

Meeting of the Federal Open Market Committee
October 6, 1992

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, October 6, 1992, at 9:00 a.m.

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

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

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

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

Messrs. R. Davis, T. Davis, Ms. Munnell,
Messrs. Lindsey, Promisel, Siegman, and
Stockton, Associate Economists

Mr. McDonough, Manager of the System Open Market
Account

Ms. Greene, Deputy Manager for Foreign
Operations

Ms. Lovett, Deputy Manager for Domestic
Operations

Mr. Ettin, Deputy Director, Division of Research
and Statistics, Board of Governors

Mr. Slifman, Associate Director, Division of
Research and Statistics, Board of Governors

Ms. Low, Open Market Secretariat Assistant,
Division of Monetary Affairs, Board of Governors

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

Messrs. Judd and Sniderman, and Ms. White, Vice
Presidents, Federal Reserve Banks of San Francisco
Cleveland, and New York, respectively

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CHAIRMAN GREENSPAN. I think it is most appropriate for me to comment that as far as I can judge we've been handling the issue of confidentiality awfully well. I haven't seen the slightest indication of any breach of security out of these meetings--the last two--and I merely wanted to note that fact and hope that whatever it is we're doing we continue to do. With that, I'd like to request a motion to approve the minutes.

VICE CHAIRMAN CORRIGAN. Move it.

CHAIRMAN GREENSPAN. Is there a second?

MR. SYRON. Second.

CHAIRMAN GREENSPAN. Without objection. As you know, today is the first meeting in which Bill McDonough is in charge of both Desks in New York; he took over obviously very recently. And I'd like to call on Bill for his usual start--the Foreign Desk report.

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

CHAIRMAN GREENSPAN. Thank you. Any questions for Bill?

MR. BOEHNE. You ended on a note about staying alert to early signs of a run on the dollar. But there really isn't much one can do in terms of contingency plans. Essentially, we have interest rates to deal with that and we have foreign exchange operations to deal with that, and foreign exchange operations have shown that they're not effective in [countering] these kinds of massive movements in capital flows. Domestic concerns would make an interest rate movement not a good course. That exhausts my list. What else is on that list that one can do if this kind of situation should materialize?

MR. MCDONOUGH. Intervention is unlikely to be highly effective because it would be very difficult under the circumstances to organize a coordinated intervention. It is tough to be effective intervening on our own. I think it's a tool and, quoting President Corrigan at the last meeting, I'd be inclined to say "never say never." It is something that we may want to use. The reason it would be difficult to organize a coordinated intervention is that most of the Europeans don't have any deutschemarks, which would be the currency of intervention. And the Bundesbank, I would think, probably would want commitments from the Chairman on the future of monetary policy that I suspect he would be very reluctant to give. Because of their concern about what [intervention] did to the management of their money supply, it would be a fairly tough argument to make in any case. In the midst of a political campaign, if one or more of the candidates could be induced to say that a weak dollar policy is not what he has in mind, that could be somewhat useful if it were done with good timing.

MR. JORDAN. Earlier this year we heard some things about the difficulties the Germans were having with sterilization and their desire to see us diversify

and so forth. What were they saying during September about their problems with the other countries? And was that a constraint on our options?

MR. MCDONOUGH. Well, all during September we were very much in the mode of not wishing to intervene because of the likely counterproductive effect on [our] domestic markets, especially the bond market. Therefore, in fact, I didn't have any discussions of "What if...?" or "What do you think we should do?" with them. At that time the main thing that would have inhibited any desire by the Germans to do an intervention operation with us is that they very much wanted the ERM to come apart in order to stop having the monetary policy problems they had and to establish what they think is the single most important principle of the mechanism, i.e. that it be flexible. So, I think the main concern they had was purely internally European.

MR. JORDAN. So, our actions would have appeared to be trying to hold the ERM together?

MR. MCDONOUGH. Right.

MR. JORDAN. And they didn't want to hold it together.

MR. MCDONOUGH. Exactly. When we did intervention operations during the summer, the other European countries were just delighted every time we even mentioned the [possibility] of it. The Germans were much more reluctant, but they didn't want to get "noticed" as being against an operation which the other Europeans saw as positive because in weakening the mark it helped them keep the system together.

MR. JORDAN. Your remark about [intervention] giving us domestic problems: Was that because if you're selling deutschmark-denominated securities you are going to be sterilizing them by buying domestic-denominated securities?

MR. MCDONOUGH. The technical monetary effect of the intervention wasn't what we were concerned about. It was the psychological effect of an unsuccessful intervention operation on other markets.

MR. JORDAN. The psychological effect is one thing, but the idea is that if you sold deutschmark-denominated securities, you'd be buying U.S. Treasuries.

MR. MCDONOUGH. Right.

MR. JORDAN. And that would be helpful. Given the position of other central banks now with deutschmarks and given our desire to reduce our holdings of deutschmark-denominated assets, do you have an opportunity to do off-market sales of some of our deutschmark holdings and, the counterpart, to buy more Treasuries?

MR. MCDONOUGH.

CHAIRMAN GREENSPAN.

MR. MCDONOUGH.

MR. JORDAN. One last question: Going forward, if we do start to get more stability--even firmness--of the dollar, what is your attitude going to be toward moving into the market and still reducing our position in deutschemarks?

MR. MCDONOUGH. As you know, we have this [conundrum] with the Treasury, and about 55 to 60 percent of U.S. reserves belong to this Committee and the rest belong to the Treasury. Perhaps understandably, given everything else that has been going on, the Treasury has not been able to focus on the whole issue of reserve levels or management since we've had these discussions this year with the Committee. I think realistically what we have to do is wait until after the election and until this Treasury team or whatever Treasury team is prepared to talk about it, and then we can come back to the Committee.

MR. TRUMAN. President Jordan, two points seem to need to be added here. One is that in the second phase--the September phase of all this--I at least detected from my own contacts that there was essentially no pressure on us from the other Europeans to operate. We did not have the same thing going in August. So, they too were not looking for us to get involved in Europe. On the last point, I think it's worthwhile sharing with the Committee the current attitude of the Treasury, which was that they were not interested in sharing the operation with Sweden. That's why you are about to approve the entire \$400 million. So, there is a certain reluctance there. It is my judgment, certainly, that these are not the right circumstances to put that issue squarely to the Treasury. It is probably better to wait until things settle down.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. I just want to commend those of you who had a part in the decision for having tried to urge the Treasury not to do this intervention. I think you proved your point very well.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Bill, I just want to be sure that I didn't mishear something you said before. Did you say that you thought the market had--"built in" is too strong a phrase--a sort of preponderance of expectation of a 25 basis point cut in the funds rate?

MR. MCDONOUGH. The foreign exchange market, yes.

MR. SYRON. I was just going to ask you this: To the extent one can reconcile that with the question Ed Boehne raised on your point regarding concern about a potential break away on the down side, is the market seeing that as a factor that might lead to this break away? Is that a factor they see that might or might not lead to this?

MR. MCDONOUGH. No. It could happen, but my judgment is that the highly expected 25 basis point easing in the funds rate would not do much of anything in the foreign exchange market.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. How effective have the Germans been in sterilizing? I think short-term rates have come down a fair amount, which would suggest that they have [not completed the sterilization].

MR. MCDONOUGH. They definitely don't have all of these operations sterilized yet; I don't have a good feel of what would be a reasonable percentage.

MR. TRUMAN. In many respects, given the magnitudes that Bill described, which are unprecedented in terms of anything I've heard of [unintelligible], I think they have been remarkably successful--so remarkably successful in fact that they had already put the markets back in a position in which they were net short of funds at the end of the maintenance period last week, which is one of the ways the Germans were able to stabilize the situation. In talking to people at the Bundesbank--though every person one talks to probably would give a different answer on that question--my impression is that at a very technical level they have been able to force some changes in their own operating procedures, but nothing like the price system to [unintelligible] instruments. But they have been quite successful in the first round. However, there's a big dispute within the Bundesbank that goes back decades about whether one can fully sterilize any of these operations. The only way I could understand it is that if you have large capital flows, it is not clear that you could return the liability side of the central bank's balance sheet to its status quo ante. But it's not clear with that and the same interest rates that you have changes in the demand for money that will give you different money supply numbers, a change in the multipliers, or whatever you want to call it. There's a lot of dispute within the Bundesbank itself about whether one can truly sterilize the [effect on the] money supply. That's at a different level, I think.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. Any further questions for Bill? If not, would somebody like to move to ratify the actions taken by the Desk since the last meeting?

VICE CHAIRMAN CORRIGAN. I move it.

MR. KELLEY. Second.

CHAIRMAN GREENSPAN. Without objection. Bill, would you introduce Joan Lovett officially?

MR. MCDONOUGH. Thank you, Mr. Chairman. There are two things I've learned by this the fourth business day of responsibility for the Open Market Desk, judging from the first three days: Deciding exactly how to go about adding or subtracting reserves and in what amount is a lot tougher than I think anybody, especially me, realized.

CHAIRMAN GREENSPAN. Arithmetic is a pretty rough activity!

MR. MCDONOUGH. It has been an interesting baptism. The smartest thing I could possibly do was not to fake it for the whole period and, therefore, Joan Lovett will give the report.

CHAIRMAN GREENSPAN. Go ahead. Welcome.

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

CHAIRMAN GREENSPAN. The bond market was about 1/4 point lower this morning and I think the bill rate is up about 3 or 4 basis points. Is there any commentary around as to what this type of mood is suggesting?

MS. LOVETT. This morning?

CHAIRMAN GREENSPAN. Yes.

MS. LOVETT. The early read we got was that a technical adjustment had been taking place in the market yesterday afternoon as the stock market recovered from its lows. And with the world stock market this morning also tending to recover from the lows seen yesterday, there is just what one would call normal, technical position adjustments taking place. There didn't seem to be anything more fundamental than that at work.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Joan, I know this most recent reserve period started off with continued pressure on the funds rate. I don't know if that has continued into this week or not. Were you surprised by that? I know the quarter-end has passed and we may still have Treasury balance problems and so forth. How do you evaluate that?

MS. LOVETT. We were somewhat surprised. The quarter had finished on a firm note. We really thought that we had put in [enough] reserves and made an allowance for even higher-than-normal excess reserves for the quarter-end, but we had a very large miss. Therefore, the next morning, which was the beginning of this maintenance period, the funds market started out on the firm side; and sometimes that carries over. But I have to say we were surprised by the carryover firmness because it was the first day of the maintenance period and the banks had the whole remainder [of the period to adjust] and it was also prior to the time when there were widespread expectations that the Fed would be cutting the rate. So, we're having a very difficult time trying to understand why people would pay these higher rates so early on. The rates aren't consistent with the reserve numbers either. Reserves don't show [a need for us] to put in that volume of reserves. So, we've been surprised by it. The market hasn't been as surprised because they think the need is bigger than we are saying. This is one of those periods where right after the quarter-end the Treasury balances plummet because they have to pay out these social security [checks]. And the market, even though it knows that, thinks the need is bigger. So, the market hasn't been as surprised about the firmness of the funds rate as we have been. The firmness that we're hearing about is coming more or less from regional sources, and we just don't have a satisfactory explanation for it.

MR. MCDONOUGH. The first couple of days were aggravated, as was the September 30th quarter-end, when Bank of America's computers went down about halfway through the day on Wednesday. And I believe, Bob, they didn't get them fully back up until yesterday.

MR. PARRY. Wells Fargo had a problem too.

MR. MCDONOUGH. Well, I didn't know that. Bank of America is usually a pretty good size supplier of fed funds, so I think that was probably at least a marginal contributor. But it isn't the whole explanation of why funds have been quite as tight as they have been.

CHAIRMAN GREENSPAN. It was also in the context, as I recall, of days when the bill rate was actually easing quite considerably.

MS. LOVETT. The fact that the funds rate hasn't behaved quite the way it should has been largely ignored by the market thus far. It is seen as something that's technically driven at this point.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Do the traders look at any of the various measures of bank reserves, the monetary base, or monetary aggregates in forming their expectations about Fed actions?

MS. LOVETT. I guess I could answer that in two ways. They look at those kinds of aggregates broadly in terms of their impact on policy, but I think they see that impact as being somewhat removed. They look more closely at their estimates of reserve requirements as an operating factor that we have to contend with. And I think that's as close as their focus would go on that.

MR. JORDAN. What would it take to get them to move away from focusing on the perception of a weak economy to looking at some kind of monetary indicator in determining what we do?

MS. LOVETT. Well, the market looks at what it thinks the Federal Reserve acts on; they feel reasonably confident that that is the thing to do. They don't see the monetary aggregates as being the driving force to policy right now. They find it very difficult to read what the aggregates are saying, and everything they read says the Committee does too. So, they don't tend to look at them that closely.

MR. JORDAN. So, at the moment, if miraculously M2 and M3 started to soar as in Germany and if M1 and the base plunged--again as in Germany--the Street wouldn't react to it as long as they thought we were going to react to unfolding real economic indicators?

MS. LOVETT. They don't ignore the money numbers by any stretch of the imagination; they do look at them. Some people are commenting a lot about the rapid growth of M1 being a harbinger of trouble, but others aren't. Some say one can't look at that because the Fed is looking at the broader aggregates. Nobody understands fully or positively what is going on here. If they thought we were going to be acting on it or if they thought we should be because the growth rates are out of historical experience, then they would respond to it.

MR. JORDAN. One more question: How do you reconcile the perception that in the long run we have big problems--fiscal stimulus, inflation, and all of that--with the constant drumbeat of the need for us to ease because of weak economic conditions? What is it they want us to do? Do they want us [unintelligible] or don't they?

MR. MCDONOUGH. I think the attention span of most people who trade securities is relatively short. [Laughter] The big thinkers have tomorrow in mind! Seriously, one of the things that makes them think that way is that their bonus systems are based on thinking for rather quick gratification rather than longer term. Going back to your earlier question, in most of the firms the Fed watchers have become much less important than the traders. And the traders very much look at psychology; they're getting more and more married to the black box which says that the past is the mirror of the future. So it has changed a great deal from the period when the Fed watchers and the economists in the big trading firms were really quite powerful. I think there would have to be an extended period of this [unintelligible] off to concentrate on the monetary variables for a change to take place because the firms would have to recast their own internal structures and to whom they listen.

MR. JORDAN. But that dichotomy suggests that it's not necessarily inconsistent, given what is going on there, for the perception to be simultaneously that we're too tight and that we need to ease and we're in the process of inflating.

MS. LOVETT. Right.

MR. MCDONOUGH. Exactly.

MR. KOHN. Then we'll have to tighten later.

MS. LOVETT. Right.

MR. KOHN. I take that back. I think we've had something of a contradiction in this whole episode of an upward sloped yield curve which suggests that at some point-- [unintelligible] through liquidity premiums or whatnot-- rates would have to come back up again and [given the] immediate expectations of consumers or constant disappointment with how the economy is turning out, the Fed will ease. So, I don't think there is anything new. If anything has happened over the last three or four months, it's that the middle part of the yield curve-- the one, two, and three-year part-- has really come down quite a bit, particularly after the June employment report. So, a sense of when the rates would have to go up has been pushed out [in time].

CHAIRMAN GREENSPAN. I'm sure I shouldn't read this and I don't have his permission, but I insist. This is a Corrigan-gram which says we could put Bill and Joan on the road. [Laughter]

MS. LOVETT. I don't know what that means! [Laughter]

MR. MELZER. At whose expense, right?

MR. MCDONOUGH. I think we'd like to discuss that Corrigan-gram!

CHAIRMAN GREENSPAN. Are there any further questions? If not, I think we have to get the ratification very quickly. Would somebody like to move the ratification?

MR. MELZER. Move it.

MR. SYRON. Second.

CHAIRMAN GREENSPAN. Without objection. Let's move on now to Messrs. Prell and Truman.

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

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

CHAIRMAN GREENSPAN. Questions for either?

MR. BOEHNE. Mike, would you elaborate some on your comment about going from 3 percent to zero--and presumably we could [even] have a negative real [federal funds rate]. It's an article of faith for anybody who has taken one or certainly two economics classes that lower interest rates are going to be a positive [for] growth, and I'm not quarreling with that orthodoxy. But when one goes out and talks with people in the business community and consumers, one almost invariably runs into the view that lower rates are not the [solution]. If I probe that, an answer I frequently get is: "If I thought interest rates were going to stay down, then lower rates would help. But if you lower interest rates now, I know you'll have to raise them a few months or a year down the road. Just knowing that rates are going to be down for a short period doesn't help me because I'm going to have to finance whatever I'm going to buy with this [loan] for 5 or 8 or 10 years." I find increasingly that the view in the business community is at odds with what most of us have accepted as a good [economic] relationship. I wonder if you could help me through some of that.

MR. PRELL. It's a difficult question. I think many people in different positions perceive the effects of changes in short-term rates differently. A retiree living on the proceeds of short-term deposits would not see an improvement coming from lower short-term rates. A business that has a heavy load of short-term floating rate debt or debt that rolls over frequently is going to achieve some significant improvements in the bottom line from the decline in interest costs. I think it is fair to say that some of the channels of positive influence from declining rates have been somewhat diminished in their effectiveness in the past couple of years because such sectors as commercial real estate are just so far out of kilter in terms of the fundamentals of supply and demand that making borrowing cheaper is not going to make new investments particularly profitable. It may enhance property values to some degree and diminish the write-downs that will occur, but we're not going to get quite the stimulus we would have in other circumstances. Similarly, to the extent that credit availability has been the problem for some classes of borrowers, a small reduction in rates probably is not going to make a very great difference.

But there are a lot of borrowers for whom lower rates will make a considerable difference. I think we've seen that the decline in rates has significantly abetted the balance sheet restructuring process. I think lower rates have played a role in sustaining relatively high valuations in the stock market and probably have cushioned the falls in a variety of other asset values. We have not argued that modest changes in short-term rates are going to make a

night and day difference, but if you feel that there is nothing else here to provide a great deal of push to the economy over the next few quarters, our assumption of a decline in long rates looms rather large as a factor in the projected acceleration. And the question becomes one of whether some easing of short rates is needed to facilitate that process. If people thought that the Fed was overdoing it and that the implication of the easing was that we would have significantly higher inflationary pressures down the road and that we wouldn't reverse course in a timely way, then we might not get the beneficial effects in the bond market. My sense is that unless the Fed went to 1 percent on the funds rate tomorrow--if the movement was gradual--that in the context of weak economic indicators we are more likely to get the "too little too late" complaint than we are the notion that we've overdone it and have shifted to a grossly inflationary posture. So, there are a lot of things to weigh here. But, as we suggested, I don't think we should ignore the fundamental notion that on balance easing probably does give us some stimulative effect. It's a very long answer.

MR. BOEHNE. Thanks.

CHAIRMAN GREENSPAN. On this subject, do we have any evidence that the marginal propensity to spend out of interest income tends to rise as interest rates fall on the assumption that the [unintelligible] part of the standard of living of interest receivers is fixed?

MR. PRELL. I'm confident that we don't have any evidence to support that but no evidence to counter it either. It's hard enough to discern a general phenomenon of a lower propensity to spend out of interest income in general. They refine it to that point. I don't know that anyone has even endeavored to do that. By postwar standards this is rather an extraordinary episode in terms of the dimension of the decline in interest income, partly because we started the rate decline early and there's a lag effect here as instruments roll over. I'm not sure we have a great historical sample from which to try to discern those [relationships].

MR. JORDAN. As a response on that, I don't think there is any empirical evidence about the people who already are living on interest income, but I've been testing the attitudes--this is all purely anecdotal--of people who are not yet at that stage. Bankers tell me that their customers who are looking ahead to retirement have a threshold in mind of interest income they're going to need. And what they've been doing is raising the amount of assets they feel they need in order to achieve their desired interest income as we move to a lower rate structure.

MR. PRELL. This is the income-to-price effect. We have the classic question here about how interest rates will affect consumption and savings.

CHAIRMAN GREENSPAN. Are you saying that they're moving out on the interest rate maturity curve for a higher yield?

MR. JORDAN. No, they're just raising the amount of assets that they feel they need to set aside.

MR. PRELL. Their target is trying to get current income.

MR. KELLEY. I'm sure it's more than they have.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mike, relative to previous forecasts, this forecast seems to get started a bit later and when we get to the faster growth it's not quite as strong, at least in 1993, as it was before. Would you characterize this as an indication of greater uncertainty on your part as to the strength of the economy, both short and long term?

MR. PRELL. Well, I suppose we ought to be more uncertain [given that] we have been disappointed in our prior thinking, but I don't conceive of it as more uncertain, though it's still very uncertain. I think the risks are reasonably balanced at this point. One might argue that we have tipped the scales in a more negative direction by taking the position we have on productivity, in a sense making the personal saving rate more directly a function of what is going on in the labor market. But I think this forecast is no more certain in the end than our prior forecast was. We've been less than confident for some time now about what was going on.

MR. PARRY. I would ask Ted a question as well. The import numbers are really quite strong; I guess that's attributed to computers. If one looks at the normal relationship between an economy exhibiting the characteristics that we currently see, isn't this really an extraordinary increase in imports given what we see for [unintelligible]?

MR. TRUMAN. I think most of the surprises are in the computer area. If you strip out computers and look at nominal imports, our standard equations are not--

MR. PARRY. Doing too well?

MR. TRUMAN. --doing any worse than they were before, if I may put it that way. So, when you take out computers, other imports have not gone up. The real surprise has been in computers which seems to be [a mystery]. First of all, no one has a good model about what drives computer imports at this stage. What seems to be going on is that there are a lot of applications with more power, but they are at the low end of the technological scale and that's where we are relatively import intensive. At the higher end of the technological scale we are export intensive. As a result we have a situation in which the computer trade balance is reversed. And even assuming exports and imports now grow at the same rate, we would have a widening of that gap.

MR. PARRY. Do people in the industry feel as though this is going to continue for some period?

MR. TRUMAN. We cooperate with R&S on this, and our sense from contacts we had after the Greenbook went to print was that the very rapid rate that we already had in the forecast might underestimate what is going on.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. I'd like to ask Ted and Mike a statistical question. We know that the things we don't measure well are exports and imports. Anecdotally, when I was in San Francisco lately, I was on the Fisherman's Wharf on a Sunday and I heard German, I heard French, and I heard lots and lots of Japanese. When I'm on an airplane, I'm one of the few Americans in the first class section. Howard Banks just wrote a piece saying it was cheaper for a Brit to spend a long weekend in New York than a long weekend in Paris. We have all this anecdotal evidence. An expression I heard that sums it up best is: "We've become the world's Wal-Mart." Now, with all these tourists packing their suitcases full of Gucci and whatever else they buy on Fifth Avenue, isn't it possible that we are seeing a miscalculation of the effect of the dollar and that a lot of what we're picking up as consumption might actually be exports?

MR. TRUMAN. That certainly is possible, though I will make two comments. One is that over the last decade the Commerce Department has dramatically improved its collection of data in this area. Moreover, we do see a dramatic upward trend in our exports of services of all kinds. Now, the question you're asking basically is whether we're picking up as much of it as we should be. The answer may be that the statistical system probably is lagging behind somewhat. That's one of the reasons why, as I commented at the end [of my remarks], the services component of exports of goods and services is growing in the forecast even while the goods side of it is shrinking.

MR. PRELL. Your question raises an interesting issue about the consumption behavior that we've observed because consumption has not been stronger than one might have expected given the usual determinants. So, that would suggest it has been running fundamentally even weaker if this phenomenon is--

MR. LINDSEY. Right. But if our fundamental domestic economy is weaker than we think but the dollar is having a bigger effect than we think--

MR. TRUMAN. As I said, I think it is unappreciated that, as opposed to the 1970s, one of the big impacts of the weaker dollar--not where it has been but where it has gone--has been the income effect as growth picked up in the rest of the world.

MR. LINDSEY. Right.

MR. TRUMAN. Income differentials are less so that foreign travel, which is generally a luxury good anyhow, is cheaper and easier for people to do. So, there are two things together: Coming to see the Grand Canyon or Fisherman's Wharf or whatever is a big deal and it's cheaper and easier, and it affects the--

CHAIRMAN GREENSPAN. It's true that it affects the net export position and personal consumption expenditures, but it does not affect the current account.

MR. LINDSEY. Right.

CHAIRMAN GREENSPAN. It appears in a different line of the current account and, as far as the total system is concerned, it clearly doesn't matter.

MR. TRUMAN. It does affect the GNP, I think.

CHAIRMAN GREENSPAN. [It does] affect the GNP, but it doesn't affect the current account balance.

MR. TRUMAN. Right.

CHAIRMAN GREENSPAN. It is in the services area.

MR. TRUMAN. If it's accurately measured, it's in the services area.

MR. LINDSEY. Not if they buy the goods that are in their suitcases.

MR. PARRY. They're not making the distinction of whether it's a U.S. purchase or a German purchase.

CHAIRMAN GREENSPAN. Not in that sense; it is put together with increases in U.S. net exports.

MR. TRUMAN. Right.

CHAIRMAN GREENSPAN. We also have the same problem with direct foreign investment. If somebody came and dismantled an office tower in Los Angeles and moved it brick-by-brick abroad, we'd consider that an export.

MR. KELLEY. It's a good idea!

MR. MULLINS. We should probably do that!

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Ted, maybe I read too much into your comments, but you seem to take some comfort in the fact that the dollar is up on a trade-weighted exchange basis something like 1-1/2 percent over the intermeeting period and maybe 4-1/2 percent from the lows. I must say I don't share that [view]. The reason is that when one looks at how we've done against the other two principal reserve currencies, the DM and the yen, [the dollar is] down significantly and at historical lows. I'm concerned that in a period of international turmoil we're really not providing much of an option in terms of a safe haven, and I think we ought to take note of that. I don't know what your reaction to that is. I would have expected that we would have provided more of an option and that in fact maybe we were part of the problem rather than the solution. So, I just don't take that much comfort in looking at the broad trade-weighted exchange rate.

MR. TRUMAN. I take your point; I actually was trying to have it both ways, if I may put it that way. It depends on what question you're asking. I would separate it into two parts. One relates to what has been going on with respect to the yen, where the dollar has been weaker. But given the size of the Japanese current account

surplus, it's difficult to imagine that the dollar isn't going to have to move down against the yen at least in the near term. It is difficult to believe anything else is right for that particular problem.

On the European side, the normal historical pattern back in the 1980s when we had more frequent realignments in the EMS and ERM was for the dollar basically to be unchanged on average following [the realignments] because the mark was going up and the franc was going down. The market in some sense is simply thinking in terms of competitiveness. They had the dollar unchanged. And the fact that the dollar has come up on average in the face of all this is something that should be noted because, among other reasons, in terms of thinking about the outlook it is a real appreciation and it has a damping effect. It comes back to this question of how we live in this new ERM [era]. They jumped in the canoe and we have for some period questioned whether they would toss us into the lake. So, I think it is not irrelevant that the dollar is down relative to its level at the time of the last FOMC meeting by 3 or 4 pfennigs against the mark but up 3 or 4 pfennigs from the low of 138. So, in that sense we have a bit to go; there is a cushion there, it seems to me, before we really are breaking new territory on the part of the European currencies.

I would put the yen on the side. But, the important point that you're emphasizing--and I agree with it--is that the markets, as we saw yesterday, seem to be extraordinarily jittery. One needs to recognize that fact. And whether this is the right time to log another action, which may or may not be fully discounted in the markets, I think is a question.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. On this issue, just a word on the perspective of the dollar being weak. Some have suggested that it has held its value pretty well against commodities, but that's not really my area.

MR. ANGELL. I'm glad to have you contribute your part to that!

MR. MULLINS. We're running out of candidates for engines to pull the economy out of this. One which reappears--you mentioned it and it is one of the few pluses in the outlook--is the prospect that the long bond rate might fall another 75 basis points or so as we move through next year. Supposing in the post-election period it became fairly obvious that the prospects of a large fiscal package were quite high. How would that be reflected in the long bond rate in the forecast?

MR. PRELL. I guess the simple answer would be that we don't have that in our forecast. There could be a tradeoff between the direct effects of lower taxes on income or higher expenditures on activity that would eliminate the need and probably tend to elevate long rates relative to what they are in our scenario.

MR. MULLINS. Indeed, last year during the first-quarter debate [on fiscal packages] the long bond went up 60 basis points.

MR. PRELL. Yes. It's an open question, of course, whether rates are now higher than they would otherwise be if there were not already considerable concern about the possibility of some significant enhancement in the size of the budget deficit. So, it's a little [hard] to sort out what the effects would be; but I can envision circumstances, as you're suggesting, in which the bond markets would be adversely affected at least temporarily.

MR. MULLINS. Or at least we wouldn't get the 75 basis points decline; rates would stay constant.

MR. PRELL. I can't say that we have a lot of company in this projection. There are some other forecasters who are looking for that kind of rate effect, but it is clearly not what is built into the market structure at this point. There are always uncertainties about liquidity premiums in the term structure, but I don't think it's built into the market now nor is it necessarily clear that the forecasters generally are talking about this. But it's interesting, I might note, that most private forecasters are anticipating flat or maybe even a slight upward tilt to long rates over the coming year or so. A growth forecast of the dimensions we're showing here is also quite [common], so they're in essence saying that [a decline in long rates] isn't essential. We're taking a bit more negative view of what the underlying strength of demand will be ex any effective fiscal stimulus, post-election surge in sentiment, or something.

MR. MULLINS. Don't you think the other forecasters will catch up in a few weeks once they grind through all the latest data?

MR. PRELL. Possibly; it's hard to say. Even before the employment report last week, having much the same information as we had, I sensed more positive expectations than we had. For example, I attended a meeting of the technical [consultants] of the Business Council last Tuesday and the prevailing forecast--there was a slight lag in this, admittedly--was for growth more around 3 percent without interest rate declines and without a general expectation of significant fiscal stimulus.

MR. MULLINS. Three percent for 1993?

MR. PRELL. For 1993.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Thank you. Ted Truman already answered my question, Mr. Chairman.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mike, I'd like to follow up on Ed Boehne's question. If I understood you correctly, you were saying that within the context of having provided a fair amount of liquidity for the readjustment, you are expecting things to improve down the road next year and beyond based on where rates have already fallen. But if the improvement doesn't happen, you suggested toward the end of your comments that we might have to make substantial reductions in rates to move the economy along. Having said that, is your discussion about a

modest reduction now an insurance policy on the rates that have already come down or did I misunderstand you?

MR. PRELL. Well, I guess it could be viewed that way in the context of a prevailing expectation now that some small amount of easing is going to be occurring, which might have a little negative effect on bond yields if the market were disappointed, all other things equal. Basically, as we were putting this forecast together, my sense was that given the behavior of the Committee what we were forecasting seemed highly probable and that, unless you switched gears, some slight further easing would be consistent behavior. We did not assume anything that we felt was really material to the basic thrust of the forecast. As we indicated, we are thinking only of a small fractional further decline in the funds rate as being in the range that underlies this forecast. If our story is right, most of the decline in long rates that we have projected would occur even if the funds rate were held at 3 percent. But that's a conjecture. Basically what I said in my briefing was that we have the expansion beginning to pick up gradually fairly soon. If something is wrong in our analysis, the only logical conclusion we could draw in terms of policy implications is that more needs to be done if you want to do at least as well if not better than the forecast. We're falling short of what the Committee's expectations were for economic activity as it stands, so that was the conclusion we reached.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mike, returning for just a moment to the discussion a few minutes ago about how we measure things: There have been some comments around here recently about the possibility that our inflation measurements may in fact be lagging the reality. Could you comment on that?

MR. PRELL. Well, I don't have anything new to add. As we've noted in the past, there is possibly some measurement bias toward higher inflation than in truth is occurring. That probably has prevailed for some time. It could conceivably be getting worse, but that's even harder to judge. The 1 to 1-1/2 percent inflation that I held out as a possibility sometime out toward the middle of the decade could be interpreted in light of the scientific evidence available as being essentially price stability. So, if I were at DRI, I would probably title this a price stability forecast. We are following a path very much akin to what we've outlined in the past. Dave Stockton and his colleagues in briefings to the FOMC have indicated possible paths to price stability; and inadvertently in terms of what our forecast have been, we've been on that unemployment path for the last couple of years and our forecast continues on that path in essence. We're on a gradual path back toward full employment in this forecast but it's far enough down the road that we'd be making a lot further progress on disinflation.

MR. KELLEY. If we may be meaningfully overstating the inflation rate, how does that play through to nominal GDP and real GDP?

MR. PRELL. Well, nothing obvious on nominal GDP--there may be some tricks of measuring here that would have an effect--but real GDP presumably is being underestimated. But then so, too, is

potential GDP in some sense. The benchmark I think you want to put an eye on here is capital resource utilization. The unemployment rate isn't affected by any of these measurement issues and it has been trending upward in this recovery. We expect it will be going up further, so there is room by that measure for the economy to grow faster; no matter how fast it is growing, it can grow faster than it has been.

MR. KELLEY. If all these things are happening, where it must be getting absorbed is in even higher productivity growth rates.

MR. PRELL. Indeed, and that may go back a considerable ways into postwar history.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I'd like to go back to long-term interest rates one more time. You put a lot of emphasis on their decline. Is that-- I just don't remember--a sharply different view than you've had before?

MR. PRELL. There is no material change, for example, from the last forecast to this one in terms of the path for the long-term rate. Now, I think we've gradually come down over the past several forecasts. In 1992 basically long-term rates have followed the path we charted at the beginning of the year. It took a lot of short-term rate decline apparently [Laughter] and that is something that one might want to consider in terms of the prospects for achieving the further interest rate decline that we have forecast. Whether we would be where we are now if we had not had those cuts in short-term rates is difficult to say. On the one hand, we wouldn't have had the pull from those short rates punishing people who don't go out and invest at the long end. On the other hand, we probably would have reduced aggregate demand to some extent and lowered inflation expectations and tended to lower nominal bond yields. But we've been saying for some time that we expect the long rates to come down significantly over the forecast period.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. I want to ask Ted a question. I don't mean to try to put too fine a point on this, but it's just because I find today's discussions even more difficult than usual even though they're often very difficult. Ted, you mentioned the jitters in the markets. This links back to what Bill McDonough was talking about before. Do you see a difference in the jitters in the markets given their expectations of what we're going to do one way or the other? In other words, are the markets likely to become more or less jittery whether we act or don't act or is it pretty much center-weighted?

MR. TRUMAN. That's a very difficult question.

MR. SYRON. It's a very difficult situation.

MR. TRUMAN. I think that's right. In some sense this is the position we were in at the beginning of September when we had the bad employment report. Do you disrupt the market more by disappointing it relative to its expectations or do you disrupt it more by giving it

what it expects, assuming we have [assessed] the expectations right? We can guess, but our guess is not perfect. I'd just add one point from a rest-of-the-world perspective. It's one thing if we were just running our own situation. But one of the problems, which makes this a little different, is the uncertainty that has been generated by the European situation and the fact that that has not played itself out in all its political as well as economic dimensions. That does seem to me to add one small note of caution. I don't think it is decisive, but to the extent that Federal Reserve easing at this point disappoints Mr. Sapin again, he may have to cut off a few more heads [unintelligible] go forward. But I think that goes with the territory. That would be basically my response, but it is a possibility.

MR. PRELL. May I correct something I said? While the interest rate decline going out to 1994 is essentially the same amount as before, in light of the weaker economy over the next few quarters we've moved that decline up in time somewhat. More of it occurs quickly. So, on this forecast we have somewhere between 1/4 to 1/2 point more decline by next spring than before; then the rate flattens out more as the economy picks up.

MR. MCDONOUGH. If I could pick up on Ted's comment for just a moment: I think we have to recognize that the situation in Europe is still very unstable. So, something could happen in Europe whether we lower the fed funds rate here or don't lower the fed funds rate; it could have very little to do with what we do or don't do. But establishing that causality necessarily would be very difficult. I come to the conclusion that the foreign market does not inhibit the Committee from doing what it otherwise wishes to do.

MR. SYRON. That's precisely the answer. Thank you.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Well, speaking of what might or might not inhibit our activity, we've had several references this morning to the fact that expectations of further ease already seem to be built into both interest rates and foreign exchange rates. Yet we're within a month of the election and I thought it was conventional wisdom that we weren't expected to act so close to an election. But I never see any references to that anymore. Whatever happened to that?

MR. PRELL. I've seen a few, but I think the more predominant notion is that the recent weakness in economic indicators just seems to make a compelling case in light of the past patterns of behavior of the Committee.

MR. BOEHNE. It also isn't true. There are numerous examples of this Committee tightening within a month of an election, not just easing.

MR. SYRON. And given lags.

MR. MCTEER. Well, tightening doesn't affect our credibility the same way that easing might. We're usually accused of doing things to help the incumbent, I believe.

MS. PHILLIPS. But it's a long lag.

CHAIRMAN GREENSPAN. Any further questions for either of these two gentlemen?

MR. JORDAN. I have a couple of questions for Mike involving quotes from the Greenbook. Some of this may already have been covered in the questions and responses but I'm still looking. I have two different questions, really. One is about the linkages, the model that you use in assessing the effects of policy on the outlook. That's still not clear to me. On page 23 in Section I of the Greenbook it says at the bottom of the first paragraph: "The rise in short-term rates in 1994 is assumed necessary to prevent aggregate demand from gaining so much momentum that noninflationary levels of resource utilization are subsequently exceeded." There's a gap in there but also an implied linkage from nominal interest rates to GNP, I suppose; you've already responded a little to that in your answer to Tom's question. Then the Greenbook says: "Long-term rates are expected to edge down further as expectations of inflation continue to recede." So, the long-term expected rate of inflation is somehow influenced by observed actual inflation. Now, all of this taken together implies that real short-term interest rates are rising even if nominal rates are not. But you're saying that the rise in real short-term rates is not sufficient in your framework to keep the economy on a noninflationary path and so you need an increase in nominal rates as well as real rates since obviously inflationary expectations are coming down and real rates are rising.

MR. PRELL. We in essence have the real short-term rate moving back toward what might be regarded as more the equilibrium level in the longer run as we use up some of the slack in the economy to insure that aggregate demand doesn't overshoot a disinflation path. Our assumption is that we have reached further in the direction of relatively low real short-term rates, below what would be sustainable in the long haul. We have it coming back up some. Another factor in this is that we are getting some extra retardation in a sense in the financial sphere now from the credit crunch and other experiences in the financial system. As those ease, some adjustment in the nominal market and real market rates would be called for in order to exert adequate restraint on aggregate demand.

MR. JORDAN. Meaning further increases in real rates; the natural increase is not enough and you need further increases in real rates in your framework. But it also depends on a linkage between nominal interest rates and nominal spending.

MR. PRELL. Well, we're thinking of this more in terms of a link from real interest rates to spending decisions. And there's a whole dynamic here of activity and resource utilization and inflation; the inflation results do affect expectations about future inflation. That gets built into the bond yields and so on.

MR. JORDAN. Well, I know you have said that in your presentations from previous months and in the arguments I have listened to about inflation expectations, the inflation [component] in the long rates, and what's coming down based on experience. But when I talk to business leaders and people in small and large businesses regarding their inflation forecasts, or look at the Michigan Survey or

[that of the National Association of] Business Economists they have this persistent 4 to 5 percent inflation range or higher. No one mentions the gap between current [and potential] output or the unemployment rate. If they mention anything at all, they mention the budget deficit or they say: "I don't know, but that's what always happens--inflation goes up." But you are in effect saying that inflation expectations are going to come down, bringing long-term interest rates down in spite of these perceptions, [and] that eventually experience with lower prices grudgingly will dominate their view about [the effects of] fiscal impulses on inflation.

MR. PRELL. But I think it's not a sustainable relationship here to have inflation running at 2 or 3 percent and inflation expectations remaining at 4 or 5 percent. Something has to give: Either those inflation expectations will prove such a serious impediment to lower wage agreements and provide some momentum somewhere in the price system that we won't get the disinflation we have [forecast] or, as experience builds that the norm is not the 5 or 6 percent inflation we've experienced over the last two decades but 3 percent or 2 percent, there's going to be an adjustment. The experience to date suggests that the brute force effect of slack in the system has been able to overcome any stickiness in this inflation expectation that's evident in the consumer surveys or even many professional economists forecasts. Indeed, we pointed out over the past year that it didn't appear that the private economists were generally expecting inflation to come down further in the latter part of this year or 1993. I've seen a shift in that. I think there is more movement in our direction. We're still a bit ahead of the average in our expectation about the disinflation progress, but there is a change. Some of you have noted that businessmen increasingly are thinking that they are going to have to do their planning in a pricing environment that is going to be more consistent with lower inflation.

MR. JORDAN. But in this transition until the expectations of private decisionmakers come into line with where we think policies are taking inflation, we do have these very substantial transition costs on the economy. Does all of this suggest that you're not relying on any version of the P* model anymore in forming your inflation outlook?

MR. PRELL. Well, I will confess that we never did, [at least] on the straight P* form--though there are elements of the P* model that are very much consistent with our models. That is, the output gap there is the critical lever in lowering inflation, and that is equivalent to the aggregate model we're using. Obviously, the money growth numbers don't argue against our forecast; they argue for an even more rapid deceleration of prices. And if you believe that money is behaving in a normal way, then I guess you'd want to argue that we grossly [over]stated where the inflation rate is going to be in 1993-94.

CHAIRMAN GREENSPAN. Any further questions? If not, who would like to start the Committee's discussion? Bob Parry.

MR. PARRY. Mr. Chairman, economic weakness persists in most of the Twelfth District and it may have intensified since our last meeting. District-wide employment fell in August at a 4.6 percent annual rate, led by weakness in construction and manufacturing. Job losses have been most severe in California, where employment fell at a

6.2 percent annual rate in August and at a 2.1 percent rate in September, bringing employment in the state of California to a new cyclical low. Other District states also are beginning to show some signs of weakness. Previously robust growth in Idaho and Utah has [waned], with employment declining on balance since February. Cutbacks in aerospace production are affecting Washington, and the lumber and wood products business is contracting in Oregon in large part due to environmental restrictions. Both business contacts and statistical indicators of District activity give little evidence of renewed economic growth. The outlook for California is of particular concern. Already announced cutbacks in aerospace, defense, and state and local government, together with an overhang in commercial real estate, suggest weakness could persist well into 1993.

Turning to the national economy, our forecast is quite similar to that of the Greenbook. I would characterize our forecast as one in which the pickup in the economy, instead of being just around the corner, appears to be just around the corner and well down the block. In addition, once economic activity gets to that point it doesn't seem to be quite as robust as we had it before. That development produces greater uncertainty at least on my part. That combined with what appear to be better inflation rates in the offing suggests that a policy move at this time would be appropriate.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. There seems to be little disagreement in the views that I expect to hear as the go-around continues and the staff forecast. It does not seem to me likely that the economy is going to be substantially stronger than the forecast. Since I anticipate so much agreement in regard to the current state of the economy, it seems to me it would be well for us to continue the earlier discussion, which involved assessing how well monetary policy is working to accomplish any impact upon the real economy. Now, I for one have more confidence, I think, in Mike Prell's forecast than maybe he does.

MR. PRELL. You might think about whether it makes sense!

MR. ANGELL. My confidence is based upon the fact that he has produced consistently biased errors in one direction over the last three years. That seems to me entirely likely if you have someone who has some motive other than getting the forecast right or if the model is defective. And it seems to me it's time for us to examine more carefully the model that produced such biased errors. Let me go back to the Humphrey-Hawkins period and the July FOMC meeting: I think the pickup in M2 growth in August and September to a very slight 3 percent rate was due more to the declines in intermediate rates, which were almost unprecedented, following the Humphrey-Hawkins testimony in July. We had dramatic declines in two-year, three-year, five-year, seven-year, and ten-year Treasury rates, and that seems to me to account for the rise in M2. Now, I would hold that lower fed funds rates under some conditions may well reduce aggregate demand and that under some conditions lowering the fed funds rate may very well cause intermediate rates to rise. Under those circumstances it seems to me that M2 will grow more slowly rather than more rapidly and we will then end up with unintended consequences.

But to me the most important point is not necessarily to look at the [transmission] mechanism through the fed funds rate on M2 but to look at it in terms of its impact upon household balance sheets and on household income statements. I believe it's time for us to devote a great deal of attention to the question of the duration of household assets and the duration of household liabilities. If households have taken [on] a huge interest rate debt and if the duration of household assets were conditioned by a period of rising interest rates or an expectation that interest rates would rise again and if households then are holding very short duration assets, under those conditions a fall in the fed funds rate is going to result in a substantial reduction in household income. Now, I do not know what the duration of household assets might be by looking at their flow-of-funds. I don't know whether anyone knows what that duration might be. What I'm suggesting is that there may be some conditions under which lowering the fed funds rate is not going to work the way we'd anticipate. Since we have watched the fed funds rate come down from 9.90 percent to 3 percent--that's 690 basis points--and it has had less than the intended effect upon credit and upon spending, then it seems very appropriate for us to look again at this model.

Now I'm going to live a little dangerously: I think I disagree with Bill McDonough's comment that the foreign exchange market does not in a sense have an implication for our domestic monetary decisions. I would agree that a reserve currency country does not take its cues from trying to follow somebody else's exchange rate. But it seems to me that the dramatic fall in intermediate interest rates in July and August put the spot foreign exchange value of the dollar on a downward course, unless the implied forward rate of the dollar were rising faster than those rates were falling. So, we have to ask ourselves then: What will happen if we reduce the fed funds rate at a time when the foreign exchange value of the dollar may be at a precarious point? It seems to me that making a fed funds rate move might very well feed into a weaker dollar. I think all of us must understand that we have a very exploding global money market condition; we have almost pure competition in this market--not perfect because information is catching up--but it's exploding also. So, with this very perfected money market that is global, we have to look at the feedback loops that possibly exist between the fed funds rate and its impact upon the weaker dollar and its subsequent impact, which could very well cause intermediate rates to rise. Indeed, if the implied forward exchange rate is to remain constant, then under those circumstances lowering the fed funds rate [and] lowering the two-year Treasury rate, has to raise the implied forward rate at years 9 and 10; otherwise we're going to be out of adjustment on the forward rates. So, I believe we're in a precarious place here. One of the good things we have going for us in an economy that needs growth is that the U.S. equity market has not yet taken a tumble. But I think most are very leery concerning where we are here.

My assessment, then, of our current economic condition is that it is a global-money capital-market-driven relationship. We have gone a long way. And I am not optimistic about the impact of lowering the fed funds rate at this point in time in terms of stimulating economic growth. Now, if we are willing to make our fed funds rate moves based upon price level targeting and if everyone knows that's the basis upon which we're making our moves, then it seems to me that under those circumstances we could very well expect in the future that

lower fed funds rates will provide us more bang for the buck. So, I'm in a mode of saying that there may be lower fed funds rates out there that will be helpful in the future if we are on the path that Mike Prell has suggested toward price level stability. But the question for us is: How do we get the most bang for the buck?

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. The latest national reports--especially that of the National Association of Purchasing Managers, the employment figures, and the downturn in consumer expectations--have been very disheartening to say the least. In light of those reports, I think the staff was correct in lowering its projection; what they've done seems pretty reasonable to me. But I don't think anybody really understands why we are getting this persistent weakness in the economy. In such a case it looks to me as if the risks of error on any kind of forecast are very high indeed. I would be more hesitant to guess which way the risks of error might lie in this particular period of time.

I do take a small measure of comfort in the most recent information we have gotten from around our District. The economic picture may not be as bleak as suggested by the national data; some of the District information is [more current]. For example, reports of our directors at the September meeting certainly did nothing to suggest that there would be any further decline in business activity in their view in our District. The same is true of the reports that we got in our regular survey of manufacturers and retailers. In fact, that survey actually suggested a slight improvement in a number of areas such as retail sales, manufacturing, business sentiment, and residential real estate. And I think the recent growth in bank credit and money also presents at least a ray of hope about the future. Indications that loans are now more available, as reported in the Greenbook, are pretty well consistent with what we are hearing in our District through anecdotal information. While the 3 percent rate of growth in M2 in August and September is lower than I would like to see at this point, it's a big improvement over the negative rates of growth that we had for the previous five months. I hope this could be the beginning of some sustained period of higher growth.

Insofar as the inflation forecast is concerned, as you know, the Greenbook is showing a decline in the CPI down to a rate of about 2 percent by the end of 1994. That seems reasonable to me, given the sharp deceleration in money growth that we've had over the last several years. If we were to achieve this low inflation rate, however, then I think we have to be prepared if necessary to let the federal funds rate rise rather quickly when economic activity and the rate of growth of money do speed up, although I hope what Governor Angell described is really what will happen in that case. I'll return to this point later when we get to the policy discussion.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, conditions in the District have not changed that much since the last meeting. While the trends are somewhat mixed, I think on balance the overall rate of economic activity has moderated; and certainly attitudes have deteriorated further. The auto industry and all auto-related activities are

weaker. Third-quarter sales were lower than the industry's earlier expectations and the sales forecasts for the fourth quarter have already been reduced and, I think, still may be on the high side. As a result, fourth-quarter production plans are steadily being reduced. At one point, the fourth-quarter schedules were significantly higher than last year--though last year was a weak comparative period--but by now they have been scaled back and are only about 4 percent over last year's level. Again, I think the production risk is on the down side.

Farm equipment sales and manufacturing continue to deteriorate. The sales of major [farm equipment] units for the year through August are off 18 percent from last year and off 24 percent from two years ago. One major manufacturer has reduced its fourth-quarter production schedule again and is now planning fourth-quarter production that is 21 percent below last year. Other parts of the manufacturing sector in the District, however, continue to expand but, again, the growth rate has moderated. Orders for Class 8 trucks, the big trucks, are running some 25 percent over 1991. But in the last 30 days there has been a perceptible change in the attitude of major truck customers, and the manufacturers are now concerned that this [orders trend] might turn around quite quickly. Therefore, their confidence regarding the rest of this year, but more importantly for 1993, is not very strong. Medium truck sales, Class 6 and Class 7, are about level with 1991 and no improvement is expected. Offsetting this, though, housing activity in the District continues to show strength. New single-family home sales in the Midwest rose 15 percent in July and continued to climb in August. Home starts also were strong and that strength is carrying through to the manufacturers of building materials. In the retail area, sales continue to run about 6 to 8 percent ahead of last year. Customers, however, as I've commented before, are very, very price conscious. And retailers who import a good deal of their merchandise are continuing to have to raise prices to reflect the plunge in the dollar. Finally, in the agricultural sector, I think crop production is going to bring very good news. We're clearly going to have good crops--indeed, perhaps bumper crops--in both corn and soybeans. Prices are way down, but we're going to have very good production.

In the inflation area--price pressures--the news continues to improve. Intense competitive conditions are continuing to restrain price increases and many manufacturers are holding the increased cost of their purchases to very, very minimum levels. In the case of a couple of large manufacturers, they have actually been able to accomplish reductions in their purchase prices on a year-over-year basis. But at this point inflation is just not an issue, certainly among the people I talk with, and they are growingly disturbed that they just can't get price increases to stick in the marketplace. In turn, they have worked [to hold down] their purchase prices, as I suggested. In the labor area, contracts continue to be settled on what I think are very favorable terms.

In a national context, I find the overall economic outlook increasingly worrisome. [The economy has remained] a long time in this very steady state--I think perhaps too long--and there is a real risk at this point that [the expansion] will lose momentum. We continue to reduce our growth forecast and are now down to a point that the sustainability of even the current very moderate rate has to be open to question. In this environment, despite the policy easing

moves that we have made, the risk of the economy taking off at such a rapid rate as to cause strong inflationary pressures seems pretty close to zero. But I think the risk that the economy could fall back into negative growth is very real and is increasing with the passage of time. Therefore, in a monetary policy context, I think we ought to move again as early as we have the opportunity to do so.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, leaving aside the effects of Hurricane Andrew, conditions in the Sixth District appear to have stabilized in the last six weeks or so. That, of course, represents a change in our situation because, as you remember, I've been reporting for some time that we've had considerable deterioration in economic activity in the first half of the year, particularly on the employment side. I hasten to add that the improvements that we're seeing are very marginal in nature, although I would say that the outlook does seem a little better because the imbalances in our local economy are not quite as evident as they were at the beginning of the year.

Looking at some particular sectors, residential real estate is expanding modestly and we're getting reports from realtors in several cities that they experienced higher sales of single-family houses in September. Rents appear to be firming in the District, although multifamily and commercial building rents are flat. Construction of industrial facilities is rising, basically because, interestingly, the vacancy rate in the industrial sector in our city is below that of the national market. We recently completed a survey of manufacturing plants and that survey shows some improvement in August, with more respondents reporting gains in production as well as in shipments compared to July and compared to a year earlier. On the other hand, the survey does show some softness in capital spending and expenditures; they are going to be confined apparently to productivity enhancements as opposed to plant expansion or expenditures on equipment. Our unemployment rate continues to be above the national average. In terms of individual states, Florida has been hit pretty hard, of course, not only by the hurricane but by defense cutbacks and very slow in-migration. Louisiana and Mississippi are being impacted adversely by weakness in the energy sector. Despite this poor employment situation, retail sales have increased modestly but I guess the [operative] word there is "modestly." We, too, Governor Lindsey, are seeing sharp increases in the number of foreign visitors to the District; that has been going on for some time but has accelerated with the weakness in the dollar. However, the recent hurricane in Florida has caused tourism to be off there not only in the impacted area but throughout the state as well. We see bookings off, for example, in Orlando where the hurricane didn't hit. As we noted in our special report on the hurricane, the District will at least temporarily be a beneficiary of the hurricane in the near term because of the concentration of industries throughout the District that are related to housing and construction. Finally, we see no inflationary pressures and no price pressures at all in the District.

Looking at the national economy, like the Board staff, we've lowered our forecast of real GDP over the balance of this year and into 1993, although perhaps not by quite as much as the Board staff. On inflation we're pretty much the same in the near term. So, basically we're comfortable with the staff's forecast, although I

don't feel very comfortable about any forecast these days and haven't for some time. It's difficult for me to see sources of improvement in the economy anywhere in the near term. The outlook for growth abroad has deteriorated steadily and certainly it's not being helped by the volatility in the foreign exchange markets and the recessionary trends in the economies of many of our trading partners. Of course, as we have talked about several times, we are seeing the restructuring of balance sheets both on the part of households and corporations, but it seems to me we have a long way to go. A continuation of that process is going to temper spending for some time longer, I think. From people that I talk with and from what I'm observing in the press, people are very concerned and very pessimistic about the state of the federal budget deficit. I think they are expecting tax increases to deal with that situation and that, too, is going to crimp incomes in the 1990s and beyond and certainly crimp spending. When I put all of that together, Mr. Chairman, it seems to me that the risk is very much on the down side; and we need to take that into account as we deal with monetary policy.

While I have the floor, if I could go back to the hurricane for just a minute--though this is really a non-FOMC matter--I'd just very quickly like to say what I've already written to most if not all of you: The people in Miami and certainly we in the District appreciate tremendously the wonderful outpouring of support of all kinds that came from around the Federal Reserve System. If ever the family spirit of the System was evident, it certainly was in this period. So, we thank you very much.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Conditions in the Philadelphia District are mixed, but on the whole I think they've deteriorated some in recent weeks. The major source of that deterioration has been in manufacturing. Manufacturing was a source of some uplift to the District economy in the first part of the year, but in the last couple of months manufacturing activity has slowed and I think it has now become negative. Despite continuing employment declines, which have been sharper than for the nation as a whole, particularly in New Jersey, retail sales have held up fairly well. They are not great but they are probably running a little over a year ago. In the construction area, I have nothing to add; nonresidential construction continues to decline and [sentiment] is very sour. There is some improvement in residential construction.

One of the additional changes, besides what is happening in manufacturing, is that while I would have summarized the condition of our banks until fairly recently as marginally bottoming out with some hints of improvement, I wouldn't be comfortable saying that now. I think more of our banks are deteriorating than improving. If we probe the bankers on that, we hear a number of reasons. For one, they say that a number of small and medium-size businesses that had held on through this period of slow growth are running out of string and are just dying. That is showing up in loan delinquencies and loan defaults. Some of the banks are able to cover [the resulting losses] because of their spreads; and they've lowered their other costs. But the deterioration is clearly showing up, and I think we're in for a period of some additional deterioration.

Attitudes, I think, are worse than the underlying conditions. The Mason-Dixon line makes a big difference! Our September meeting was about as pessimistic in terms of director attitudes as I have seen, reflecting this cumulation of slowness and not much prospect of getting better. As with other Districts, inflation outside the health care industry and the regulated industries is largely a non-issue. It is just hard to make price increases stick.

As far as the national economy goes, its growth is basically stagnating. I think we have about as much chance of getting some modest declines in growth as we have of modest increases. There just are no sustainable drivers. The employment-income-consumption dynamic is missing and it's very hard to see where we're going to get the thrust. Despite that, I have found this current period more difficult in thinking through monetary policy. I believe any of us sitting around the table, if we're at all objective, could come up with some good reasons to ease and some good reasons to stay where we are. I come down on the side that some good would come from some additional easing. So, I'm in the camp that thinks we ought to ease monetary policy--not that I think it will do great things but because I think at the margin it will be positive. Also, it's important that the Fed as an institution be viewed as doing whatever we reasonably can to help the economy get out of the swamp. Some additional easing in monetary policy would fall into the column of something we can do that is reasonable and I don't see a lot of downside risks in that.

CHAIRMAN GREENSPAN. President Melzer. I'm sorry, President Syron.

MR. SYRON. I'll cede.

CHAIRMAN GREENSPAN. There's nothing to cede; it's just my mistake.

MR. SYRON. I don't know if there's anything dramatically new in our District. What may be not dramatically new, consistent with what other people have said, is that there is a deepening disillusion and fear being reflected in consumption and other things. It's not panic, but fear is the word that unfortunately is [applicable] I think; I suppose [it reflects] regional problems; considering our employment is down 10-1/2 percent from the peak, that's not greatly surprising. Manufacturing over the period since the last FOMC has turned somewhat more sluggish. That's tied largely to the aircraft and the auto industries and to the problems we have that are endemic to the local computer industry and their competitive niche. Retailing is mixed. Value price retailers report some strength on mixed sales. Actually, an interesting phenomenon is that they're reporting a willingness to hold inventories longer, given the reduced costs to carry. But upscale retailers are reporting that sales are pretty poor. Auto sales are soft and that has gone on since the last period. The one sign of strength that we have seen is in the housing area for first-time home buyers--low-price houses are being built--but there has been a slowdown again in [sales of] upper price houses. Prices are very well behaved. We hear these stories about plywood prices-- I'm sure everyone does-- and the pickup trucks heading down Route 495.

As far as the U.S. economy goes, I find myself as usual in broad agreement with the Greenbook forecast. I'd quibble slightly

with some elements of it. Given the employment information we have, for the output that is in the Greenbook I think we might have an even slightly higher unemployment rate. But I do believe the forecast itself is internally consistent. There are risks, obviously. We've been on the low growth path for quite a long period of time; and we don't know what shocks or episodes could come along and knock us off this path from one side to the other. We see some of that potentially happening and then reversing itself in the stock market. Also, I personally believe that there's a lot to this headwind argument--that this is a rebalancing of people's internal balance sheets. But it's very hard, even though we see improvement, to know what the new optimal balance sheet is that individuals and even corporations have in mind, given that many of them have been through a quite frightening period.

At the end of the day, what this comes down to for me is that while many of us usually say we generally agree with the Greenbook and could be fairly comfortable with the outcome in the Greenbook, I have to say that I'm pretty uncomfortable with the outcome in this Greenbook. Looking at the third quarter next year, we still have an unemployment rate--and, as I say, mine would be slightly higher--that is hovering just below 8 percent and we haven't gone through 3 percent [GDP] growth. I think in its broadest terms this is just not going to be an acceptable outcome. Unfortunately, again repeating what other people have said, I just don't see the engines that are going to bring us away from this. So, I think we're in a very, very difficult position. I'm sure--"sure" may be a little strong--that we will see some sort of fiscal package regardless of who wins [the election]. I don't think that's something that we should be weighing in our calculations, so we're in a very delicate position. My sympathy, like Ed Boehne's, lies with doing something more. The only thing that would dissuade me in that sympathy is a strong argument that the credibility of the organization would be hurt by our doing something close to an election. I personally have a lot of skepticism about that argument because we're so close now and the lags are [long], but it's something I think we should discuss a little in the general monetary policy discussion. Thank you.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. In the District there has been a discernable but I would say small improvement in activity since the last meeting. Consumer spending has improved a bit; residential construction and sales of residential units have picked up; forest products seem for the most part to be doing reasonably well, getting a little additional kick from the hurricane. It has been a good year for tourism both from domestic and foreign tourists. And unemployment rates in the District have continued for the most part to be well below the national average. Agriculture is mixed, depending on the weather. Perhaps the only real sign of weakness is in mining where some recent layoffs have occurred up on the iron range in northern Minnesota. Despite this further improvement, I'd say attitudes remain uniformly cautious. I wouldn't describe them as particularly discouraged, but people are cautious. I don't think anybody is expecting a sharp change for the better in economic activity.

I came across the same sort of concern about interest rates that Ed Boehne expressed earlier. There does seem to be a view that

interest rates are going to go back up, perhaps significantly, at some point in the not too distant future. I don't think it's tied to any expectations one way or the other about changes in monetary policy. I don't think it's tied, at least not very directly, to expectations about an acceleration of inflation. It may in some instances be tied to people's assessment of the budget. But it's mostly that people, in their business experience, view rates as unusually low today and they don't believe that these rates are going to be sustained. The analysis essentially stops there. It's basically a judgment about what is typical.

With regard to the national economy, we are all emphasizing the very weak and disappointing statistics that we've received over the last month or six weeks. That is reflected in the forecast and I think that's fully understandable. On the other hand, if you go beyond the latest statistics--and, of course, we can't do anything about them--and look at the financial variables, if anything they look a little better. M2 growth has moved back into the positive range. Bank credit and business loans at commercial banks seem to have picked up a bit and we hear some anecdotes about greater availability and more aggressive searching for customers on the part of bankers and others. If we look at bank reserves or narrow money, we see very rapid growth, and I would say that this is something we need to keep an eye on as we go forward.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. At the last meeting I reported that our picture, which had been generally positive on the employment front, had weakened a bit. That would be the case in the most recent period as well. We have modest declines in employment, more in manufacturing than nonmanufacturing. Earlier on, gains in nonmanufacturing were really offsetting the weakness in manufacturing. Notwithstanding those numbers, I have not detected any significant change in attitudes among directors and other people I talk with. Last week I was in two areas of our District that probably have never seen a recession, as a matter of fact. Many businessmen I talked to--these tend to be small and medium-sized businessmen--are reporting record years and yet they just feel lousy. Their complaints run to things like regulation, clean air, ABA, and things like that and the impact those things are having on them. There's a great deal of uncertainty or lack of confidence--I don't know how to describe it. It's just a not good feeling about where we're going or a lack of knowledge or confidence about where we're going. And that, I think, is really affecting people. I picked up the same thing we've heard from Ed and Gary: Very seldom does anybody say that additional interest rate cuts are going to help; in fact they say quite the opposite.

On the banking side in the Eighth District, as I've commented from time-to-time, our numbers still are looking very good. We are outperforming our peers. We tend to look at banks of less than \$15 billion and I guess the most significant point is that nonperforming loans are lower--about 1-1/2 percent versus almost 3 percent in the peer group--and charge-offs are half that of the peer group, maybe 1/2 of 1 percent versus 1 percent. I think that's the principal thing affecting results. So, all during this period I've perceived our banks to be in a position to extend credit and I've felt that demand has been the problem, not supply. We've seen modest growth in loan

demand over the last year and that has continued in the most recent period. The most significant point is that it's across the board this time around. We've all read articles recently about the increase in [banks'] securities portfolios. Over the last year those have grown about 18 percent in our District but in the most recent quarter only 2 percent. So, I sense that what is going on--and I don't know whether it is a harbinger of things to come more broadly--is that with a healthy banking sector we are beginning to see a little more loan demand, which is being reflected not only in the loan growth but in much slower growth in holdings of investment securities. Probably, in terms of the aggregates, as demand picks up that will get reflected in M2. As you all know, the non-M1 components are really very weak--negative--and all the growth we're getting in M2 is from very rapid M1 growth.

Commenting nationally, the one concern I have about Mike's forecast is the longer-run inflation outlook. I hope he's right. I have no quibbles with what inflation is likely to be next year and maybe well into 1994, but the lags here are very long. And one of the things I've commented on from time-to-time is this trend growth in M1, which is a 3-year moving average. I don't think we can make short-term policy decisions based on the short-term behavior of M1; but over longer periods of time it gives us some information on what the thrust of policy has been. From, say, late '86 or early '87 we had brought that trend growth down from 11 percent to roughly 3 percent. In early 1990 it moved up in a relatively short period of time to over 7 percent and, of course, M1 is growing at about 15 percent now. Again, I don't know that it has any relevance for decisions we'll be making today but longer term I worry about whether or not we're trading away some of that basis for lower inflation that we had created several years ago and that we're reaping the benefits of now.

Just a couple of other comments, quickly. One has to do with market expectations and whether we should gratify them or not because they're there or whether that gives us room to move. I think we have to recognize that when this party comes to an end, whenever that is, it's going to be disruptive. In other words, we've had a long period of declining interest rates and human nature, being what it is, is going to anticipate more. That's just the way behavior in markets tends to work over time. So, whenever the time comes for us to say "that's it," it's going to be difficult. I don't think that will ever be easy. The other general observation I would make is that I'm more sensitive about the risks in foreign exchange markets, [along the lines of] Governor Angell's comments, than what I've heard in general around the table. I just feel that that's a process; we learned this in the mid '80s. Monetary policy was very stimulative for a long period of time and the chickens really didn't come home to roost in the foreign exchange markets until '87 as a result of actions that were taken in '85 and '86. I think we all know from that experience that once they do, it's awfully hard to get them under control again. While it's easy to say that another 25 basis points may not engender any kind of crisis, if it ever did we would have one big problem on our hands.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. We haven't detected much difference in the Eleventh District economy from the last time I reported. We still

have a positive but very flat growth trend. I believe it would put us in the top half of the Districts, though, or maybe even in the top third. Employment is still growing, largely because of government employment growth. Private sector employment growth is essentially flat; the employment growth we get is in fits and starts. The weakest sectors of the economy are energy and durable goods manufacturing. Residential construction has flattened a bit in recent months as well. The strong part of the economy, of course, is along the Mexican border, especially in retail sales. Governor Lindsey mentioned that this country may be in the process of becoming the world's Wal-Mart; ironically enough, that may apply to the Third World as well as the rest of the world. I learned this past week that McAllen, Texas, along the border, supposedly has the two most profitable Wal-Mart stores in the country. It has a mall with reportedly the highest sales per square foot of any mall in the United States. All along the border retail sales are higher than personal income. So, we are doing a lot of retailing to the Mexican customer there. Symbolically, although it's of no relevance to monetary policy, we just gained the headquarters of Southwestern Bell from St. Louis. They are moving their headquarters to San Antonio. One of the main reasons they gave for that move was to be closer to Mexico because of a joint venture they have going with the Mexican telephone company.

I've been engaged in a series of eight meetings with bankers around the District to talk about various issues and see what is on their minds. Tomorrow will be the eighth of those. It was scheduled for a room in a hotel in San Antonio. We're being bumped from our room so that Presidents Bush and Salinas and Mr. Mulroney can sign the NAFTA agreement; we're going to be pushed down the hall from that little exercise. The mood of the bankers is very negative; they're focused almost exclusively on the regulatory burden and what is coming at them with this new FDICIA legislation. When you talk about a credit crunch with them, they associate that with supply constraints and they deny that there is any credit crunch when they [look at] it that way. They attribute the flatness in lending almost exclusively to weak demand for quality loans. On the other hand, in other conversations with them when we are talking about the regulatory burden, they seem to be saying that lending is flat in part because it has become much riskier to lend and a lot easier, and just as profitable these days, to invest in government securities. So, lending is still very flat in the Eleventh District after all this time of healing. I guess the lesson from that is that even after measures of bank health improve, and have been improving for a long time, it's still a long time before that results in additional lending. Most measures of health in banking in the Eleventh District have been improving for quite some time and now stand significantly above those in the rest of the country. If you look at the bank loan situation from the point of view of potential borrowers rather than from bankers, up until a few months ago they did believe that the credit crunch was more than weak quality-loan demand; they believed it was supply constraints from the banks. But there have been reports now for two or three months that that is changing. They are reporting that bankers are out there soliciting loan business to a much greater degree than they were previously.

From the tone of meetings of our directors and small business advisory councils and others I'd say that the mood has deteriorated a little over the period since the last FOMC meeting. And based on what

we all read in the press more than anything that has been happening locally, our reading of the national economy is that it is much worse off than the local economy. Also, we have no disagreement with the Greenbook forecast.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, I find the incoming statistics very disappointing, particularly industrial production, new orders, purchasing agents' reports, consumer attitudes, and housing starts. On the other hand, the monetary aggregates look somewhat healthier, or perhaps less sick is the right way to describe it. Bank credit apparently has begun to grow again, although certainly not ebulliently. Attitudes are being affected by media expectations of instantaneous increases in employment and decreases in unemployment to reflect what is going on in the economy. The predilection to dwell on gloom and doom is exemplified by the way they deal with headlines in any economic article. A good example is recent articles predicting masses of bank failures and estimates as high as \$80 billion of assets in the banks that are due to fail over the next six months. They emphasize all of that instead of talking about the much stronger earnings and the much healthier capital ratios that are typical in the industry. The increasing uncertainty about our political future I think is a major factor here. With neither party candidate for president offering a credible program for dealing with the nation's problems, I'm more convinced than ever that the current partial paralysis of the economy will continue until after the election and that the expected clarification of what the future holds [will be delayed].

In that kind of environment, I doubt that short-term interest rates lower than those already in place will have any stimulative effect. I think this is a time to say that the inventory in the candy store is sold out; we should hold steady where we are to allow the full effect of the previous easing and rationalize the attitudes on the part of consumers to stimulate more vigorous growth. Furthermore, the risk of additional chaos in the foreign exchange markets and the possible rekindling of long-term inflationary expectations is real in my mind, and it can only be avoided by keeping with our present stance.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, as I reflect on the period since the last meeting, it seems that a lot has happened but very little has changed. That may be the one thing that makes this meeting so difficult for me certainly, and maybe for most of us. We've been over all this; we're still struggling with a recovery. I guess technically we're about to have to call it an expansion. We should have crossed over into new high ground during the third quarter by almost any expected growth rate, for whatever that's worth. We're certainly stretching out--forever it seems--the expected time to break out. On the good news side, the inflation news seems to keep improving. I believe the restructurings that have been going on, financial and otherwise, have been the big story of this situation and have been the cause of this stretch-out we're going through. They need to be allowed to go through to completion. I think it's very important for the long run that this be allowed to work through. We've made a lot

of progress and I think policy has been about right in balancing the need to get inflation down, the need to allow these restructurings to continue and be completed, and the need to maintain something close to a decent economy in the process. I still believe all those things. But, as I said last time we were together, at some point this has to be completed. At some appropriate point we need to see some solid progress. Otherwise, as has been indicated this morning, we run an increasing risk of having this sluggishness begin to feed on itself. And if indeed inflation is meaningfully lower than we're measuring it, we may slip into deflation without realizing it and that might turn out to be as hard to stop as inflation was.

I'll breathe easier--I guess we'll all breathe easier--when we can generate some sense that there's an inertia of motion that is beginning to take over from the inertia of risk. I don't get that sense yet. Certainly, in the key area of employment, there's no sense of any dependable improvement. Another issue that's beginning to gnaw on me is: What is going to mark a completion of this restructuring process? Dick Syron touched on this a few minutes ago. Where is the new equilibrium going to be? I've looked recently at debt service ratios both for households and corporations--debt service relative to income and in the case of corporations relative to cash flow--and both of those ratios are falling rapidly. But if you look at their history back to, say, 1960 or so, it's hard to identify any natural support levels. There is no easily identifiable equilibrium that one could say: "When we get to this place we're going to have it made and it will balance out." There was no equilibrium at all in the '80s; it was just a steady increase in these burdens. In the '70s there was something that might be called an equilibrium level, but it was at a considerably lower level than where we are right now. In the '60s, when there was some equilibrium for a period of time, it was a good deal lower on both of those measures than where we are right now. I can envision, I'm afraid, that we could easily fall back to that '60s level given the psychology that seems to be abroad in the land right now. If that's the case, it might imply that we have a long way to go indeed. I have to say in candor that I've been relatively comfortable so far, but I'm beginning to experience the first faint cringes of impatience. As time goes on, I'm a bit more ready to see some signs that we are getting through this and I don't see them yet. That's beginning to make me more nervous than I have been heretofore.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Looking at the data--they've been pretty well discussed by a number of people--it's clear that our annual fall-winter swoon seems to be in full flower; it seems to be an annual event.

CHAIRMAN GREENSPAN. It has been only two years.

MR. MULLINS. Actually, one could say 1990 was not a walk in the park. To me the data coming in are pretty consistently negative. I thought the September employment report was worse than the August one because of the collapse in hours and the implications for personal income, spending, industrial production, and the like. And virtually all the indicators for the real economy at least seem to be pointing south. The Greenbook has translated this into 1 percent growth, roughly speaking, in the fourth quarter. We can't really do anything

about that fourth quarter to speak of here, although we might think about the implications of the fourth quarter on attitudes and spending as we move into the quarters we can affect.

The question has been raised a number of times: The Fed has gone from a fed funds rate of almost 10 percent in '89 to 3 percent now and where is the impact? I think there has been an impact. One can see it most clearly in the broad statistics on the banking industry; when you look at the entire industry compared to the fall of 1990 I think it has improved dramatically. As Ed Boehne pointed out, though, there is a segment--and that segment is an economically significant one--which is finding this period quite difficult. We don't need to go through the statistics, but I asked at the briefing the other day about the market value to book value ratios for the top 50 banks. In December 1990, it was about 85 percent; they were showing 85 percent of book and now it's 150 percent. So, I think there has been a big improvement there. I believe the corporate restructuring is going quite well. In fact, corporations are issuing commercial paper again, which suggests that they are moving right along. The consumer side is the difficult side because consumers, unlike banks and corporations, can't issue equity. And they have a long, tough process. They've reduced debt burdens but it's not clear to me that the principal of the debt has been reduced. So, I think there have been benefits but primarily in cushioning this process and moving it along. One only has to look at the experience of economies that are going through this de-leveraging process without the benefit of a responsive monetary policy. The UK would be a prime example; they've had more than two years of negative growth and 10 percent unemployment. There are a number of economies like that, and I think there but for the grace of monetary policy goes the U.S. economy. Indeed, when you look around--we had a staff review of the industrialized economies around the world--the United States looks like the fastest horse or the best horse on a very sloppy track, and it's getting sloppier all the time. I think monetary policy can be credited with the fact that we haven't had a very severe situation here. I know all of this is cold comfort, but I think it's hard reality, and I'm glad I'm not running for election in this campaign. We just have to admit that this restructuring process is severe, persistent, and long-lived and, indeed, for a consumer with excess debt, there's no quick and easy fix. It just takes a long time of diverting resources to pay it down. People are comparing this with short-term cyclical adjustments [but] as has been suggested, the process is long and severe. And other countries are learning that as well.

The next question is: Would additional rate cuts have any substantive beneficial impact? It seems to me that there are sound reasons for believing additional actions would be beneficial--beneficial to the growth of M2, which is still weak. We'd certainly get another prime rate cut. We're right on the cusp of a prime rate cut, and I do not expect that to unleash a wave of borrowing and spending. It may be helpful to reinforce this recent very modest uptick in borrowing, but most pertinently it would reduce the debt burdens on firms and on individuals who have home equity loans tied to the prime rate. Moreover, those who analyze the outstanding stock of mortgages at different interest rates project that a lowering of rates would ignite yet another significant round of mortgage refinancing. And, of course, the market expects and seems to have priced in

additional action, so it wouldn't surprise anyone. I might add that just because I believe the next shot will be a potent shot does not necessarily mean we should fire it. Indeed, I'm not so sure about the [potency of the] shot after that and it might be nice to have a potent shot around. I think the timing of any additional action is difficult.

While the real economy is clearly decelerating and the deceleration has momentum, we do have a substantial slug of ease in the system. The fed funds rate is down 75 basis points over the past three months. As Governor Angell pointed out, the 30-year bond is down 50 basis points. The 10-year rate is down 100 basis points in the last three months. The dollar has fallen. We've seen some pickup in M2; even with a yield curve adjustment, it's still probably below our lower bound, but that deceleration has stabilized. And we have the slight hint of a pickup in credit demand. Business loans at banks and at finance companies, commercial paper, and the debt aggregate all have shown some stirrings. Now, of course, this could simply reflect a financing of the modest backup in inventories, but I would hope that is not the case. So, we have some stirring in both money and credit growth and we also already have a refinancing boom in full flower now both in the corporate sector and in mortgages. So, I think we do have some countervailing financial force already at work against the real economy. And there is risk in moving in the current environment on the currency side as the dollar has fallen to new lows. So has the long bond rate. So, I think it's difficult to argue that this has ignited inflationary fears or flight of foreign investors so far. But if we should move, I would acknowledge that there is some risk of destabilizing the dollar. The hot money speculators are bulging with profits from their European escapades. And if they did start an attack, who would stop it? Who would stand in the way of a run on the dollar? The Administration has not evidenced any strong concern over a weak dollar. Central bank intervention has not been impressively efficacious in recent weeks, to understate the situation. So it seems to me that there is some chance, however remote, that we could have a problem there, and that would be disruptive. I agree with Tom Melzer that it might be difficult to get the genie back in the bottle because this [move] would be one which would infect the bond and stock market. And that argues for a little caution. So far it hasn't affected the bond and stock market as far as I see. And, of course, there are other potential shocks and uncertainties looming in the pre- and post-election periods. All of this argues for [some] caution and saving a little ammunition.

There is also, of course, the very real risk of going too far. This will turn around some day. I have no persuasive evidence to support that statement [Laughter], but I do believe this will end. Given the lags associated with monetary policy and the risk that headwinds could become modest tailwinds, we should not overreact to pessimism on the real economy. Nonetheless, given the weakness in the real economy and the need to reinforce weak growth in money and credit if the current trends continue, we likely will be confronted with a persuasive case for a rate cut. Indeed, I think the case is fairly persuasive now. The timing and execution are difficult. I tend to think it has been quite useful that we haven't moved in the past few days. Nevertheless, there's some danger in being too cute on timing and losing momentum--and the momentum we have in the aggregates is real--and risking a severe deterioration. We may be able to avoid a

rate cut if things start to firm; the timing of additional action is difficult and we need to discuss that. In my own mind the appropriate policy stance is clear. We ought to lean very hard toward additional action and be prepared to ease if confronted with more disappointing forward-looking data.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Our District continues [to expand] at a very modest pace overall and employment is up just a little over last year. The agricultural sector is flat; there may be a little decline in [farm] income, even though crops are good, because prices are less robust. Manufacturing is basically flat. Our aircraft industry is suffering because of the reduced demand overseas. Our manufacturing of autos is either flat or there is significant [unused] capacity. So, there is not a lot of activity there. As far as construction goes, the residential sector is still strong throughout the District and in some areas the nonresidential sector remains good. In the energy sector, the movement in natural gas prices is in a sense positive. I think more fundamentally than the effects of the hurricane there has been an improving trend; supplies have been brought into a little better alignment with demand so prices are increasing nationally. In talking to people in that industry, though, they say if that were to continue, they wouldn't really have resources until sometime next year, so that's not an immediate pickup for our District at all.

On the national scene, we have no real differences with the Greenbook. We're not quite as pessimistic for the fourth quarter. Fundamentally, we're looking at the negative numbers and adjusting our projections of real activity down a little. Also, like the staff, we do not expect inflation to be a major problem.

With regard to policy considerations, I have to admit I'm a little more ambivalent about easing than I was last time, partly because we have talked to business people, as others of you have, and they're saying that interest rates are not a problem right now. We don't need it, given the other aspects of the economy and the so-called headwinds we've talked about. Credit growth is a little better and I have some concerns about the foreign exchange situation. But on balance I'm personally still comfortable with easing because we are looking at a continued [sluggish] and maybe even weakening economy. And while I say that credit is improving, it's still weak in every way. The monetary aggregates, M2 and so forth, are still weak by every definition. And price inflation is not at this point a major issue; we don't see inflation picking up again given these other factors and, therefore, we have some room to ease. And on the margin I feel that easing would facilitate this restructuring that is still in process, even though we don't know where the equilibrium may be. We know it is in process and there are still significant adjustments that have to take place. So, as I wash all this out, I have to come down on the side of some further ease.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I've met with a number of people throughout the District in recent weeks, and the general sense is that our area of the country is now fully recovered from the 1982 recession.

[Laughter] We didn't experience the 1990-91 one. Employment growth has been better than the nation; industrial production has been better than for the nation; jobs are up about 1-1/2 percent since the beginning of the year. The unemployment rate hasn't come down as much because labor force growth is very strong. Other people following me could be moving back from southern California to the Midwest. In many respects it's somewhat of a reversal of what we saw in the '85-'89 period when I was out West.

We have a large number of major national retail organizations headquartered in the District. In talking with them they say this September was better than they had expected, better than earlier months, and better than they [had first] thought. There was a bigger pickup in sales post Labor Day. We're running retail sales increases in our District of about 6-1/2 percent versus 4 percent nationally, but they say they are seeing better numbers across the country than they had expected and they are raising their expectations now about Christmas retail sales. They say home-improvement related items and furnishings have been extremely strong--double-digit increases. People aren't getting any yield on their assets in the banks so they put it in the brick and mortar of a patio or something.

We're the second largest auto and auto-related manufacturing District in the country. And while the auto companies report flat sales and some concerns, the auto suppliers are more optimistic because they've been getting orders from the transplant companies. They feel that they are very competitive with imports. They're taking back some market [share] they previously had lost. Heavy truck orders are much better than expected just a couple months ago [and the truck manufacturers] are feeling very good about their backlog. Home sales and home starts are strong throughout the District, going along with the better employment and labor force that we have in our area.

The Fourth District round table economists--mostly nonbank business economists with a few bank economists in there--met recently and they are more optimistic than the Greenbook. They have 3 percent real GDP as an average forecast of the group for 1993. There has been some improvement in their inflation outlook; it's still up around 3-1/2 percent but trending down. More people are talking about inflation going under 3 percent than just three months ago when the group met. So, we've had a little movement there.

Our banks are even better than Tom Melzer's banks. We have the strongest banks in the country. Aggregate market capital is second only to New York; without Morgan and Bankers Trust we beat them all. None of the banking assets in our District are owned [by banking institutions] outside the District. Our banks are looking for earning assets; they're giving incentives to go out looking for loans. My head examiner was in to see me worried about the banks looking too hard for loans; I said "Don't worry about it yet." They're also looking for opportunities to inject capital into banks in other Districts, so you will be hearing from them a lot in 1993 as they seek opportunities to spread their skills and their capital.

Talking with business leaders about their strategies for the '90s has been very interesting. They characterize the past as having been an environment of counting on rising sales where they hire people, order some stuff, mark it up, and they make money. Their new

strategy is not to expect increases in sales in the '90s but basically to view the situation as one where all increases and earnings are going to come from cutting costs: reductions in the work force and productivity increases. When I asked both large and small businesses about their inflation expectations, there was a contradiction [in their responses]. They say they can't raise their prices at all; they have no expectation or plans to raise their prices and in some cases they talk about how rapidly the prices would be cut in the future. But they expect nationwide inflation to remain high. So, when I question them about how they are going to handle that with their labor costs or what their employees think of it, they say "It has to come from productivity or we're in a deep stew." Dick Syron asked about the [economy's] engine. I look at what both households and businesses are doing; they are basing their plans on the expectation of higher inflation in the future, with the idea that it is transitorily low [now] and is going to rise. And we're engaged in policy actions that say "No, inflation is not only down but it's going to go even lower." That inconsistency between what is out there in the marketplace and what we're doing is creating this drag. Now, there are two ways to reconcile that. Either we simply conform our actions to their expectations or we try to do whatever we can to help accelerate the process of their adjusting their expectations down to where we intend to go on policy. I ask business people why they don't believe us when we say we're going to zero inflation. I tell them the budget deficit or other things they worry about don't matter; it's what the central banks does that determines that. They just sort of shrug and say they don't believe it. They say we keep easing policy in order to promote growth, and one of these days it's going to wind up in higher inflation. I point to slow M2 growth and how we're all trying to work toward a stable price environment, and they tend just to shrug it off. I think the issue we have to attack is the credibility of our commitment; we as a Committee need to convey in the clearest way we possibly can that we are going toward zero inflation. That's what we should tell them about how to gauge our policy.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. I had two thoughts: One was on the economy and was prompted by something Mike Kelley said; the second was on the financial markets. Twenty years ago I was sitting in freshmen economics with Samuelson's Eighth Edition, and the first thing we were taught was something called the "paradox of thrift." The paradox of thrift was the 1972--or probably the 1952--way of saying "balance sheet restructuring will lead to less economic activity." When I thought of Governor Kelley becoming impatient, all I could think of was Keynes's famous quip about how in the long run we are all dead. And that was, in fact, the response.

CHAIRMAN GREENSPAN. What about the parable of the bees?

MR. LINDSEY. Well, we've been trying to unlearn Keynesian economics for the last 20 years and that may have been a mistake because, in fact, I think it's probably very close to the situation we're in now with balance sheet restructuring in part caused by this mismatch that Jerry Jordan just spoke of between inflation expectations and our inflationary reality. As for the economy, I think that's clearly in lousy shape, and my normal training would say we should move to ease.

The second thing I'd like to talk about is financial markets. Yesterday, frankly, I had a bit of an epiphany. I hope these things don't happen too much in life. I looked very closely at what happened in both the foreign exchange market and the stock market. I can tell exactly what happened in the stock market because I've set up my telerate to do that. I couldn't tell [exactly] in the foreign exchange market but it was close. The stock market bottomed at minus 100 and something at exactly 11:29 a.m. And it looked as if the foreign exchange markets did a similar thing. What is important about 11:29 a.m.? Well, that's Fed time and the markets woke up and said "Oh, they're not coming in." I assume that's what they did. I don't know what else is important about 11:29 a.m.; maybe it was just one data point and so I have an R-squared of one. But it looked pretty convincing to me. It's also where we hit the circuit breaker.

SPEAKER(?). Yes, they hit the 100-point circuit breaker.

MR. KELLEY. Yes, it worked.

MR. LINDSEY. It worked anyway. So, I think yesterday the market was telling us that their bet was we weren't in. Looking at the numbers, I also agree exactly with Joan and Bill's analysis that a 25 basis point reduction is factored into the market. So, I have to say I'm confused because on the one hand the market already has us in and on the other hand the market is telling us not to come in. The only way I can work that out--and I worked it out to my own satisfaction overnight, if not to anyone else's--was that I had your model in mind. What the market is not telling us is whether to tighten or ease. It's telling us something else and that is whether this organization is in reactive mode or what I would call deliberative mode. If you watch the pattern of the market's reaction to our not moving Friday and the pattern of its reaction to our not moving yesterday, the relief came because we weren't panicked. We were waiting for this every sixth-week meeting and we were actually going to sit down and talk through rationally what we were going to do. And I think the markets were applauding us for having done that. Now, again, it doesn't answer what we should do; but it does say that we get rewarded for being deliberative and not reacting to the latest employment report. So, that was my epiphany.

Now, what should we do? I think, frankly, that our next move is going to be to ease. It might be because there is a sharp break in the market and we have to move in to the stem the gap--something like the October '87 [episode], perhaps. I hope that's not the case because then we are back to the reactive mode. It might be because, as Ed Boehne said, the Fed should be viewed as doing anything we reasonably can in the face of the current economic statistics, which are bad. That could be reactive or it could be deliberative. The question is: When do we move? Option one is to wait for the new Administration, until January 20th or later. Clearly, the next Administration is going to need help no matter who wins the election. We're going to have a fiscal stimulus which is going to send long rates up; and while fiscal policy is going to be more stimulative, I think its quality is going to go down, in particular with regard to getting small business and employment taxes. I think health care is going to be hit no matter who wins the election. And while it's good for us in the long run, it's lousy for the health care industry in the short run and that's one of the few growth industries we have. So,

we're going to add our hospitals to the layoff lists next year. That's a case for waiting until January, when [the economy is] going to need help. We could wait until after the election but before January; I wouldn't recommend that. It's going to be a time of maximum uncertainty largely because appointments are going to be coming out at a rate of about one every two or three days. I would not want our actions to be interpreted as applauding or rejecting particular nominees, say, for Secretary of the Treasury. The other possibility is to act now at this meeting. I believe that's the commendable course of action. Even if I don't know what the rules are on our specifying a time-- whether or not we have to vote to do it today--I think we should take the action here at this meeting and not leave it to random events in the future. I think the odds that we will be [easing] before the next meeting are overwhelming. I think it will come either from a stock market break or because the economic statistics will make it imperative for us to do so. Given that choice and given that reality, I think we should be deliberative and not reactive and we should vote to ease here today.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, it's almost time for dinner, so I'll be brief. First of all, I don't see anything new on the economic outlook that differs from the bulk of what has been said around the table. I do think that attitudes have gotten at least a bit more glum. I put a lot of weight on Mike Prell's simultaneity paradox of linkages or reverse linkages among income, employment, and spending, especially in a context in which the saving rate is already very low and we're not going to get any more spending through a reduction in the saving rate. I think there is superimposed on top of that a whole lot of concerns that intensify those things that are somewhat easy to identify--some of them political, some of them involving a growing recognition that out there in the great beyond there is a very large, very expensive series of national economic problems that are going to have to be dealt with in a context in which there are vast social problems that also have to be dealt with. And I think people worry about that. So, as I said, the bottom line in terms of the outlook is more of the same with, if anything, a tilt toward a bit more concern and a bit more sour expectations.

I agree with those who said that inflation in some sense is a non-issue, whether it's measured correctly or not. I also agree with those who are saying that whether the Fed does something now or next week is not going to have a whole lot of adverse implications for so-called Fed credibility on inflation. The inflation outlook is a lot better, but it is a lot better because we're going to have 16, 17, or 18 straight quarters with an unemployment rate above 6-1/2 percent and 11 or 12 quarters with an unemployment rate above 7 percent. There's no magic to it at all. We have better inflation the old fashioned way: We paid for it. I do have some sympathy, though, with Jerry Jordan's comment or quandary as to why nobody quite believes there is at least a fighting chance of preserving that [progress on inflation] over time.

The main point I want to make--and others have said it in slightly different ways--is that we do have a renewed case of the financial jitters out there. It's not all that hard to explain why that's there. I do think the principal points of vulnerability are

the stock market and the exchange market. But I don't think anybody is even remotely clairvoyant enough to be able to anticipate through what channels a disturbance might work itself into those markets. And that was the thrust of Bill McDonough's comments, if I can put words in his mouth. I also do not think that a modest change or even a big change in monetary policy in the direction of ease right now is going to forestall the possibility that one of those disturbances might happen. It won't work that way; if anything, it might work the other way. But it will not work in the direction of forestalling it.

I agree with a number of comments that have been made that if something starts to tilt the wrong way, the situation could get pretty messy. Ed Boehne's comment about four hours ago about limited tools in a foreign exchange situation is quite valid. But having said that, it is potentially dicey. I think it's important to recognize, as a number of people have said, that major banks and major nonbank financial institutions in the United States, with one or two obvious exceptions, are in a much stronger condition today than they were in 1990, or in '87 or '84 or '82; and that's a plus. What is not a plus is that the second-tier institutions, especially nonbanks, are in weaker condition. And it's also important to recognize that if we get into one of these [situations], all institutions are going to be a lot more defensive. That may be good news in one sense, but it's bad news in another sense in that it makes it that much more difficult to deal with them. So, no matter what the Committee in its wisdom decides about near-term monetary policy in the conventional meaning of the word, I think that decision should be couched in a context in which it is implicitly understood that in the period ahead there could be circumstances in which the Desk or Desks will need at least a margin of greater flexibility.

In terms of monetary policy in conventional terms, I am very much of the view that for a variety of reasons the better course of action, at least for the moment, would be to "maintain." I'd have a distinctly asymmetric bias but I would not do anything. But above all, whatever the Committee decides about policy as a whole, we need to recognize that there could be circumstances where on a day-to-day basis an extra margin of flexibility is going to have to be built in. I don't think that has to be part of the directive, but it has to be recognized.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Well, since I think I am the last one to speak, I'll be very short. I'm much more comfortable with the Greenbook forecast this time--the marking down [of the economic growth projection]. I've been a bit more pessimistic all along with respect to the real economy. I'm not pleased to see a markdown to 1.2 percent real growth in the fourth quarter, but I think it's fairly realistic. I'm also in agreement generally that inflation is under control by almost any measure. And I think we're getting to where--with the discussions of what the CPI means, the measurement problems, and so on--we're recognizing that we may be getting close to that deflationary point that Governor Kelley mentioned. The fact that we've gone on so long with this weak economy adds another uncertainty generally. The uncertainty is reflected in the market. We've talked about the political uncertainty, and certainly the international uncertainty is reflected in the markets. As for the uncertainty with

respect to how long this balance sheet adjustment is going to go on, though, the duration of this weakness and of the adjustment process is continuing to drag people down and that is further damping the capability of the economy to recover.

The last couple of times we've scratched our heads trying to figure out what M2 was telling us and whether or not we should change the cones or move the cones around. So we said we weren't going to do anything because we didn't know enough about what the monetary aggregates were telling us. We've seen some small improvements in M2 lately but it still looks as if it's moving sideways. Maybe the monetary aggregates were telling us more than we were paying attention to earlier. With respect to exchange rates, I recognize that if we allow the dollar to be a policy constraint for us, we may end up lengthening the cycle--lengthening this long period of slow economic growth--and in fact it may hurt us in the long run.

Adding all of these things up, I come out thinking that we probably are going to need another easing move. I'm somewhat concerned about its timing; care needs to be given to when we do it. I'm not enthusiastic about this reputation that we seem to have garnered that we react to various things and I'm a little concerned about getting "gamed" by the traders who I think are having a rather grand time these days. So, I come out for a move toward ease but I think the timing needs to be considered carefully.

CHAIRMAN GREENSPAN. It's really quite late, so let's take a very short coffee break--in fact, 10 minutes.

[Coffee break]

MR. KOHN. Thank you, Mr. Chairman. I saw him nod; some of us are very attuned to those nods. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Any questions for Don? If not, let me start off. This has to be one of the most difficult periods for policymaking that I remember. The reason essentially is that we're dealing with an outlook that is far more difficult to fathom than I think any of us had really thought about. It is by no means certain that the restructuring model we're looking at is of the type that I discussed here a couple of meetings ago; [that model involves] affecting the restructuring process and the improved balance sheet process by a level of interest rates that essentially over time restructures the balance sheets and induces a restoration of spending out of cash flows. The alternate model I raised was what I called the "seize-up" model, namely that what we are looking at is an old 19th century major balance sheet seizing up under crisis conditions in which if we inject liquidity and ease into the market, it temporarily looks as though it is recovering but then as the stimulus runs out it reverts to the old [19th century process] of very rapid balance sheet adjustments. And what we find is that the cash flow that is being engendered gets disproportionately shifted toward balance sheet repair and savings and there is general weakness in economic activity. As Governor Mullins indicated, this is a sort of periodic "fall" problem; it's the third straight year that we've run into this. I'm not sure that the date is particularly relevant, but there is evidence that [economic activity] does not wish to accelerate. I do, however, think it is premature to conclude that what we are dealing with is a

cumulative process in which the previous injections of liquidity have petered out and the economy is now beginning to "seize up" again and move toward a negative growth pattern. If that were actually occurring right now, it's hard to believe we would have the auto and truck sales numbers that were released yesterday, which were fairly good. I also wonder whether the other evidence of reasonably good retail sales would be emerging; and I wonder whether loan demand, which may be nothing more than a shift from external financing to commercial bank financing, means all that much. These are very fragile indications [on the positive side] and I must tell you I scrounged very hard to find them. Nonetheless, it is not immediately evident that we are moving toward a cumulative deterioration.

As a consequence of that, I would be reluctant to move toward further ease at this point. But I do think we may be at the cusp of some deterioration which just hasn't cumulated in the usual pattern that one would expect. We have some fairly unstable financial conditions, especially the stock market, that a number of you have alluded to. There is unquestionably a potential danger in easing and I think we have to be very careful of that when we are looking at the market responses to what we are doing or what everyone thinks we are doing. We are largely getting a response from the dealers who inventory bonds and who react very rapidly to what they think we are doing. It's not altogether clear that they are going to judge their retail markets, their pension funds, correctly. It may very well be that one of these times, when we see bond markets getting very strong with the expectation of ease, we're going to find that that's a result of a build-up of inventories on the part of dealers who are unable to sell them to their customers, and the markets will reverse very sharply.

So, we have a very touchy problem here. I'm aware, as you all are, that everyone expects us to ease and that becomes a self-fulfilling activity. While the case for easing right now is quite strong, I would be far more inclined to wait for a short while--maybe a couple of weeks--to see what is developing in the financial markets, what is developing in the foreign exchange markets, what is developing in Europe, and what is developing in the overall economy. I do not think one can argue, especially in the context of some of the discussions I've heard here, that this economy is slipping off the edge. It may; we may find evidence of that within a reasonable period of time. I would argue further that if we do not get improvement within the next couple of weeks, the odds will then very strongly favor [the hypothesis] that this "seize-up" model I mentioned at the beginning is functioning. So, having gone back and forth in the last 48 hours looking at all sorts of numbers, I myself would feel most comfortable with a hard asymmetric directive toward ease, reflecting the fact that we would do nothing at the moment. But unless we begin to see some firming in particular indicators, I do think we should move lower. I say this without a great conviction because anyone who has a great conviction at this stage about what the economy is doing or what proper policy is I think is under a mild state of delusion.

I would like to say finally that I wish we had the luxury to sit back and do nothing until after the election, as is the conventional procedure of the Federal Open Market Committee. I don't think we have that luxury. However, I don't think the markets have been viewing anything we have been doing as politically motivated.

There are obviously those who make those statements, but I don't think that's a serious issue confronting us. So, I would dismiss that as a consideration; it's not something we need to be overly concerned about. But if the money supply weakens and the markets behave poorly and we have the evidence that we've getting cumulative deterioration-- or more exactly that the economy is not picking up, which is I think the main criterion at this particular stage--I do think that we should move toward ease. And ease in this context I would say definitely would require a discount rate cut and some action on the funds rate. So, I would put that out as a recommendation to start the discussion and hope somebody may be able to expand on it with some great insights as to how policy is functioning.

MR. LAWARE. Question, Mr. Chairman?

CHAIRMAN GREENSPAN. Yes.

MR. LAWARE. As stated in the Bluebook, "A" requires a reduction immediately in the federal funds rate to 2-1/2 percent. Was that your intent?

CHAIRMAN GREENSPAN. No, I'm arguing for "B."

MR. LAWARE. All right, "B." I thought you said "A." I'm sorry.

CHAIRMAN GREENSPAN. I may have said "A" then "B." I'm arguing for alternative B asymmetric toward ease, with the expectation that if the economy fails to show signs that it's [improving], we will reconsider whether to move. President Jordan.

MR. JORDAN. I wish I had more confidence about what indicator to look at to gauge our policy. But much more so I wish the private decisionmakers had more confidence about how they will be able to gauge our policies in the future because it's our future policy actions that are going to influence their decisions most. It struck me in recent weeks in looking at the turmoil in Europe that the Germans have very slow growth in their narrow monetary aggregates and very rapid growth in their broad aggregates and they chose to gauge their policy by M3. They have a sharply inverted yield curve at a very high level of nominal interest rates and what we would generally regard as high real interest rates and an extraordinarily strong currency. We have had a very steep yield curve, very low short-term interest rates relative to long rates, [low] recent inflation, extraordinarily rapid growth in the narrow aggregates, which is disturbing, and almost no growth at all in the broad aggregates, M2 and M3. And we tend to characterize our policies by the broader aggregates as having been restrictive, which is not consistent with our weak currency. The markets seem to be saying--looking at a lot of indicators, including surveys--that our policies have been and will continue to be expansionary and that the Germans' policies have been and will continue to be restrictive.

I'm not sure the Germans are right in looking at M3, but they keep saying they are going to persevere and people believe them. I'm not sure that we're right in saying M2 is the right measure, but people are not believing it and do not believe that we are going to persevere. Don Kohn in his remarks mentioned the risks about how to

perceive what we do and why. If it's clear that it's due to a weak economy and that in the future we're going to maintain slack in the economy, then maybe the markets would take it okay. But that casts this Committee as being anti-growth, and I'm not anti-growth. I'm not comfortable with the idea that we're going to maintain slack and slow growth as the method of achieving price stability. I want price stability because I want fast growth.

I would prefer at this point to take Committee action to complete what we suspended on July 1st, and that is setting targets for 1993--what I argued for then but didn't succeed in getting. I'd suggest that we announce a reduction in the [M2] target range for 1993; my preference would be a full percentage point. I think we should have been at 2 to 6 percent this year and I think we should have 1-1/2 to 5-1/2 percent for next year. I'd go ahead and announce it and couple it with an immediate action to inject reserves and probably to cut the discount rate because of the necessity of a press release in order to say we are taking action as a Committee to achieve the minimum of our target range in monetary growth. I'd say we are not satisfied with being below the target, we want to get growth up [within the range], and we're at the same time lowering our target range for next year because we're not going to let [growth exceed] the top end of the range either. We should take this step, coupling what is perceived as an easing action in the short run with an announcement of lowering the target range for '93 as re-enthroning M2 because it's the only horse we have to ride to gauge our policies at this time. Until such time as the Committee is ready to say we are going to restructure M2 or switch to some other aggregate, we have to stick with M2 because it's what we have, just as the Germans have to stick with M3 with all of its faults. I wish we had their credibility.

CHAIRMAN GREENSPAN. Jerry, let me just comment on this for a second. I think you're raising a crucial question about whether we should lock back in on a specific aggregate. We obviously are confronted with the difference between the yield curve effect on M1 versus M2 and M3. It would be nice if we had a particular conviction that one or the other or some other M was the best one; if we did, then clearly we should lock in. But I don't know if we can say that merely locking in, irrespective of whether in our judgment it's the right measure on which to lock in, is a wise move. So, while you're raising a correct issue--that we really ought to review our guidelines --I think it's regrettable but it's a little late in the game for this meeting. But I do think that should be on the agenda for the next meeting because we did, in fact, say that we would do it before next year, and the next meeting would be the appropriate time to do it. But to make a judgment that we are locking in on M2--enthroning it as you put it--presupposes that we have confidence that that's the right measure. I would much prefer to be uncommitted to which particular money aggregate we are functioning with until we have a judgment as to what we want to work with. If M2 is wrong and we lock in, we're going to have far more difficulties in aligning ourselves than if we lock into something when we have considerable confidence. I don't think we have that confidence at this stage. President Forrestal.

MR. FORRESTAL. As I was reflecting on the policy stance for this meeting last night, I thought about what I have been doing over the last three weeks and I came to the conclusion that I have been sitting in front of a screen becoming increasingly depressed almost on

a daily basis, perhaps even on an hourly basis, by the negative numbers that were coming in. Not all of them were negative, of course, but even going back to August we had a low number for employment and industrial production. Orders are down, confidence is down. Exports, which had been a minor engine of growth, are off. M2 is improving a little. All of this led me to conclude that what we ought to do is to ease policy now. As other people have said, easing policy--lowering interest rates--has helped the economy. And I think additional ease would help in this particular situation. I'm not sure that we're not on the edge of a downward, cumulative, spiral here. It may not be upon us at this exact moment, but the potential is there. So, I think we need to ease. But having said that, the case you made for waiting is certainly a reasonable one; and certainly we have offsetting considerations in the international exchange market. So, I would support your strong asymmetric-toward-ease directive.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I'd like to set aside for the moment the issues of financial instability and what could happen in foreign exchange markets and the issues associated with being close to the election. But it seems to me that in many ways this has been a very different meeting from those we've had in the past. In the past, we've seen a forecast where the economy looked as though it was going to pick up almost imminently and that the rate of growth would be something on the order of acceptable. There were certainly concerns about whether or not that would be realized. That generally would result in our having asymmetric language and then when we saw some statistics come out that confirmed or heightened those uncertainties, we would ease. I think this is a unique meeting. This is a meeting where the Greenbook has come up with a forecast that is much more negative; it shows that the pickup is coming considerably later and that when the economy does expand it's going to be less strong. Based on the discussion, I counted approximately 11 who seemed to be in substantial agreement with that and who voiced concern about the direction of the economy. That is far more powerful to me as [an indication of] what we should do on policy--the work has been done collectively by all of us and our staffs and in the Greenbook--than what developments might occur in the next two to three weeks. Consequently, I would recommend that we reduce rates--my proposal would be 25 basis points in terms of the funds rate--and that we have asymmetric language.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Mr. Chairman, I was hoping we would come into this meeting and be prepared to be patient, be prepared to seize the initiative from financial markets and indicate that we were conducting monetary policy in a deliberative way as Governor Lindsey suggested. I think what you've given us, Mr. Chairman, is a courageous action in that it does step back from market expectations. However, there is a difference between courage and foolhardiness; and no matter how strongly I believe that it would be appropriate for us not to take a step at this time, I do want to see how the markets react to this news because what you've suggested is, it seems to me, news. So, it's a courageous step and I think we should see how the markets behave [in reaction to] the step that we're taking. If at a point in time the Board of Governors were to decide to lower the discount rate, then it

would be appropriate under those circumstances to have a telephone conference call. Even though my preference would be a straight "B," you certainly accommodate what I believe is appropriate under these conditions.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, it may be that epiphanies only happen rarely; it's probably good for the soul that it's that way. I looked at the list of upcoming indicators and I have to say I agree with President Parry: I don't see one that would convince me any more than the discussion that we had around the table today as to what shape the economy is in. The major statistic coming out is industrial production; we know what that is; that's going to be released a week from Friday. The other two big indicators are the PPI and the CPI. I don't think they really give us a--

CHAIRMAN GREENSPAN. I think initial claims, which come out [soon], are a very crucial indicator of short-term deterioration; it has been one of the problems. The retail sales figure [could] show weakness.

MR. LINDSEY. Yes, you're right. Again, what I think we should do is for this Committee to establish the guidelines; that decision should be made here [today] because we're being gamed very much the way the European central banks were being gamed. With each major statistic that comes out, people take sides; [people talk about] the possibility that someone may have some inside knowledge or rumors spread that someone has it and that's going to affect Fed actions; that is what is driving markets. Frankly, I think that's increasing the instability in the markets. And the way to restore stability to the markets in part is to have this body make decisions and have a fixed date rather than an effectively random date for taking actions. One particular area of instability that has been mentioned is the foreign exchange market, and that is an area of concern. But I would make two observations. First of all, to the extent we have a concern about the foreign exchange market, it would not fit into the paradigm of strongly asymmetric because the only "cure" that we would come up with would be an increase in rates, and I don't see that coming. Also, I think the fundamentals are quite different here in the United States. I think the United States is like France and not like Italy or the UK in that we do not have an obviously overvalued currency; quite frankly, we have an undervalued currency. So, for both of those reasons I don't think the foreign exchange instability is a reason for not acting now. I think we ought to make the decision here. In my mind that decision could even be a contingent decision: contingent on having over 400,000 or whatever you would like in the initial unemployment claims or a CPI under 3 percent. But I really think there's an advantage in our making the decision here today, and that would be my very strong preference.

CHAIRMAN GREENSPAN. I might say that the decision will be made obviously also in conjunction with the Board of Governors on the discount rate, so that issue gets involved.

MR. LINDSEY. Yes.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I think the policy decision that we face this morning is, as Don said, essentially a matter of weighing the risk of a renewed deterioration in the economy against the risk that a further easing at this juncture will damage our credibility and might not do any good in any event. My real preference, reading the tea leaves the way I do, is to do something now--move a quarter point --but I can accept your formulation of "B" with an asymmetric directive. But I want to underscore what Jerry Jordan said: This decision would be a lot easier if we had cut those targets back in July. Governor Angell and I felt strongly enough about advocating a cut in the [1992] targets [in July 1991] that we actually dissented on [the vote to retain them]. But if we do cut them regularly, I think we establish the credibility whereby we can make these short-term lowering [moves] without scaring the market half to death because we would reassure them that we have not lost sight of our long-term targets.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, for all the reasons I stated before, I would prefer "B" symmetric because I don't have any confidence that a further change in rates can accomplish the stimulative effects that it's supposed to have. And I'm very reluctant to take the risks that are inherent in the foreign exchange markets, which I believe are there. On the other hand, I think your argument that we need some emergency firepower in the event of an accident or a surprise is persuasive for asymmetric language. But I would prefer to have it symmetric with the idea of reconvening the Committee if the emergency happens. Maybe the emergency will happen too fast to make that practical, but until I hear the other comments around the table I'd like to be recorded as favoring "B" symmetric.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. In general, Mr. Chairman, I support your recommendation and would only add a couple of thoughts. First of all, in assessing the question of asymmetry and timing, I hope we cast a relatively broad net. I am concerned about the foreign exchange markets. On the one hand, we seem to believe that the dollar is lower than is sustainable but the presumption is that it's going to go lower still; and that doesn't seem to me to be an equilibrium, let me put it that way. On top of that, as we weigh the desirability or necessity of additional interest rate cuts to sustain or further the recovery, I hope that we will bear in mind its consistency with our long-run objective for price stability. And I must say that I don't quite understand what we would have gained by lowering the monetary aggregate targets and locking in more tightly on M2 in these circumstances. There's certainly some information value in M2 but there's also a lot of uncertainty surrounding both its behavior and its implications for economic performance in the future, and I don't see how we would enhance our credibility by focusing on something with that degree of uncertainty associated with it.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, as time goes on here, economic events are making the case for ease stronger and stronger. But I do strongly support your recommendation for today because I do not think

this is a propitious time to ease. I worry that we could set off a run on the dollar. The traders are feeling their oats these days and they might just like to take us on, and we don't need that. It's very important that the FOMC regain control of monetary policy, which I think we have largely lost to the market and the media. I do not share the view that today is a day when we could look reflective rather than reactive. Real rates are very low, as we've seen on the handout distributed here this morning. So, I don't think there is any strong urgency, on that merit, to [move] today. I think it's desirable to get a reading on events as time goes along and desirable to have our powder dry in case some of these potential emergencies show up. So, I strongly support your prescription.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Mr. Chairman, I agree with the number of people who have argued for us to take the initiative back [from] the markets. I think the FOMC is the place to make these decisions and generally I would prefer to make them during the meetings. I have a continuing preference for symmetric directives. And given the turmoil in the world right now and the low level of interest rates that we already have, I think our best contribution could be to act as a force for stability. So, my preference, if I were a voting member, would be for "B" with a symmetric directive.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I think we all feel the ambivalence that you talked about; there clearly is uncertainty. I find it difficult to believe that any of the new data that are going to come out in the next couple of weeks will make this any clearer. Jerking the markets around--first they think we will ease and then they think we won't and then we try to come back and do it again--may have a cuteness to it or too much cuteness to it, but I think that undermines our credibility. There are times when you step up to the batter's box and you try to get on base. We've had a good discussion but I think this discussion is probably ahead of the data. I would prefer to make the decision and do it--and not try to second guess this event or that event or this statistic or that statistic--by sticking to the fundamentals. And I think the fundamentals call for lower rates.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mr. Chairman, I would prefer to act and I'd prefer to act now. But let me add some qualifiers to this. This is as tough a situation as we've seen, at least in a while. And it seems to me that on the basis of the discussion there is little question about which direction--unless we're happily surprised or we get extraordinary shocks the other way--our next move will be. Generally, I prefer to do things at meetings. I have some sympathy for the arguments that were raised by Governor Lindsey in that regard. We do have uncertainties out there and I have no illusions about my ability to read these uncertainties in terms of the exchange market or other things that might come along. There is this question of just how much data we're going to get in. I guess it depends on how one interprets your recommendation. I interpret your recommendation on being highly asymmetric toward ease as saying that the timing to some extent will be decided by you. The direction is not necessarily completely

decided yet, but there would be a predisposition to ease--I was writing down your words--unless we were to see some strengthening in the economy. On that basis and given all of the uncertainties in the economy and in institutions, I would reluctantly support your recommendation.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, my view on today's decision really is completely separate from either exchange market or other market expectations or political issues. It does seem to me that these are matters that we can reasonably deal with, given any decision that we come to today. Rather, my decision would be based on the economic situation, which I think clearly has weakened and quite considerably so. At this point the risk that the economy could fall back into a negative situation is not insignificant; I think the balance here is very delicate. It seems to me that we already have the data that we need to make a decision. It's very much there on the record. Therefore, as I indicated in my comments earlier, I could live with "B" asymmetric, but I frankly would have a far stronger preference to move now and to use this meeting as a reason for making that decision.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. To repeat myself a little, Mr. Chairman, I came in a little more ambivalent, and I think we have had a very good discussion. The preponderance of views is that ease is appropriate. I think now would be the time [to ease], having had the discussion, and it would be a deliberative move. However, given your [explanation], I can live with "hard asymmetric."

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Alan, if it were up to me, I'd prefer to take action here at this meeting. Having said that, I would vote "no." [Laughter] I basically view the hard asymmetric you've described as a decision to move. It's almost a certainty. And for the reasons I've articulated at other meetings, I just can't support that. I think we're expecting far too much out of monetary policy as a short-run, fine-tuning tool for the real economy. Frankly, I think there probably would be some benefits in terms of stability and so forth in communicating to markets: The easing is over; now let's adjust to this level of rates and work from here. I think there's ample stimulus in train. To cite a quote from you: "My mild state of delusion continues." [Laughter]

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. First of all, I'd like to support President Jordan's suggestion that we take another look at the M2 cones. In essence, if M2 is a policy guide, we should have eased earlier. If it's not a policy guide but only an aggregate that we forecast, then we should be lowering our forecast. So, I find this inconsistent attention to M2 somewhat troubling. I would prefer to ease today, so my preference is alternative A. However, having said that, because of my concerns about the traders' voracious attempts to "game" the System --and having had first-hand experience with that crowd--I will reluctantly support ["B"] asymmetric.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I think there's a sufficient case for ease now but I can support ["B"] asymmetric. In terms of what information to focus on, I think it will be useful to focus on money and credit flows and how those develop.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Your prescription is fine with me, Mr. Chairman.

CHAIRMAN GREENSPAN. President Jordan, I never did get an indication from you as to how you came out.

MR. JORDAN. I'm still working on it! [Laughter]

CHAIRMAN GREENSPAN. Let me just say something that I think is important for us to focus on. This is a very close call here and what I don't want to do is to convey a sense that I have some strong conviction as to what is involved here. I want to make certain that we're not getting a Committee vote which merely acquiesces in a view that I have stipulated because, as we have all indicated around this table, this is an extremely difficult period. I want to make certain that we get a vote which is essentially a Committee vote rather an acquiescence to the position of the Chairman. Ordinarily, I would never say such a thing! [Laughter]

MR. ANGELL. Which votes are you trying to lose? [Laughter]

CHAIRMAN GREENSPAN. The fact is that we all recognize that this is a very tough decision we are making and it's best that we all say exactly what it is that we [prefer]. As a consequence of that, I want to read off my notes to be sure that I have gotten everyone's view and priorities correctly. Accordingly, I'm going to poll each of you, starting from the bottom. President Syron would prefer easing at this meeting but will accept asymmetric toward ease. The same is true of Governor Phillips [and of Governor Mullins]. Do I gather this correctly?

MR. MULLINS. I think there's a case for ease now but I--

CHAIRMAN GREENSPAN. But that's not the [unintelligible] question.

MR. MULLINS. I would go "B" asymmetric.

CHAIRMAN GREENSPAN. That there is a case for ease now is unquestioned, but what's your priority?

MR. MULLINS. "B" asymmetric.

CHAIRMAN GREENSPAN. Your priority is asymmetric?

MR. MULLINS. Yes.

CHAIRMAN GREENSPAN. So, your preference is asymmetric but there is a case for easing; it's the other way around.

MR. MULLINS. Yes.

CHAIRMAN GREENSPAN. President Melzer votes "no" on ease and symmetric language with "B." Governor Lindsey very specifically indicated a desire to ease now. Governor LaWare wants symmetric now.

MR. LAWARE. Symmetric "B."

CHAIRMAN GREENSPAN. I'm sorry, "B." Governor Kelley wants asymmetric toward ease, but I gathered from your comments that while you could accept [a move toward] ease you would prefer not [to move]?

MR. KELLEY. Mr. Chairman, I may be the only one at the table who supports you on the merits of your case! [Laughter]

MR. MULLINS. He [talked] me into it.

CHAIRMAN GREENSPAN. President Hoenig is asymmetric toward ease but could accept ease, if I gather correctly.

MR. BLACK. But not on the merits of the case!

CHAIRMAN GREENSPAN. Governor Angell would not be in favor of ease, but would do asymmetric toward ease. I would suspect that the Vice Chairman is asymmetric toward ease because that's his conviction.

MR. CORRIGAN. That's right.

CHAIRMAN GREENSPAN. I wonder whether President Jordan finally has his solution.

MR. JORDAN. The reason I have a problem with "B" asymmetric is that no matter what we think it is we're doing [any action] will be the result of real economic indicators and reinforce the idea that we ease policy when the economy is soft and we are going to tighten policy when the economy is strong. I have a problem with that. So, I would prefer either to act today and do it because of weak money growth and make it very clear that we're trying to get short-term money growth up and long-term money growth down or, if we don't do that, adopt "B" symmetric but without the discretion of judgment for the future.

CHAIRMAN GREENSPAN. Okay, as I now reconfirm what the views are, there is a majority for asymmetric toward ease in the form which I originally stipulated it. Therefore, I would request that you read the [directive language].

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

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD

| | |
|------------------------|-----|
| Chairman Greenspan | Yes |
| Vice Chairman Corrigan | Yes |
| Governor Angell | Yes |
| President Hoenig | Yes |
| President Jordan | No |
| Governor Kelley | Yes |
| Governor LaWare | No |
| Governor Lindsey | No |
| President Melzer | No |
| Governor Mullins | Yes |
| Governor Phillips | Yes |
| President Syron | Yes |

CHAIRMAN GREENSPAN. Okay. Let's go have lunch.

END OF MEETING