

**Telephone Conference Meeting of the Federal Open Market Committee on
April 16, 2003**

A telephone conference of the Federal Open Market Committee was held on Tuesday, April 16, 2003, at noon. Those present were the following:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Bernanke
Ms. Bies
Mr. Broaddus
Mr. Ferguson
Mr. Gramlich
Mr. Gynn
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. McTeer, Santomero, and Stern, Presidents of the Federal Reserve
Banks of Dallas, Philadelphia, and Minneapolis respectively

Mr. Reinhart, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Gillum, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Ms. K. Johnson, Economist

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

Mr. Kos, Manager, System Open Market Account

Ms. J. Johnson, Secretary, Office of the Secretary, Board of Governors

Messrs. Ettin and Madigan, Deputy Directors, Divisions of Research and Statistics
and Monetary Affairs respectively, Board of Governors

Mr. Slifman, 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, First Vice President, Federal Reserve Bank of Dallas

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

Messrs. Altig and Rudebusch, Vice Presidents, Federal Reserve Banks of Cleveland and
San Francisco respectively

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

**Transcript of the Federal Open Market Committee Conference Call on
April 16, 2003**

MR. BERNARD. Let me just note that all Board members are present here in Washington except for Governor Kohn who is at the Minneapolis Reserve Bank and Governor Gramlich who is also out of town and calling in. All Reserve Bank Presidents but President Minehan are on the line, and we are trying to establish a connection with the Boston Reserve Bank.

CHAIRMAN GREENSPAN. Let's move ahead and start off with the most important business of the day by calling on William J. McDonough to tell us about his new venture.

VICE CHAIRMAN MCDONOUGH. Thank you, Mr. Chairman. When I discussed this with you before it became public, I asked you whether you thought I was taking leave of my senses to accept this position, and it's true that I may be. But when Bill Donaldson started to talk to me about it, he was able to invoke two of my character traits—my puritanism on some issues and my patriotism streak. So I decided, rather than take it easy or make lots of money somewhere, that I would respond to the call of public service again. And I must say that I'm looking forward to the challenge and to continuing to work with all of you, if not as a member of the Fed team anymore.

CHAIRMAN GREENSPAN. As you know, Bill, we're going to miss you. But because of your new venture, we may very well see more of you than we would have otherwise. So congratulations, though I don't know whether it's a promotion or demotion! [Laughter] It certainly is going to be interesting because a lot hangs on the numbers that come out of our financial reporting systems, as you know probably better than anyone else. Dino Kos, would you start us off?

MR. KOS. Thank you, Mr. Chairman. The markets have slowly shifted their focus from headlines about Iraq to headlines about the economy. But the data the markets are getting currently are viewed as contaminated by the effects of the war, and therefore, market participants are really looking ahead toward the clean data that they expect to get in coming weeks. So with that setting and a rather wide range of expectations about how the economy will be performing, the markets have tended to churn in fairly well defined ranges. The Dow Jones, to take just one example on the equity side, has fluctuated between 8200 and 8400 for most of April, and the ten-year Treasury yield has traded in a range between 3.9 and 4 percent or thereabouts. The dollar also has traded in a relatively narrowly defined corridor against both the euro and the yen. So with that kind of “range” trading, implied volatilities have trended downward. The VIX, for example, has moved down to the middle to high 20s from the mid-30s that had been typical for most of the spring and late winter. Spreads, both high yield and investment grade, have been narrowing slowly. The interesting point, at least for me, is that cash levels are fairly high and there is demand among investors. But issuance has trended downward, especially in the last few weeks. Whereas in January and February issuance of investment-grade bonds was at or slightly above year-ago levels, March issuance was \$36 billion compared with \$66 billion a year ago, and in April for the month to date it has been \$19 billion versus \$41 billion last year. That just may suggest that there is less demand for funding—that corporations either are funding through internal cash sources or are not seeing investment opportunities. Let me stop there, Mr. Chairman.

CHAIRMAN GREENSPAN. Questions for Dino?

MS. MINEHAN. I don't have a question, but I just want to report that Boston finally got on the call.

CHAIRMAN GREENSPAN. Cathy, when did you get on the line?

MS. MINEHAN. At the end of Dino's presentation.

CHAIRMAN GREENSPAN. He left the more important information until the end for you! Vincent Reinhart.

MR. REINHART.¹ Thank you, Mr. Chairman. Given that Dino has run down market developments of late, I'd like to review very briefly the net changes since the staff forecast for the March meeting was put to bed and then focus on the current configuration of expectations about monetary policy. In doing that I'll be referring to the material on financial markets that was distributed to you earlier.

As can be seen in the top panel of your first exhibit, Treasury yields have marched unsteadily higher over the past month to post net increases, as presented in the bottom

¹ The materials used by Mr. Reinhart are appended to this transcript (appendix 1).

panel, of 24 to 38 basis points. Note that indexed debt yields moved up even more, suggesting a shift in expectations about the prospects for the real economy. But this is probably more manifest in the review of equity markets in exhibit 2. Major equity indexes are currently about 10 percent higher than when the Greenbook was closed, and a forward-looking measure of share price volatility (shown in the middle panel) has moved noticeably lower.

As shown in the top panel of exhibit 3, near-term money market futures rates have extended their rise from their low point at the end of March. On net, the path of expected futures rates (in the middle left panel) has shifted up about 25 basis points fairly evenly across the maturity structure. The shifting up of the very front end of the expected path of rates appears consistent with an unwinding of any expectation of an intermeeting move, a notion that had gained some currency among market participants in the previous two weeks. More-recent market commentary appears consistent with the belief that policy easing, if it comes at all, will be deferred. Indeed, the May futures contracts can be read as implying that much less weight is now being placed on policy ease, with the probability of a ¼ point easing move at the May 6 meeting (shown in the bottom panel) having fallen to 1 in 4.

As for private markets, in exhibit 4 you'll see that swap spreads on balance have declined just a touch over the month since March 12. Also, share prices for key intermediaries (shown in the middle panel) are up more than the general market, and their credit default swap premiums have come in some. That's all I have, Mr. Chairman.

CHAIRMAN GREENSPAN. Is there anything special in the implied volatility numbers, especially in the stock market?

MR. REINHART. The middle panel of exhibit 2 shows equity volatility.

CHAIRMAN GREENSPAN. That indicates a downward draft from March 9 through March 15.

MR. REINHART. Yes. That importantly is related to the increase in the level of equity prices. We often observe that inverse correlation.

CHAIRMAN GREENSPAN. So it's really not telling us anything different from the S&P 100 itself?

MR. REINHART. I think one could probably say that about nearly every figure in this presentation. Share prices are higher on balance, and that has been associated with increases in yields and declines in volatilities.

CHAIRMAN GREENSPAN. Further questions for Vincent? If not, Karen Johnson.

MS. JOHNSON.² Thank you, Mr. Chairman. I will be referring to the charts entitled "International Financial Markets" that we sent out to you. I would agree with Dino's characterization that the changes we've seen in global financial markets and in the information we get from market chitchat reflect a swing back to a focus on economic news from war news. Economic developments, such as they are, are the factors that are moving these markets. Over the past week since your previous conference call, there has been no really dramatic trend that these markets have shared in common. In some sense the moves are sideways or only slightly up or down across these markets.

Chart 1 depicts selected exchange rates. In the eight days since your previous conference call last Tuesday, the dollar has moved down just a bit on a weighted-average nominal basis against the major foreign currencies—that's the dotted blue line in the bottom chart. In particular, the dollar has been moving down in most recent days against the euro and the Canadian dollar. The Bank of Canada raised its official lending rate 25 basis points this week. Bank officials cited inflation and the implications for activity of capacity utilization of resources as reasons for the increase and referred as well to what they perceived to be a better balance with respect to factors coming from outside the Canadian economy. The yen versus the dollar has moved largely sideways. We have been tracking commercial bank deposits with the Bank of Japan as carried on the balance sheet of the Bank of Japan. Those deposits grossed 35 trillion yen at the end of the fiscal year on March 31 and presumably are heading back down toward the target of 22 trillion yen. But they have been in the vicinity of 27 trillion to 28 trillion yen for some time now, and the Bank of Japan clearly is in no hurry, at least, to move them all the way back down to 22 trillion. If anything, the level at which the BOJ is maintaining those liquid balances has been relatively narrow recently.

Chart 2 depicts short-term interest rates as measured by three-month Eurocurrency futures rates on the left; there's a longer-term look on the right in calculated one-year forward rates derived from swaps. Short-term interest rates have changed only slightly, and the direction is somewhat mixed. They are up for the euro and sterling, consistent with what we interpret as a further lessening of expectations of policy ease by the ECB or by the Bank of England. In market terms, there is still an expectation that the ECB is going to ease by perhaps another 25 basis points some time during this year, but there is no high probability built into such a move any time soon. In yen rates we've seen downward moves in the longer-term area to new record

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

lows; and Japanese ten-year and twenty-year rates are falling further, having reached remarkably low levels earlier this week.

Chart 3 shows stock markets, which have already been characterized a bit. I would point out that there is a difference between what is happening in Europe versus Japan. European indexes are still well off their lows of March 12, and they have moved up further over the past week in line with U.S. markets, which Vincent was talking about just a minute ago. In Japan, stock prices are down on balance since last Tuesday, although they have moved up just a bit in the last two days. Generally they moved sideways in March and to date in April rather than having the clear upward trend displayed in the other panels of the chart. There is an issue being talked about with respect to Japanese share prices that we do not know exactly how to quantify. It has to do with an incentive now in effect for private pension plans to give back to the government management of the public portion of what in fact are shared pension plans. Allegedly that is triggering sales of equities, but there's really no way to establish how important that is in explaining why Japanese share prices are not rising while those elsewhere generally are rising. As for countries not shown on the chart, share prices have been moving down in Hong Kong and Singapore—which we are attributing in part to the consequences of SARS on those economies—and have been moving up in Korea and Taiwan.

Finally, chart 4 reports the latest developments in oil prices. Oil prices have edged up most recently. Today spot is trading around \$29, and the May contract is at that level, too. As you can see in the top panel, the June contract actually is slightly lower, reflecting the fact that the near-term portion of the futures curve still has a slightly downward slope. So futures prices fall a bit from May and June, but as I mentioned last week, the curve has flattened and is pretty much flat after mid-2004 or so. I can report, as you probably already know, that the oil fields in northern Iraq are now secure, so that source of risk to oil prices seems to have abated. OPEC is planning a meeting on April 24 to address issues with respect to price, including concerns that oil markets are in fact oversupplied—which they have at least suggested—and that further downward pressure on prices is a risk. As for Nigeria, no new element is threatening in events there, but the unfolding of the election process is ongoing. Parliamentary elections have been held, and the presidential elections are to be held shortly. We have seen some violence as a consequence of elections being conducted, which suggests that there's some risk of further disruption. The country is at the point where about half of the shut-in capacity has been restored. So of the 800,000 that was shut-in, 300,000 to 400,000 is thought to be back in operation. That concludes my remarks.

CHAIRMAN GREENSPAN. Questions for Karen?

MR. FERGUSON. Karen, you passed by the SARS issue. Do you see any risk that that could become a broader macroeconomic issue? It has had an impact on a few airlines, and I

understand that the trade show now going on in China has very low participation. How much risk, if any, should we ascribe to SARS as an impact on Asia in a macroeconomic sense?

MS. JOHNSON. We think it will be visible in the data in some sense for Hong Kong and Singapore most especially and perhaps a tiny bit for China. Based on what we now know, we think the effects will be enough to show through but not be a major source of pressure. There really is no way of knowing if SARS is about to be contained and recede or whether it's going to continue to surprise us. And if it continues to surprise us, it's unclear whether it will be as a nagging but still small factor or if it will grow. So in all honesty I really can't answer the question. Our thinking now is that this will be a major factor only in the places where it has already been very evident as such. But that judgment is based on the lack of any reason for making a more aggressive assumption. We're just in a wait-and-see mode.

MS. MINEHAN. Roger?

MR. FERGUSON. Yes.

MS. MINEHAN. This is Cathy. I had some conversations with contacts at high-tech firms here in Boston, and I was surprised by the degree to which SARS was mentioned. One anecdote is from a company that makes very big pieces of equipment that go on a production line and test the quality of chips as the chips are being manufactured. The firm supports its equipment with staff from here in the United States, using very high tech procedures to install it and so forth. Instead of that being three days of work on the production lines—particularly in China but throughout Asia as well—their people now have to go through a ten-day quarantine period, do the three-day job, and then be quarantined for ten days afterwards. So it has really played havoc with the businesses of companies that try to support operations in Asia from here. Other companies—for example, a major manufacturer of consumer goods in our District that has

plants in China—don't see SARS as much of a threat because their Chinese operations are very self contained and don't need to be supported much from here. But for anybody who has an airline connection or for any firm that provides support or other interaction that requires travel, it has become very difficult.

CHAIRMAN GREENSPAN. Any further questions for Karen? If not, David Wilcox.

MR. WILCOX.³ Thank you, Mr. Chairman. I will be referring to the package of charts labeled "Nonfinancial Developments." Since last week, when Dave Stockton summarized the nonfinancial outlook for you, three major releases have been published—industrial production, the consumer price index, and housing starts. As shown on line 1 of our first chart, total IP currently is estimated to have declined ½ percent in March. In part this reflected a sharp decline in the output of utilities (line 8) owing to warmer-than-normal weather. But even leaving that aside, manufacturing output (line 3) declined 0.2 percent. Moreover, previous estimates for December and February were revised down noticeably, as newly available and revised source data were brought on board. As shown on line 5, high-tech output moved up in March, but elsewhere in manufacturing the situation remains discouraging. As shown in the middle right panel, manufacturing output excluding the motor vehicle and high-tech industries has been flat over the last three months. Unfortunately, none of the available indicators—including the orders data from the Census Bureau and the various purchasing manager series—gives us reason to think that the next three months will be any better. Overall, the picture in the industrial sector looks somewhat softer in the recent past than we had previously estimated and somewhat softer in the next few months as well.

As indicated in line 1 of your next chart, the consumer price index increased 0.3 percent in March, pushed up by another sizable increase in energy prices (line 2). As shown on line 4, the CPI excluding food and energy was unchanged in March, reflecting another small decline in core commodity prices and a second consecutive low reading on inflation in non-energy services prices. The middle panel depicts two workhorse measures of core consumer inflation, which continued to edge down. Over the past twelve months, the core CPI has decelerated 0.7 percentage point. Core PCE price inflation, shown as the red line, appears to have decelerated only 0.1 percentage point through March, based on our translation of the CPI data released this morning. But the market-based subset of this index has decelerated an estimated 0.5 percentage point, more in line with the contour of the core CPI. The bottom left panel displays this morning's data on housing starts and permits. As shown in line 2, single-family starts rebounded in March, and preliminary inspection of the data suggests that the bounceback was of about the magnitude we had been expecting on the basis of the adverse weather conditions in February. However, the permits number came in softer than we had been anticipating, and mortgage rates have edged

³ The materials used by Mr. Wilcox are appended to this transcript (appendix 3).

up since the time of the March Greenbook. So we will likely be trimming our forecast a bit for housing construction in the upcoming Greenbook projection.

As shown in the top left panel of your next chart, the four-week moving average of initial claims for unemployment insurance has remained in the neighborhood of 420,000, consistent with a further decline in payroll employment in the labor market report for April. In the motor vehicle sector, the subject of your middle two panels, the key factor is that inventories have remained on the high side. In response, General Motors is now offering zero percent financing on sixty-month loans, and the PIN data show a sizable step-up in incentives at the beginning of April on an industry average basis. As can be seen in the middle left panel, our contacts on the whole seem extraordinarily uncertain about how much of an effect the higher incentives will have, but they are reasonably optimistic overall. As shown in the middle right panel, the motor vehicle manufacturers also have responded by scheduling production at a distinctly lower level in the second quarter than in the first. We currently are guessing that motor vehicle production will take about $\frac{3}{4}$ percentage point off the growth of real GDP in the second quarter. The bottom left panel shows that sales at chain stores improved in the most recent week, but sales are still essentially trendless since the beginning of the year. As shown to the right, consumer sentiment, as measured in the University of Michigan's index, inched up a bit further in early April from its late March reading.

On balance, the information we've received since the March Greenbook points to slightly weaker activity in the second quarter than we had expected. Our current estimate of GDP growth in the second quarter is down only a hair but the composition is now noticeably different, with defense spending providing a good deal more thrust than we had earlier anticipated and private domestic final sales looking a bit more anemic. Our projection for the growth of manufacturing IP in the second quarter has been revised down about $2\frac{1}{2}$ percentage points at an annual rate. And the labor market looks a little more sluggish than was implicit in our March outlook, with claims hanging up higher and longer than we had been anticipating and with surveys of both business and household sentiment remaining very soft.

Looking to the second half, as Dave Stockton indicated last week, we will be inclined to tamp down our projection for growth, partly reflecting our somewhat more subdued assessment of the labor markets and also the absence thus far of any reassuring harbingers of increased vigor on the investment front. Another factor reflects simply the arithmetic of defense spending having built a higher base in the second quarter and, therefore, given what we know about appropriations, having less room to contribute to growth in the second half. That said, the stock market is up, as others have noted, in the neighborhood of 10 percent relative to our expectation in the March Greenbook, and oil prices have fallen faster than we had assumed. So we wouldn't want to mark down our projection very far. In the end, I suspect that we'll be left with an economy displaying roughly the same gap in resource utilization by the end of 2004 as in the previous forecast and an inflation rate that may be just a shade lower than in the March Greenbook. That concludes my remarks.

CHAIRMAN GREENSPAN. Questions for David?

MR. PARRY. David, this is Bob Parry. I was wondering if it's possible at this point to quantify the second half of the year and 2004 a bit. At the time of the Greenbook, of course, you had a little over 4 percent growth in the second half of 2003 and a little over 4½ percent in 2004. Are you talking about a tenth or two or—

MR. WILCOX. My guess would be, Bob, that our forecast for the second half of this year might be in the neighborhood of ¼ percentage point softer and that perhaps the bulk of that will be made up next year on the strength of equity market developments.

MR. PARRY. Okay, thank you.

CHAIRMAN GREENSPAN. Further questions for David? If not, as I indicated a couple of weeks ago, I thought it might be worthwhile to do a somewhat truncated roundtable today. So, for those of you who have remarks you'd like to make, what I plan to do is to go sequentially through the Banks, starting with the First District, and then turn to the Board members. Cathy, as President of the Boston Bank, do you have any comments to make now that you're on the line?

MS. MINEHAN. Yes. Let me very quickly summarize a whole range of conversations we've had with various contacts. Some of these conversations occurred in the normal course of business—in the Beige Book calls and in meetings that had been scheduled—and some involved discussions I've had with CEOs in the region representing a wide range of industries.

In general, while the Iraqi war situation seems to be getting a bit clearer, almost all of the contacts we talked to continue to see a great deal of uncertainty as they look ahead. No one had a sense of confidence in projections for later this year or for 2004. The most common characteristic of their attitude, as they expressed it, was extreme caution. They don't see the

economy moving into negative territory, but they don't see it growing much either; and they talked about the risks almost to the exclusion of the opportunities.

I mentioned SARS before and noted that I was surprised by how much that issue was raised. The slow-to-flat activity in Europe and Japan was rated as a key risk factor by a couple of major manufacturers with global consumer or capital markets. At least one of them characterized the situation in Latin America as a "return to the '50s," with economies, particularly consumer demand, collapsing. Firms are affected to some extent, as you can imagine, by the decline in the dollar—particularly when a significant amount of production and revenue is generated abroad. Finally, several software companies told us that to actually make a sale they have to prove that the period of time necessary to generate a return on investment is ever shorter. A year or so ago they had to show that the software was going to provide a return in twelve months, and that has shifted down to three months now. They think that is used as an excuse by most of their customers, who just are not willing to spend any money or to buy anything at this time.

There are some bright spots. If you're a small biotech software company here in New England—and by "small" I mean in the \$10 million to \$50 million range in revenue—you're probably hiring and growing. We're also seeing a bit of a flattening out in the declines in working capital borrowing by companies across a number of industries. That kind of borrowing isn't growing much, if at all, but the bankers generally think it has stopped declining. One high-tech manufacturer pointed to low inventory levels as a reason to expect that, when capital spending starts, it might start with a bang. He believes the long supply chains combined with low inventories, both driven by cost-cutting initiatives, suggest that a lot of companies may not be able to handle even a small surge in demand. He is betting that capacity might have to be

added quickly and at a high cost, if demand grows at all. In sum, the words “cautious,” “uncertain,” and “flat” were used repeatedly by our contacts. Companies want a lot more evidence of a rebound in economic activity before they are going to hire or spend on much of anything that doesn’t help them cut costs. That’s about it.

CHAIRMAN GREENSPAN. Thank you. Vice Chair.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, I’ll be very brief. The mood in the Second District is very much related to what is going on in financial markets and financial firms. Usually reliable sources say that the global settlements with the financial firms regarding their research conflicts of interest may occur very soon and that the global settlement on Enron will take place perhaps a week later. That will remove the fog of uncertainty very substantially in this District, and I think the attitude of the investment houses and the commercial banks will be, Let’s get this behind us and go back to doing our business with a more optimistic mood. That certainly will help the District and probably will help the national mood as well.

CHAIRMAN GREENSPAN. President Santomero.

MR. SANTOMERO. Thank you, Mr. Chairman. I have two observations to report. The first is the information from our April business outlook survey, which will be released tomorrow at noon. It shows somewhat weaker activity in the manufacturing sector but I think less of a softening than is now being anticipated. The index of general activity goes from minus 8.0 in March to minus 8.8 in April. The indexes of new orders and shipments and employment all fell this month as well, and negative indexes for delivery times and unfilled orders are consistent with the weakness in manufacturing. In this survey we asked some questions about how much of the decline was associated with the war and how much was associated with the general decline in demand. About one-quarter of these firms indicated that the decline was associated with the war,

with most indicating that the effect was slight or moderate. However, 14 percent reported that their war-related declines were fairly significant. There was a general sense that business was clearly not improving and was deteriorating slightly on the manufacturing side and that at least some of that was war driven.

Second, we went back to our Beige Book contacts to ask them for some notion of how things stand, and they are reporting some softening in conditions in early April. Retail sales in the District were running below year-ago levels in all lines of merchandise. Auto sales were down compared with March and April of last year, and store executives attributed weak sales to a combination of both cold weather and the war in Iraq. Our retailers have mixed views about the future. Some expect improvement as soon as the weather improves and the war winds down. Others are more cautious.

In summary, I would say that the situation is best described by the words of one of our board members. He said that we have been going through a period of several months in which the order books were meandering and falling into somewhat of a malaise and now the question is whether we will get out of it after the war is at least somewhat settled. That's all I have to report.

CHAIRMAN GREENSPAN. Thank you. President Pianalto.

MS. PIANALTO. Thank you, Mr. Chairman. The economic information that I've gathered from my directors and other business contacts in the past few weeks really hasn't altered my view of the economy. The economy is still expanding, but growth remains subdued. With the exception of steel manufacturers and a few durable goods manufacturers, most of the people I've talked to say that they expect conditions to improve in the next six months. Very few of my contacts reported any noticeable change in their business due to the war in Iraq. The exception was retailers, who did notice a slowdown in traffic but only during the first few days

of the war. One of my directors called it the “CNN effect,” people staying home to watch the war on TV. Although consumer spending reports were generally weak in April, retailers that I talked to are optimistic that sales will bounce back, in part because of improved weather, but they also are hoping that the longer Easter buying season will improve sales.

Most manufacturers that I talked to noted that production and sales were flat or slightly improving. In general, growth was stronger in the nondurables sector than it was in the durable goods sector. Nondurable goods producers reported steady or even increasing employment as well as some significant overtime at their plants; durable goods manufacturers, on the other hand, reported some layoffs and staff reductions as well as shortened overtime schedules. Most durables manufacturers expected conditions to remain flat in the near future, but some did have a degree of optimism regarding increased sales and production during the latter half of 2003.

The bankers in our District continue to see strong mortgage refinancings. For the first time, though, I also heard more of our banking contacts say that commercial borrowers were taking advantage of the lower interest rates by refinancing their outstanding loans. Bankers are reporting that they are flush with deposits and that net interest margins are being squeezed.

In summary, I haven’t seen much change in the economy over the past few weeks—no deterioration but also no improvement. That concludes my comments, Mr. Chairman.

CHAIRMAN GREENSPAN. Thank you. President Broaddus.

MR. BROADDUS. Thank you, Mr. Chairman. Our District’s economy is still fairly sluggish overall, and the manufacturing sector is clearly the weakest part. We do a monthly survey, which showed shipments and orders both down in the most recent report, and the weakness in autos was especially pronounced. One bright spot is textiles, which have benefited to some degree from the military buildup.

In the services sector, conditions are not much better. Sales are flat, but again there are a couple of bright spots. For one, bookings for tourist activity along the Carolina coast are significantly stronger than had been anticipated not too many weeks ago. Also, a fairly sizable trucking operation that I hear from every month had reported to me that their activity was quite weak early in the year, in January and February. But their activity picked up a lot in March and is continuing to pick up so far in April.

Capital spending is still weak, obviously, and in trying to look forward it's a little hard to read business attitudes. Some people that I talk to think that the end of the war and the related reduction in uncertainty is going to make some difference in that regard. Others think that the economy will remain weak. One piece of information, though, is that a lot of companies reportedly have projects on the shelf that are ready to go if firms get some sense that business is going to pick up.

Housing activity is still rather strong; though the pace may be slackening a bit, the level is still very high. As far as labor markets are concerned, they are soft, as is the case elsewhere in the country, but my sense is that currently they are not softening significantly further. We actually had a drop in unemployment rates in a couple of our District states recently, although that was in February, so it's not particularly recent information. In sum, it's still a pretty mixed bag in our District. That's all I have to contribute.

CHAIRMAN GREENSPAN. Thank you. President Guynn.

MR. GUYNN. Thank you, Mr. Chairman. I, too, can be brief. My views overall haven't changed a great deal since we last were around the table together. We haven't gotten the happy positive surprises that we all might have hoped for; on the other hand, things have played

out pretty much as I think we expected. We've avoided some of the worst case scenarios with regard to both the length of the war and oil prices, and I think that's at least a small positive.

One regional contact that is new for us and has become a regular source is a large temporary talent agency—I think it may be the third largest in the country. In our discussions this past week, I picked up a couple of interesting tidbits. They reported that they had revised down their expectations with regard to the demand for temporary talent. One thing they've noticed in the last few weeks is that companies are requesting fewer workers but that those employing new temporary workers are working those people slightly longer hours. My contact interprets that as less confidence on the part of businesses that they're eventually going to want to employ more labor.

When I combine that observation with the other developments we've already had on our list—productivity growth and reports about the ability to function with fewer workers that we hear from firms such as those in the new southern auto industry—I think we might expect subdued growth in employment. Another comment we've heard several times is that the burden associated with a new hire is even higher now because of escalating health care costs and the need to begin to fund pensions for each new worker. All in all, those developments have tempered my own expectations at least about how quickly and how robust job growth might be. But putting that aside, I'd say again that in my view things have played out about as most of us expected. I don't think there's much else I'd add. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Thank you. President Moskow.

MR. MOSKOW. Thank you, Mr. Chairman. Economic activity in our District does not appear to have changed much in recent weeks, a situation that is similar to what my colleagues have said about their Districts. A few of our contacts saw some further softening when the war

began, but no one noted a significant deterioration in activity. Neither do they expect sharp increases with the conclusion of the war. Many of our contacts continue to be pessimistic about the outlook for investment. They do not see enough projects that are far enough along in the planning process to produce a major increase in capital spending in the second half of the year.

Labor demand is still soft but does not appear to be eroding further. For example, both of the large temporary help supply companies headquartered in our District reported that year-over-year growth rates in billable hours had been falling since the beginning of the year but had stabilized in recent weeks. One firm reported that some big customers currently are making plans for projects that would require hiring a significant number of temporary workers, but those firms are waiting to see how the economy evolves before committing to the deals. He thought they would be sitting on the fence for another two to six weeks.

Consumer spending still seems to be moving forward, though at a relatively sluggish pace. Sales figures for March generally were in line with expectations according to our retail contacts. Similar to what David Wilcox said, we also are receiving mixed signals about consumers' responses to the latest rounds of auto sales incentives, though it's too early to judge on that.

Overall, our information since the last meeting is consistent with the economy still moving forward, albeit at a disappointing pace. Looking ahead, even though our contacts do not see any underlying catalysts that will rekindle robust growth, the collective mindset seems to be that the economy will grind on through these rough times. This attitude suggests that even if we saw a few more bad numbers or were hit by some modest adverse shock, business confidence would be resilient enough to absorb them. That concludes my comments, Mr. Chairman.

CHAIRMAN GREENSPAN. Thank you. President Poole.

MR. POOLE. Thank you, Mr. Chairman. I met last week with our directors at our regular board meeting, we had a luncheon here at the Bank with local retailers, and I made a number of phone calls. Overall conditions are flat. The standard comment from many of our contacts, as it has been for several months now, is that they are "just muddling along." I spoke with my contact at Wal-Mart early in the week and at that time he said that Wal-Mart was projecting April to be up 8 percent year over year. March was up only about ½ percent. Since that time I saw newspaper reports that Wal-Mart had a 7 percent projection for April. That was greeted in the papers as being optimistic. But I think most of the increase in sales is a consequence of the fact that Easter is late compared with last year. My contact said that it's rather difficult to sort out from their data how much of what is occurring in the retail sector is a consequence of the war, the rotten weather over a good part of the country, or the late Easter. He did report that SARS is affecting Wal-Mart not in terms of the flow of goods from Asia but with regard to buying trips. They have cancelled all of their buyers' trips to Asia. That is certainly a new issue that we had not anticipated. My FedEx contact also mentioned SARS, noting that their operations had not been affected but that they have curtailed unnecessary travel to Asia. I don't think there's any question that SARS is an unexpected and very unpleasant development at this point. That summarizes the story in my District. Thank you.

CHAIRMAN GREENSPAN. Thank you. President Stern.

MR. STERN. Thank you, Mr. Chairman. The one comment I would make is that, in my conversations with a variety of business people over the last several weeks, I've found a conviction among them that the war, both its prospect and its conduct, was not a major restraint on their activity or their plans. As a consequence they felt that when the war ended, that would not lead to any particular pickup in activity. The one caveat I would add to that is that I don't

know what they were anticipating about oil prices. As David Wilcox indicated, those prices probably have come down a bit more quickly and sharply than might have been anticipated.

That's all I have.

CHAIRMAN GREENSPAN. Governor Kohn I gather is with you, is he not?

MR. STERN. He's here, and I think he's ready to participate if you'd like.

CHAIRMAN GREENSPAN. Why don't we put him on the program now.

MR. STERN. Okay.

MR. KOHN. Thank you, Mr. Chairman. It's evident from what we've been hearing that the general sense of a very sluggish economic expansion hasn't left us yet, but it's probably a little early to expect a rebound triggered by the end of the war, the decline in oil prices, and the rise in equity prices. Still, I suppose it's a little discouraging to hear that attitudes don't seem to have changed. Given the low level of resource utilization and low inflation, I think it will be important to look for some early signs that the economy is going to break out of this 2 percent growth rut that the staff has penciled in for the first half of the year. Hopefully, we'll have some more clues in that regard when we get together on May 6.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Yes, Mr. Chairman. Our District economy continues to show a mixed but overall sluggish performance, as I noted at the last FOMC meeting. Retail sales in our region have been relatively lackluster. Manufacturing was down slightly in March according to our survey, but manufacturers are still fairly optimistic as they look six months out. Also, we contacted a couple of our manufacturers again very recently, and they are more optimistic than they were at the time of the survey. They are at least getting more inquiries, and that gives them some optimism, although the inquiries have not been converted into orders at this point. As for

our labor market, layoff announcements still continue, but they have slowed and noticeably so. Let me mention the energy sector. We drill primarily for natural gas in our region, and activity is currently very strong and is picking up as well. I want to piggyback on a comment that was made earlier. In our talking to and surveying some of our businesses they, too, are saying that the effect of the war is not causing them to delay or accelerate decisions. They are, in a sense, putting that aside for the moment. Our banks are interesting in that there is some steady loan growth but loan demand is not strong at all. So they have good liquidity as they look forward. Finally, I'll just mention that residential activity remains generally good; there has been some downturn in Denver, but we think that was mostly weather-related. I think I'll stop there, Mr. Chairman.

CHAIRMAN GREENSPAN. Thank you. President McTeer.

MR. MCTEER. The Eleventh District economy appears to remain somewhat weaker than the national average overall. There are a couple of isolated encouraging signs, however. One of them is that drilling activity for natural gas, as Tom indicated for his District, has picked up lately. Our interpretation is that people are finally beginning to think that the higher prices may be around for a while. Of course, what prompted that pickup in drilling for natural gas will be a negative for the nation as a whole while it's a positive for Texas. The high-tech sector seems to be showing a little life in computers and in the wireless telecom industry. Although activity in those two areas has picked up somewhat, generally speaking we see weakness in our high-tech sector. There is a lot of anecdotal evidence indicating that, to the extent that workers are being reemployed in high-tech industries, they are being hired at much lower wages than they earned before they were laid off.

The big question in our part of the country is the fate of American Airlines, but it's a question of whether it will be bad versus worse. As you know from the newspapers, two of the three unions have voted for substantial concessions to keep the company from having to file for bankruptcy. The third union, the flight attendants' union, did not vote; there were some glitches in their voting software, which gave everybody an excuse for a revote today. It's uncertain how that vote is going to come out. Either way, whether the airline avoids bankruptcy or not, substantial layoffs are expected—though the layoffs will be somewhat greater if they do file for bankruptcy than otherwise.

Our Beige Book reports have been characterized as mixed and confusing. That's probably a little improvement from the uniformly negative reports we've had the last couple of times. We had our board meeting last Thursday—it was a joint meeting with directors from Branches throughout the District—and the views of our directors were pretty negative. But there was zero sentiment for easing monetary policy. No one thought that easing policy would do any good, and some thought that it might send out the wrong signal. I guess at the margin I tend to agree with that. That's all.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Thank you, Mr. Chairman. Indications are that economic growth in the West is still sluggish, with the situation in Iraq having little discernible effect on spending in most sectors. Uncertainty continues to hamper business spending. Capital investment that can be postponed still is being postponed. Moreover, some businesses are revising down their estimates for sales in coming quarters. For example, some department stores are concerned about spring and summer sales and have canceled some apparel orders for the quarter. Also, we're still getting reports of layoffs, and firms appear reluctant to add to their payrolls. The

continuing sense of caution is confirmed by our banker contacts, who report that business spending is still quite weak, although some strength exists in southern California and in Hawaii.

Residential real estate except for high-end houses was doing well in the weeks before the war started. Since then, however, new home sales appear to have remained strong, but the resale market may have started to slip to some extent. Consumer spending can be described as fragile. Tourism, especially from abroad, is one area that has weakened noticeably over the past few weeks, reflecting the effects perhaps of the conflict in Iraq but certainly concern over SARS. Passenger loads are down for international flights at all the major airports, and some airlines have cancelled international flights. Hotel occupancy rates are down, and sales are down at restaurants and at retailers dependent on tourism.

Finally, turning to the national economy, like the Greenbook authors, we have lowered our near-term forecast in response to incoming data. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Thank you. Governor Ferguson.

MR. FERGUSON. Thank you, Mr. Chairman. My read of the data, which is that they mostly suggest only sluggish growth at best, is not inconsistent with what I've heard thus far. I would say that the forward-looking indicators are very much mixed but certainly do not convey any sense of being a harbinger of higher growth. As I've reviewed our forecast here at the Board and also the consensus forecast, I would tend to agree with what Bob Parry just said. Almost all the forecasts seem to show what I would describe as continuing erosion over the most recent short period in response to weaker-than-expected data. As a result of that erosion I would say that the forecasts all have tended to push out the point at which a rebound—a pickup with some element of strength—is expected. Therefore, I think it will be very important and constructive to

keep a close eye on the data between now and the next meeting. At that point we can decide whether or not the stance of policy is consistent with our two primary objectives.

CHAIRMAN GREENSPAN. Governor Bernanke.

MR. BERNANKE. Thank you, Mr. Chairman. Everyone has talked about the real side of the economy, so let me say a word about the other objective, which relates to inflation. The twelve-month inflation rate as measured by the core PCE deflator is currently 1.4 percent. As measured by the core chain weighted CPI, it's 1.2 percent; by the so-called market-based core PCE deflator, it's 0.9 percent. All of these inflation measures have been falling in the last year. If the U.S. economy grows 3 percent in 2003 and 4 percent in 2004 as projected, there will still be considerable economic slack going into 2005 and, of course, there are downside risks to that growth forecast. So there seems to be a reasonable likelihood of further disinflation.

I personally am uncomfortable with measured inflation in the range of 1 percent or below, so I think such an outcome is worth preempting if possible. In short, I think a weak economy with a background inflation of 1 percent is a very different situation from a weak economy with background inflation of 3 or 4 percent. For that reason I hope that we will keep potential further easing on the table as we go forward. I believe we could justify that as taking out insurance, providing support for a developing recovery, or even with a specific reference to stabilizing inflation at a desirable level. Thank you.

CHAIRMAN GREENSPAN. Governor Bies.

MS. BIES. Thank you, Mr. Chairman. I have just a couple of comments. We're at the beginning of the earnings season, and so far it looks as if corporate earnings are coming in at the expected levels, even though they are lower than what was expected at the beginning of the quarter. I had a conversation with a consultant who helps companies develop business in China,

and she said that when the news of SARS came out, several of her clients actually went into crisis-management mode. They started contacting the CDC and other health services to determine if the virus could be transmitted in the containers used for exports out of China into the United States. These companies were concerned that they would be selling contaminated products. At this point the CDC is saying that SARS can't be transmitted in a dry environment; it needs moisture. But that issue was a concern for several days and it did affect some companies. They are continuing to monitor the situation as the medical community looks at how the disease can be transmitted. She also commented that, if SARS is a short-run problem, it shouldn't have material effects but that we may see some effects if the problem goes on for several months. That's because the development of new investments really requires face-to-face contact in China and many firms are deferring trips that they would need to make to get new products or projects initiated. So SARS is something that her clients are very concerned about, and they won't know to what extent it will affect their business until they fully understand the risks going forward.

CHAIRMAN GREENSPAN. Governor Olson.

MR. OLSON. On a fiscal policy note, the Congress did pass a budget resolution last week, which ordinarily would provide some clarity on fiscal policy. However, the joint resolution that was passed allows, at least initially, for a different tax cut figure in the Senate than in the House. The President yesterday signaled that he might be willing to accept significantly less of a tax cut than his initial request. It seems that the two-week congressional recess period now will be used in part to test public sentiment as to whether or not the President's popularity in Iraq can roll over to influence his domestic agenda, most notably the tax cut. So even though we've seen a budget resolution, the fact that there is that disparity between

the House and the Senate versions means that we are still in a period of uncertainty with respect to that portion of fiscal policy.

CHAIRMAN GREENSPAN. Governor Gramlich.

MR. GRAMLICH. Yes. I'm one of Al Broaddus's visitors down on the Carolina coast this week, and life is a bit less frenetic here. But I have a few things to say. First off, I'd say to Bob McTeer that I want everybody in Dallas to know that American Airlines never applied for a loan guarantee. Second, as I have read the papers and heard what all of you have said, the good news seems to be an absence of bad news, and the bad news seems to be an absence of good news. In other words, we're sitting here right in the middle just the way we were at the March meeting. I think, as Ben was suggesting, that we may well need to have a big discussion about the outlook and what we ought to do in May, but it doesn't seem sensible to do anything today; and I'm not so sure that we need to continue these weekly phone calls. I think we know enough about what will be coming up between now and our May meeting that we can wait and debate the issues at that time. So I'd sit tight for now, but in my view we ought to have a heart-to-heart talk in May. Thank you.

CHAIRMAN GREENSPAN. Well, thank you very much, Ned. You saved me a number of sentences! I agree that the most positive development in recent weeks is that things that could have gone wrong did not. However, I didn't think of the other side of that, which you put very succinctly. It is certainly the case that the reason the financial markets have been behaving so well recently is not the evidence of good news but the significant diminution of the tail ends of the probability distributions of various events. Merely eliminating those tail ends—granted that risk aversion is the general state of affairs—would tend to buoy markets, as indeed occurred just before the war started. One can't argue that anything changed fundamentally at that point with

respect to the probability of the torching of the oil fields, of considerable distress in the Middle East, and a number of other concerns that would arise as a consequence of the war. One can't argue that between the day that the President put out the ultimatum and the day the war started any significant news came out. But what did happen is that the probability that the war would end sooner created a positive force for financial markets, and the markets all moved very substantially as you remember.

In listening to the roundtable and looking at the data we've received, I, too, would say that really very little of a positive nature has happened in the economy as a consequence of the end of the war, if that is indeed what it is. But it's probably too soon to get anything definitive in the data. The information we are getting, obviously, is that consumer confidence went up. Is it the ABC/Time survey that—

MR. WILCOX. *Money*.

CHAIRMAN GREENSPAN. I'm sorry, it's *Money* magazine. Are they still owned by Time? According to ABC/*Money*—which is probably not the best of the three surveys on consumer sentiment but it's the only weekly one—confidence went up sharply last week. In any case, I think we're at least in a position where our concerns about a very adverse event—one that would affect the economic outlook significantly—occurring between our previous meeting and May 6 have diminished very materially. Those concerns have not been replaced, however, with any set of positive forces. It's really quite remarkable that almost across the board everybody who is forecasting is projecting an acceleration of economic activity in the third quarter. Nobody has any evidence that the acceleration has started. So it's a very unusual situation. I also would agree with Ned that we can dispense with our weekly calls, unless there is significant dissent to the contrary, and wait until our May 6 meeting to review the situation. Let me just put that on

the table for your general reaction. I think Ned's position of holding off—not taking any action now but leaving open the possibility that we may want to do something on May 6—is reasonable. Certainly in the context of what we've been seeing I would not make a policy move before then. Would anyone like to comment?

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, Bill McDonough here. I think that is very wise. The likelihood of our needing to have meetings for the next two weeks is very low, and I believe we ought to go into May 6 with our eyes very wide open to our responsibilities then.

MR. MOSKOW. Mr. Chairman, this is Michael Moskow. I agree completely. I don't see any reason to have weekly phone calls. I certainly think the current stance of monetary policy is fine until May 6, and we can reconsider it at that point.

MR. SANTOMERO. This is Tony Santomero in Philadelphia. I agree with the sentiments that have already been expressed.

MR. STERN. The contingent at the Minneapolis Fed agrees with you, too, Mr. Chairman.

CHAIRMAN GREENSPAN. That's pretty heavy weight!

MR. KOHN. Heavier than it ought to be, I think!

CHAIRMAN GREENSPAN. Does anybody else want to comment?

MS. MINEHAN. We agree in Boston, too, Mr. Chairman.

MR. BROADDUS. This is Al Broaddus, Mr. Chairman. I agree with your position.

MR. POOLE. St. Louis agrees.

CHAIRMAN GREENSPAN. If no one else wishes to comment, I presume there is unanimity on that insight and recommendation.

MR. HOENIG. Excellent presumption.

CHAIRMAN GREENSPAN. In that case, we'll see you all on May 6.

END OF MEETING