOSKINS. That's close enough, thanks.

CHAIRMAN GREENSPAN. Until you get the retail sales, how can you feel that comfortable?

MR. PRELL. All right, 65 percent. [Laughter.] I'm not going to be enormously more confident when I've seen the first set of retail sales data knowing how much they are vulnerable to revision subsequently. But it would certainly help to make the pieces fall into place in this puzzle that we tried to put together here. We have had, basically, a very large drop in hours [worked]. Historically that has proven to be one of the most reliable indicators at our disposal of short-term movements in output. We had discounted that because the drop in the average work week, especially outside of manufacturing, was just huge and seems incredible. But even with that discounting, we're off to a very bad start. Initial claims don't suggest that the labor markets are firming; we're looking for further declines in employment and a noticeable drop in hours overall for the quarter.

CHAIRMAN GREENSPAN. It's not that I disagree--actually I agree with your forecast--but let me play the devil's advocate for a minute. Initial claims are up sharply, but it is the level of the initial claims not their direction that determines the rate of change in economic activity. And that level is back at the 1986 level, not back to 1982.

SPEAKER(?). That's recession.

CHAIRMAN GREENSPAN. And the only hard retail number we have at the moment is motor vehicle sales; and while they're off a bit, they're clearly not implying anything in a negative direction. And while the data from the October employment report, which picks up wages and salaries, certainly are low implicitly as are the hours those data are notoriously subject to revision. I don't know if it's 70 or 80 percent, but Lee is not raising a totally illegitimate question. [Laughter.]

MR. PRELL. [Unintelligible] are still set with a wide confidence interval. No one could state this with normal certainty. We do know one other thing and that is that motor vehicle production is going to be down appreciably in this quarter and that alone by our arithmetic--when you put the cars and the trucks together--probably cuts better than a percentage point off of GNP growth in this quarter.

CHAIRMAN GREENSPAN. I think that's a difficult call.

MR. PRELL. That's helpful in adding these things up. We know that, unless something bizarre happens with wages in this quarter, real labor income is going to be very weak because of the oil price increase. So then it becomes a matter of how aggressive people are going to be about spending what they have. And the Christmas spirit--my predecessor was always inclined to bring that up at this time of the year--may move people to spend very freely. But we have to try to make our judgment based on all of the information at our disposal. And we don't hear anything that suggests that kind of pattern emerging at this point. So, we think it's a negative quarter. Basically by going [from a forecast of minus 1 percent], which was just slightly different from 0 in our perspective, to [minus] two percent we're signaling that we think it's going to be a negative quarter and we feel fairly confident about that.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Let me just pick up on this. I know we started some of this this morning. [Secretary's note: The reference is to a briefing of the Board of Governors by its staff.] We have a strange phenomenon because the auto experience is a good example of the producers having cut back even though the hard sales data are not down. And it sounds as if most of the evidence is that the producers have decided, just as our staff has decided, that demand is going to be down so they started laying people off and started not producing. My guess is the result will be that demand will be down.

MR. PRELL. Well, if they are wrong and demand holds up reasonably well, we're going to see a drag on inventories here that's going to give us the possibility of some bounceback in the early part of next year.

MR. MULLINS. Well, presumably some of the people laid off will now decide not to be quite as aggressive as they might have been.

MR. PRELL. That's true. There's some income that is lost in this process.

MR. MULLINS. Can we talk about the snapback as well, just to clarify that? The logic is: oil prices went up and that shattered

consumer confidence. And then when they come down consumer confidence will be reconstituted with about the same lag and there will be someone around to finance the increase, this snapback effect, in the second quarter of next year.

MR. PRELL. Well, some of it is just the straight price effects on real purchasing power. But I wouldn't set aside the question of confidence. It isn't just an oil price shock; it's a whole discussion of war and peace and one's sense of the stability of the world after a very good move that developed because of [unintelligible] in eastern Europe. So, I think with that, plus the debacle of the budget in Washington, there have just been a number of things which seem to have led to an enormous shift in the sentiment of American households. With the passage of time maybe the budget issue will be forgotten and something will happen with respect to the military situation. I guess it's implicit in this that the risks don't look worse several months down the road.

MR. MULLINS. In fact, it did seem like the budget experience was a second impact on consumer confidence.

MR. PRELL. My sense is that the polls suggested some loss of confidence in our economic policy makers at that point.

SPEAKER(?). It's hard to believe!

MR. MULLINS. The markets have not been marking up the probability of war but certainly in the political rhetoric and in troop movements there is some suggestion that maybe the probability has gone up a bit. What is the staff's--

MR. PRELL. I've tried to puzzle through this. The people on Wall Street keep saying that the economy has hit a wall. They think that we're going into a serious recession and that we need dramatic monetary policy action to cushion the economy. Yet they have not bid the bond prices up further than they have. I suspect part of that, and I've heard it said, is that people don't want to buy bonds in front of a war. So I think there is a risk premium embedded in there and it is reflecting this.

MR. MULLINS. What is your current scenario of what happens in the event of a war?

MR. PRELL. What happens in a war? You mean economically?

MR. MULLINS. Yes, economically.

MR. PRELL. Well, I don't think we would presume to have enormous insight. There's a considerable range of things that could happen. Clearly, if there were significant damage to the production facilities and the transport facilities and so on, we could have a period of time in which supplies were significantly disrupted. On the other hand, perhaps in that circumstance we would get the drawdown in reserves and that could be a cushion for a period. There could be military spending consequences if a war went on and utilized a large amount of munitions that it was felt had to be replaced within our lifetime. It's conceivable that some things just would not be

replaced immediately, but the sign there I think is positive--i.e., that there would be more military spending.

MR. MULLINS. But we haven't had many recessions during wars.

CHAIRMAN GREENSPAN. In fact, we haven't had many of either.

MR. TRUMAN. Implicitly, I think the assumption is that the war would be short and would have, as Mike said, relatively minor impacts on the production side. The other scenario, which I think is also broadly consistent with the oil price assumption but doesn't have quite the same broader psychological impacts, would be just a stalemate. And under those circumstances we could have much higher prices. That is, with oil prices that are consistent with existing supply and demand relations you would find a gradual erosion in oil prices. You can even argue that that's what has happened to some extent over the past several weeks. I don't want to push these data too much, but we've had some of both scenarios. So, it's fair to say that this is not a "long war forecast," if you want to put it that way.

MR. MULLINS. Thank you.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Ted, in your analysis you referred to a 5 percent further drop in the value of the dollar. I presume that that's based on the same interest rate assumption: that is, that we keep the fed funds rate and other rates about where they are.

MR. TRUMAN. And it is essentially the drop in the dollar that has occurred between the forecasts.

MR. LAWARE. Okay. Now, the Bluebook refers to a further sharp drop in the dollar if we go to a sharp reduction in rates. Can you give us some idea of what that expectation is--what quantification you put on that?

MR. TRUMAN. Well, the models, such as they are, don't help very much in this area. The quantitative history does say 50 basis points on the funds rate is not going to do much more than 1 or 2 percentage points at most on the dollar. What the Bluebook was trying to point to is that there are things that are [beyond the] model. In some sense we haven't had much change in interest rates since July. We had an 11-1/2 percent drop in the dollar. So, it really is a question of how much more of that there is in the pipeline. As you know from dealing with economists these days, there are two views. One would be the market view that Sam put forward: that things are very fragile and [the dollar] could move quite far and quite quickly. The other view, as Sam also said, is a sense that has been partly articulated that authorities might take action. But one could even say--I'm putting words in his mouth that he didn't actually say--that there's a sense that the dollar has moved a long way down and, therefore, has created more of an upside potential.

MR. LAWARE. All right, but I'm still trying to pin you down a little.

MR. TRUMAN. I think what the Bluebook was trying to point out was that there is no significant risk! [Laughter.]

MR. LAWARE. All right, let me ask a simpler question. To what extent does the current level of the dollar reflect a forward discounting of expectations of further easing--in other words, another quarter point on the funds rate?

MR. TRUMAN. With another quarter point you're going to get some [dollar movement], and we saw that over the last several days--though, as always, these observations over the last 10 days or so are contaminated with things like the Bundesbank moves or other events that happened in the world. But I would say that with another quarter point the dollar would move down marginally because it is already mostly discounted.

MR. CROSS. Based on forward rates and so forth we think that most people are expecting it. As I was indicating earlier, that doesn't mean that it might not continue to have an effect--maybe not immediately, but it influences people's views about the next x weeks.

MR. KOHN. The authors of the Bluebook had in mind a bit how the market perceived the Fed's priorities in making this [recent] move. The Fed has been seen as a very reluctant "easer" through a period of weakness. If the next move were perceived as changing the priorities--moving toward [concern about] the real economy and a bit away from prices, that could have a significant impact. If, on the other hand, it didn't see it that way--. That's why there is this uncertainty; it's really impossible to answer the question because it's a question of the psychology and the perceptions about our reaction, basically.

MR. LAWARE. Yet it's a very important part of making this decision today.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I want to go back to the discussion that took place between Governor Mullins and the staff with regard to the plant closings on automobiles and trucks. There was some implication that there would be fewer consumer purchases simply because of that event. It's my understanding that [auto workers] will continue to draw between 90 and 95 percent of their pay during these one-week or two-week closedown periods. So, there is not a great diminution of purchasing power.

MR. PRELL. I think you're right. Under the contract there are these unemployment benefits. You probably have it nailed down better than I do.

MS. SEGER. But, Roger, that's not true of the suppliers. That's the Big Three aspect. Between the sub-benefit and the unemployment benefit the auto workers come up to around 95 percent. But everybody who feeds into the auto industry--those producing widgets and nuts and bolts and all those things--is not necessarily that protected.

MR. PRELL. Look through the corporate [unintelligible], if you want to get fancy. You would figure that's coming out of Big Three profits, all other things equal, and that certainly affects the shareholders ultimately.

CHAIRMAN GREENSPAN. Further questions? If not, why don't we take a short break.

[Coffee break]

[Secretary's note: Chairman Greenspan called on Mr. Parry to begin the review of economic conditions and the outlook.]

MR. PARRY. The Twelfth District accounts for just under 30 percent of U.S. oil production. Higher oil prices have stimulated very little additional production in Alaska and California due to uncertainty about how long prices will remain high and also due to problems associated with environmental restrictions. Even at current levels, however, higher prices are yielding a windfall of revenues for Alaska's state government and also are stimulating the Alaska economy in a significant way.

Home sales have declined sharply and median home prices have declined moderately during the past year in California markets. The southern California real estate market is particularly weak; sales activity is down in the previously hot Seattle and Sacramento markets and price increases there are moderating. Concerns about overbuilding in nonresidential markets, particularly in southern California, are widespread; and recent declines in rents and leasing concessions are consistent with these concerns. After adjusting for the normal relationship between bank lending and economic activity, lending by large banks in the Twelfth District has not been unusually low.

Turning to the national outlook, the basic scenario of the Greenbook forecast certainly seems plausible. However, real growth may be a little stronger and inflation somewhat higher than in the Greenbook, especially if interest rates follow a lower path than that assumed in the Greenbook. We expect negative net real growth in the current quarter and probably also in the first quarter of next year related largely to the effect of oil prices. As the effects of higher oil prices begin to dissipate when oil prices decline, however, the economy should pick up by next spring. Although consumption spending will continue to be weak for a while, I would agree with the Greenbook that net exports will contribute over 1 percentage point to the growth of GNP next year and help to prevent a serious downturn. The underlying rate of inflation is not likely to rise significantly next year, but I expect that the lower value of the dollar will be a factor contributing over 1 percentage point to the inflation in GNP prices next year and even more to consumer prices. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Bob Forrestal.

MR. FORRESTAL. Thank you, Mr. Chairman. Economic activity in the Sixth District pretty much mirrors what has been happening in the rest of the country, as I reported last time. Our retail sales have been flat on average around the District with noticeable declines in autos, household appliances, and furnishings. The retailers in the District are very cautious about orders since they're not expecting a

good Christmas season at all. We have seen discounting already, even this early in the season, so it appears that the emphasis is on tighter inventory control.

On the production side, new orders have declined in a number of key industries, especially carpet and apparel. But, as I believe I mentioned last time, those manufacturers who have established export markets are seeing strong sales growth. As a consequence, manufacturing activity overall is continuing to expand although rather slowly, while domestic sales and employment are falling in those same [industries]. The only other report I heard on strong sales was from a small businesswoman who said she's making a lot of money selling deodorant to the government for distribution to the troops in Saudi Arabia. On the price front, where we can separate out the oil shock effects we find very few pressures on prices in the District outside of medical services. And looking at the oil-producing area, again as we've reported several times, severe shortages of skilled laborers, particularly welders, are constraining production at the present time. The premium for these workers is now upwards of 20 percent in the last two months, and with that kind of a premium attraction we're likely to get back some of those industry workers who were dropped in the last five years.

In looking at some of the loan data for banks in our District I was surprised to find that, unlike the rest of the country, our consumer loans are weaker than real estate loans. And that pattern has existed from April through September. Real estate loans really have not changed all that much.

Looking at the national economy, given all of the uncertainties surrounding these forecasts, my own feeling is that the Greenbook forecast is fairly plausible. We've heard a lot of talk about whether we're in recession or not; I think that's really an irrelevant question at the moment. The key issue, it seems to me, is how deep it may be if in fact we are in a recession. And that's the critical question I have with respect to this forecast--whether the negative growth in the fourth and first quarters will be as mild and whether the rebound will be as much as is forecast in the Greenbook scenario. For those reasons, and I'll talk about this later, I continue to favor some cushioning of the economy against a substantial downturn.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I think the Greenbook's forecast is certainly plausible and internally consistent, given the kinds of assumptions the staff is making about policy and the price of oil over the forecast horizon. But it seems to me that the risk is clearly on the down side even if one assumes that oil prices will behave as the staff has concluded by declining significantly. What impresses me about all the recent data we have received, both statistical and anecdotal, is that it is just universally bad. As Mike Prell indicated a while ago, the worst is the employment figures. But the National Association of Purchasing Managers' figures don't look good. We got the figures on industrial production and capacity utilization this morning and they certainly didn't look good. The Beigebook suggested that virtually all parts of the economy--in most sectors and in most regions--are experiencing slower growth or even some decline

in business activity. From our directors and other grassroots contacts, except for those in the agricultural area, we're just not getting any good comments at all. At last Thursday's meeting of our board, for example, they were more pessimistic than I remember for years and years; even at the meeting before there were a few bright spots that were mentioned, but absolutely none at this one. We even had one letter from an unusually affable former director who is a strong supporter of this System saying that the System really didn't understand how bad it was out there. He was irked by all the statements that we don't know whether we are in a recession or not and he proceeded to give me a set of figures that demonstrated to his satisfaction that we are, though they were hardly conclusive.

Obviously, none of this suggests that we're about to fall over the edge of the cliff. But given the state of business and consumer confidence, which as I assess it is lower than I can remember for many a day, it seems to me that there's a better than even chance that we're going to have a greater drop in GNP than the staff is projecting. It may well mean also that the recovery is not going to come as early as the second quarter. Now, I think the downside risks would increase pretty significantly if the growth in the aggregates comes in below what is projected, and I'm very much concerned by this further evidence of weak growth in the aggregates. I hope the Committee is going to take some steps later on to try to get the aggregates more nearly on what seems to me to be an appropriate path. Finally, I would like to say that I sure was happy to see the projections on inflation that the staff has made for down the road a way. It's certainly true that we're going to have some turbulent times, but I think we have made some progress toward our long-run objective of achieving price stability. I'm delighted to see this reflected in the forecast, and I believe the staff is going to be right on that.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. As far as New England goes, the economy obviously continues to deteriorate. Bob Parry's report sounded like [his District was in] the early stages of some of the things we complain about. I'd say that in a sense the rate of decline [captured] in the second derivative may be turning a little in that the steepness of the decline seems to be attenuating a bit. A lot of this is in real estate, obviously. In the residential area we've actually seen prices decline by probably about 20 to 25 percent; and that is bringing greater activity and activity has sort of stabilized. The commercial area is still quite poor, with vacancy rates up around 25 percent in the suburban areas. Related to that, we're seeing an absolute decline in hookups for electrical power, which by the way ends up being very coincident with nonpayments or corporate delinquencies for electrical bills; it's very highly correlated with that. We've seen a substantial jump in that and a significant jump in bankruptcies, particularly among customers of Massachusetts utilities.

CHAIRMAN GREENSPAN. It's shocking!

MR. SYRON. Well, I want to get a charge out of it; we try to stay plugged in! In our manufacturing sector, demand is weakening with a few exceptions; interestingly, net exports now are declining

for our manufacturers except for a few off the shelf items that have improved somewhat in the computer area. The retail area is very soft, with a lot of price promotions. Actually, there are a lot of complaints among retailers that the weather has been too good thus far this fall and that there really have been soft sales of heavy winter clothing. Retailers say that they're in pretty good shape on inventories, but they're trying to be very, very cautious and push a lot of stuff out of the door before the Christmas season. Most of them feel that they just don't want to go into December carrying very much.

The banking sector, I'm afraid we have to say, is truly dismal. Some asset markets just literally have ceased to exist. And this is not just in the real estate area; I'm talking about loans to small businesses and that sort of thing. As a result of all this, I think the good news--and perhaps it's somewhat better than in the nation--is that we're seeing some improved price performance, though [unintelligible].

I'm concerned, though, about the implications both for the region and nationally of all of this on confidence as far as the bounceback goes. I must say with regard to the national economy that if I thought we could get the kind of result that's in the Greenbook with the policy implications that are contained in the Greenbook, I'd be happy to take it in a way. But Mike made the point, and I think it's the relevant one, that it depends on what one thinks is causing all this. The forecast seems a little too optimistic, though perhaps my view is too much influenced by our local situation. But I don't think this is all an oil phenomenon; I think it has to do particularly with the credit situation. I'm also worried to some extent, given the outlook in Canada and the United Kingdom, just how much export growth will continue to be a source of strength and bring us out of the weak economy here. I must say--and this is somewhat related but not directly to what we do in the funds market--I've developed what I'm afraid are [unintelligible] some radical beliefs. I used to think you couldn't have a credit crunch, as we traditionally found, unless there was a breakdown in markets. It feels somewhat silly raising this, but I think what is becoming more and more an issue nationwide, and it is for real, is that we need to take some steps to reconcile our objectives in macro policy with what we're doing in the supervisory area. I must say I hate to raise that because it apparently goes against a lot of things we all believe. But I just can't come to a different conclusion because regardless of what we do in policy--and we're constrained with the dollar on one side of the prospective policy--it would take an awful big move to divert some of the enormous increase in conservatism and risk premiums by many lending institutions, and not just commercial banks, given the problems that they have. There are several actions that we could take in that area, though as I say they're not directly germane to today's [discussion] on what has to be done. But I think we really have to give an awful lot of thought to that as being part of how we proceed--that leaning against the wind may apply to supervisory policy in many cases just as well as monetary policy. I hope that in these observations I'm overly influenced by parochialism, but that may not be the case.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Well, Mr. Chairman, I really don't take much exception to the staff forecast through the first quarter of next year. I do wonder a little, as others have, about the bounceback of growth in the second quarter and thereafter on the inflation side. I hope it turns out to be the way that it's forecast. I guess I have slightly less optimism in that regard.

As far as developments in the Dallas District, it does seem that conditions down our way, at least on average, are reflecting the same set of weaknesses that are affecting the rest of the country. Higher oil prices are supposed to improve matters in Texas, Louisiana, and New Mexico but so far we're not seeing any of the benefit. For example, neither drilling activity nor employment in the oil and gas industries has increased significantly. Manufacturing employment is down; construction is down slightly; employment growth is stalling in the private producing sectors; agricultural incomes are lower than expected because of increased fuel costs. Government is the only robust sector, and to me that's a bit of a negative. Uncertainty is a major factor that seems to be depressing economic activity in the District. The volatility in the oil markets leaves oil and gas producers uncertain about the future price of oil and, therefore, cautious about expansion. In addition, there seems to be heightened uncertainty about the health of the national economy, interest rates, the tax load, and the possibility of war in the Middle East. All of these factors seem to be leading consumers to postpone purchases, particularly purchases of real estate and durable goods.

Within the District, growth patterns are very uneven. New Mexico, which had been showing the strongest growth of our three states, has shown actual declines in employment and other economic measures through 1990. Louisiana had been laggard in the recovery in the Southwest but has been showing steady growth and improvement. Texas, particularly in the last few months, seems to be slowing almost to a standstill. We had a joint meeting last week of all four of our boards of directors and the comments made at that meeting certainly confirmed what our statistics are saying. There was very little optimism expressed at that meeting. In short, the near-term outlook is on the pessimistic side; but looking further out, we can expect to see some improvement only if higher oil prices are sustained.

MR. BLACK. Is that your unbiased report?

MR. KELLEY. Clearly a regional view.

CHAIRMAN GREENSPAN. The newest member of OPEC!

MR. KELLEY. That's where they learned how to do it.

SPEAKER(?). Texas railroad commission!

MR. KEEHN. Mr. Chairman, in the District context, I think our part of the Midwest is still operating at a better level than is true of the national indicators. Nonetheless, clear signs of weakening are beginning to emerge. In the steel business the plants are operating at a comparatively high level, at about 84 percent of capacity; and at this point of the year, the year being really all but done, they are rather sure that they will see shipments this year of about 84 million tons. So comparatively, it's quite a good year. But

for the first time in quite some while, they're seeing a deferment of orders. Two markets that in particular have this phenomenon are autos and appliances; appliances really have been very, very weak.

The price increases that have gone into effect in the steel business certainly are not sticking; competitive pressures, I'm told, have been very tough and, therefore, the price increases really are not sticking. The automotive sector we talked a little about this afternoon. An explanation I would offer for the strength in sales relates to this fleet sale phenomenon. The company that I talked with has had a very significant increase in the fleet component of their sales. Going back to 1987, for example, fleet sales were about 27 percent of their total volume; this year they are going to be about 35 percent. That selling is largely behind [them] at this point of the year. Therefore, they are reducing their production schedules, which we talked about, and they have reduced their sales outlook for the industry next year--cars and light trucks--to about 14 million units.

In the agricultural sector, though obviously we have had a good crop year, the production and sales of agricultural equipment are down. There is a lot of uncertainty out there in the market because of the impact the tax bill is going to have on subsidies. That uncertainty has caused farmers to defer major purchases. And in order to keep inventories in line, some of the major producers are planning significant layoffs between now and the end of January so they can keep inventories low. Heavy construction equipment is declining, reflecting [weaker] conditions in real estate, mining, and forest products. And real estate construction, which in our area had been holding up I think surprisingly well, is now showing signs of softness in both residential and commercial sectors. Interestingly, I've had a chance to talk to a number of different architectural firms recently and their business has just absolutely stopped. There are no new projects coming on line; they're finishing off some of them, but new projects have just dried up. Retail sales, particularly in those areas that are affected by the auto sector, are weak; and home appliances are pointed out as being something particularly soft.

In the financial sector, I think there's still a question but we are seeing a tightening of credit conditions. The banks have raised their credit standards and also certainly are raising their prices for credit extensions. There is a growing apprehension that there's going to be a very significant tightness in the markets as we get close to the end of the year. A lot of banks are beginning to play with [unintelligible] measures to be sure that they get past the year-end [unintelligible]. Therefore, I think it's the time when capital ratios could be impacted by year-end transactions that [unintelligible] some measures to control that. With regard to inflation, excluding energy, I sense [price trends] are showing signs of, if not improving, certainly not getting any worse. And given the weakening economic circumstances the [competitive] pressures, I think, are very high. Labor costs particularly are showing similar and reasonable restraint.

Now, I don't think anybody is forecasting anything like a collapse; nonetheless, I do think we are seeing signs of weakening and it's perhaps very likely that we're in for a rough quarter or two. Certainly our outlook in a national context for the fourth quarter of

this year and the first quarter of next year would be consistent at least in direction with the forecast that the staff has given.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. On the national level, given the uncertainties and the assumptions contained in the Greenbook, the staff forecast seems to me as plausible a projection as one could make.

On the District level, the economy continues to grow at a moderate pace. Agriculture and energy are giving it a bit of a boost. On the other hand, manufacturing and construction activities are sluggish and actually are deteriorating somewhat. In the agricultural area, District farmers are completing the third [quarter]--and maybe the fourth, depending upon the area of the District--of an excellent year. Farm income will be strong for 1990, although livestock producers will have a better year than crop producers largely because the wheat harvest came in at or near a record, which has depressed the price. That feeds over, of course, into the [costs in the] livestock area for finishing off the cattle and hog in the red meat area. As a result, the livestock producers will probably do better than the crop producers; but taken in the aggregate the farm sector has done very well in 1990. There is some concern, as Si Keehn mentioned, about the budget package as put together and what that will mean for subsidies in the period ahead. Quite clearly, subsidies are going to be less in the future than they have been, but [questions about] how they're administered and the Administration's timing of those subsidies have created a lot of uncertainty. And that does feed back into farm machinery sales, which have been almost at a standstill as far as we can tell.

In the energy sector, because in October domestic oil prices were roughly double what they were back in June, there has been some modest increase in activity, principally in drilling. For example, in the District in October there were 325 rigs working; that was up from 305 in September. There has been a modest increase in the national rig count, and I'm sure the staff has those numbers.

With respect to manufacturing, as I've indicated before, District auto plants are taking one-week or two-week sabbaticals--well, layoffs. There is a shutdown at both the Ford and the GM plants in Kansas City; neither worked the first week in November and the GM plant has continued to be closed for the second week of November. On the other hand, the general aviation industry, which is a fairly large component part of our District economic activity, has begun to rebound although the light aircraft sector continues to decline. Sales of turbo props and business jets are up very significantly and plants in Wichita will build the front section of the new Boeing 777 airplane for which they have substantial orders already on the books. So, there is a very favorable outlook for the period ahead. In construction, both residential and nonresidential contracts awarded in the District fell in September; they're at levels now about 13 percent below what they were one year ago. There isn't really any evidence at the moment that either of those two sectors will see any revival until at least the spring of 1991.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. On the positive side, the District's economy, although spottier than it has been, remains in pretty good shape--especially in the rural areas because agriculture, as others have commented, had a good to very good year at least in most parts of our District. And mining had a good year; indeed, they are talking about further expansion in that industry in a variety of states in the District and I would anticipate that they're going to go ahead with at least some of those plans. Retailers, as best I can judge, are cautious but not particularly pessimistic at this point, at least about holiday sales.

Having said all that, I think the pattern of activity for the national economy for the near term, as reflected in the Greenbook with a couple quarters of contraction, is a reasonable forecast. I have a very distinct sense, based on a variety of anecdotal evidence, that the weakness we're seeing isn't particularly related to the energy situation, although obviously that's a factor. At least as I get the story, it's really a combination of factors, some of which were in place before oil prices ran up. Clearly, the credit availability issue has grown in importance as time has gone on. And I have the sense that what we are seeing is not particularly driven by energy, but by a combination of negative factors, some of which have affected attitudes and some of which simply have cut into important sectors or regions of the economy.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I think almost everybody in the Philadelphia District is dressed up in a bear suit because it's hard to find any optimistic note. The manufacturers still talk about downturns, which we have had for months. There is a hint that maybe the rate of descent is slowing, but that's not much consolation for them. Attitudes among retailers are just terrible; they're very pessimistic. In fact, they're so pessimistic and are following such conservative Christmas inventory policies that even if in the Christmas spirit there were a rush to buy, I'm not sure they would have the kind of stocks that could really turn it into a good season for them. The real estate market remains very soft and much of this is spilling over into the banking system. I think we have some significant problems ahead of us there.

On the national scene, I think in some sense what we're seeing is a typical pattern. We've been debating around this table and around the country for several months about whether we're going to have a recession or not. Now most people are convinced we are having a recession and the debate is about how bad it is going to be. The Fed's job--and we've talked about it around this table--is to buy some insurance against a deep and long recession. All that is fairly typical; what I think is different, however, is the condition of the financial system, because I think that makes the need to buy some insurance against a deep downturn more important than usual. If major cracks develop in the financial system, we're going to end up in a pretty bad economic downturn. So, what I see here are some real discontinuities. Either we're going to get away with a mild recession and the financial system is going to hold up generally, or we're going to end up with a financial weakness and with a very deep and long recession. It's hard to envision a lot in between. If it weren't for the constraint of the dollar, I would be favoring today a more

substantial move toward easing than I think we prudently can do, given the dollar's condition. But we're dealing here with a situation that I find increasingly scary because the risks of a really deep downturn, given the condition of the financial system, strike me as much larger than I recall [in my years of] sitting around this table.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. In our District for the most recent three-month period the economy is still growing, albeit at a slowing rate. Right now if you could measure it, we're probably just bumping along holding our own. But that performance is somewhat better than the national average. Payroll employment in that period was up about 1 percent; the gains are in government services; employment in wholesale and retail trade and manufacturing is down about 1 percent. The area that I hear the most about in manufacturing is the consumer durables area; both Whirlpool and GE have had layoffs that are very much tied into the housing industry. One interesting note in Missouri itself--and Missouri is the second largest state in terms of automobile and auto-related employment--we had some layoffs by the Big-Three and also at McDonnell Douglas, but District-wide auto employment in the most recent quarter is flat. Basically, what has happened is that the Japanese transplants in Kentucky and Tennessee and their suppliers have really picked up that slack. Finally, construction activity, while it's declining, is not nearly as depressed in our District as nationally. In the first nine months of the year residential construction was down only .1 percent compared to 7 percent nationally, and nonresidential construction was down not quite 4 percent. One bit of anecdotal information, which I've heard on a couple of different occasions, is the sense that inventories are being managed more closely. I picked that up from _____ in the trucking industry; the pattern they're seeing there is one of much more frequent shipments of smaller amounts. His general interpretation of that is that firms really are trying to manage their inventories very closely.

I still have the feeling that the sentiment is probably worse than the reality, although I agree with Mike that there is more evidence of a downturn. In that connection, I think probably the most important factor bearing on sentiment is the Middle East situation. I just wonder--and this may be politically naive--whether or not from an economic point of view a stalemate situation couldn't be construed as somewhat stable and we could see some drop in oil prices that could turn that sentiment somewhat.

On the national situation, generally I haven't been terribly concerned about some of the forecasts in terms of a slowdown in economic activity or a recession. That has been based primarily on my general feeling that the thrust of monetary policy has been about right as measured by the behavior of the monetary aggregates. If that's the way you look at things, when you see a month like October you have to be a bit concerned. I'd simply say that at this point I would not be inclined to overreact based on one-month's data. I'm not sure that we really have the ability--though I know how much effort goes into it--to project with all that much confidence what the aggregates are going to do down the road. And, of course, the most recent easing really isn't reflected in the aggregates at all.

The final point I would make is that I don't think there is a lot we can do about the availability of credit. We can make sure that we provide adequate reserves and that money grows at an appropriate rate, but I think the behavior of credit really is largely out of our control. I would simply observe that in the months of August and September--we don't have complete data on October yet--short- and intermediate-term business credit was growing at a fairly decent rate: 7.7 percent in August and 10.1 percent in September. I think there's some evidence that the commercial paper market and finance companies and so forth are picking up some of the slack from the banking system.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. At the beginning of the year when I was trying to get Mike Prell to tell me why I couldn't see the strength in the economy, he sort of suggested kindly that I needed new glasses. So, I just wanted you to know that I went to the ophthalmologist two weeks ago and got an exam and a prescription for new strong lenses. And now that I can read the numbers they look worse! But seriously, I do get concerned about the numerous signs of weakness in the economy. I agree with the staff forecast that we should look at things more modestly than we have been. I hope that the weakness doesn't turn out to be still worse than the staff is showing in the Greenbook forecast. Business is so bad that I noticed that George McGovern, innkeeper, filed for bankruptcy; maybe that's not a function of the economy but more a function of his competence. Also, Lipton is closing a teabag plant in Texas. And Mr. Forrestal's Peachtree Center in the Sun Belt of Atlanta is being foreclosed on I understand by Equitable. So, there are some pretty scary pieces of news around. Also, the regional sales numbers really bothered me simply because two major chains that are pretty strong financially showed sales in October that were actually below year-ago levels. Even Nordstroms, which is considered a rather superior place and operates in the boom part of the United States that is Bob Parry's District, is talking in less optimistic terms.

I'd also like to put in my two bits worth on the auto situation. I believe what has happened is that the auto sales figures that are reported really are distorted by deliveries of police cars and cars for corporate fleets, etc. Most dealers don't see those deliveries; they go through just a handful. So, the average dealer is looking at a showroom which is devoid of much traffic. People who do come in are not eager actually to close the deal. And the dealer looks out the back door and sees all these cars on the acreage that are not being sold and he is paying interest to carry them. So, I think there's good reason for most dealers to be very negative. And they are the ones who have to send orders in to the manufacturers or the manufacturers don't have enough to keep their plants running. I think that's what is driving these decisions. They are not made unilaterally by the car producers; they are based on the orders received from the people out in the so-called trenches. If you look at inventories that way, we are not in as good shape as the aggregate figures might suggest.

I'm more concerned about the housing situation I think than Michael is, mainly because housing under construction is the sector that really is taking the brunt of the credit crunch, if you care to call it that. Also, I think there is going to be a growing problem

coming from state and local governments. Now that the elections are over we're going to see some more honest statistics presented. They looked pretty bad even before the election, but now that that's behind us I think we're going to see still more states [and cities] that are in not very good condition. Mr. Boehne's Philadelphia is the greatest basket case, but it's probably going to have some competition.

MR. BOEHNE. We have some company coming along from the Big Apple.

MS. SEGER. Exactly, the Rotten Apple! Those are some of my concerns. Putting this all together, I would love to believe the staff forecast and would love to accept the idea that the improved oil price situation will turn the economy around in a couple of quarters. But because I don't believe that the oil price hike is the main problem, I'm not as convinced that having oil prices behave well will turn things around. I really think we are going to have to deal with this fragility in the banking system and the credit availability situation or we are going to have something that none of us has seen before. Thank you.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, there's not much more I can add. It is now clear to me that we have had what I would characterize as a violent shock to expectations and attitudes. As far as I can piece together the diagnostics of that, I rather agree with Gary Stern's view of it. I think the oil situation and the war issue are in the realm of the straws that broke the camel's back. A lot of stuff was there to begin with. The budget process hurt a lot. But I might say in that regard, having now had the time myself to put that budget package under a bit of a microscope, I find that there's a helluva lot more substance to it than I thought there was, especially in the out years. But, of course, there too what happened was that the process was so long and the near-term deficits were so large that what in fact is not a bad package has just been swept away. I think there's no recognition of that at all.

I spoke a few moments ago about the international dimension of this situation, but I really think it does need emphasis. Maybe anecdotes don't do much, but the fact of the matter is that over the past, I'd say, four to six weeks I have had literally a string of people whom I consider to be the true elder statesmen of international finance--these are guys who have been around for 40 years in many cases--telling me that they have never seen a situation as delicate as the one right now. And the focus is all directed at the United States, with particular emphasis on U.S. financial institutions. And as Peter said in his remarks earlier, it is by no means limited to banks. It is across the board and it is indiscriminate; AAA-rated companies are being affected just as much as lesser rated companies. And as I said, I cannot help but take seriously comments like these from people who have been around the track, in a couple of cases almost longer than I've been alive. I think there is the danger--I don't want to call it a probability or anything like that--of some kind of a serious liquidity shock originating offshore. And that, of course, makes for a further serious complication in the context of the whole exchange rate situation, because in the eyes of the rest of the world these problems are very much linked back to the exchange rate.

But what we have is something that appears now to be taking on the organic, if not the statistical, properties of a recession. But it's a different kind of recession and this is a little like what I think Ed Boehne was driving at. If indeed we are in a recession, it will be the first recession in recent memory that has not been predated by a sharp and protracted rise in interest rates and the underlying inflation rate. I don't know if my history is right but I suspect that if it is a recession it will be the first in the postwar period that will have that trait of not being preceded by a buildup in inflation and a sharp rise in interest rates. In those circumstances, I think that the policy response, as Ed Boehne said, is a helluva lot more difficult. It is partly expectations to be sure; but at this point it's very hard to take exception to the fact that the credit side of the equation is a powerful force at work here. When I look at that credit side of the equation in kind of snapshot terms, I still come to the view that it is not as bad as all of the market forces, press reports, or rumor forces would have one believe. But the problem with snapshots, of course, is that they are frozen in time and they don't tell you a lot about the future. And one of the things that has become a matter of some increasing concern to me is that I can now easily see any number of other parts of the country besides the Northeast that could get bitten rather sharply by the real estate problem that is at the heart of so many of the problems, at least in the Northeast. And, of course, as Ed was suggesting, if that does begin to play out and reinforce itself on the credit side, I think it can make things a heck of a lot more difficult. In the context particularly of the risk--however large or small you may think it is--of some kind of a serious liquidity problem originating offshore and of the sensitivity of the dollar, there are limits at least at this point as to how much can or should be done with lower interest rates. That also brings me to the view--not unlike Dick Syron's suggestion or I think implicit in Ed Boehne's suggestions--that maybe we have to start looking at some other things here. I mentioned this at the last Committee meeting and almost got run out of the room--it's not the first time that has happened and it won't be the last--but I must say that despite the political risks I still have an awful lot of sympathy in this environment for thinking about doing something with reserve requirements, even if it had to be watered down and phased in and convoluted. I think I am fully sensitive to the risks, but I'm also sensitive to the risks on the other side, which I think are more than anyone knows at this point.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, the economy in the Potomac district is decidedly mixed. Real estate is very sloppy with hardly any construction going on and over 100 houses on the market with no bidders. Retail sales are very soft and gasoline prices are much too high.

CHAIRMAN GREENSPAN. Which district is this?

MR. LAWARE. This is the Potomac district, so it is the 13th district.

CHAIRMAN GREENSPAN. That's an unlucky number!

MR. BLACK. That's a subdivision of the Fifth District, Mr. Chairman.

MR. KELLEY. It's a zip code.

MR. LAWARE. Turning to the national economy, I guess I'm in a policy quandary at the moment. I'm convinced that these gloomy consumer attitudes will be reflected this quarter in retail sales, with the exception perhaps of the luxury items that will be subject to tax after the first of the year and may be moved back into the quarter. But perhaps that argues that the first quarter will be a little softer. Corporate profits, although they're a little better in the third quarter than predicted, are still far from robust and are very spotty. Add to that the problems of the airlines and anybody else involved with energy and it seems to me that there is a lot of pressure there. Capital markets at least in the near term are increasingly closed to the banks and I think that potentially is going to create some very severe problems for the banking system, not just in real capital but also perhaps in short-term funding. In all probability, I don't believe that the banks will lend us back into growth at least until they see some improvement in earnings, understand and know how to deal with the current regulatory constraints, and feel comfortable with their capital ratios. What I'm implying is that this downsizing that is being undertaken to either get capital ratios to the minimums or to build additional cushions is going to continue. And that's not consistent with pro-growth lending in my opinion. I think recession obviously has real downside risks due to the often cited fragilities, and I've probably cited them more often than anybody. On the other hand, an easier policy would put the dollar at risk, and I'm convinced that the implications of a very weak dollar--a flight from dollar securities--in the midst of this bad image that we have projected of disarray in terms of political leadership could have long-term consequences that would be uncontrollable from the standpoint of monetary or even fiscal policy. And I think that the psychological attitudes out there right now, which we hear being expressed not only by consumers but also by businessmen and bankers, may prevent any ease from being stimulative in the long run. So, the possible contradictory effects of policy moves in either direction leave me in a quandary as to where to go from here. I guess that sums up where I am.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Well, I think we have a recessionary psychology in full bloom. It has captured the staff and also most business people as well as consumers. Even though the hard evidence is not in yet, everyone is behaving as if we're in a recession. It interests me that in the lending officers survey the primary reason given for tightening credit standards is the condition of the overall economy. Presumably, that was just after the third-quarter GNP number of 1.8 percent was released. I think the evidence is fairly clear that the staff is pretty much right this time. As Jerry Corrigan mentioned earlier, it is a curious recession. It breaks a number of the rules--not only the rule that we usually expect a precipitous spike in inflation and an inverted yield curve. That may be sufficient for a recession but it apparently is not necessary. Another rule we've broken, which has been mentioned a number of times, is that we see no inventory accumulation problem; maybe that's a thing of the past if

people take a different approach toward inventories and we now have the technology to back up that approach. The other thing which may be curious about this recession is that we may go through it with an unemployment rate that is right around what we used to consider full employment. In October the unemployment rate stayed constant despite the weakness in the report because the labor force dropped by about the same amount as jobs dropped. I think we'll probably not break that rule, though, and that unemployment will drift up. But it's pretty much a full employment recession, so far at least. All those signs would suggest that the recession should be relatively mild because we don't have the imbalances in inventories and we haven't had the spike in interest rates. It also suggests that maybe we can make some progress on inflation. As the staff mentioned, we have a number of pieces of good news there. I think it's instructive that commodity prices still show no real signs of taking off. Most of the indices we follow are lower than they were last week, last month, and even last year once you take out the energy prices. So, given the increasing slack in the economy, maybe we're making some progress there, although it probably would take quite a few months to convince us that we really have made any progress. It's just better than going in the opposite direction.

I tend to agree with the sentiment of a number of people that the real problem is in credit markets. I'm concerned with how below investment grade companies get credit. We've seen some widening of the spreads; default rates are up in corporate bonds and I think they're going to continue to rise, especially as the big bulk of junk bonds ages and gets to the age where default rates typically go up. It is true, as Tom Melzer mentioned, that we can see people going to alternative paths when bank credit is not available. Commercial paper issuance has gone up and finance company lending has increased markedly. That I think is hard evidence of tightness in bank lending. I wonder, though, whether those channels are sufficient to meet all comers. Generally, we see a lot of evidence of below investment grade, medium grade firms, having difficulties. I think it was Peter who mentioned that the spreads between high-yield bond indices and Treasuries are now 1200 basis points, which is up from about 400 basis points. Still, I think the greatest reason for concern is financial institutions. I see weakness across the board, not only in the banking system.

Another thing Peter mentioned is what's going to happen at the end of the year. We continue to hear stories that institutional investors are going to go to great lengths not to show banking securities on their year-end statements, which could give us some interesting times. We've talked a lot about the banking system, but if you look beyond the banking system you see developing problems in virtually all other types of financial institutions. The "good thrifts," if that's not an oxymoron, have exhibited deteriorating profitability in the third quarter. Insurance companies are suffering from asset quality problems. It may be that Equitable has closed on Peachtree Center, but people are closing in on Equitable as well. Securities firms are also not in great shape and are under quite a bit of pressure. There's excess capacity; there's simply no business out there in mergers and acquisitions or in underwriting. They have some trouble with asset quality with some bridge loans and the like. Maybe some of those things are getting taken care of, but we hear even the best investment banks complain about skittishness in the suppliers of

capital to them; we've heard a lot of that from some of the best ones. The health of the finance companies who are called upon to increase their lending is also being called into question. And even the government sponsored enterprises [are having problems]: Freddie Mac, as you might have noticed, has had some difficulties with multifamily housing; Fannie Mae has tightened standards; and Sallie Mae also has had some difficulty. So, when you look across a broad range of financial institutions you see weakness; and you see a system which is not in good shape to provide credit to people who need it and who are worthy of it. These sorts of trends are clearly understood by the capital markets. The long rate has come down substantially, reflecting the slowdown, perhaps 50 basis points or so. And quality spreads for these financial institutions have widened, giving evidence to the problems there. In terms of the monetary aggregates I see seven months where M2 has grown a little less than 3 percent. So, I tend to believe that monetary policy has remained reasonably tight over the full [1990] period. Going from the fourth quarter of 1989 it's still above 4 percent; but M2 growth was 7 percent in the fourth quarter of 1989 and 6-1/2 percent in the first quarter of 1990. When you average together the last six or seven months--maybe that's still not long enough--even if you take all the components of M2 together, that aggregate has not been growing very rapidly. So, when I look at it, I agree with the projection of a mild downturn; I also agree that there's a great risk that the downturn could become much more severe and longer in duration, given the weakness of the financial system. I also think there's a credible case that some lowering of short rates would improve the financial health of these institutions and perhaps at the margin also loosen up some credit and produce a growth rate in the aggregates that would at least creep back into the lower range of our accepted policy.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Well, Mr. Chairman, by late in the day when it's your turn to speak, you always run the risk that by then somebody already has expressed your view. And David just expressed mine. As a consequence, I'll try not to be redundant. I've been increasingly concerned in recent weeks about the specific composition of what's going on here. We have been going through a series of rolling recessions in this economy for a decade I guess, and I would argue that on balance it's been a very positive experience. Industries and indeed all regions have had an opportunity to go through a planned decline, to restructure, and to come out of it stronger. And they've been doing it against a background of overall strength so that it has been able to be done rather quickly. Although it's never any fun while you're in it, at least it's about as good a process as you could expect and it's rather healthy. But we have two sectors going now that seem to me to be rather unique, and they are very interrelated and very interactive. And, of course, those two are the real estate sector, where we are grossly overbuilt, and the financial institutions. David just gave us a good [overview] on that and I won't repeat it. But it seems to me that these two in decline together have the prospect of having a materially different effect on the economy than maybe almost any other two sectors that one can think of because of all the leverage they exercise on the rest of the economy. First of all, they are felt everywhere and are not just in a specific constrained region or constrained industry; it's a drag across the board. Secondly, there is the wealth effect on confidence

and on people that has to have some effect on buying decisions. And perhaps it will come to have an effect on debt servicing. But it's obviously essential to the growth of every industry; and there's enormous leverage when credit gets tight, as we all know. Also, these two situations feed on each other. It's going to be interesting to see how that process exhausts itself. The asset quality of banks is being dragged down by real estate; on the other hand, you can't work through the real estate recession because the lack of credit is pulling down the ability of real estate to be moved and cleared out. I don't know where else that could occur where we have that kind of interaction. We've seen automobiles and agriculture going into the tank and they were not terribly interactive. Energy and textiles were going into the tank and they were not terribly interactive. But these two are. And taken in tandem I worry that there's the potential for very serious mischief. I would hope that we're going to watch that very closely and perhaps take out a little insurance against the possibility that these are the two that could get away from us on the down side.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I've been noticing as I've been listening to the comments around the table that in reflecting we quite often use the words symmetric and asymmetric. And I've been thinking that there's somewhat of a lack of symmetry in regard to the way we're approaching two quarters of expected growth below where we'd like it to be. I have a feeling that if we had [in prospect] two quarters of growth above where we would want it to be, there wouldn't be near the kind of alarm and the wondering about how we're going to get it down three quarters from now so we only have two quarters of boom. But you can't have six quarters or seven or eight quarters that are stronger than you want and then turn around and have two that are less than you want and come out with anything like price stability. Some of you talk as if the worst case scenario is that we might not get this recession, if we're in one. And I'm about as sure as David Mullins is on that; it clearly is very soft. But some of you are worried that we're not going to get out of it in two quarters. The only recession that I remember that was five or six months in length didn't make a single bit of difference in regard to the underlying rate of inflation. This is not an event induced by a monetary shock event. It might be a culmination of monetary restraint, but it's not a monetary shock event. And if we try to jab our way out with a monetary reaction, we might very well find ourselves worse off than we were before. In other words, I think we have to have more confidence that the system will work and that we don't have to have a policy that in a sense is countercyclical; we just have to avoid policy that's procyclical, because I believe that the recovery forces in the kind of economy we have out there will be in place. So, I'm a little more worried about balancing our way back out of it before we get the imbalances corrected. If we're in a recession and it takes three or four quarters to get out and we get the price level thing together, then it seems to me that we have a much better chance to avoid what we most wish to avoid.

I think the question is: Can we get out of this situation without having a downside event? And it seems to me a downside event is not now in place. It seems to me that we run the risk of having some other events take place which could cause destabilization in

financial markets, and that's when we're going to be in real difficulty I think. That's why I join with those who worry about the foreign exchange value of the dollar. We are a reserve currency country that has a good deal of the world's claims that rest with us. And the global ability to take one's money and go is much more volatile than I think we've ever experienced before. So, to get ourselves in a position in which our rate of inflation is higher and our interest rates are dramatically lower than those of major competitive reserve currency countries--and if we begin to move dramatically on policy in that kind of environment--seems to me is most likely to precipitate a destabilization of markets. Now, I agree that the financial situation and financial institutions pose risks and I don't favor interest rate targeting. But clearly if we have an end of the year kind of event, interest rate targeting might be exactly what keeps that from getting out of hand in a sense, Mr. Chairman. That is, interest rate targeting in that kind of environment does mean that we might end up supplying a few more reserves at the end of the year than we may be anticipating doing. So, my view is that the foreign exchange value of the dollar will be okay even if it drifts downward in an environment in which price level corrections are evident to all. That is, if we see the rate of inflation really coming around and if we have commodity prices that are deflating, then in that atmosphere I believe we can have considerable ease without being disruptive. But I think it's pretty risky for us to get too premature with all that.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. Well, let me be very brief. The District is not too much different from what I reported to you last time. People were pessimistic last time, if you recall, but when I checked their order books they also had a reason as to why their own specific firm was going to do all right. Now we're actually picking up some cancellation of orders to firms and that kind of thing. So, it's a little softer. But perhaps surprising to some of you is that manufacturing employment still is almost at the same level it was when it reached its high in early 1989. So, there hasn't been much deterioration and there probably still is some growth left in the District. Steel, for some very special reasons, is running at a pretty good rate. Those special reasons are that the dollar is weak and imports are shut down and Canada, of course, has a steel strike under way. So, we're getting some special help there. What has changed the most is what I would call a loss of confidence by the bankers in the District. It's not so much a view that the world is coming to an end but just this hunkering down attitude that we're going to build a fortress balance sheet and that's the way to survive. That's the nature of what we hear all the time and that's a little disturbing to me.

Switching to the national outlook, I haven't any reason to object to what Mike has presented in the forecast. I have trouble with forecasts because the errors are really quite large in them. But the reason I asked the question was that it seems to me there are two kinds of errors that we can make if we are in a recession or heading into one. One is that if we try to head off a recession or keep it relatively short in time or very shallow without having all the necessary information about where we are in the economy, by an aggressive easing of some kind we could actually cause an increase in

inflation, notching it up and making ourselves worse off. That's why I was interested in your confidence intervals. So, it seems to me that one mistake we don't want to make is to ease aggressively, cause inflation to rise, and be caught in that potential trap that Wayne alluded to. The second kind of error is the one that concerns me and really is the subject of Don's talk later on, and that is that we've been pegging the funds rate. If the economy is weak and we're pegging the funds rate too high, then the aggregates are going to shrink and we will provide a monetary shock to the economy. And while two months don't make the case, as Governor Mullins pointed out, we've had a rather strange pattern in M2. So, I have some concerns about that risk as well.

CHAIRMAN GREENSPAN. Don Kohn.

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

CHAIRMAN GREENSPAN. Questions?

MR. HOSKINS. Don, how do you get your December number for money?

MR. KOHN. Well, it's largely an assumption. The incoming data are quite weak. The most recent weekly data actually suggested a decline; I don't have anything new since the Bluebook. Our presumption was that, with short-term rates having declined, some of the weakness was a bit of an aberration and some of that would level out and start back up again. So, it's a projection based on past relationships and based on the staff's economic forecast which is for weak income growth and still an increase in nominal income.

MR. PRELL. I might note that in terms of our forecast, nominal consumer expenditures will grow in excess of 6 percent in the fourth quarter, which would affect transactions demands for money.

MR. KOHN. We certainly have projected considerably less money than the models suggest.

MR. HOSKINS. No, I was just curious because the model hasn't been performing very well and--

MR. KOHN. We've actually allowed a larger shortfall from the model's projection in the fourth quarter than we've had for the past few.

CHAIRMAN GREENSPAN. Other questions for Don? If not, let me start off by saying a little more about oil prices. At this particular stage we have an economy where supply and demand have come into balance. The Saudis have brought back liftings to a point where the shortfalls that occur as a consequence of an embargo are pretty much closed at this stage. As is typically the case whenever you get higher prices, all the other OPEC members cheat. You can see it in the data and you can see that the inventories are no longer under pressures. And there is some evidence that consumption is slowing down against these higher prices. What we obviously have is a group of refineries throughout the world that think there's going to be a war and that they don't have adequate inventories; and it's their bidding in the market for existing inventories which has kept the spot

crude price \$10 to \$12 a barrel over its equilibrium position. There is some reasonable assumption that at where inventories are now there are potential storage problems. The evidence is that inventories on the seas are increasing; the tankers are slowing down again, which is a typical pattern when there's a bit too much oil out in the system.

This announcement of no rotation of U.S. troops in the Gulf is a statement that short term, either we are picking up our bags and leaving or we're taking a bunch of shots and then picking up our bags and leaving. And unless we get severe damage to the Saudi fields at this particular point or accidents in the refinery systems around the world including Kuwait, which I think we could probably write off at this stage, the oil price assumptions in the Greenbook short term are too high. In this market it's going to go straight down for a while until we get a readjustment. I'm not altogether certain that that is unequivocally positive. The reason I say that is that we're thinking that we're dealing with a symmetrical system in which higher prices--leaving our OPEC members aside--are negative and lower prices are basically positive. But what I think we have here is a system in which, as a lot of you have said, the oil price rise essentially has had an income effect, which basically we see as crucial at this stage on consumption expenditures.

Unquestionably, there is a very large risk premium that has hit the market as a consequence of the Middle East situation. We can see it in the yield spreads on securities, which have all of a sudden just taken off; the A1/P1 to A2/P2 spread has moved over all maturities; everything has opened up. If you take a look at the forward exchange rates that we calculate, the so-called 10-year forwards--which as a practical matter are a rough cut to get at what's happening to the exchange rates by subtracting the yield spread changes from the exchange rate--what you see is a relatively high forward exchange rate for the dollar in the G-10 currencies, which holds up until about midyear and then starts to come down; and with the budget problems and the Gulf problems it just falls like a rock. All of this suggests that we have a very unstable environment--one in which the economy is being pressed down by the [adverse] psychology. I think, for example, that the uncertainties and the risk premiums coupled with the oil tax, if we may call it that, are pushing down on consumption, opening up savings. And if there were inventories sitting behind this, I think we would be in a free fall right at this stage. I don't think the evidence--at least from the initial claims, which are the best figures we have--suggests that the economy is falling off the cliff as yet; it may three weeks from now, but it hasn't yet. It seems to be crumbling very gradually under the financial pressure that everyone has been talking about. What we have basically is old-fashioned disintermediation; that is, it is not that the net underlying credit demands that finance the GNP are collapsing; they seem to be going up slower than they were but we sure enough seem to be seeing that the intermediation system--not only depository institutions but insurance companies, finance companies, and everybody else--seems to be pulling back. And what we are getting is the obvious tightness, which I think clearly is the major factor in a contraction of M2 and which is only one side of the depository institutions' balance sheets. You can basically see the thing squeezing down as we get loan officers pulling back.

The one great advantage that we have in all of this I think is that slowing inflation is now finally becoming credible. Certainly, the employment cost index was a very important indicator, and even now there's a lot of question about the zero average hourly earnings number that we saw in the October release. It is all consistent with a significant slowing down, which I think is beginning to show up in the underlying price data. Indeed, if you disaggregate the CPI prices and reconstitute them with the weights coming from GNP --that is, using the fixed-weight PCE deflator--there's a very significant lower core rate of inflation implicit in there, which essentially reflects the problems we are all having with the housing service component in the CPI. And there you have the very anomalous question of the market value of the underlying assets of this residential or quasi-residential group. That's going down slightly and rents are going up. Now, rates of return don't do that. And I'm merely offering the suggestion that the commodities CPI is under 4 percent. If you substitute some reasonable estimates for the services component for housing, I think we're beginning to get some evidence that at a minimum the acceleration has stopped. While it's still premature, and indeed I think it's potentially dangerously premature, to assume that we have it beaten, I think that for the first time there are hard numbers that suggest there's something going on. Under these conditions one would not assume, were it not for the crisis atmosphere, that the dollar would weaken as much as it has because one cannot explain the extraordinary weakness in the spot exchange rates strictly by the yield spread differences. In fact, the type of calculation that we make, which tries to separate that, clearly suggests that a very significant part of the weakness in the dollar is essentially a vote of no confidence in the United States obviously with respect to the banks, financial institutions, and everything else.

Under those conditions, it's very clear to me that if we are perceived as responding excessively easily to all of the other signs that would induce central bank ease, that the risks of the system cracking on us are much too dangerous. I think we have to be awfully careful. Nonetheless, I don't think that we have the choice at this stage of not trying to ease into the markets, being fully aware that at the first sign that we get of negative response we're going to have to stop. I don't know whether or not we can do more than a 1/4 point over the next several months. I would say the economy and M2 and the financial markets require it, but we may not have the choice. In any event, I would suggest that we do have the possibility here--because there is no inventory system throwing us into a potentially sharp decline--that what we are looking at is a non-inventory shallow contraction which can stabilize after the saving rate adjustment is completed as a consequence of the oil price shock. Even though, as I said before, I don't think that the decline in oil prices is going to be symmetrical with respect to [unintelligible], I still think that the oil tax will reverse, but I'm not sure that the psychological impact is going to be readily soothed over, so to speak.

So, I think we have a good shot at actually coming up with the Greenbook's forecast. However, I would read it slightly differently; I think that the best thing to do at this stage, when confronted with the types of problems which give John LaWare difficulties, is to remember what a central bank is here for. A central bank is here to maintain monetary conditions in a stable

manner. And I would say that at this moment, if we had a money supply that was going up around 5 percent, I would be very concerned about moving in the direction of ease even in this context of weakness. But with the money supply doing what it's doing and the evidence of the continuous contraction that is going on, I would opt to ease 25 basis points right now and stay asymmetric [toward ease] with the understanding that only if the situation continues to worsen and is manifested in the credit aggregates in one form or another should we move again. But if there is any evidence of significant weakness in the dollar, I think we will have to pull back and harbor the thought; it's not inconceivable to me that at some point if we overdo it, we will have to move back up. Anyway, I would propose that as sort of the "least-worst" policy alternative that I can conceive of at the moment. In summary, it's essentially for us to go down 25 basis points and stay asymmetric and watch the system as closely as we can. Ed Boehne, do you--

MR. BOEHNE. I support your least-worst policy.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. I concur with your recommendation.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. I agree entirely, Mr. Chairman, except that I think that we also have the possibility of moving another 25 basis points if the markets don't react adversely. In other words, my preference would be to do 25 now and then wait for another opportunity to do another 25.

CHAIRMAN GREENSPAN. Well, that is basically what I'm saying. But we have to be very careful on how we interpret things; in other words if the markets behave at all adversely and we hit them at the point when they are marginally adverse, I think there a danger. Governor Angell.

MR. ANGELL. Mr. Chairman, I can live with your formulation because it seems to me that you placed the emphasis upon the tenuousness of the situation. And it does not indicate that, except under the best conditions, we would go farther. I would comment in regard to M2 that I could very well support a regime in which you announce and thus the whole world knew what we were doing with M2 and would thereby not conceive of it as an easing. Because in a sense, if we were on an M2 regime, this would not be an easing. And I think the foreign exchange markets might interpret it as not being an easing. I have a little difficulty with--

VICE CHAIRMAN CORRIGAN. You lost me on that last lap there, Wayne.

MR. ANGELL. Yes, I know. I have a little difficulty trying to blend this formulation of policy with that one because it's hard for the foreign exchange markets to know exactly what it is we're doing. But the bottom line is: I could live with your formulation.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. I would support it as well.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. I would also support it. I do have a question, however, Mr. Chairman: Why an asymmetrical directive?

CHAIRMAN GREENSPAN. Well, basically because I think the evidence at this particular stage is that we're more likely to have an opportunity to ease before the December 18th meeting than that a break in the foreign exchange markets is going to cause us to go in reverse.

MR. GUFFEY. I think I understand that we eased two weeks ago, and I assume you're proposing under this recommendation to ease tomorrow or sometime when it's convenient to the Desk. That's essentially two easing moves within 2 or 2-1/2 weeks and there may be a further opportunity in the period ahead before the December 18th meeting. But I would prefer if we're going to ease now--and I would delay it for a few days, by the way, and not do it right at this meeting but wait until we get some additional numbers on retail sales which come out tomorrow and do it next week--to accept your recommendation and then have a consultation before we ease again. In other words, it could be three times in something over a month.

CHAIRMAN GREENSPAN. Well, let me say that I think it would be a mistake, short of some extraordinary event, to move again in another week or so. I don't think that's a good--

MR. GUFFEY. What is the exact effect of an asymmetrical directive, then?

CHAIRMAN GREENSPAN. Personally, I'm saying we're going to have to go through December 18th. In other words, if a situation emerges in which the economy continues to soften, I would consider that what we're dealing with is early December, something of that sort. Let me put it this way: I don't think it would be wise to try to formulate exactly what would be done. If it is sufficiently ambiguous and a difficult decision to make, I think it would be appropriate to call a telephone meeting and get the advice of this Committee. It may not be that way; it may be as it was, for example, for quite a while when we were asymmetric and didn't move for weeks from one period to the next. It's going to depend on events.

MR. GUFFEY. I understand that, and you have been very prompt to call a consultation under the circumstances you've just described. I guess maybe I need some clarification of what a symmetrical and asymmetrical directive mean then. Because if I understood what has been discussed before an asymmetrical directive would give the Chairman the flexibility to move without consultation one time in the intermeeting period.

CHAIRMAN GREENSPAN. I agree with that. The only reason I prefer the asymmetrical language is that it's my impression of the forces we are looking at that it is more likely that we will be moving down than moving up. That's all it means. Frankly, I'm not certain that it really has that much operational significance because if the economic events are clear enough, it's not going to matter one way or the other what that tilt is.

MR. ANGELL. In a sense you didn't want to change the directive; you wanted to leave it the way it was?

CHAIRMAN GREENSPAN. That's correct.

MR. ANGELL. But basically, you have a kind of balance in your recommendation, which is a little unusual.

CHAIRMAN GREENSPAN. Yes. Vice Chairman.

VICE CHAIRMAN CORRIGAN. I support your recommendation.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I support it as well.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I support it.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. I think it's the least-worst [position] and I support it. I'm concerned about the fragility issue, but I'm not sure any greater move would do anything beneficial; it may not.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. My preference would be "B," although I could support this. One of the things I worry about a little is all this prior unfortunate dialogue and how through comments the Administration has made and so forth we sort of have been linked into this budget process. I'd really prefer to do something after more time has passed because I think all that runs fundamentally to our credibility. I guess the reason I'm worried about it is the point Jerry and others were making about the dollar. I think we really have to guard our credibility because when it comes to defending the dollar we're really the only act in town. So, that gives me some concern; but I can live with [your proposal].

CHAIRMAN GREENSPAN. The move we made at the time the budget agreement occurred was not interpreted as a roaring--

MR. MELZER. No, I understand that. I just worry that this might be interpreted as a second installment, and I don't like that linkage.

CHAIRMAN GREENSPAN. I think that's right, but when they see the minutes of the last meeting I'm not--. Governor Seger.

MS. SEGER. I'll support it, although I wish we could go 50 basis points, maybe just based on my having a negative--

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. I'm more in the Melzer-Guffey camp on this in the sense that the economy does really appear to be softening up, but I think the reasons have to do with structural problems that we've all

talked about, as well as the oil price shock, not necessarily Fed-type policy. I'm not sure there's much we ought to do about that. I do think we ought to guard against the error of having a continuation of money growth that is so low that we will shock the economy. Now, two months doesn't make a trend, but given the other things that people have talked about here in terms of a weak economy and fragility in the banking system, I can go along with your proposal. I would like to delay it, but I won't make a big issue out of that.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. I support it, Mr. Chairman.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. I concur, Mr. Chairman. I do feel a little of the sentiment that Tom Melzer expressed.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I support it; I think it's fully consistent with the reduction in long rates that we've seen.

CHAIRMAN GREENSPAN. Can the Secretary read the appropriate directive?

MR. BERNARD. "In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about"-- I'm not sure what--

MR. KOHN. 1-1/2 and 0.

MR. BERNARD. --"1-1/2 and 0 percent respectively." There would be no final sentence.

CHAIRMAN GREENSPAN. There's no final sentence. Would the Secretary call the roll?

VICE CHAIRMAN CORRIGAN. Can we live with saying 1 to 2 percent or something instead of putting that 0 in there?

MR. KOHN. Zero? Can you have 1 to 2 percent on M2 and just forget M3? The 0 is for M3.

MR. MULLINS. How about 1/2?

VICE CHAIRMAN CORRIGAN. Say "M2 and M3 in the range of 1 to 2 percent" or something like that.

MR. KOHN. Just forget about M3?

CHAIRMAN GREENSPAN. Leave M3 out.

MR. MULLINS. Don't you think people will read that as M2 targeting?

SPEAKER(?). As a change.

MR. KELLEY. We ought to call all the Fed watchers right there.

MR. SYRON. Yes, give them two things to talk about: no last sentence and no M3!

CHAIRMAN GREENSPAN. The minutes will have captured the substance of these changes; there is no problem.

MR. LAWARE. They'll assume that we're going back to M1.

CHAIRMAN GREENSPAN. I don't know. Don, can you accept 1 to 2 percent for M3 as well?

MR. KOHN. Sure. I think we won't get it, but that's fine.

MR. ANGELL. Why do that?

MR. BERNARD.

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

CHAIRMAN GREENSPAN. The next meeting is on December 18th.

END OF MEETING