APPENDIX

FOMC BRIEFING - P.R. FISHER

March 28th, 1995

Mr. Chairman,

I will be focusing on why the dollar has declined so sharply in the last two months. I will then briefly review: foreign operations, the forces at work in the bond market, and domestic operations.

To understand the dollar's recent decline, I think it is helpful to look back at the perceptions that have been driving expectations for the mark, the yen and the dollar for the past year or so. The dollar's decline during the first quarter of 1995 can then be understood as reflecting the simultaneous disappointment of the particular combination of expectations that provided the basis for the dollar's upward movement at the end of 1994.

For market participants, the dollar's position relative to the mark and yen has been significantly determined by shifting expectations about the answers to three questions.

First: Is Germany on a converging or diverging path with the other, major European economies and, in either case, what are the implications of that path for interest rate differentials between Germany and the U.S.?

Second: Is there something that will offset Japan's export-related surplus OR reverse the logic by which it seems that a weak Japanese economy and fragile financial sector translate into a strong yen? And,

Third: Can interest rates in the United States ever get high enough to offset the drag of the current account deficit?

With respect to European convergence, there is a political question whether the process of European monetary union will continue; there is a structural question whether the German economy will emerge from the unification process in a significantly enhanced competitive position; and there is a cyclical question whether other European economies are in-step or out-of-step with the German economy and German monetary policy.

In recent years, as the perceived answers to these questions have shifted, European exchange rates and the mark have adjusted. When the cyclical and structural positions of the European countries look most divergent from Germany, then the economic

conditions for monetary union are suspect. If, at the same time, there appears to be a lack of political will to keep monetary union on track, or a lack of willingness on the part of the Bundesbank to provide an hospitable interest rate environment, then the mark appreciates sharply.

However, if overall German economic performance is no better than the average of Europe and if, at the end of the day, the Bundesbank will make sure that monetary union stays alive, then the Deutsche mark is more likely to be blended into a pan-European currency. On the other hand, if German economic performance is much better than the rest of Europe and if the Bundesbank goes its own way on interest rates, then monetary union is unlikely to occur. Put differently, an independent Deutsche mark has an obvious claim to be one of the world's reserve currencies; but a mark about to be blended into a pan-European currency is less deserving.

Turning to the yen, over the past few years, market participants have repeatedly positioned themselves on the expectation that something would be found to offset Japan's surplus. The surplus related to Japan's exports is viewed as a constant; the variable that the market has looked for is a potential offset. In the early '90s, it was thought that lower Japanese interest rates would provide the offset by stimulating capital outflows. Then it was thought that changes in trade

polices would permit an increase in imports. More recently, market participants have thought that the yen might weaken if economic activity in Japan picked up, leading to both greater imports and to improvements in the condition of Japanese financial institutions which, in turn, might permit greater outward investment.

Thus, in the past 18 months, as expectations for increased growth in Japan rise, the yen tends to stabilize or weaken. But as these expectations are disappointed, the yen renews its ascent. However, odd or ironic it may seem, the market has learned the lesson -- with the same certainty as Pavlov's dogs learned theirs -- that, until something changes, in the land of the rising surplus, a weak economy and a fragile financial sector translate into a strong currency.

The United States has been seen as the land of low interest rates and a rising current account deficit. When the foreign exchange market expects U.S. interest rates to rise, the dollar is bid on the rumor. However, on the fact of rate increases the dollar is offered, on the disappointing realization that rates are still not yet high enough, or exchange rates not yet low enough, to induce foreigners to finance the ever-widening current account deficit with unhedged, long-dollar positions.

While the dominant expectations for the mark, the yen and the dollar have been negative for the dollar -- and, thus, the

dollar's downward trend -- these expectations have shifted back and forth. Beginning this past October and continuing through early December, expectations began to line up in favor of the dollar.

In Europe, there was a modest optimism about political and fiscal prospects. In France, for example, the pro-European, pro-EMU Balladur was the frontrunner for the French presidency, providing enough flexibility in the Franco-German alliance to gratify the Bundesbank's known insistence that greater political union would be necessary for monetary union. There had been little real pressure in European exchange markets for months and Teitmeyer was still publicly stating that German interest rates were as likely to go down as they were up.

At the start of October, modest progress was announced in the U.S.-Japan trade talks. By November, there was a sense that the Japanese economy would turn the corner and record respectable growth, with forecasts of 2.5 percent for 1995 seeming quite reasonable. And in December, the Nikkei started moving up -- creating the hope that Japanese banks might be able to close the fiscal year in March with a little bit of cushion on their balance sheets.

Finally, the 75-basis-point increase by the Committee in November suggested that the Fed knew how to raise rates in meaningful increments. As I previously mentioned, this created something of an extrapolative expectation for further rate increases. At the same time, with new, Republican majorities in Congress, market participants even dared hope that something might be done about U.S. fiscal policy.

Thus, with the Fed getting serious about raising rates, Teitmeyer seemingly prepared to lower rates, and the Japanese economy expected to start real growth, it appeared reasonable to think that the U.S. current account deficit might begin to stabilize, or even shrink, at the very same time that U.S.-European interest rate differentials would move sharply in the dollar's favor. But during the first quarter of this year, ALL of the expectations that supported the dollar's rise have been disappointed.

In January, the mark began to rise against other European currencies, as fiscal and political conditions deteriorated -- especially in Spain and Italy. At the same time, as a result of German wage demands and strike threats, the Bundesbank was no longer thought capable of lowering rates and might even have to raise them. In France, Chirac replaced Balladur as the frontrunner for the presidency. Based on the Bank of England's

trade-weighted index, the mark reached an historic high on January 10th and then continued to rise an additional 5 and half percent to its peak on March 17th. Only after the mark reached these lofty levels, and after a devaluation was forced upon the escudo and the peseta, have market participants begun to consider the possibility of an ease in German interest rates, and even then only with the explicit encouragement of Teitmeyer.

The market's perception of the Japanese economic outlook has also changed sharply. Since the Kobe earthquake the prospect of a triple-dip recession is being discussed in Japan and the Nikkei's December uptick is viewed more in light of Nick Leeson's trades than as a precursor of economic growth and financial sector stability.

While Japanese financial leaders insist that there has been no significant "repatriation" flow of capital, the Japanese exporters have been aggressive dollar sellers. Moreover, the declining Nikkei serves to weaken the Japanese banks and other intermediaries, thereby further decreasing the likelihood of future capital outflows. As the yen hit new highs against the dollar, and the Nikkei continued to sink, Japanese markets have just recently begun to look for a reduction in rates by the Bank of Japan.

In January and February, the U.S. also reverted to type: offering lower-than-expected interest rates -- and, thus, shrinking interest-rate differentials with Europe -- as well as a higher-than-expected current account deficit.

In my opinion, these major shifts in expectations for Europe, Japan and the United States are the principal factors which have pulled the dollar lower over the first quarter and, in all likelihood, would have brought the dollar down to test the historic lows sooner or later.

However, the timing and abruptness of the dollar's decline in February and early March was the result of events which -- particularly for foreigners -- further eroded confidence in the U.S. government's ability to manage economic affairs. The handling of the Mexican crisis negatively affected the perception of the Administration's competence. The defeat of the balanced budget amendment unwound expectations that Republican majorities in Congress would be able promptly to follow through on promises of fiscal restraint. And, finally, comments by Committee members, perceived as suggesting indifference to the exchange value of the dollar, undermined the Federal Reserve's inflation-fighting credentials in the eyes of overseas market participants for whom exchange-rate depreciations are a major source of inflation.

With all of this in the background, and as I described during the Committee's March 10th call, we intervened in the dollar-mark and dollar-yen exchange markets on Thursday and Friday, March 2nd and 3rd, in an effort to stabilize the dollar and counteract the impression of official indifference.

On Thursday, we sold 300 million dollars worth of marks and the same amount of yen, evenly divided between the System and the ESF. On Friday, after European central banks had operated in support of the dollar, the Desk sold 450 million dollars worth of marks and 370 million dollars worth of yen, again evenly divided between the System and the ESF. Over the course of Friday, other central banks purchased a total of 2.8 billion dollars and, in addition, sold a total of 5 billion marks against their own currencies.

In my opinion, Thursday's solo operation had the beneficial effect of calming the market and temporarily stabilizing the dollar after its sharp fall that morning. Friday's concerted operation, while initially giving the dollar some support, did not plausibly appear to be able to push the dollar higher and, in retrospect, appears to have simply provided liquidity to those looking to buy marks or yen.

I think the dollar's recent stability is the result of the Chairman's statement on Wednesday, March 8th, the bond market's subsequent improvement, Teitmeyer's repeated statements that the dollar is undervalued, and the increased plausibility of rate cuts in Germany and Japan.

Turning to the U.S. securities markets, the short-end led interest rates lower over the period as expectations for further rate increases unwound. Throughout the period, the strength of investor demand seemed to surprise the dealers, who found themselves trying to catch up to the market as bond prices rallied not only following weak activity data but also, for example, after slightly higher-than-expected CPI and stronger-than-expected headline employment figures. Comments by Federal Reserve officials also played a role in market psychology, helping participants reach conclusions about the implications of the data for monetary policy. Two-year notes fell by 70 basis points in yield while bonds fell by 30 basis points in yield.

From the Committee's last meeting up to the Chairman's Humphrey-Hawkins testimony, the yield on two-year notes declined by 25 basis points and the long-bond by 10 basis points, as January's employment report, retail sales, housing starts and industrial production were seen as implying a reduction in the pace of activity. In the days following the Chairman's Humphrey-

Hawkins testimony, the two-year note shed another 30 basis points and the long-bond another 15 basis points.

The market went through one relatively brief correction during the first week of March, after the dollar's sharp decline, with the long end taking the brunt of the selling. But strong demand re-emerged by mid-March, aided by the March 13th New York Times article on the Governors' views and February data on retail sales. The rally took yet another step this past Friday after the February durable goods report.

Over the period, we heard a lot about Treasuries benefitting from large pools of cash and money managers short their indices. Central bank buying was another significant factor, particularly in the Treasury bill market.

At present, there are no expectations for Committee action at this meeting priced into the market; and forward prices are implying <u>less</u> than a 50-50 probability of a 50-basis-point increase at the Committee's next meeting.

Finally, during the period, while the Domestic Desk sought to maintain the degree of reserve pressure indicated at the Committee's last meeting, the money market traded with a soft tone, with the Federal Funds rate often at 5 and 15/16th. During much of February, this appeared to be consistent with our need to

drain reserves. In March, however, the soft tone continued even as we allowed sizable reserve needs to develop. This week, though, the market appears to have regained its appetite and the funds market has a firm tone, reflecting a remaining add need.

Mr. Chairman, I will need separate votes of the Committee to ratify the Desks' foreign and domestic operations.

In addition to the intervention operations already mentioned, and as I discussed on the Committee's March 10th call, for value February 2nd, the Banco de Mexico drew 1 billion dollars on our reciprocal swap line and, then, for value March 14th, repaid 500 million, leaving 1 billion still outstanding.

The Desk's domestic activity consisted entirely of temporary operations, with matched sale-purchase transactions dominating in February when we faced large drain needs, and RPs dominating in March as add needs emerged.

I would be happy to answer any questions.

Michael J. Prell
March 28, 1995

FOMC BRIEFING

For all practical purposes, the latest staff forecast is the same as the one we presented at the last FOMC meeting. This is not to say that we now hold that forecast with absolute confidence. But the incoming indicators have generally been in line with our expectation that 1995 would see both a substantial slowing in aggregate demand growth and a pickup in inflation.

With respect to the demand picture, the effects of monetary restraint have begun to show through more clearly, with some relatively interest-sensitive sectors leading the way in the recent deceleration of activity. On the household side, homes sales dropped last fall--a pattern that wasn't so evident before some recent data revisions. The subsequent decline in single-family starts should in turn spell weak residential construction into the spring. Similarly, the recent slippage in consumer purchases of motor vehicles is pointing to lower production in coming months, and there are hints in the latest retail sales report of a softening in the demand for furniture and appliances.

On the business side, it hadn't seemed likely that we would maintain the pace of increase in equipment spending that was observed over the past couple of years. As we reported in the Greenbook supplement, the data on manufacturers' shipments of capital goods released at the end of last week contained stronger numbers than we had anticipated; but, even so, equipment investment appears to be headed for some deceleration this quarter.

Perhaps because this is the season of the college basketball championships, a number of prominent analysts have warned that these data may be giving us a "head fake"--that they may not in fact be signaling more than a pause from above-trend growth. To be sure, most of the series to which I've just referred are subject to frequently large revisions, and they are also sufficiently variable in the short run that a couple of months don't provide compelling signals about trends. But, from the staff's viewpoint, the incoming information merely tends to confirm our prior expectations, so it's a little easier for us to buy into them. Moreover, while we are probably still in the lower portion of the range of 1995 growth forecasts, we see reasons to think that the risks in our forecast, though wide, are at least reasonably balanced.

On the domestic side, one clear possibility is that the recent rise in stock prices and decline in longer-term interest rates will buoy domestic demand in coming quarters to a greater degree than we've anticipated in this forecast. And, on the external side, the lower dollar could spur even greater export growth than we've anticipated.

But, as Ted will be discussing, there are also downside risks arising from developments abroad. And on the downside domestically, there is the possibility that the recent unexpected slackening in sales may prompt businesses to turn considerably more conservative about their inventories, triggering a sharp scaling back of orders and thence production. To be sure, we don't seem to have in place the makings of an inventory correction of recessionary dimensions-- but that statement falls in the category of "famous last words" of economic forecasters.

For the longer haul--but not so long as to be utterly irrelevant for monetary policy considerations--there is also the uncertainty about federal budget policy. I'm just not sure whether to classify that as an upside or a downside risk, relative to our forecast assumption of moderate deficit reduction! It could be that tax cut fever will yet get the upper hand, but it perhaps is just as likely that all the talk about massive deficit reduction will ultimately be reflected in greater fiscal restraint than we've built into our projection. I believe we've made a sensible fiscal assumption, under the circumstances, but this is obviously a high risk area that will necessitate careful monitoring for some time.

So, as I said earlier, we feel that our projection of aggregate demand reasonably balances the identifiable risks, and we think the same is true on the price side. As you probably noted in reading the Greenbook, we are hesitant to take the fact that the last couple of CPIs have shown the acceleration we predicted as definitive evidence that our analysis of the prospects for inflation is correct. Rather, we are simply saying that those numbers are not inconsistent with our being correct.

One reason for our caution is that the news on compensation developments has been generally favorable: Not only were the recent readings on the employment cost index and average hourly earnings surprisingly low, but the anecdotal information reported in the Beige Book and elsewhere provides scarcely a hint of wage acceleration. Another reason for caution is that, though the core CPI did accelerate in early 1995, there was no indication that it had much to do with the rise in materials prices that we thought might push finished goods prices up more rapidly. A lot of the pickup was attributable to such items as tuition, auto finance rates and used car prices.

Now, I don't want to suggest by that dissection that a bottom-up approach is necessarily the best way to think about a macro phenomenon like inflation, but the composition of price index movements can, at times, provide useful clues about the processes at work and about the flukiness of particular monthly observations. So, as we scrutinize the PPIs and CPIs that will be coming in before the next FOMC meeting, we'll certainly be looking for clearer signs that broad inflationary pressures, associated with measured levels of resource utilization and with the depreciation of the dollar, are manifesting themselves. At this point, however, we think that, with the overall core CPI showing the firmness it has of late, it makes sense to stick with our basic story that the economy is operating at such levels of resource utilization that inflation is going to trend upward over time.

Let me now turn the floor over to Ted, who will deal with the international side.

E.M.Truman
March 28, 1995

FOMC Presentation -- International Developments

In the context of little change in the broad contour of our overall forecast, our outlook for the external sector has changed somewhat from that presented at the Committee's last meeting. Principally due to our revised assessment of the Mexican situation, we now have weaker net exports of goods and services in the first half of this year. Beyond that net exports make a larger positive contribution to real GDP due to somewhat lower U.S. economic activity and the slightly lower dollar. However, as Mike has noted, the external sector is responsible for more than its normal share of the risks and uncertainties in the overall staff forecast, even if they are reasonably balanced. I thought I would review briefly three of them: Mexico, the dollar, and the January trade data.

With respect to Mexico, we have modified our projection of the size and the timing of the change in Mexico's current account deficit, and therefore its impact on the U.S. economy. The Mexican external adjustment is now somewhat larger than that incorporated in our January forecast. Moreover, we are now projecting that almost all of it will be achieved in the first half of 1995, principally in the first quarter. To put a number on it, the Mexican adjustment subtracts almost 15 billion 1987 dollars from U.S. net exports in the first half of this year, about one-third of a percentage point of real GDP.

We are now projecting that real GDP in Mexico will decline 4-1/2 percent this year. On the assumption that economic and financial conditions stabilize in Mexico, we are projecting a moderate recovery next year. This implies a level of economic activity at the end of the forecast period about 10 percent below that in our December outlook, before the peso's devaluation. We are projecting Mexican inflation of about 40 percent this year and 15 percent next year and a real depreciation of the peso of about 20 percent, with the peso settling in at around 6.50 per dollar at the end of 1996. These elements are estimated to produce a Mexican current account deficit of about $9 billion this year and $6 billion in 1996.

However, these assumptions and projections may convey a false sense of precision. It is an understatement to say that the Mexican situation and its implications for the U.S. economy are a source of considerable uncertainty. For example, the Mexican official projection of their current account deficit this year is substantially smaller than ours. Moreover, we have incorporated some negative spillover effects from Mexican developments onto other Latin American countries -- Argentina and Brazil in particular -- but there are risks associated with those estimates as well -- in both directions.

Turning to the dollar, as Peter has described, the dollar has declined substantially during the intermeeting period -- about 5 percent on our multilateral-trade-weighted index in terms of the other G-10 currencies, but not so much relative to our previous forecast. The dollar's weakness can be explained

partly by shifts in economic fundamentals such as perceptions about the future course of U.S. monetary policy and the implications of developments in Mexico for the U.S. external accounts. However, in my opinion, non-economic factors appear to be involved as well, and a sizeable part of the dollar's recent weakness, as of now, should be regarded as unexplained.

This has left us with a challenge in putting together our forecast. The dollar is now trading near the lower end of the range in which it has fluctuated over the past eight years in terms of our G-10 average, having hit new lows against the DM and the yen; this suggests that the dollar's slide may have been overdone. On the other hand, the dollar may be in the midst of a prolonged swoon that can be traced to long-term factors such as our budget and current account deficits or trends in global portfolio diversification.

In our forecast, we have adopted a compromise position between these two extremes and have the dollar continuing to trade around the lower levels that it has recently reached. However, our band of uncertainty is quite large. As was illustrated in the alternative simulations presented in the Greenbook, a substantial further depreciation or recovery of the dollar would make a considerable difference in the outlook.

A final puzzle concerns the January trade data and how they should be interpreted. The January deficit on trade in goods and services of $12.2 billion was released just as we were completing our forecast. We were somewhat surprised by the data, but we were less surprised than was the market.

The deficit on goods transactions ballooned to $17.2 billion, an increase of more than $4 billion from the December deficit, which, you will recall, was surprisingly small. Perhaps, a billion dollars of this increase can be accounted for by trade with Mexico, lending support to our assessment that we will be feeling the impact of the Mexican adjustment quickly. Another billion can be accounted for by reduced aircraft shipments, which we expect to recover. The remainder we have treated largely as statistical noise. However, with only one month of data available, and with those data falling, we believe, outside the range of reasonable variation, we could well be setting ourselves up for a nasty surprise.

While I could easily go on to describe other questions we have about our forecast, Mr. Chairman, I will stop now and let the Committee ask the questions.

March 28, 1995

FOMC Briefing
Donald L. Kohn

With economic activity apparently having decelerated of late, with the System having tightened at its last meeting, and with some of the effects of previous increases in interest rates probably still to be felt, it might be argued that the Committee could leave the stance of policy unchanged at this meeting, awaiting greater clarification of the underlying trends in the economy. If the Committee does choose alternative B, it still needs to consider its preferences for policy reactions going forward--as summarized in the symmetry or asymmetry of the directive--which I will address briefly at the end of my discussion.

The bluebook gives arguments for alternatives A and C, as well as for B. But instead of expanding on these, I thought I'd step back a little and flag one possible consequence of some of the changes in the way policy has come to be formulated and implemented in recent years. Specifically, it seems to me that a number of trends in policymaking threaten to impart greater inertia to the federal funds rate because they may increase the amount of evidence the Committee will require to justify a change in its policy stance. This, of course, would raise the risk that the funds rate would not be moved in a timely fashion to achieve the Committee's objectives.

To be sure, there were no signs of any such inertia from early 1994 to early 1995; the rise in the federal funds rate since early 1994 has been larger than the average increase over the initial 13 months of previous tightening episodes. Nonetheless, this increase followed the longest stretch of stable money market rates in 30 years.

Our knowledge of the relationship of interest rates to prices and activity is limited, but given normal variations in spending propensities and inflation expectations, we can be sure that a constant level of the nominal interest rate is unlikely to be consistent for long with fostering the Committee's objectives. The risk of overstaying a particular policy stance might be especially high over coming months, which, like 1993, could be a time when the possible lagged effects of previous actions and changing economic conditions make the appropriate policy move less obvious than it has been for a while.

What phenomena might contribute to a potential problem of inertia--if indeed there is one? First is the return to a narrow, explicit target for the federal funds rate, with the effects perhaps accentuated by the immediate announcement of each policy action. As new technology and rising wealth broadened participation in financial markets and heightened responses to new information, greater clarity in conveying the Committee's intentions became more important. These trends interacted with increased uncertainty about the underlying discount borrowing/federal funds rate relationship to provide a convincing rationale for the shift in operating procedures a few years ago to focus more on a federal funds rate target. Nonetheless, such a shift may not be without its drawbacks. In the borrowing versus fed funds targeting debates in the latter half of the 1980s, Committee members who had been around in the 1970s attributed some of the sluggishness of the response of policy to gathering inflation pressures at that time to a procedure that focussed on, and required votes for, each small change in the federal funds rate target. Since then, the Committee has avoided some of the resulting inflexibility by authorizing more between-meeting changes in the federal funds rate, though there has been shying away from this over the past year. One effect

of a federal funds rate operating target, together with the more recent practice of announcing each Committee decision, has been to virtually eliminate the distinction, in terms of public attention, between open market operations and changes in the discount rate--all policy actions now seem to attract the media and political scrutiny that used to be reserved for discount rate changes. The visibility of the federal funds rate target, along with the effort to reach Committee consensus on policy actions, could mean that the Committee will feel a need to be more certain of its decisions. Greater certainty often can be obtained only by waiting for more information.

Moreover, the Committee has lost one class of indicators that sometimes helped to key decisions in a more timely way--the monetary aggregates. I think we sometimes exaggerate the role the aggregates used to play in policy. After 1982 these variables did not trigger automatic changes in the stance of the System in reserve markets--and they were frequently allowed to run outside target bands for a good while. But movements in the aggregates were considered in a significant way in policymaking, and when they and other indicators were tending to run in the same direction, money supply developments may have prompted quicker and more forceful action. A good example of this is the turn in policy from tightening toward ease in the spring of 1989--a shift that in retrospect seems fully justified. A memo on this episode will be distributed to the Committee in the next few days. In deciding to ease policy for the first time in early June 1989, just a little more than three months after the last major tightening action, the Committee gave considerable weight to incoming data on employment and wages that suggested a flagging in the pace of expansion and no pickup in cost pressures. But it also paid considerable attention to a string of unexpectedly weak M2 numbers. Without

the aggregates nowadays, the Committee may feel the need to wait for more definitive evidence of departure of the economy from expectations before being sufficiently comfortable in changing policy.

The third change in Committee practices that might impart inertia to policy action is the recent predilection toward larger moves in the federal funds rate--that is, 50 or 75 basis point moves rather than 25 basis points. Clearly, there is no problem with moving the federal funds rate by sizable amounts when such action seems warranted, and smaller moves in such circumstances can be disruptive to markets, which quickly anticipate further action, or come to question Federal Reserve intentions. But, especially when uncertainties about appropriate policies are larger, there might be something to be said for smaller, possibly more frequent, adjustments. The problem, again, is that the larger adjustments may be seen as requiring a greater burden of proof before they can be taken.

The issues I have raised are highly conjectural, and I may well be wrong in my analysis. Furthermore, I am not suggesting a return to discount borrowing objectives or monetary targeting, which were abandoned for good reasons. But the potential for greater funds rate inertia is one the Committee members might keep in mind over coming quarters.

As I noted at the beginning of my discussion, if the Committee chooses to leave reserve conditions unchanged, it would still need to specify its predisposition toward policy changes in the future. The Committee might want to be biased toward tightening if it saw the risks still tilted toward an unacceptably high inflation outcome. With inflation already showing signs of pickup, and with the economy operating at unemployment and capacity utilization rates that in the past had been associated with accelerating prices, the Committee might

want to react especially quickly and forcefully to indications that the economy was not moving into a substantially slower growth path than in 1994. Concerns about potential inflation pressures also might be accentuated--with implications for policy reactions--by further declines in the dollar or even in bond yields that were not accompanied by convincing evidence of sagging aggregate demand.

A symmetrical directive might be considered appropriate if the Committee saw the risks to achieving its objectives as reasonably well balanced at this point, so that it saw about even odds that its next move would be up or down. Although the appropriate level of interest rates is impossible to pinpoint, real rates are still above long-run averages, which might be seen as adding to the potential for an appreciable further slowing of the economy at a time when many of the effects of the higher rates have not yet shown through to spending. A symmetrical directive might also be preferred if, in light of the uncertainties about the outlook, the Committee preferred a muted response to incoming data or market movements--muted in the sense of allowing firmer evidence to accumulate before acting and then being more comfortable with smaller rather than larger steps.