Meeting of the Federal Open Market Committee
December 22, 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, December 22, 1992, at 8:00 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. Broaddus, 1/ 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. Prell, Economist
Mr. Truman, Economist

Messrs. J. Davis, R. Davis, T. Davis, 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

1/ President-elect.

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account
Mr. Cross,1/ Manager for Foreign Operations, System Open Market Account
Mr. Coyne, Assistant to the Board of Governors
Mr. Gemmill,2/ Associate Director, Division of International Finance, Board of Governors
Mr. Kohn,2/ Senior Deputy Associate Director, Division of Research and Statistics, Board of Governors
Mr. Lindsey,2/ Assistant Director, Division of Research and Statistics, Board of Governors
Mrs. Low, Open Market Secretariat Assistant, Board of Governors

Messrs. Balbach,2/ Burns,2/ T. Davis,2/ Eisenmenger,2/ Mullineaux,2/ Scheld,2/ and Stern,2/ Senior Vice Presidents, Federal Reserve Banks of St. Louis, Dallas, Kansas City, Boston, Philadelphia, Chicago, and Minneapolis, respectively

Messrs. Broaddus,2/ and Soss, Vice Presidents, Federal Reserve Banks of Richmond, and New York

Ms. Meulendyke,2/ Manager, Securities Department, Federal Reserve Bank of New York

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CHAIRMAN GREENSPAN. Good morning, everyone. I think you all know we have a luncheon for Bob Black that I hope everyone will be able to attend. I'd like to welcome Al Broaddus to his first meeting at this table. We look forward to his joining us on a regular basis starting with the next meeting as the newly installed President of the Richmond Federal Reserve Bank.

There is nothing unusual about the agenda this morning so I'd like to get started right from the top. Would somebody like to move approval of the minutes of the November 17th meeting?

VICE CHAIRMAN CORRIGAN. I'll move it.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Bill McDonough, you're on for the Foreign Desk.

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

CHAIRMAN GREENSPAN. I didn't have a chance to pick up the cause of the runup in the dollar against the DM from 1.57 to 1.58 this morning. What explains that?

MR. MCDONOUGH. A very, very thin market. There was a remark by [Bundesbank President] Schlesinger, which seemed to give a more bland approach to his view of inflation in Germany, that helped the dollar; and then Bloomberg came in with a story interpreting what Schlesinger had said in not such a positive view, so the dollar came off a little. But we have these very, very thin pre-holiday markets; so if somebody sneezes, the exchange rate moves a half pfennig.

CHAIRMAN GREENSPAN. Let's be very careful about sneezing in this room! Any other questions? If not, we shall move on to the Domestic Desk, and Joan Lovett will bring us up to date.

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

CHAIRMAN GREENSPAN. Questions for Joan?

MR. JORDAN. I've been following this sort of seesaw market psychology and monitoring the Call during this last intermeeting period, including how we responded to and interacted with that shifting market psychology. Through the summer and into the beginning of October, the dominant view seemed to be that the economy was weaker than had been expected. Confirmation of that weakness in the various statistics that came out would lead the bond market to tend to strengthen. We tended to go with that strengthening. Then from October 1st until, say, on or about the first Tuesday of November, there was a significant backing up in market rates. As I understand that, the psychology was that it was increasingly likely that Clinton was going to be elected and that we were going to get a fiscal package that would be too expansionary and, therefore, it was adverse to the market. Then something started to shift at that point. I don't know whether it was before or after our last meeting. Now we've been in a period where even strong economic news does not cause the market to sell off as it was doing before. Previously, any signs of strong numbers on industrial production or anything that would come out would tend to get an adverse reaction in the market. Don Kohn referred to this one morning on the Call as the "new Clinton effect." The idea now is that strong economic news means we're not going to get a big fiscal stimulus package. Therefore, it's a reason to rally whereas before it would have been a reason to sell off. If that's a good characterization of what has been going on, how much more potential is there for that kind of effect if we continue to get strong economic news going into the new year? Do you think the market is poised for a further relief effect [based on the view] that we're not going to be getting a massive dose of fiscal stimulus or maybe something worse like a deficit-neutral package?

MR. MCDONOUGH. We think the view that Clinton is not likely to have a bigger stimulus package than the $25 to $30 billion that Joan mentioned is probably fully in the market. But what we're hearing now, especially in our morning dealer meetings, is the view that the yield curve from fed funds out to about 2 years is too steep. And we are beginning to get views, although not yet reflected in trading positions because of the tight year-end period, that bonds in the short end of the curve are very good buys. So, if you listen to what the dealers are saying, the market structure would say that we're going to have a very strong economic recovery and that the Fed will tighten about 25 basis points per quarter for the coming year. But when we talk to market participants and ask what they think is really going to happen, they have a view that is very close to the staff forecast. I'd say just in the last 10 days we have begun to hear people say that if this is what we believe the economy will do and the yield curve is saying that there's much more economic growth and much more Fed tightening than seems to make sense, there ought to be a bond market rally. We are just beginning to hear that.

MR. JORDAN. The steepening that did occur in that period from October 1st into early November was in the 2- to 3-year range. Most of that has not come back out, whereas at the longer end we've had some flattening.

MR. MCDONOUGH. Exactly. And that's why people who are beginning to talk themselves into thinking that there is a great buying opportunity are focusing on exactly that part of the curve.

CHAIRMAN GREENSPAN. I think there's another force that is beginning to work here that we can see when we unbundle the whole coupon yield into the 1-year futures. As you are all aware, there has been a very significant decline in [rates in] the 10- to 30-year area; indeed, one is sensing that there is a really fundamental shift in the outlook as reflected in the various positions along the yield curve. What we may finally be seeing is a downward revision of long-term inflation expectations. There may be a hope--and I underline the word "hope"--that the budget deficit may be addressed in this particular period because the only time that it can be [cut] is during the so-called "honeymoon period." I think there's a market expectation that something fundamental may happen and that is being addressed in the longer end of the market; and even though we're getting this upward surge in the short end, it's more than offset on the long end and the total effective yield in the 30-year coupon has been coming down. I think there is an intermediate cycle of the type that Jerry Jordan is talking about which has been superimposed on that process. If that is true, then there may still be further downside rate possibilities in the long end of the market. Indeed, what this is saying essentially is that the yield curve is going to flatten and possibly flatten quite significantly. If, however, the honeymoon comes and goes and we get the usual no action, then I think we're likely to see that go right back where it was, or maybe worse.

MR. MCDONOUGH. Mr. Chairman, there's also some play in the market now because of the view that the new Treasury team may reduce issuance in the 30-year area. So, there is some attractiveness to the 30-year bond among those betting that that will happen, and some of the higher yield or back-up in the 2-year note is the opposite effect --that there will be more supply at the short end of the market and less in the long end of the market. But I agree with your view of the more basic thing that is happening.

MS. LOVETT. It's worth noting that Jerry Powell told everyone yesterday that as an outgoing Treasury official for debt management he would advise the transition team not to make that change.

CHAIRMAN GREENSPAN. Any further questions for Joan? If not, would somebody like to move to ratify the transactions since the last meeting?

VICE CHAIRMAN CORRIGAN. I move it.

MR. SYRON. Second.

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

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

CHAIRMAN GREENSPAN. Did I hear you correctly when you said that the gold exports in October appear to have come from the coffers of the Federal Reserve Bank of New York? Has anyone looked lately?

MR. TRUMAN. Well, I didn't want to tell too many secrets in this temple!

VICE CHAIRMAN CORRIGAN. Obviously, we knew what happened to the gold, but I don't think we knew what it did to exports.

MR. TRUMAN. What happens in the Census data is that the Federal Reserve Bank of New York is treated as a foreign country. [Laughter] And when a real foreign country takes some of the gold out of New York and ships it abroad, it counts first as imports and then as exports. However, the import side is not picked up in the Census data. So there you get the export side of it.

MR. LAWARE. Great accounting!

MR. BOEHNE. Great confidence building!

MR. TRUMAN. That's because you haven't been filling out your import documents!

MR. ANGELL. Let me run this by again. You mean a country owns gold and has it stored in the Federal Reserve Bank of New York and if they ship it out, that's an export?

MR. TRUMAN. And in the balance of payments accounts it also counts as an import, so it washes out.

CHAIRMAN GREENSPAN. The Federal Reserve Bank's basement is a foreign country. When they move it out of the basement into the United States, it's an import. Then, when they ship it out again, it's an export.

MR. ANGELL. That makes sense!

MR. TRUMAN. And sometimes when they sell the gold, it might be sold into the United States, so it should count as an import. It doesn't necessarily always show up as an export.

MR. BOEHNE. That really clarifies it!

MR. KELLEY. Does it have to get out of your vault at all in order to be considered an import and an export?

VICE CHAIRMAN CORRIGAN. Well, I'm not even going to try to answer that. In this particular case I know what happened, so I think the description you have is correct.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Ted, I thought the Hooper-Johnson memo was extremely interesting in a number of dimensions. That shows that [growth abroad] has more of an impact, obviously, in a polar-case situation on U.S. growth than I would have thought intuitively. It is a polar-case situation, but it shows the importance of exports. I wanted to ask you to give a horseback kind of guess: If you didn't have something as extreme as their situation is--which may be based on a probability of less than 5 percent--but you could get to something that had a probability of, say, 30 percent, where would that leave us? Is it halfway between what we have in the Greenbook and what they had in their note? What would the impact of that be on growth in the United States? I didn't know how to interpret this; I don't know whether it is a linear interpretation.

MR. TRUMAN. Essentially, it's linear. If you want to say the cutback in growth is approximately half of what we built into that worst case scenario, the impact on U.S. growth would be roughly half. I do think that memo in a way indicates that the worst case scenario is more probable in 1993 than in 1994 just because, with the passage of time, we are going to get more in the way of positive policy responses than one would expect, although it becomes increasingly possible to have two bad years as it is to have one. I was surprised at that, too, but the basic reason why we get a bigger impact than one might intuitively have thought stems from two factors. One is the dollar appreciation; that is quite substantial and it has a big impact, which one doesn't normally associate with this kind of scenario on a sustained basis. Secondly, with income elasticity, generally when you get above 1 you get a multiplication effect; things begin to add up.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mike, I'm a little concerned about the signals we're going to be getting next year if we have a particular fiscal twist. If I listen to Little Rock right, what we should be doing is moving social spending off the government's books and onto the books of businesses. Let's suppose we did that; say there is $50 billion less fiscal spending but mandated benefits of the same amount. I think of that as something like a lump sum labor tax. In my mind the markets would interpret that as fiscal contraction and rates would drop, but at the same time we would be seeing costs rise and perhaps we'd be getting higher inflation numbers as a result. Is that a reasonable interpretation of what we'd be seeing?

MR. PRELL. I don't want to venture a political judgment, but--

MR. LINDSEY. No, it's a "what if" question.

MR. PRELL. I can't argue with the direction of what you're saying. It would look like reduced budget deficits. That might be favorable for the financial markets but they would also perceive the cost-push and worry about it translating, unless monetary policy were very restrictive, into ongoing higher inflation. So, it's hard to say how that would net out as a bond market shock.

MR. LINDSEY. Would that cause a net increase in measured inflation rates?

MR. PRELL. I think so. I'm not sure what kinds of changes you're assuming, but if they are mandated health care, mandated expenditures on training--though I gather there may be some signs of a backing away from that--they would enter the cost structure one way or another and tend to be passed through.

CHAIRMAN GREENSPAN. There's also another way of looking at it. How that shifting of the net borrowing ex ante from government to the private sector works its way out in the financial markets is also related to this.

MR. LINDSEY. In an ideal world, shouldn't it be a wash?

CHAIRMAN GREENSPAN. Not if the elasticity of the demand and supply of funds is different between the two sectors, as it surely is.

MR. JORDAN. It depends on its ultimate incidence: How much is borne by the workers in lower real wages and how much by the shareholders--it could hit the stock market harder than the bond market--versus how much is passed on to the consumers as prices. But we don't know enough to answer that.

CHAIRMAN GREENSPAN. [Some of those effects] obviously are occurring today.

MR. LINDSEY. Bill, I don't see that [issue raised] at all in the newspapers. It is rather strange. I see references to a chance of fiscal contraction or $25 billion in extra spending, but I don't see that mentioned at all as a possibility.

MR. MCDONOUGH. No, and we don't hear it discussed in the market at all. The assumption is that that which is virtuous on the fiscal side will not be turned into anything negative in the private sector.

CHAIRMAN GREENSPAN. There is another possible way of looking at this. If the federal borrowing requirement is lowered and a cost is imposed on the economy or on business, there's also the perception that economic activity will slow in the process. And that would not fully offset the downward pressure on long-term rates that would occur as a consequence of the reduction in the budget deficit.

MR. ANGELL. But that again depends upon the elasticity of demand for the products.

CHAIRMAN GREENSPAN. It depends on the elasticity of demand for financial instruments and the incidence of the costs and the incoming productivity trends. The net effect of that has to be to lower GNP. It's a tax and its effect really depends on what is done.

MR. ANGELL. But it seems to me it's quite different if it occurs in a period of sustained monetary restraint than if it occurs in a period in which that monetary restraint is not in place.

CHAIRMAN GREENSPAN. Yes. Any other questions?

MR. JORDAN. A couple of questions. First for Ted, regarding your comments about the effects on [the United States] of [what is happening in] Europe and elsewhere around the world: Isn't it somewhat of a recursive process? I saw a press report about OECD raising its forecast for the United States. By the time that group gets together for the next Working Party Meetings in Paris they will hold up the prospects of a stronger '93, incorporate that in their numbers, and raise their numbers.

MR. TRUMAN. Yes, our forecast is somewhat weaker than the recent OECD forecast and the IMF forecast released today that I heard on National Public Radio. That is partly because we forecast more often and have a faster turnaround in this process.

MR. JORDAN. But in their summer and fall estimates, wasn't it the case that as the prospects of [growth in] the United States came down these other countries were revising down their forecasts?

MR. TRUMAN. Yes, though I think on balance for all of them including the staff [unintelligible] the U.S. story--although it fluctuated up and down within a relatively narrow range over the last 12 months--has been their most accurate forecast, whatever consensus one wants to take. The one that has been the most [unintelligible] has been Canada. Whereas the Canadians, if you go back 12 months, for obvious reasons were looking for a faster pickup in the first half of this year than they actually had, that was one of the factors that weighed on their marking things down [unintelligible].

MR. JORDAN. Let me turn to some questions for Mike about the U.S. economy. I was looking back over the last year--I haven't gone back further--trying to understand the dynamics of the forecasts as they are put together and the subsequent revisions. A year ago at this time the prospects were for the first quarter to be very, very weak. It came in considerably stronger than expected. The change there, of course, between what had been expected and what occurred was the most dramatic--much more so than even for the third quarter--and tended to have the auto-regressive effect of raising the prospects out into the future. The second quarter then came in considerably stronger than expected. At that time you revised down very sharply the third-quarter numbers; I think we were all feeling in that August-September period that things were very, very much weaker than expected. Now we see that the third quarter came in considerably stronger than those numbers, raising not only the reported number for the third quarter--what we have so far--but the forecasts for the fourth quarter and the first quarter of 1993, which also have been revised up. That worries me a bit. If you look back at the third quarter in particular and the reasons for having revised [your forecast] down sharply, with the advantage of hindsight, were there things that would have told you that it was still going to be quite a strong quarter despite the news [indicating strength] in the second quarter? Could that forecasting error have been avoided if we had looked at the right things?

MR. PRELL. Incidentally, the [revised] third-quarter GDP number is 3.4 percent. Maybe there was something; I don't know. If there was, we missed it, obviously. Another possibility is that all those quarterly numbers will be revised in ways that will alter our perception of where we went wrong. To be sure, we are trying to forecast numbers that are consistent with the current scheme of estimation, but there is an erratic quality in this. One wonders whether the fourth quarter of last year was as low and then the first quarter as high, and so on, or whether there are some flaws in the numbers. We pointed out that at this point through the first three quarters of the year--at least before today's revision--there was a somewhat puzzling, growing discrepancy between the income and expenditure sides of the accounts. All of these things I think you need to recognize as the [unintelligible] pattern of errors. But I don't know what magic forecasting tool we missed. I will remind folks that in May or June you were presented with an analysis of how we had disregarded the information from M2. It suggested that our forecast should have been revised down to 1-1/2 percent for the third quarter and for the fourth quarter. So, M2 at that point wasn't the missing forecasting tool, at least applied the way that particular model presented it. I just don't know what it was.

MR. JORDAN. Let me shift this in a slightly different direction. I'm still trying to understand the interaction between what we do and how that works in your thinking about the economy in the Greenbook exercise. In the beginning of the Greenbook, the first page, second paragraph gives two alternatives. The first one says the upside surprise in the second half is confirmation that cuts in short-term rates can still be a potent stimulative force even in the face of various financial strains and so on. As I understand it, that's kind of a linkage in your model. At an earlier point nominal interest rates rose, representing a restrictive policy. And with a very long lag inflation is coming down. In the meantime nominal interest rates also were declining, giving some positive effect on the economy. But at some point [in your forecast] nominal interest rates stop declining, but [for a while] inflation continues to come down so real interest rates start rising. So, the reason you have 1994 real [GDP growth] slowing with the same nominal interest rates or even slightly higher nominal interest rates is mainly because inflation continues to decline and real interest rates go up.

MR. PRELL. Well, let me say two things. One is that after having lowered the real short-term rate, even stability means that the time profile of growth rates of GDP will show a bulge and then will come back down as the level effect peters out. The growth rate effect disappears and becomes negative. But we've added on to that a rise in nominal short-term rates in 1994 plus the further modest deceleration of prices, which enhances the increase in real rates. And, yes, the rise in real interest rates in 1994 is a factor in this forecast.

MR. JORDAN. But if I read it right, isn't that the primary factor slowing real GDP growth in 1994?

MR. TRUMAN. The other factor--I hesitate to mention it--is the appreciation of the dollar, which is partly a function of what is going on with U.S. real rates and partly what we assume is going on with foreign real rates. That's the major factor in the attenuation of growth on the external side, the net exports side, in 1994. The appreciation building over a two-year period begins to have effects. It's like a tightening in monetary policy, [resulting in] weaker growth in the short run. The stronger dollar affects '94 predominantly.

MR. PRELL. Just to be clear on why we've done what we've done: Obviously, we need to make some decision about what assumption to base the forecast on. In this case we're making some judgment about where the Committee desires the economy to head. Starting with one rather simple observation, which is that real short-term rates now are very low and lower than we think would be consistent with some steady state, and secondly that the other financial restraints in the system will presumably diminish over time as capital positions of financial intermediaries improve and so on, it seemed to us that at some point the short-term rate should go up. We could have postponed that until beyond 1994, but in our assessment of the trends in the economy that ran the risk of overshooting going out into 1995--hitting full employment and tending to head through it and thus reversing the disinflation process. We could fine-tune this, but that is the basic sense of what is behind the interest rate outlook.

MR. JORDAN. Just to be clear: You have been saying that the modest increase in nominal interest rates you built in or the increase in real interest rates resulting from lower inflation has its dominant effect in '94.

MR. PRELL. Well, the reduction in inflation was less than the nominal interest rate change. We notionally put in about 3/4 of a percentage point increase in the nominal federal funds rate. The disinflation at that point is progressing at several tenths per year. So, it's a small element in this rise in real rates.

MR. JORDAN. The reason I ask the question--and I don't know how to incorporate the international effects that Ted referred to--is that there seems to be a crosscurrent in our discussions between the concept that the economy tends to expand in the absence of various depressing forces that are retarding economic activity, and somehow policy may work against those adjustment constraints, versus the view that the economy tends to stagnate in the absence of stimulus to make it go forward. I'm trying to get at how, at least in the Greenbook projections, what we are doing with respect to policy comes to bear on the forecast.

MR. PRELL. Our notion is that, yes, there are natural equilibration processes in the system. With adequate monetary expansion, there are corrective mechanisms through the price system that ultimately push the system back toward [equilibrium]. But those take time; and it's rather hard for us to define this in terms of some monetary path, given the uncertainties.

MR. TRUMAN. But those could be short-circuited, too. I'll give an example in a European context--maybe it's a far-fetched example: One could argue that in Germany, given what they've set in motion, if they don't ease short-term interest rates, it essentially would be using policy against the natural lubricating forces in the economy. So, if policy is too tight for any extended period of time, ultimately maybe the economy could adjust to sustained high levels of short-term interest rates of 8 percent or 9 percent, but you'd have to tell a very complicated story about how you got to that--

CHAIRMAN GREENSPAN. Further questions? If not, who would like to start our Committee discussion?

MR. BROADDUS. I'm happy to say, Mr. Chairman, that the latest information on conditions in our District is quite favorable and actually more optimistic than some of the information underlying our report for the Beigebook. It seems clear that economic activity in our region is advancing at a faster pace than we had thought to be the case earlier. There are a number of indications of this. One indicator that we are looking at now with respect to the District's overall performance is the states' withholding tax collections. They have been running ahead of projections in several different states now through the month of October. We don't have full data for November, but in Virginia at least that's continuing through November. Sector-by-sector we're getting very strong reports on Christmas sales in every District state. There also are signs of greater strength in housing and manufacturing. And perhaps of more than passing interest, we are beginning to hear at least a few slightly good things about commercial real estate markets in our area. Specifically, we're told that markets for both retail space and office space are beginning to stabilize. We have some evidence that office vacancy rates have actually declined in a few areas in our District and rents appear to be bottoming out, all of which strikes us as hopeful and broadly consistent with the Greenbook projection of some improvement in nonresidential investment in the quarters ahead.

As far as the national economy is concerned, we think the Greenbook forecast is certainly plausible. While the growth of GDP shown in the projections for '93 and '94 is pretty subdued and the unemployment rate remains quite high at the end of the projection period, there is a further decline in inflation. So, all in all, the Greenbook projection strikes us as a reasonably favorable near-term outcome if we can get it. We could definitely do a lot better, but we could also do a lot worse. We think there are risks on both sides of the projection. We think the biggest downside risk is the possibility that both the Japanese and European economies could turn out to be weaker than projected. But there also are upside risks as we see it, both externally and on the domestic side. As Ted Truman mentioned, fiscal stimulus is already in the process of being put in place in Japan. There is certainly a possibility that the Bank of Japan will ease monetary policy further in the near term. There is a widespread expectation that if conditions in Germany remain weak, we also will see some easing by the Bundesbank at some point. So, it seems to us that there is at least a possibility that the external picture may be somewhat brighter than the Greenbook projections as we move into the second half of next year and the first part of 1994.

On the domestic side, we in Richmond sense a much more solid and more permanent increase in aggregate demand and in both household and business confidence now than in the other several episodes of accelerated growth so far in this recovery. Netting it all out, we think the overall risk in the outlook has shifted rather decidedly toward the up side in the last several weeks, and we think it would be appropriate for the Committee to take account of this in reaching its policy decision this morning.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, in terms of the District, the level of economic activity continues to increase. Coming into the last meeting, conditions were starting to show signs of improvement and, if anything, the rate of improvement has accelerated a bit as we came into this meeting. And I do think this improvement is fairly broad-based. Auto sales have been a little better. The first-quarter production schedules have been set about 15 percent over last year, so that's a good increase. The auto manufacturers are anticipating an improvement in the sales level next year that is still below what they describe as the baseline but it is higher than this year. The heavy truck business has been particularly strong. Sales of Class 8 units are up 15 percent this year and are forecast to be up another 16 percent next year. The backlog now is some 12 to 16 weeks for these units; it's pretty broad-based and is viewed as quite strong. Steel production continues at a good level, operating at about 80 percent [of capacity]. Steel producers also are reasonably optimistic about next year. And certainly the international trade cases that are currently going on ought to be beneficial to the industry. Between the subsidy constraints and the dumping constraints--and I think the latter will be announced later in January--they are expecting that imports next year will be reduced by 4 to 5 million tons. That should also have the effect of improving the operating levels of the industry by some 5 percent, and they would expect that to occur by the end of the first quarter. This ought to provide a better environment for pricing, which continues to be very, very rugged.

Retail sales in the District continue at a good pace, but I must say some of the strength that we saw early in the Christmas season has eased a bit in the last few days. This is a very tough period to judge because the selling season is longer, but I must say many of the people that I've talked to who earlier were expecting, say, an 8 percent increase this Christmas season now are talking more in the area of 4 to 5 percent. We have particularly strong [sales] in communications equipment. Orders for communications equipment bottomed out in mid-1991 and have been increasing rapidly at annual rates of 20 to 25 percent. The expectation for next year is that growth will be a little lower but still some 15 to 16 percent ahead of 1992. Even in the agricultural equipment business, there is a little better tone, or at least it's not worse. One major manufacturer is expecting a 5 percent increase in unit sales next year, but that is after a 12 percent decline in '92 and a 9 percent decline in '91. So, it's an improvement from a pretty low level. I will say, though, that inherent to the better outlook for '93 is the expectation that an ITC tax will be enacted, which will be beneficial to agricultural equipment.

The inflation news continues to be very good. To hold down their cost of purchases, large companies are exerting tremendous pressure on their suppliers with very good results. More than a few, in fact, have achieved reductions in the average cost of their purchases this year and they are expecting equally good results next year. Competitive conditions in the marketplace make it awfully tough to increase prices. Labor contracts continue to be negotiated on favorable terms, and certainly this continuing drumbeat of layoffs and plant closings has an effect on labor expectations. The fact that of GM's 28 planned plant closings 12 so far have been in Michigan certainly is unsettling to employment conditions in that state.

Turning to the national economy, while I do think the outlook has improved--certainly we have no reason to question the staff's forecast--I must say that I continue to have at least lingering questions as to the underlying strength and sustainability of the recovery. The employment numbers that will be coming out over the next few months I think will give us pretty good indications as to how things will work out next year.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, economic conditions in most states of the Twelfth District are improving, but deterioration continues in California. In District states outside of California, employment grew at an annual rate of 3-1/2 percent in October, and employment in these states is now roughly 0.9 of a percent higher than it was a year ago. Employment growth is consistent with anecdotal reports of strong retail sales and renewed consumer confidence in much of the West. However, contacts in the state of Washington report widespread concern about the area's future due largely to Boeing's announcements of cancellations and delays of aircraft orders and resulting layoffs. Despite these concerns, many contacts report that current business conditions in the state of Washington are actually quite good, and employment in Washington actually picked up smartly in both September and October. In contrast, there is no sign of improvement in California, a point that I'm sure you've read about in several articles so far this week. Employment continued to decline in November, bringing the decline to 155,000 jobs or 1-1/4 percent, compared with a small rise in the national economy. Defense cutbacks and commercial real estate problems will continue to be a drag on southern California's economy for some time, and budget problems will lead to cutbacks in levels of state and local government spending throughout the state.

Turning to the national economy, recent economic data actually have been encouraging. It's possible that a moderate expansion may finally have taken hold. Although we are not quite as optimistic as the Greenbook concerning economic growth next year, we have raised our forecast moderately to about 2-1/2 percent in 1993, assuming no change in policy. Most of the pickup is likely to come from interest-sensitive sectors: consumer durables, housing, and business equipment. Consistent with this moderate growth, the unemployment rate is likely to decline only moderately over the next couple of years and we would expect the CPI inflation to come in somewhat lower than that forecast by the Greenbook. Thank you.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I'm happy to say that the outlook for the Sixth District looks much more positive than it has for some time, and the improvement that we're seeing seems to be pretty much across the board. The Christmas surge in retail sales looks quite promising; it looks to us as if the South may very well lead the nation in this area. Spending is the highest in four years and is broadly based. Home furnishings and durables in particular are generally quite strong. Retail sales are beginning to spill over into manufacturing. Inventories were quite light at the beginning of the season and now manufacturers and transporters are reporting unusually heavy activity for this late in the season. Both home furnishings and white sales have a disproportionate representation in regional manufacturing and employment [growth] as a result. The pickup in housing nationally is seen as well in the District; the building associated with Hurricane Andrew is helping the Sixth District. Our survey of manufacturing plants was also more positive this time. That survey suggests that capital goods orders are likely to increase over the next six months. Moreover, more than 40 percent of the respondents expect to add workers over the next six months as compared to about one-third last month. The anecdotal information that we're getting from a variety of sources suggests that consumer and business confidence has shifted noticeably since our last meeting. We've pretty much stopped hearing negative remarks even from our small business advisory council members, and we are now confronted by what seem to be overly optimistic expectations--most frequently reported by retailers. So, I think the pendulum has swung from perhaps overly negative to perhaps overly optimistic. The inflation news continues to be relatively good in the District.

To be sure, there are some negatives to report, although I don't think they are likely to tip the balance the other way. In particular, on the employment side, just when we thought we had seen the end of the consolidation and cost cutting, we are now hearing of new layoffs and cutbacks, particularly by Delta Airlines, which obviously is a major employer in our District. Many of our state governments are doing better than they had been, but Louisiana and Florida still face financial pressures. Finally, the energy sector is still in very poor shape, and that affects the Gulf areas particularly. But clearly, as I said at the outset, the situation looks much better than it did even at the last meeting, and the outlook seems encouraging.

Looking at the national economy, over the entire forecast horizon our forecast is very similar to the Greenbook although we have growth [turning up] a little sooner. Both consumer and business spending on durables is higher in the Greenbook forecast than in ours. And the Greenbook sees relatively more of these durables consisting of imports than we do; as a result we have a less negative outlook for net exports even though the export growth rates are fairly close. We have a lower unemployment rate throughout the forecast. A difference that I've been reporting for some time is in the inflation numbers, where our forecast for inflation remains somewhat higher and is probably closer to the Blue Chip forecast. When I put all of this together, it does seem to me that the expansion has greater possibilities for being sustained this time around, and I think the risks to the economy are more symmetrical than they have been for some time.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. The District is generally better both in tone and activity but still is lagging the nation. There's something about that Mason-Dixon line which seems to make things go faster below it and more slowly above it!

CHAIRMAN GREENSPAN. Excluding California.

MR. BOEHNE. Right. The shift in tone is more pronounced than in activity. I agree with someone else's remark at the table that people are more optimistic relative to activity than they were before when in my view they were too pessimistic given the level of activity. In terms of the sectors, manufacturing is up and retail sales are up--I don't think as much as in the Atlanta District, but our retailers are generally happy about the Christmas season. We hear more comments about improvement in residential activity. And bankers keep talking about improvement in loan demand--if not in loans booked at least those in the pipeline. But having said that, there still are some clear areas of weakness. Job growth is generally quite soft in the District. The reports from heavy industry, notably steel, are quite weak. I haven't really done this in any scientific way, but it seems to me that if we have a group of small and medium-sized business people and a group of big business people, the big business people don't share the same kind of better feelings that the smaller business people have. The commercial real estate market is still quite flat. I had a group of people from that industry in and I suggested it might take three years, perhaps five years, to get the District turned around, and I was told that that was considerably too optimistic. They were talking well out into the decade.

On the national scene, I think the key issue--and it has been underscored already--is whether we now have a self-feeding moderate recovery going. I feel better that we do have one going at this point. I would put the risks at about even on the up side and the down side. The key continues to be employment growth. If we get some moderate employment growth in the months ahead, then I think [the recovery] will be self-feeding. If we do not--and I think that is potentially the weakest link--then we could still have some difficulty. Also, the downward pressures on inflation rates continue. It is difficult to make price increases stick. The layoffs that are reported in the newspapers help keep wage increases down. And I suspect we may do better on the inflation front than the Greenbook suggests.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I'd like to make three comments on the national economy. First, just as a lesson for the future, I'd like to remind us all that as recently as two meetings ago we couldn't see the strength that was unfolding in the second half. That isn't a criticism of the Greenbook forecast. It wasn't in our forecast; it wasn't in other forecasts; and it wasn't in the anecdotal reports. We were standing right on top of it and we couldn't see it. That's just an important lesson to remember going forward. It's not a question in my mind of whether we made mistakes in the forecast. It just points out how difficult it is to do that and really use it as a basis for making policy decisions. Secondly, I realize that Mike has to make an assumption with respect to what policy is going to be, but it's just inconceivable to me that we'll get through 1993 without an increase in the funds rate. The real issue may be that we are probably lucky to be getting out of 1992 without making one; I think it's something we're going to have to be thinking about a lot sooner than [the staff's] assumptions might imply.

The final point I'd like to make, and it relates to the second one, is that it troubles me greatly when I read pieces in the paper--I don't hear it around this table--about how we need to have more economic stimulus, whether it's fiscal stimulus or monetary stimulus, to increase the rate of employment growth. In my mind, the reason that we're seeing sluggish employment growth is that we're getting good productivity gains, and that's what one would expect at this stage of the cycle. Those gains are going to provide the basis for increased output and income and eventually employment down the road. To jeopardize this basic setting we have of declining inflation or to jeopardize the progress that we're making toward price stability in order to try to increase employment gains would be a mistake. The final observation I'd make on that particular issue is that just because of demographics and slower labor force growth, we won't be seeing the kind of employment gains that we've seen in other recoveries. That's an important factor in that.

With respect to the District, my comment would be that in employment basically we're seeing a pickup in momentum. For a good deal of the months during the middle part of this year, I wouldn't say we were lagging but the pace had slowed to that in the rest of the country. I'm seeing increased momentum in the most recent three-month period in relation to the last year and significantly higher gains both in the last three months and over the last year than for the nation as a whole. So, we have another one of those situations where there are very significant regional differences that are somewhat masked in the overall numbers.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, our District continues to improve modestly, although we would note that the anecdotal evidence is much stronger than the statistics are showing. Our energy activity continues to improve, especially in gas drilling. Our agricultural area is sound, with improving livestock prices offsetting some of the negatives from the lower grain prices. But overall, our agricultural income is still solid. Construction activity generally is improving a little more modestly, but the single-family housing area is very strong, particularly in the western part of our region. In manufacturing, although we continue to hear about expansion plans by Ford Motor Company in our area, that expansion has not taken place yet. Our manufacturing job growth is flat for the time being. We hear a lot of optimism from our small business groups. They are still saying that they would like to expand even more but are having some difficulty getting credit from banks; that's on their minds still.

On the national front, we anticipate growth as we look out to 1994 similar to that of the Greenbook, although our path is a bit different and a little more modest inintially. Still, we end up about in the same place. We are a little less optimistic on consumer demand, though. We also see improvements in inflation. We've revised that somewhat; it's not quite as favorable as we thought earlier. Overall, though, we think the economy is expanding at a persistent pace going forward into 1993.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I have reported for some time that the District economy was expanding, and it is certainly continuing to do so. The tone of the anecdotal evidence suggests that there has been some further distinct strengthening. In fact, in some ways the anecdotes sound like what one would expect early in a recovery, which of course is not [the case for] this expansion chronologically. In some of the sectors, though certainly not all, people are turning ebullient; I'm talking about housing, autos, and retail sales more generally. Whether this is just a spike or something that is sustainable remains to be seen. But clearly, in the District at the moment things are going better in terms of expansion and there is still virtually a total lack of inflationary pressures, at least according to the business contacts we have. So, in most circumstances, things look quite positive.

With regard to the national economy, I don't have any problems taking the Greenbook forecast as a base. If I were looking for downside risks, I would point to the foreign situation. Business contacts in the Twin Cities that do any amount of business in Europe or Japan have reported exceedingly negative results recently. They suggest to me that those economies are far worse than I at least had understood them to be. Whether that is a precursor of things to come is much more difficult to say. But clearly, they report very bad conditions and, at least as far as their own businesses are concerned, they are not optimistic [about the outlook for exports]. On the other hand, though, putting that one risk aside, I would not be at all surprised to see the national economy grow somewhat more rapidly than the Greenbook suggests. My reading of history in the postwar period at least is that once the economy develops some momentum on the up side--and I think that may be in the process of occurring--we tend to be surprised both at its duration and, for a time, at its magnitude. While the Greenbook forecast for the most part has a rather nice, steady 2-1/2 to 3 percent growth quarter-by-quarter, if momentum is really building here, I think for a time we will see more rapid growth than that.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thanks, Mr. Chairman. Tom Melzer referred to the regional differences. In listening to what has been said here, I am somewhat struck by the fact that we do have quite pronounced differences--I don't know exactly where the line is--in the north of California and in some other parts of the country. In terms of activity, I would say that in the New England region nothing is very different than at the time of the last meeting, but there is a palpable improvement in mood and attitude. I don't think there is anyone who is ebullient in New England at this point, but retailers are considerably more optimistic about Christmas. They have seen better activity so far and, interestingly, in the nondurables area. There are the usual complaints about margins, with price competition being very severe. Where the final retailing figures will come out in our part of the country is not completely clear because retailers did lose two days with the storm last weekend. They think they will get most but not all of it back, but that will offset a lot of the extra two days in the shopping season.

The employment markets remain relatively soft with hiring being impacted by continued layoffs. In our District that includes IBM and of course the defense sector, which is going to [lay off workers] for some time. One sector where we do see some improvement is in housing, consistent with what other people have said. Housing prices have stabilized and in fact some isolated markets actually show increases. We also think it's going to take a long time for the commercial real estate sector to work out its problems. Our banks say that they are seeing some improvement in loan demand, with some growth in loans; but that is being offset in terms of the gross figures by paydowns from other sectors. Like other people, our manufacturers have expressed a great deal of concern about the exports side. We have a lot of people who sell things [abroad], including non-price-sensitive high-tech kinds of things, who are seeing a quite pronounced slowdown in Europe. Perhaps like Richmond, our tax receipts are showing some improvement; but interestingly they are more on the sales side than on the income-related withholding side, where we really haven't seen improvement.

For the nation, I think there has been a definite improvement; one can't help but be impressed by the breadth of the sectors reflecting this improvement. I still have concerns about sustainability, though I have to say that is something only time will tell, given--to use Don Kohn's phrase--the litany of structural drags that we have. I have a real concern about exports, which is particularly reflected in this work done by Johnson, et. al. Overall, we're somewhat more optimistic on the price side and somewhat more pessimistic on the growth side on a marginal basis than the Greenbook. I think at this point the risks are pretty symmetrical. Things are improving but the sustainability is not guaranteed at this stage.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. The sharp improvement in tone since the last meeting that Bob Forrestal reported for the Southeast occurred one meeting earlier in the Southwest. The District economy has remained very positive during the past few weeks, but it hasn't continued to improve. We continue to do a little better in the Southwest than the country as a whole. During the past year our employment has grown a little over a percent and a half. At the last meeting, I reported that one of the sources of strength in our District has been Mexican shoppers along the border area. I should mention this time that the Mexican authorities have imposed a $50 limit on what may be brought back duty free in cars and on foot across the bridges.

CHAIRMAN GREENSPAN. Didn't that cause something of a riot?

MR. MCTEER. There was a riot in Nuevo Laredo over that. It's good to see people rioting because of limits on their imports rather than consumer exports! This has happened before at Christmas time when the outflow of cash has been extreme, but it is causing some very sharp cutbacks in a lot of our border towns. Some of the Kmart and Wal-Mart stores are showing a drop in sales of up to 30 percent over these past few weeks because of that.

It seems that things are going well nationally with the 3.4 percent growth in the third quarter and prospects for about the same in the fourth quarter. The risks do seem to have balanced out on the up and down sides. I think policy is in a good position, and the only thing I'm still a little concerned about is the very slow growth in M2. It would have been nice if we could have ended this year at least touching the lower bounds [of the ranges] for M2 and M3. That gives me some concern for the future, but for right now I think we're in good shape.

CHAIRMAN GREENSPAN. Do you have a question, Bob?

MR. PARRY. Yes, I just want to comment on something Tom Melzer mentioned about regional disparities. I mentioned in my report on California the decline of about 155,000 [jobs] in the last six months. If we back out California from the statistics, we get almost a completely different picture of what is happening: We see an employment picture in terms of nonfarm employment where the rest of the country is up 300,000 in the last six months. That's not robust but it is increasing. If we back out California from the civilian employment numbers, we get an unemployment rate of 6.8 percent, and we would have started from the same point.

CHAIRMAN GREENSPAN. Are you about to suggest something? [Laughter]

MR. PARRY. We are not seceding...yet! What I'm suggesting is that a majority of people in the country are experiencing something very significantly different from what a group of people in one state, or maybe even half a state, are.

MR. KELLEY. That has been going on for a long time.

CHAIRMAN GREENSPAN. What is the difference at this stage as you see it between northern and southern California?

MR. PARRY. There's a significant difference: 80 percent of the loss of employment is in southern California. They have about 60 percent of the jobs. Parts of northern California--for example, the Silicon Valley--show some strength. Intel has added 1600 jobs in the last year. We now talk about the United States as being the leader in d-ram chips at this point. Biotech is doing quite well. So, there are signs of relatively robust activity in the north, although I don't think they approach what we are seeing in the Dallas District or the Atlanta District. It's very concentrated. Although it's dangerous to take an area out and set it aside, as I said, the national figures in some respects don't give a good indication of what is happening to the overwhelming majority of people.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. It seems apparent that the economy is stronger than we had anticipated. I think the question we should be asking ourselves is why. Now, it may be that this is a normal cyclical surprise, but I doubt it because normally we get a monetary aggregate like M2 growing at a fairly rapid rate in a recovery period and normally we get some upward movement in commodity prices as recoveries begin. This recovery doesn't have those features and yet we have surprising growth in the midst of a period in which pessimism was the predominant view. If we ask why, I think we may ask ourselves whether we have underestimated the short-run growth stimulus of getting the rate of inflation down. We have decreased the tax rate on capital goods by lowering the rate of inflation, and that may have been in place long enough now to be giving us some real lift. We're also seeing a labor productivity rebound which has been as strong as it has been in a normal cyclical [stage] in which employment and output both were growing. So, this is something that we ought to keep in mind. The one awesome worry out there is the external situation. Will slow growth abroad and will the penchant for protectionism through either tariffs or subsidies or whatever cause the world's economy to be derailed? That's still a worry even though the U.S. economy does seem to be well on its way to sustained expansion. Now, it seems to me that the price level in the United States is still rising but at a decreasing rate. And it seems to me that the price of gold may be falling at a decreasing rate. Somewhere in here, if the rise in prices levels out at 3 percent, we may be missing a wonderful opportunity. If short-run growth does respond as well as we might believe to lower inflation expectations, it would be unfortunate if we lost sight of the goal of monetary policy at the very time in which the field is most fertile for achievement of our long-term goal.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, I have a Christmas present for the Committee! I'm going to spare the Committee my usual comprehensive and picturesque discussion of the economy sector by sector. I simply want to make the point that I remain more optimistic than the staff does about where we're going and the pace at which we're going. The thing that puzzles me about the Greenbook projection is that the relatively slow rate of growth in 1993 and continuing into 1994 and the major slack reflected in the unemployment numbers would indicate a more rapid rate of progress on the inflation front than is contained in the Greenbook projection. My own feeling is that the growth rate of GDP in 1993 will probably be up to 50 basis points higher [than the Greenbook forecast] and I think that rate of growth may be consistent with somewhat lower unemployment numbers and with the Greenbook projection on inflation. In summary, I feel more optimistic about the rate of growth in the economy and the rate of decline in the unemployment rate than the Greenbook. I think the risks in the projection are about symmetric with a slightly greater tilt toward the upside risk.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Well, the situation in my part of the country brightened considerably on two occasions since the last meeting when the sun came out very briefly. It hadn't happened since September. It did improve the mood of the place.

MS. PHILLIPS. Sensitive about this are you, Jerry?

MR. JORDAN. Like some others have commented around the table, the shift in mood is striking. People were reporting their own situations as not so bad but we were getting this disparity between what they saw nationally and how gloomy they were versus their strong order books, their backlogs, their goods production, and so on. So, at the time of our October meeting when the downbeat mood was so pervasive--including here--I was hearing the same thing from all the business groups and directors and others. That has totally vanished. Nothing has changed in what they say about what is going on in their own situations. Housing is still good; retailing is good. As Si Keehn reported, [sales of] heavy trucks are very strong--about the best in five years. We assemble a lot of light vehicles--small trucks and vans that people use as cars--in our District and they are also very strong. The gloominess comes from the large international corporations that have foreign operations. The negative commentary is very, very strong about Canada and Europe. I don't know whether to give more weight--

CHAIRMAN GREENSPAN. They are including Canada in that?

MR. JORDAN. Yes, they are including Canada because of labor costs and the political situation; they're still very worried about the cost of benefits. One major manufacturer who has a very large operation up there says that by far his most productive, efficient plant in the technical sense is in Canada, but he cannot get contracts in the United States because people do not trust having to depend on a Canadian supplier.

Turning to the national scene, I don't know whether to give more credence to what is now an upbeat note in the outlook than I would have to a downbeat note three months ago. My bias is to think that the economy does tend to expand. As Gary Stern was saying, the history would say that once the economy starts in an upward direction, revisions tend to feed on themselves, as we've seen this year so far. The numbers come in stronger than anticipated and the revisions generally tend to be in an upward direction. I think that has sustainability. I don't think it's symmetrical; there's a natural bias in an upward direction. So my own national outlook would probably be stronger than what the Greenbook says.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, as far as the outlook is concerned, our forecast is essentially the same as Mike's, so I think that's a reasonable point of departure. The export sector probably is the area that I would worry about most in terms of a conventional assessment of the forecast. On the anecdotal side, there are a couple of things I want to mention briefly. First, in the case of very large multinational corporations--and I'm not limiting this at all to IBM--it's quite clear to me from the comments I get from CEOs that this restructuring process has not run its course. That still has a ways to go. IBM may be symptomatic of that, but I'm getting that from CEOs of other very, very big companies as well. Second, from the anecdotal area, there is some life in loan demand out there. It's not pervasive and it's not robust, but it is there. And consistent with a number of comments others have made about retail sales and so on, some very large credit card issuers, bank and nonbank alike, are telling me that credit card usage really is up. Interestingly enough, even though usage is up, paydowns continue and payments against usage are coming much faster than they have in the past so that among other things the levels of card usage debt are probably not capturing fully the rate of card usage in the past four to six weeks.

In the commercial real estate area, I want to echo something Ed Boehne said earlier. We still are getting anecdotal reports that suggest that price declines probably have bottomed out and that rental rates and concessions are probably bottoming out. However, I have just heard for the first time over the past couple of weeks that some people are adding on to the length of the work-out process. The reason is because they are becoming more aware of rather large pockets of space currently under lease that have been essentially vacated as employment levels have been reduced, in the financial sector in particular. That means that these various statistics of vacancy rates aren't telling the whole story. As a result of that there is a bit, not major, of adding on--quarters as opposed to years--in terms of the work-out process. Another thing about this burst of confidence, if that's what it is, is that I think the election phenomenon has something to do with it.

CHAIRMAN GREENSPAN. That could be the ending of the campaign!

VICE CHAIRMAN CORRIGAN. I think that's part of it, but what has fed on that a little is that a lot of people, including red blooded Republican businessmen and women, are very impressed by what they seem to [observe]. The problem is that if what you get is not what you see, that process of feeling good can reverse itself very quickly. So, I think one has to be a bit cautious about that. My own sense of the risks [to the economic outlook] is a little hard to describe because I don't think of the risks in quite conventional terms. I think there is something greater than a zero possibility that all of this could turn out to be another flash in the pan. But I don't view those risks as high, which is another way of saying that I think there is a little more to this, barring a big disappointment on the fiscal budgetary side, than we've seen in the past. But consistent with what Gary Stern and several others have said, it's not hard for me to visualize circumstances in which growth over, say, the next four or five quarters could be stronger than projected in the Greenbook. I wouldn't bet my life on that, but it isn't hard for me to see circumstances in which that could in fact materialize, especially if this burst of confidence is bolstered by what turns out to be sound national policies, including budgetary policies. So, I have a little trouble trying to balance the risks because in one sense I don't think they lend themselves to any kind of statistical probability basis; but I certainly would not rule out the possibility that the economy could actually turn out to be a bit stronger even though, as I say, I do not consider the risk to be zero that it could fall on its face again.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, 1992 has been a great year and it's too bad we didn't enjoy it until December! But now that we have a President that the Washington Post credited with the upward revision of the October retail sales data and who has an expansion named after him that started in the third quarter of the year before he took office, I think we all should just hang it up and go on vacation! I wasn't going to say anything, but I'm going to anyway. As a way of introduction, Don Kohn talked at the Christmas tree lighting ceremony about a tax-free, regulation-free enterprise zone at the North Pole and then introduced me as the Fed's only certified supply-sider and, therefore, the person who should talk about it. So, I'm going to take that tack.

I have to agree with a lot of the comments here that (a) quarter-to-quarter projections are hard to make and that (b) if anything, we should be biased at the moment toward a slightly faster expansion in the quarters ahead. But I'd like to look down the road just a little at what I think are some of the problems headed this way. First, I'll pull out my supply-sider's list of longer-term problems this economy was facing in May 1990; it is a list that I was asked to create in my last job before the current recession began. The three that were on that list were: the expansion of OSHA that occurred in the Bush Administration; the Clean Air Act; and wetlands. Just to show how important these can be in terms of our hitting a brick wall, I'll relate a story from who comes from Wisconsin. As a biased Easterner, I always think of Wisconsin as a place where housing inflation should never occur. But he tells of tremendous housing inflation in Wisconsin because of a shortage of nonwet land to build on. They've had something like 12 to 15 percent house price inflation up there, which means that what they are hitting really is supply constraints. That as well as clean air are going to be examples of our hitting supply constraints earlier than we otherwise would.

The second area of supply shock I see comes from labor market changes. I think labor market legislation is made all the easier during a period of expansion, so I think we're going to see striker replacement legislation, an increase in the minimum wage, and even more aggressive Civil Rights legislation, all of which are going to put upward pressure quickly on costs in the labor market. Finally, I think the chances of a supply shock on the international side are high. I agree with the forecast that the dollar is going to rise and that our trade deficit is going to increase, and the supply-side result of that is increased protectionism--probably starting as a game, but one never knows when it will get out of hand. All of these factors suggest that, if anything, what we're going to see is an increase in measured inflation sooner than we otherwise would expect. But what is different about it, and what I hope we keep in mind in 1993, is that inflation induced from these factors is not a monetary phenomenon. It is a one-time increase in costs that will ultimately be played out in the form of lower GDP. So, my wish for 1993 is that the staff forecast is right; but my fear for 1993 is that, if anything, we're going to see more inflation sooner than we'd like, and I'm afraid we're not going to react properly to it.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. That's the first sour note of the morning, really. The main thrust of what we've been hearing this morning from the Districts is highly encouraging, though certainly not totally ebullient and appropriately so. I would suggest that perhaps the character of the progress the economy is making here is not really changing that much; we may be seeing basically more of the stop/start kind of pattern that we have seen in the past, hopefully at a somewhat higher level but of the same general character. That would imply that there will be downside news along with the upside news. It would certainly appear that we're building upside momentum here, and that's great. But it continues to struggle against these drags that we've had for a long time and that certainly haven't gone away: the downsizing in defense, the real estate situation, the deleveraging, and the restructuring. We know that litany. It seems to me that we may be seeing the upside momentum struggling against these drags and slowly gaining the upper hand, but perhaps that episode isn't over yet. Where does all of this net out? Well, one senses that the risks appear to be tilting in the upside direction, but it's probably too soon to be very sure of that; maybe they should be characterized as symmetric. I took very much to mind Tom Melzer's remarks earlier of where we were two meetings ago and what happened immediately thereafter. I think we'd all agree that gives us all plenty of reason to be humble when it comes to making projections. I'm struck by the fact that so many people this morning have said that the tone of things is leading the statistics. That's probably to be expected; on the other hand, it's not to be trusted either. So, we undoubtedly have challenging times ahead and difficult choices out there. Maybe they will come sooner than we think. They're probably going to be on the up side, but it's too soon to be totally confident of that.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Well, I don't have much to add. I agree with Larry that we've had a great year; we didn't know it.

CHAIRMAN GREENSPAN. We didn't appreciate it.

MR. MULLINS. We didn't appreciate it. We only learned about it in the last week or two, but we should take the next week off and celebrate. I agree with Governor Angell that we should think about why we had such a good year. It's certainly not money growth; the economy has been growing on velocity increases, whatever that is. And it's certainly not employment growth either; the economy has been growing on productivity increases. So, as best I can figure out, the economy has been running on fumes so far in '92. I don't think the numbers have changed much from what we expected earlier in the year even with the ups and downs. So far growth for the year is only 2.6 percent, which is pretty good; and we probably will do a little better than that. I suppose one of the motivating factors could be the election psychology. One would hope that it would turn out better here than it did in the United Kingdom and other places where they've had that phenomenon. I suppose there is the upside risk that Jerry mentioned of sound budgetary policies at the federal level. I guess I have a lot of confidence that that's not too great a risk. [Laughter] We do seem to be lifting ourselves gradually out of the mire. I see nothing robust even in these latest numbers and no real signs yet that we may be approaching an overly robust upturn. The risk is that, despite the slack the staff talks about, we don't have nearly so much slack as after the last recession when unemployment was 10 percent and capacity utilization was probably 70 percent. In terms of sustainability, I'll feel a lot more comfortable when we do get employment growth; also, some money and credit growth would be nice. We probably have had some marginal tightening from the dollar and from the increase in short- and intermediate-rates as near-term inflationary expectations have fallen. I also think the reduction in long rates could well be reversed very quickly once we see the character of Congress's pent-up demand for spending as this process gets started. To me one of the interesting things we're going to have to face is the coming collapse of M2 growth again. In February, the next time we meet, we could well have had two months of zero M2 growth and once again be back in that debate over what sort of policy we're following at the time we decide on next year's ranges. I would just conclude by saying that we should take the rest of the week off and celebrate a job well accomplished!

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. The reports that we've heard today and the reports in the last week or so are certainly the strongest evidence since I've been on the Board that the economy appears to be breaking out of this pattern of fits and starts that have characterized this recovery. Still, the persistence of regional differences remains a concern. I think the signs that are perhaps the most encouraging coming out of this plethora of news include the steady improvement on the employment front and in consumer confidence. Maybe it's the fact that we've now had six quarters of positive GDP that is finally dawning on people. Or maybe, as some have suggested, it's the post-election phenomenon. Or maybe people are just plain tired of being down in the dumps and generally depressed. We're making good progress on housing; industrial production seems to be on track after a bit of a swoon in the early part of the third quarter. We're seeing some small improvement, some strengthening, on the credit side. It seems very tenuous considering the situation that we've seen on business bank borrowing in December but still there's some improvement there. We have stronger corporate profits. The stock market has been holding up. The Dow hasn't moved a lot over the year; other indexes have improved. But overall, given the rather high PE ratios that we're still seeing, the fact that the stock market has held in there as long as it has is a good sign. The flattening of the yield curve is a generally good sign. I hope that is sustained and that it continues to flatten on the long end. Generally, the financial sector seems to be in better shape now to support a recovery than we've seen.

I'm glad to see that some of our discussion here today has centered on inflation. There are differing views as to whether or not we're starting to see a buildup of concerns with respect to inflation. And I was glad to see the extensive analysis in the Greenbook on inflation. Concentrating on a variety of indicators--looking at the PPI components, commodity prices, and the wage indexes as opposed to just the CPI--I thought was helpful.

Like others, I have some gnawing concerns as we go into 1993. The trade balance has been mentioned. I wonder if it's not just the concern about what Europe and Japan as trading partners may portend for the United States; if they get into bigger problems than might now be anticipated, I wonder if there will be some spillover effects that might come to our economy. On the employment side we still have a ways to go on operating restructuring and defense restructuring, so employment still seems to be a key to sustainability. I think the financial deleveraging has lessened, as [have] the Chairman's headwinds, but I'm not sure that we know how much further we have to go yet with respect to financial deleveraging. As a final note, I must say that I am concerned about the monetary aggregates. We're going to have to look very carefully at the M2 deceleration that we're seeing currently in December and that is projected for the next couple of months. I think the monetary aggregates bear careful watching.

CHAIRMAN GREENSPAN. We have coffee out there or will have momentarily, if it's not there already.

[Coffee break]

CHAIRMAN GREENSPAN. We have just learned that the NBER has ruled that the current recovery began in March 1991.

SPEAKER(?). It's not a really timely call.

CHAIRMAN GREENSPAN. If you think you can match that, Mr. Kohn, you're welcome to try!

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

CHAIRMAN GREENSPAN. Questions for Don?

MR. JORDAN. This question of when the time is going to come to change the [funds] rate--especially in an upward direction--and the criteria for doing so has been on my mind a lot, and I'm sure it has been in everybody's thinking. This is my seventh meeting, and I thought it was time to go back and review the last year and to look at what actually has happened in terms of all kinds of economic indicators--monetary as well as economic indicators, nominal and real indicators--and Committee actions to see if I could deduce an implicit model. I read the newsletters, as I'm sure everybody does; and [unintelligible] and I don't see it in the numbers, it's certainly not inflation. It's not the various money measures: M1, M2, the base, or bank reserves. I don't even think it's real GDP. I put together a table--a big matrix of every forecast for as many quarters out as the Greenbook does it--for every meeting for the last year. What struck me was that it looked as if we were on a de facto nominal GNP target. When nominal GNP is at or above expectations, the funds rate is held stable; but when nominal GNP comes in below what has been expected, we cut the funds rate. Do you want to comment?

MR. KOHN. You can interpret some of what the Committee does to a certain extent that way. I think it's a difficult question. The Committee does not have a nominal GDP target that it announces. It's difficult partly for political reasons: The Committee has no authority to announce a nominal GDP target; and to the extent that it would imply something about real output and unemployment rates, that could get you into some hot water [depending on] how people interpret it. A nominal GDP target has a lot of attractive aspects, I think. You have to think about how to react to unexpected developments or shocks. It implies equal reaction to shortfalls in inflation and output, and you might not want to do that; it might be very dependent on where you are in the business cycle. But there are a number of caveats, if you think about it. And even a nominal GDP target is implicitly still a forecasting exercise. It really involves trying to figure out where the economy is going to be any number of quarters ahead of time. So, I don't think that gets around the problems you and President Melzer raised earlier about having to rely inevitably to a certain extent on your forecast of the economy. I don't think there's any way around that.

MR. JORDAN. Well, I've read the things that academicians have had to say about nominal income targeting. Despite some sort of theoretical appeal to some people, in this context I would be concerned that what could cause nominal GNP to grow significantly faster than currently expected in 1993 would be real output. There's very little likelihood that it's going to come from the price side. So, to have a de facto nominal GNP target would put the Committee in the position of being characterized as anti-growth, if it's perceived that we're tightening because of faster real growth.

MR. KOHN. Well, I think that's the same thing I was trying to say before about how the Committee reacts. If you do tighten because real growth is much higher next year, I think it would be because your projection was that this was moving the economy closer to potential and there would be a danger of short-circuiting the downward trend of inflation or even accelerating inflation the following year. So, it wouldn't be explainable necessarily just on the nominal GDP terms; it would be looking forward regarding what that implies about inflation.

MR. JORDAN. But then you have to have a theory or model about what causes inflation that's coherent or else you're going to run into some trouble.

MR. PRELL. I'd like to establish that in the past the Federal Reserve has shied away from enunciating a view about potential GDP growth, remaining agnostic and being prepared presumably to accommodate any positive surprise. If the positive surprise on nominal GDP could be discerned to be a favorable supply shock, then accommodating it would be a more natural thing to do than if you felt it was a demand shock which tightened up markets and had inflationary consequences down the road. But viewing nominal GDP targeting as your basic approach takes some things as given, as being relatively stable. You may view this [approach] as a way of having an automatic stabilizer over time so that it would be natural to react if you're overshooting, with the thought that you would end up with some price pressures later [if you don't react].

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. If I could pursue what Don said, and maybe the General Counsel would like to comment: Are we precluded from announcing a nominal GDP target?

MR. KOHN. Well, I don't see anything in the Humphrey-Hawkins Act that would preclude us from announcing whatever target we wanted to as long as we still have money and credit targets.

MR. MATTINGLY. Right.

MR. LINDSEY. Oh, I see. Your view is that we're not mandated by law as opposed to not allowed by the law.

MR. KOHN. Sure.

MR. LINDSEY. Okay.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Jerry, in the discussion about nominal income targeting it's clear to me that there are some problems associated with it. But what is perhaps more relevant is whether the problems associated with nominal income targeting are greater or lesser than those associated with interest rate targeting. I'm afraid a lot of the academic literature would suggest that we probably would reduce the chance of making the kinds of mistakes that we make with interest rate targeting if we followed a nominal income target.

CHAIRMAN GREENSPAN. We could actually [target] nominal GDP, but we'd come out awfully [unintelligible] on the policy side. The problem I have with that [and a reason we're] not doing it is the forecast, which doesn't readily address itself to this automatically. Look, the whole purpose of money targeting is that it is a proxy for nominal GDP. If we can do it directly, do we need the proxy?

SPEAKER(?). Right.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Well, nominal GDP targeting is really not as bad as it might seem in that it does have a heavy price level direction to it. That is, the advantage of using nominal GDP as a target versus using real GDP is that we are saying to other policymakers that if they in some sense gear up activities that tend to cause wage rate pressures or other price pressures to take place, then they are voting for lower real GDP. So, nominal GDP targeting is not that far away from what I think is price level targeting. I think price level targeting is better, but we'll see.

CHAIRMAN GREENSPAN. He views it as real and you view it as price.

MR. KOHN. But in the case of a supply shock, a lot of people have advocated nominal GDP targeting. We discussed this actually in August of 1990 in the face of supply shocks. It is supportive, as Governor Angell said, because it has some of these automatic stabilizer-type properties that Mike was talking about; you can't overshoot too badly on one side or another and you bring about corrective actions, particularly when you're unsure with prices going one way and quantities going the other way.

MR. ANGELL. Take the supply-side shock we had in 1973. That supply-side shock with nominal GDP targeting would have produced about the same kind of monetary restraint we would have had if we'd pursued a price level target. A very severe monetary restraint would have been induced by that kind of supply-side shock.

MR. PARRY. It depends on how flexible our policy rule is, I suspect. It doesn't have to be [inflexible]. We can take into account special effects. There are supply-side shocks that we may want to accommodate and some that we don't.

MR. ANGELL. Yes, but the problem is that the FOMC in the 1970s did too much of that.

MR. LINDSEY. The advantage of nominal GDP targeting, especially if we allow a range, is that we're not driven to guessing whether this is a positive supply shock or a negative one. Jerry, I'm a little surprised by your negative comments on nominal GDP targeting.

MR. JORDAN. Compared to what? That is the problem. It's not that I would prefer interest rate targeting. I'm mainly concerned in this environment that the thing that would cause this Committee to raise the funds rate would be real GNP growing faster, being reflected in faster nominal GNP in the current environment.

MR. LINDSEY. Let's say, for instance, that we had nominal GDP growth over 6-1/2 percent. What would be your policy prescription for such a result?

MR. JORDAN. Mine wouldn't be anything. I'd want to look at what the money supply was doing.

CHAIRMAN GREENSPAN. Which money supply?

MR. JORDAN. The monetary base. But I would be concerned about the Committee reacting to that factor--nominal GDP caused by faster real growth--as though we needed to maintain slack in the economy to bring downward pressure on prices. I still would prefer ultimately a price level check, but we can't control the prices directly by anything that we do.

MR. ANGELL. If you had chosen the monetary base, your voting record would have been more conservative than Tom Melzer's!

MR. JORDAN. I think I can reconcile--

CHAIRMAN GREENSPAN. Any other questions? Let me start off by first identifying what I consider to be a more buoyant outlook [among the participants] in this meeting than I frankly had expected. It's clearly more buoyant than the Beigebook, which is the closest thing we have to a region-by-region look. And especially, as Bob Parry points out, if we expunge southern California, things are really moving at a surprising pace. I do think, however, that we have to be a little careful about these volatile moves, and that applies in both directions. Tom Melzer noted that we were unduly pessimistic last October. I would point out, however, that policy didn't change as a consequence of that--that the [policy] mechanism does not capture these swings and I hope it will not. As a consequence, I don't think we are about to jump on board the most recent swings until we understand what the process is. One of the more interesting aspects of what is going on at the moment--it's something that a number have alluded to--is that we basically have a productivity-driven recovery, or more exactly arithmetically the gross domestic product increase is largely attributable to the rise in productivity and to a marginal extent to the rise in average hours worked. The outlook for that particular variable is really quite critical to a number of the issues that have been raised around this table. There is an interesting question as to whether, in fact, we can have continued strong growth without employment growth. Obviously, theoretically we can. The question really gets to the issue of whether or not this productivity surge we've been looking at is abnormal or not. It is quite unprecedented in the context of how little economic growth we have had since March 1991.

There are essentially two hypotheses about what those increases are attributable to, both of which could turn out to be right. The first is that the level of output per work hour at the bottom of the recession was quite low relative to the inputs of both physical capital and human capital. In a sense that's saying that the economy was not operating at an efficient level relative to its inputs. In that case, by just tightening up one can very readily reduce labor input and create within a certain range a rise in output per work hour. One presumes that that can continue to increase until we run up to the upper edge of that range, meaning that the existing capital, both physical and human, is being employed at its most efficient levels.

The second possibility here is that the norm of long-term productivity growth, which is implicit in this concept of a range, has tilted upward. In that case, we're not looking at 1 percent or slightly more than 1 percent [as the norm], but conceivably all of a sudden something has occurred which has changed the longer-term productivity growth [trend]. Some anecdotal evidence suggests that there is at least something to that. Jerry [Corrigan], I don't know if you remember that breakfast where we had a very interesting representation of manufacturing corporations who were raising the point that this restructuring that is going on had only really begun, which is the same issue that you were getting from the New York [business leaders]. It strikes me that what may be happening--and I say "may"--is that we have looked for years and years for the significant impact of productivity growth coming off the major computer input in telecommunications and high-tech capital assets and, as you may recall, we got very little of it. I think the reason is that we did not have the software. Essentially we could not really employ that degree of computational power without a major upswing in the analytic capabilities in using the equipment. In the last five or six years, or maybe a little longer, there has been a very dramatic increase in applicable software. One need only look at the stock market price of Microsoft to see the market valuation of this particular asset coming on stream. The people Jerry and I were talking to at the breakfast were talking about [unintelligible] systems manufacturing. I remember one of the people there was an old friend of mine from a company called which used to put DC motors into the rolling mills of a lot of the steel operations; that was their market. So, I raised the question: Is the big steel business now basically heavily DC motors? And he said "We don't even think that way anymore. What we think of is complete computer operating systems of manufacturing." If you go around and speak to people, what you find is that in the last two or three years there has been a major change in the way manufactured goods are created. And if you look at the data in the nonmanufacturing area, we are finally beginning to see some definite quickening in output per work hour in that area as well.

So, what we may well be looking at, and what the restructuring is essentially all about, is the stripping out of big segments of employment. Companies are literally taking divisions and just wiping them out. A lot of that is directly applicable to the information systems that are created by the telecommunications-computer matrix. That is, a very large part of overhead has been communications overhead, meaning in the extreme form [a situation] where everyone just writes memoranda to each other. But the communications managerial systems have improved very dramatically to the point where people have been washed out of the system at a very rapid rate.

If this is the beginning of something of quite important significance, the question is whether it is in fact saying that our potential GDP is being underestimated. Something may be going on here. The trouble is that we will not be able to know that for a while. It is quite conceivable that part of the problem that we're looking at is that the marginal cost of adding new people is so great at this stage that it may be creating somewhat of an illusion about the relationship between capital and labor; it may be creating an attitude on the part of a number of managers that they just will not hire new people except under duress because the obvious medical costs, employment training, and all the other costs are very large. And the big upswing in the temporary employment rolls is really quite impressive and clearly out of line with what the previous history of temporary employment has been.

So, we may have a technical problem here which is obscuring what is going on and may be making it appear to be a much bigger issue than it is. But what is certainly the case, if the Greenbook GDP figures are right or if those figures are any stronger than that, is that we are going to get one of two scenarios. One is that we will get a very marked increase in actual employment growth, because it's difficult to imagine the average workweek going very much higher than it is. And if we are at the upper ranges of productivity growth, then the arithmetic of the system basically says that it all falls out to increased employment. The alternate scenario is that we are badly missing a major secular change in the productivity trend, in which case this is going to work out somewhat differently. It's not clear to me how it will play out in the sense that we do know that without a significant increase in employment, we will run into problems with how to get consumption continuing to [increase], especially when the saving rate is as low as it is. And this is a low saving rate despite the fact that we still have significant debt repayment going on. The debt pressures are clearly still there.

I suspect the outlook, therefore, is a bit uncertain because of secular changes that are occurring, and I'm a little hesitant at this point to argue that we have a clear view as to how it will come out. I'm not saying, incidentally, that there are negative elements in this. There is, however, as pointed out by a number of you and in the excellent memo that the International Division put out, a very clear indication that the rest of the world is in really sad shape. We don't need the published data from foreign statistical agencies to tell us what is going on. As a number of you have mentioned, in terms of the general view of the multinational corporations, sometime a couple of months ago the order series for the foreign affiliates of U.S. corporate manufacturers all of a sudden just went "bang." There was a hole and Germany apparently just fell off the cliff. That's true in a lot of discussions. I was a little surprised at the Canadian [situation], but presumably that's not all that much different. But there is a potentially fairly significant drag coming from the international side, which affects this [outlook] as well.

On the positive side, however, there are two elements that suggest there is considerable support remaining in this buoyancy that we're seeing. The first, which hasn't really been mentioned except by Mike in the Greenbook, is that inventory/sales ratios are really quite low. And if the economy starts to move faster than is generally expected, then lead times on production, orders, and deliveries will start to move out and the desired levels of inventories in the system will begin to move up. We could see even with all the computer-based controls and everything else like that, a bigger inventory accumulation than is forecast in the Greenbook. There's nothing like inventory accumulation to feed through to profit margins, which feeds through to capital investment, and it would be very easy to turn the Greenbook forecast into a lower estimate. The problem I have with that is the low saving rate. Mike wrote somewhere that we have a low saving rate pending the next revision of the national income accounts on what the history is all about. That may be a very prescient insight. We do know that as existing home sales begin to move up, as indeed they have, we are creating realized capital gains on the sales of homes which in turn are substantially financed by net increases in mortgage debt on existing homes. [The result is] cash to the sellers of homes which is unencumbered cash and is not all that distinguishable from disposable income. That means, in effect, that there is more income and more household savings--or at least it's perceived as savings--on the part of the household community. They basically look not only at the existing stock of wealth and how it's changing but also, as is obvious from the data, how it is markedly affected by the actual capital gains cash flow which occurs as the turnover of houses increases.

All in all, the evidence we're looking at clearly has taken on a better tone and potentially a very significantly better tone for the longer run if productivity and potentially [favorable factors] that may be emerging are real and not just going to boomerang. On the other hand, I do think we have to be careful about being overly buoyant because it's very difficult with the extraordinary globalization of the world's economies to believe that the United States can move in any vibrant manner independently of what is going on in the rest of the world. So, we have concerns, mainly with regard to the rest of the world. We don't have any real insights into what could happen in the event there is a major political turnaround in Russia or the Ukraine or elsewhere. These are orders of magnitude, if they occur, that would have extraordinary impacts for one on our defense budget. Think of what would happen to defense appropriations if all of a sudden there were a totalitarian swing in Russia. The turnaround [in defense spending] could be quite remarkable and, needless to say, would have a very important effect on economic activity.

In closing, I merely want to say, listening to the discussion around this table, that we clearly have moved away from asymmetry toward ease and have moved somewhat in the other direction. How far we go or what is the longer-term future for policy will unfold over time. But I must say that I am encouraged by what I have heard around this table so far.

MR. SYRON. Mr. Chairman, in terms of policy direction, I prefer "B" symmetrical, and let me mention why. While we study [the economy] an awful lot, I don't think that excludes us from a natural human tendency to have expectations and sentiments that swing too far in one direction or the other. I don't think we're exempt from that general tendency. I'm encouraged that the [economic outlook] is better, but I think it's far from certain for a number of the reasons you have mentioned. I'm inclined to think the potential is greater than we have assumed. But the timing of changes in potential as these released workers, if you want to call them that, become more fungible and can be absorbed in a different capacity back into the work force is very, very uncertain and hard to judge. I just don't see in the global situation that we will have price pressures in the immediate future. I'm not saying that won't happen before long--obviously we have to be diligent about [monitoring] that--but I don't think there is a strong concern about that at this time. Also we have this very difficult situation of the very slow rate of growth of M2, with M2 being what we do report to the Congress regardless of my skepticism about it, and the fact that you are going to have to go up [to Congress and testify]. So, coming from where we've been in an asymmetric stand toward ease, I think it would be premature at this time not to have at least a way station for some time in terms of symmetry.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, recent developments suggest that a moderate expansion is underway, and we are seeing numbers in the inflation area that certainly are encouraging. That would lead me to recommend alternative B. Also, since the economy is picking up, I believe we probably should give somewhat less weight to the risk of stagnant real economic activity and more weight to the possibility that it may accelerate more sharply, and that would lead me to a symmetric directive at this point. So, I would favor "B" symmetric.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. A couple of comments and thoughts about the first part of your remarks: I think these fundamental structural technological things are very, very major. I am concerned about whether the national income accounts conceptually are appropriate for capturing [what is occurring]. Even the definition of what is output is going to have to be rethought at some point as is how we measure and assess productivity. One of the fastest growing employers in my District is in Lexington, Kentucky. They've doubled their work force --it's not a big number--from 30 people to 60 people in a year; it is moving along pretty well. The Lexington area has 4 percent unemployment. The problem is finding people who have the skills they want, so they [attract] them in from southern California or somewhere. I don't think that sort of thing shows up very well in the way we put these numbers together.

During the Little Rock Summit, Governor Clinton raised the question of whether it would be desirable policy to have as a goal trying to move manufacturing employment from where it currently is at 16-17 percent [of the workforce] up to 20 percent because our major trade [partners] often have 30 percent. I think an issue that is going to have to be addressed at some point is what is manufacturing employment. These companies don't want to hire people to get their hands dirty. They want to buy the software from somebody else. So, a lot of economists think public policy is going to have to address those kinds of issues.

Turning to monetary policy, I want to comment on this issue of money and economic activity and my view of it. Both Governors Angell and Mullins in their remarks said that the growth [in GDP] is not a result of--Wayne said M2 and Dave said money--and I'm not sure that that's at all true. I can interpret what has happened this year as the lagged effects of the very slow growth we have had in M2 for some time, which has brought down inflation. Wayne talked about the stimulative effect of lower inflation, but what caused low inflation? I think it's the lagged effects of the much slower growth of M2. And at the same time we have had very rapid growth in the narrow aggregates. M2 has never been a good indicator of turning points in economic activity; it has never been a predictor of real output or even that good a predictor of nominal GNP. It is an indicator over a three-to-five year horizon of basic inflationary pressures. I still think there's validity in the P* model. My emphasis on M2 has been two-fold: One is the idea that the long-term objective for the monetary policy part of total financial economic policy is to move to price stability, and that means we emphasize M2; the second is that M2 is what this Committee has been going to the Hill and announcing as our target, worrying about the credibility of the Committee if we announce the target and then don't take action to try to hit it.

But in terms of shorter-term effects on real output or especially on total spending, nominal GDP, I have always thought the narrow measures, M1 or the monetary base, are a better gauge of the thrust of our actions. I tend to accept the view that monetary policy as reflected in the narrow measures of money has been countering more of the headwinds or process of down drafting or it would have been much worse. Monetary policy in fact has been very stimulative, and the critical thing would be to back off from that kind of short-run stimulus in the narrow measures before we do see the future inflation. I think we can reconcile what has happened to our narrow and broad measures just as the Germans have with the opposite situation. They have had extraordinarily slow growth of M1, until very recently, and very rapid growth of M2 with high inflation. For them, M3 goes along with high inflation. The slow growth of M1 and the inverted yield curve and all of that go along with no output growth. So, I think these disparities can be put back together. Currently--being this close to the end of the year and not knowing how we're going to rebase the targets for 1993--I wouldn't have a basis for dissenting on the grounds of trying to hit an M2 target. There's nothing that we could do now that would have any effect on that. So, in the current situation I would simply support alternative B symmetric really by default--not knowing what else to do.

CHAIRMAN GREENSPAN. Let me respond, incidentally, to Dick Syron's body language, which may have occurred because I've been holding back so far from making a recommendation. Basically I think you are inferring that I would go beyond symmetric. The answer is: That is not my view at all.

MR. SYRON. No, I didn't think you would.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. "B" symmetric.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. "B" symmetric.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. I think "B" symmetric is the appropriate policy for the moment. But as we sit in the middle of that directive, I think we have to be very careful to look at both sides of the equation as it were and not give in to the euphoria that I sense is out there among people. On the other hand, we also need to be very vigilant about the price situation and be prepared to move in the other direction if that becomes necessary. That, it seems to me, is the challenge that faces us at the moment. But "B" symmetric is fine with me.

CHAIRMAN GREENSPAN. The challenge is not now; it's ahead in the meetings in the future.

MR. SYRON. That's right.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Mr. Chairman, I strongly support "B" symmetric. I have no appetite for asymmetry toward tightness at this point, first, because I think there still are some weak spots out there. But more importantly, I see no signs that in this intermeeting period we are likely to need a tightening immediately. I just don't see that need right now. Also, I have the feeling that if we do need to tighten, 25 basis points is probably not going to be enough; that is, when we hit the point where we need to tighten, we may need to go 200 basis points in one nice move. [Laughter] That would help the markets get out of this habit that they get into every time we have this kind of circumstance and we move 25 basis points and then 50 basis points and the markets say: Well, this is the first of a series and the bond market really takes a big hit. It seems to me that we can't be so lucky that a 3 percent fed funds rate is just exactly right, but I see nothing now that would cause me to believe that a move is imminent.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I agree with "B" symmetric. I feel that the economy is in a continued modest expansion [phase]. But there are some underlying [concerns] that you and others have identified, including where we are in the employment picture, the deficit picture, and the spending picture. So, I think we would be well advised to stick with "B" symmetric at this point.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I'd be in favor of "B" symmetric. It does seem to me that there has been a shift both in fundamentals and attitudes. But I have a lingering question about the sustainability of that shift, so I think "B" symmetric is appropriate at this point.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. "B" symmetric.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I'm wondering how I can outdo Wayne here! I would favor "B" biased toward tightening, but I could accept "B" symmetric. And just for the video cameras, I once dissented in favor of an easier policy in 1989!

Alan, just to pick up on what you were saying, if you're right about this productivity phenomenon--and I know you weren't asserting this but just laid it out as an explanation--and we in effect have greater potential than we realize but temporarily we also have associated debt and more unemployment, this goes back to what I was saying before: I really don't think it's the job of monetary policy to hurry the adjustment [process] along, and I don't think you were suggesting that. The economy is going to have to absorb that, and we've got to focus on price stability. As I think Don said at the end of his statement, we can't use a pickup in inflation as our signal that we need to begin to tighten policy. I've heard that suggested, but if we wait until then I think all of us know that we're going to be way too late--probably by not just a matter of months but by years.

The other thing I would say is that [when we were easing policy] we said that we would very likely overshoot in terms of trying to stimulate the economy and get the funds rate too low, but that once things turned around--and I know this turnaround has been long in coming and there is still uncertainty about it--we would have to be prepared to pull that rope back fairly quickly. I think we're approaching that point. That's what I have to say.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. "B" symmetric.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. "B" symmetric.

CHAIRMAN GREENSPAN. President McTeer.

MR.MCTEER. "B" symmetric.

CHAIRMAN GREENSPAN. President-elect Broaddus.

MR. BROADDUS. We favor "B," and we have a strong preference for a symmetric directive, Mr. Chairman. We think it would be a mistake not to move to symmetry now because that might send a message to those who look at these things that we're not going to be vigilant going forward if we run into unexpected strength in the economy. So, we would strongly support symmetric language.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, if my colleague wants to change 200 basis points to get us out of the habit of being at 3 percent, I'm afraid the Dow is going to get out of the habit of being at 3000, too. But "B" symmetric is clearly the right move.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. "B" symmetric.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I support "B" symmetric and look forward to the Humphrey-Hawkins testimony when this becomes public at a time when we have had two months of zero M2 growth and are lowering our ranges! But I think, clearly, it's "B" symmetric. We seem to be ascending toward an orderly growth path. It's not at all inconceivable to me that the current rate environment is unsustainable. If we do have a period of disinflation, bringing inflation expectations down and real rates up, I think it's more likely that we will need adjustments. And obviously, if European rates come down, the dollar is likely to go up. The ultimate target here is a [sustainable] rate environment. In my view we ought to think about getting ahead of that with some modest adjustment if we see signs of trouble rather than risk waiting, in which case I think we really might need what my colleague, Mr. Angell, has suggested. So, "B" symmetric.

CHAIRMAN GREENSPAN. Wayne, I must admit that you got everybody's attention! I think we have a fairly uniform position in this institution and I would ask the Secretary to read a "B" symmetric directive.

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 or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with M2 growing at a rate of around 1-1/2 percent and M3 about unchanged in the period from November through March."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Hoenig	Yes
President Jordan	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President Melzer	Yes
Governor Mullins	Yes
Governor Phillips	Yes
President Syron	Yes

CHAIRMAN GREENSPAN. Our next meeting is scheduled for Tuesday-Wednesday, February 2-3.

END OF MEETING