Telephone Conference Meeting of the Federal Open Market Committee on March 25, 2003

A telephone conference of the Federal Open Market Committee was held on Tuesday, March 25, 2003, at 11:00 a.m. Those present were the following:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Bernanke
Ms. Bies
Mr. Broaddus
Mr. Ferguson
Mr. Gramlich
Mr. Guynn
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Parry

Mr. Hoenig, Mses. Minehan and Pianalto, Messrs. Poole and Stewart, Alternate Members of the Federal Open Market Committee

Messrs. Santomero and Stern, Presidents of the Federal Reserve Banks of Philadelphia and Minneapolis respectively

Mr. Reinhart, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Gillum, Assistant Secretary
Ms. K. Johnson, Economist
Ms. Smith, Assistant Secretary
Mr. Stockton, Economist

Mr. Connors, Ms. Cumming, Messrs. Eisenbeis, Howard, Judd, Lindsey, Struckmeyer, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

Mr. Frierson, Deputy Secretary, Office of the Secretary, Board of Governors

Mr. Madigan, Deputy Director, Division of Monetary Affairs, Board of Governors

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

Mr. Whitesell, Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

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

Ms. Holcomb and Mr. Lyon, First Vice Presidents, Federal Reserve Banks of Dallas and Minneapolis respectively

Messrs. Fuhrer and Hakkio, Ms. Mester, Messrs. Rasche, Rolnick, Rosenblum, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, Philadelphia, St. Louis, Minneapolis, Dallas, and Cleveland respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

Transcript of the Federal Open Market Committee Conference Call on March 25, 2003

CHAIRMAN GREENSPAN. Good morning, everybody. As you recall, the general purpose of this conference call is to update everyone on recent data and any changes that have been occurring and to get any new judgments on the part of the members of the Committee, both Bank presidents and Board members. In any event, we'll go through a series of staff presentations and then open up the meeting for general discussion of any subject or for comments any member would like to offer. Let's start with Dino Kos. Dino, are you available?

MR. KOS.[1] Yes. Thank you, Mr. Chairman. I can be very brief, aided by the material that Vincent Reinhart sent out I believe either last night or this morning. As for the financial markets, the price changes are covered on the graphs in that material, and I think much of that will be familiar to the members of the Committee. So I thought I would just say a few words about conditions in the markets. In general they're fine. Liquidity is reported as either good or adequate in almost all market segments. The volume in the foreign exchange market has actually been above average. On the EBS system, which is the primary means of interbank trading, volume has been above average for the last few weeks. Liquidity in the Treasury market is reported to be okay. In some of the other markets it is variable, but it is not ragged in any case, although in specific areas such as the TIPS market, where some unique factors are involved, liquidity is a little below average. In the agency and swap markets, perhaps just because of their much larger size, market participants are saying that it's somewhat more difficult getting large trades done. But that's only for the largest trades. The more or less run-of-the-mill hedging operations that investors need to do are reportedly going quite well. In the equity market the story is similar. Volume was actually below average for most of February; it then picked up with the rally and now is down again. But on the whole, liquidity there is said to be fine. Bid-offered spreads in most markets are also reported to be within their normal ranges. I think I can stop there, Mr. Chairman.

CHAIRMAN GREENSPAN. Are there any questions for Dino? If not, let's move on to Vincent Reinhart.

MR. REINHART. I am going to refer to the same material that Dino was speaking from and emphasize the net changes in market quotes rather than the market conditions that Dino updated you on. As can be seen in the top panel of exhibit 1, Treasury yields are not much different from their levels just before the 8:00 p.m. deadline to Iraq on March 19. An initial wave of optimism associated with the

[1] The materials used by Messrs. Kos and Reinhart are appended to this transcript (appendix 1).

success of the air campaign buoyed equity markets and removed some of the safe haven demands for Treasury securities. That optimism faded with the grimmer reality of the ground campaign. On net, Treasury yields are a touch lower, and the yield curve now (the middle left panel) is barely discernible from that on March 19. While yields are down on net since the onset of hostilities, as shown in the bottom panel, they are up from just before the FOMC meeting on March 18 and more sharply so from the publication date of the Greenbook. From the time of the FOMC meeting, yields are up 6 to 21 basis points; and from the time the Greenbook was published, yields are from 27 to about 50 basis points higher. The reason Treasury yields are higher is evident in exhibit 2 in that the expectation and the onset of war significantly boosted equity prices and lowered expected volatilities. As a result, Dave Stockton is facing equity values that are about 7 percent higher than when the Greenbook was closed.

With this backdrop, money market future rates—shown in exhibit 3—have risen since you met, although they moved a tick lower yesterday. On net, the path of the expected federal funds rate (the middle left panel) has edged lower before turning up next year. Our read is that there's a probability in markets of about 60 percent of a ¼ percentage point easing by the FOMC by May. It's hard to get as reliable readings on credit markets at a high frequency. What we have is in exhibit 4, and it suggests no evident problems. Swap spreads over Treasuries are a little higher, but credit default swap premiums have narrowed a touch. All in all, as Dino said, markets are functioning well, but they are very sensitive to every television bulletin from the war front. That's it, Mr. Chairman.

CHAIRMAN GREENSPAN. Questions for Vincent?

MR. BERNANKE. There's a report of the Desk buying TIPS. Is that correct?

MR. REINHART. Dino, Governor Bernanke is asking whether you did an outright purchase of Treasury indexed securities.

MR. KOS. Yes, we're doing it as we speak. We had been planning that for weeks, and we decided not to defer it.

CHAIRMAN GREENSPAN. Further questions? If not, Karen Johnson, please.

MS. JOHNSON.[2] Thank you, Mr. Chairman. We, too, posted some charts that I hope the Presidents have received and can refer to. For the most part, financial variables abroad have followed the lead of U.S. markets, with certain timing differences associated with holidays and time zones and whatnot. As you can see in chart 1, the dollar appreciated against most currencies and on average through the period from March 12 to the March 18 FOMC meeting. It continued to appreciate

[2] The materials used by Ms. Johnson are appended to this transcript (appendix 2).

slightly after the FOMC meeting, but in the trading after the weekend it moved back down. Relative to the levels at the time of the FOMC meeting, the changes against various currencies are for the most part very close to zero. The dollar moved up a little further today in some cases, but nothing significant. So, it is stronger than shown in the Greenbook but not greatly different from what it was on FOMC meeting day.

As you can see in chart 2, that's largely true for most of the forward-looking curves that we've depicted. March 12 is a benchmark we're using because it was the time when the oil price turned down and when many stock markets turned up, although not every financial variable reached its turning point on that date. These forward rates moved up further through Friday of last week but have since retraced those moves. So, the net changes over the period since the FOMC meeting are zero, but it has been a time of fairly substantial volatility.

The next chart makes that clear with respect to stock prices, which did continue to rise through Friday in most places. Japan is a bit of an exception, but in part that's owing to a holiday. Subsequently, as the somewhat less favorable news came out over the weekend and on Monday, stock prices came back down—led in part by U.S. stock market developments but to a large extent these markets trade first. Again, these stock market indexes are up substantially from their low points but are not greatly changed from FOMC day. We have had some news on foreign economic activity that might be moderately relevant. There is a bit of positive data coming out of Japan that suggests that the economy may not be as weakly situated for Q1 as previously expected. So the base on which these events are happening might be a tiny bit stronger in Japan than we had pictured it. There was today an extraordinary meeting of the Bank of Japan's policy board, which was called on fairly short notice. Markets are now puzzled because the outcome of that meeting was a unanimous vote not to change policy. So it's a little unclear why the new governor called the meeting and how to think about the vote today in terms of what the policy board might do two weeks from now at their regular meeting. Other than some small adjustments of certain limits and a clear statement that the Bank of Japan stands ready to be flexible should markets need more liquidity in light of events elsewhere in the world—which may in fact have been the meeting's purpose—little else actually came out of the meeting.

The final chart, chart 4, is a picture of recent oil market developments, and I thought I'd give a little detail on that. As I said a moment ago, oil prices turned down on March 12. They continued to fall quite sharply in the days following the March 18 FOMC meeting through last Friday. They rose on Monday, which is the last date plotted on this chart; today, through trading as of now, they have increased a bit more. Three factors, I think, are driving oil markets at the moment. One is the news coming out of Iraq, which over the weekend turned negative for oil market developments as much as for other things, though that news was not substantively about oil. The second factor is that the markets are taking some comfort from the securing of the southern oil fields in Iraq and the fact that a very limited number of those were set on fire. People believe that the coalition forces now have control of those oil fields and that is providing some positive news to oil trading. The third factor is the negative news coming out of Nigeria. It appears that the situation in Nigeria is deteriorating and that certain Western oil companies that have a collaborative relationship with the government actually are closing down their operations and removing their people from Nigeria. As much as 800,000 barrels a day could be at stake for the shut-ins that we now know about. So this news just out of Nigeria combined with the turn of events after the weekend has caused the oil price to go back up. But obviously it is significantly lower than it was at its peak and is still markedly lower than it was on the day of the FOMC meeting. I'll stop there.

CHAIRMAN GREENSPAN. Questions for Karen? If not, David Stockton.

MR. STOCKTON.[3] I'll be referring to a set of charts labeled "Nonfinancial Developments" that we posted this morning. Needless to say, we haven't learned a great deal about the real economy in the past seven days; but in what we've seen thus far, there is nothing at least to challenge our view that the economy is growing sluggishly. The first chart in the package presents a few shreds of evidence gathered from the high-frequency indicators that we monitor. The top two panels show unemployment insurance. Initial claims for unemployment insurance remained elevated through mid-month, and we think that level of claims is consistent with ongoing declines in payroll employment. The middle left panel plots a weekly index that aggregates sixteen components of industrial production for which we have weekly data on physical product. The gray bars indicate a monthly aggregation of that weekly indicator. As you can see by the red line in that chart, there has been some softening in March. A significant share of the softening is concentrated in two areas: utilities and domestic motor vehicles. In the middle right panel I've plotted domestic motor vehicle production. As you can see there, not only is production likely to be down for March, but also schedules currently suggest significant cutbacks in production in the second quarter. We think that is likely to be a significant drag on second-quarter GDP, although I should note that it's no more of a drag than we had anticipated in the Greenbook forecast.

I don't put much stock in the chain store sales data, but in the spirit of heightened surveillance I'll offer them up to you. [Laughter] I think the major piece of information one might take away from those data is that we're not seeing a significant move in either direction, which is roughly consistent with the moderate growth in consumer spending that we have projected. I'd note that some press reports suggested a bit of a fallout in retail sales late last week as the war commenced, but most retailers were reporting over the weekend that sales had returned to their recent pace. I don't know how much stock to put in those reports either, for that matter.

We have been in contact with motor vehicle manufacturers. Their forecasts seem to be converging to something on the order of a 15¾ million to 16 million unit pace for total motor vehicle sales. That also is, roughly speaking, in line with the

[3] The materials used by Mr. Stockton are appended to this transcript (appendix 3).

Greenbook projection. We've also received Conference Board data on consumer sentiment for March, which is plotted in the bottom right panel. It showed a little further erosion, similar in its general pattern to what we saw in the preliminary Michigan survey. Obviously, none of this new information at this point is giving us any hint as to what might have happened in the wake of the start of the war. Almost all of it is a reflection of pre-war information.

Chart 2 presents a few highlights in the domestic energy markets. The Department of Energy today announced its weekly measure of the retail price for gasoline, which was off about 4 cents. As you can see in the top left panel, there is a long way to go to restore margins with crude oil prices. Should crude oil prices remain where they are, we would expect gasoline prices to decline quite sharply through the end of the summer and then to decline at a more moderate pace through the end of 2004. So this should be the beginning of some unwinding of the recent spike in gasoline prices. However, I would note, as you can see in the top right-hand panel, that inventories are quite lean right now relative to their seasonal norms, and that could induce significant volatility in gasoline prices going forward. Futures markets are expecting a significant drop in gasoline prices, but again, they are likely to be quite sensitive not just to news on crude oil prices but also to overall inventory positions. Natural gas prices retraced the spike that occurred at the end of February but remain relatively high, and futures markets expect those prices to stay at that recent level. We're also dealing with very tight inventories on the natural gas side—so much so that some industry analysts are a little concerned about whether those inventories can be completely restocked prior to next year's heating season. Again, with inventories tight, I think one could expect some volatility in those prices at the very least.

Chart 3 reports on housing. I reported at the FOMC meeting that starts had fallen off significantly and more so than we had expected. As you can see by looking at column two of chart 3, permits did not fall off, which certainly suggests that weather was an important factor in the decline in housing starts in February. We received data on existing home sales this morning and, as depicted in column 4, the published figure shows a slight decline. I've plotted in the bottom right-hand panel existing home sales using our seasonals, and by that measure they actually picked up a bit. On either set of seasonals, existing home sales still look relatively strong. But in general I'd say we've probably seen in some of the recent indicators just a bit of softness on the housing side, beginning with the report on February starts. Starts, the latest reading on new home sales—though we'll get another reading this week—and consumer sentiment toward home purchases all declined just a little. I don't want to make too much out of it, but the housing sector looks just a touch softer.

Chart 4 depicts last week's information on the consumer price index. The top line, Column 1, was a touch higher than we had projected, with slightly higher food and energy prices. The core measure, on the other hand, was a touch lower than anticipated. Most of that was in lodging away from home, which is a very volatile component. But the major story here is that the pattern of disinflation still seems to be quite clear in the data, and as you know from our forecast, we expect that pattern to be extended going forward.

In terms of the longer-run outlook, I feel as if we're dealing with more noise and volatility here than underlying readings. As Vincent noted, the stock market is roughly 7 percent higher than we had incorporated into the Greenbook forecast. Oil prices are lower. Working in the other direction, long-term interest rates are a bit firmer and, as Karen noted, the dollar is a little higher. Putting together all those factors, we probably would revise up our GDP forecast by a tenth or two. As I had indicated at the FOMC meeting, we were revising down the current quarter a little, so the forecast, on net, might end up a tenth higher than we had in the Greenbook. I'd call that no change. Basically, everything we're seen so far is roughly in line with our expectations.

CHAIRMAN GREENSPAN. Questions for David?

MR. PARRY. David, this is Bob Parry. When you made the revision to the current quarter did you have the data on production of domestic motor vehicles and also the IP numbers?

MR. STOCKTON. Yes, those figures are included in the 2 percent growth figure that we are now estimating for the first quarter.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. Any other questions for David? Does anybody wish to add to our state of knowledge or comment on any specific issue?

MR. MOSKOW. Mr. Chairman, Michael Moskow. I wanted to mention quickly two pieces of information, both of which are confidential. One is the Chicago Purchasing Managers' report, which will come out next Monday and will show a decline in the overall index from 54.9 in February to 48.4 in March. Of course, that survey was taken in early March. The key changes are in the production component, which declined from 62.4 to 49.1, and in the prices paid, which increased from 54.9 to 62.8. The other measures were generally unchanged. The other point I wanted to mention, also confidential, is that one of the Big Three told us very recently that they have reduced their forecast for light vehicle sales for the year from 16.5 to 16.2 million units. That is an internal projection; they have not announced that publicly.

MR. STEWART. Dino has something from New York.

MR. KOS. With respect to Governor Bernanke's question about the TIPS purchase, I wanted to report that we did the TIPS pass. We bought $572 million, mostly in the eight- to twelve-year range, and there was no discernible market effect.

CHAIRMAN GREENSPAN. Further comments? If not, let me just tell you that we haven't set specific times as yet for the next two conference calls, the ones to be held next Tuesday and the following Tuesday. Tentatively, we would appreciate it if you would put down 4:00 p.m. for April 1 and 2:00 p.m. for April 8. For your information, a transcript of this meeting and of subsequent telephone conference meetings will be made. Obviously a reference to the fact that we had these telephone conferences will be inserted in the minutes for the March 18 meeting. Unless I hear further comments or questions, this meeting is adjourned.

END OF MEETING