FEDERAL OPEN MARKET COMMITTEE MEETING TRANSCRIPTS

Prefatorv Note

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Meeting of the Federal Open Market Committee

September 26, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, September 26, 1995, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

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

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

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

Messrs. Davis, Dewald, Hunter, Lindsey, Mishkin, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Simpson, Associate Director, Division of Research and Statistics, Board of Governors

Mr. Hooper and Ms. Johnson, Assistant Directors, Division of International Finance, Board of Governors
Mr. Ramm, 1/ Section Chief, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Pianalto, First Vice President, Federal Reserve Bank of Cleveland

Messrs. Lang, Rolnick, Sniderman, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of Philadelphia, Minneapolis, Cleveland, and Atlanta respectively
Messrs. Cox, Hetzel, Judd, and McNees, Vice Presidents, Federal Reserve Banks of Dallas, Richmond, San Francisco, and Boston respectively
Ms. Meulendyke, Adviser, Federal Reserve Bank of New York

1. Attended portion of meeting relating to the Committee's economic discussion.

Transcript of Federal Open Market Committee Meeting
September 26, 1995

CHAIRMAN GREENSPAN. Would somebody like to move approval of the minutes?

MS. MINEHAN. So move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Mr. Fisher, please.

MR. FISHER. Thank you. Before permitting myself to take advantage of the new high-tech toys in the ceiling and because of the number of topics I need to cover, I thought I would try to exhaust the potential of older technologies. Thus, you should find an outline of my remarks on the table in front of you together with a single page of colored charts. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Peter?

MR. LINDSEY. There seems to be a lot of movement into Swiss francs, particularly by the Germans. Is there a general search in Europe for--I hate to use the words--a "safe haven," or what is it?

MR. FISHER. Yes. Beginning in the spring and continuing over the summer, the German banking community seemed to awake to the possibility of capturing some of the flows by placing them in Swiss investments. This coincided with some revelations about the use of Luxembourg accounts by Germans for tax avoidance. So, there was a double incentive for the German investment community to move out of Luxembourg and find some other place. German banks in Switzerland, not just Swiss banks, seem to have taken advantage of this opportunity initially through mark Eurodeposits in Switzerland but funds clearly also were moved into Swiss assets for "safe haven" reasons as well. There has been much talk in Germany about how far out the yield curve investors can afford to go, given the uncertainties about future returns. That has been part of the marketing pitch the bankers have used to stimulate this flow.

MR. LINDSEY. Are they actually going to their local Deutschebank to buy Swiss franc money market funds or whatever it might be?

MR. FISHER. Yes, precisely things like that.

MR. TRUMAN. There have been long articles in various German newspapers about the advantages of this kind of operation--newspapers such as the Frankfurter Allegemeine Zeitung and the Suddendeutsche Zeitung. The Swiss are understandably somewhat unhappy since they are just sitting there like any other emerging market, if I may put it that way. [Laughter]

MR. FISHER. I failed to mention that the Swiss lowered their rates and saw their currency keep appreciating last week.

MR. LINDSEY. How long have they been reducing their rates?

MR. FISHER. They are down to 2 percent on their discount rate.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Would the kinds of operational changes that you are contemplating, or working on, require legislative authorizations?

MR. FISHER. In the implicit division of labor between Don Kohn and myself, I am working on issues that would not involve legislative changes. There are questions about possible changes in reserve requirements that might involve new legislation, and Don may be better placed to talk about those. At the Desk, we are looking at some very simple issues such as: what time of day we can operate; what level of information we have to operate with at different times of the day; whether there is a different type of repo with which we might be able to conduct operations in the market late in the day; and whether we could change the discount window in some informal way, or perhaps some statutory way. Reserve requirement changes would be another approach.

MR. KOHN. If the Board wanted to go to a system of low, broadly based reserve requirements, that would require legislative changes. It is one of the options we are looking at. Obviously, if you wanted to pay interest on reserves, that would require legislative changes. It may be a little late for that. Legislative changes also would be required for a system under which the Federal Reserve might pay a low interest rate on excess reserves to put a floor on the federal funds rate and impose a Lombard rate or something like that to provide a ceiling. We are beginning to look at a broad range of alternatives. I think the issue has caught up with us a little faster than we thought it was going to a month or two ago.

MS. PHILLIPS. Do you think that the kinds of changes that you are looking at would reduce the propensity of banks to develop sweep arrangements, or do you think those are with us anyway and have to be factored in?

MR. KOHN. At this point I tend toward the latter view. If we were able to pay a market rate of interest on reserves, that would remove the incentive for sweeps. In that event, the current sweep arrangements might be undone, but it would be very hard to get the legislative authority in the current budget environment. The other approaches we are looking at would not remove the reserve requirement tax or the incentive to reduce required reserves.

MS. PHILLIPS. I have one other question. What is happening in the markets that is affecting the timing of operations? Are things shifting to other markets, to overseas markets?

MR. FISHER. No. If the dealer community does more of its financing early in the day, they generally have fewer securities left to finance by the time we would normally enter the market at 11:30 a.m. It is a very mechanical issue.

MS. PHILLIPS. So it is still domestic.

MR. FISHER. It is just the domestic players and they are just completing their financing. Certainty is better for someone looking to finance a large portfolio than uncertainty, and waiting to find out whether or not we will enter the market has its risks for them. It is not a major issue. On Monday of last week we received only $5.7 billion of propositions. The next day we were looking at a need between $8 and $10 billion at the time we made the decision. We did end up injecting about $8 billion, after getting about $10 billion in propositions as a result of operating earlier.

MS. PHILLIPS. Thank you.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I have a different response from the one Don gave to Susan's question about incentives for innovation. As long as we maintain a distinction between liabilities that are called deposits and liabilities that are not called deposits, there are going to be incentives. If we had a low, broad-based reserve ratio on all noncapital liabilities without the distinction between deposit and nondeposit liabilities, then that incentive would go away. So, it depends on how we do it.

MS. PHILLIPS. Yes. I suspect this is going to take some major fleshing out.

CHAIRMAN GREENSPAN. Any other questions? If not, would somebody like to move ratification of the domestic Desk operations?

SPEAKER(?). So move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Shall we move on? Let's go to Messrs. Prell and Truman.

MR. PRELL. [Statement-see Appendix.]

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

CHAIRMAN GREENSPAN. Questions for either gentleman?

MR. PARRY. Mike, you referred to what is happening to labor costs. If you look at what models seem to tell you about what is happening there, in the last three quarters, at least in terms of the model that we look at, inflation in the employment cost index has been lower than predicted by 3/4 percentage point. My impression is that that may be related to developments in medical costs, and it is possible that the effect will be of short duration. When you look out over the next two years, what assumptions do you make about what will happen to the ECI? Have we seen an intercept change or are we going to see an error decay? What assumptions have you made?

MR. PRELL. I think your characterization of a favorable surprise relative to many typical models is right. When we get surprises, we go back and start tinkering with models. We want to see whether we can fit history better and whether we can, for example, introduce something into these equations such as lagged wages that

might capture a trend in wages or a wage norm and reduce the errors significantly. I don't know whether that is particularly appealing on analytical grounds, but there is a sense that we are locked into some trend here. People seem to have a 3 percent figure in mind about wage increases. If we looked at wages alone and tried to model those, we would probably also see some surprise there in terms of how low the inflation has been. But we do think that the overall compensation number is more relevant over time, and we have seen the downward movement in medical costs as constituting something of a favorable supply shock in a sense to the system.

There are significant changes going on in the medical care market. It appears that after a period in which many businesses were surprised year after year by how fast the costs of their medical benefits were rising and they did not necessarily subtract those costs from workers' wages, we are getting a reversal of that now that there is some revolution in the market for medical services. Business firms have not passed the benefits of reduced medical cost increases through to workers on the wage side or in other benefits. As we see it, this process is likely to continue but with diminishing quantitative importance as we go forward. A lot of firms have made the shift to managed care systems. Medical care inflation itself seems to be stabilizing. There are some risks, as we noted in passing in the Greenbook, that if some of the reforms that are being proposed for Medicare and other programs are adopted, there could be more cost shifting to insurance providers. So, we think that this run may be at its end, but we just don't see anything emerging now that looks like a substantial acceleration. Many of the Reserve Banks have reported in their letters on the discount rate and in the Beigebook that there are signs of tightness here and there and that employers are responding with higher wages. But one also has a sense that there are pockets of weakness and that many employers are looking to other means besides raising compensation to solve their labor problems.

MR. PARRY. So, the inflation assumptions, which are really quite reasonably optimistic, presume that things are moving back to normal.

MR. PRELL. I think we will remain below most model forecasts, but we have projected a little acceleration in the growth of compensation costs as we go through the next few quarters.

MR. STOCKTON. A very slow decay in the forecast.

MR. PRELL. Very slow.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Mike, I also have a couple of questions about labor markets--along somewhat the same lines. One of the persistent stories that we have heard all year from large and small businesses, more so in what are described as tight labor markets than in markets that are not described that way, is how much businesses are spending for training. Businesses tend to respond to perceived conditions by being willing to spend more on in-firm training programs whose cost as we all know is expensed; it doesn't add to capital stock. There are

two motivations. One, of course, is the use of new technologies that result in the need for related skills. The second is that businesses do not respond to the need for low-skilled and unskilled workers by bidding wages up in an effort to get the workers they want, but by in a sense saying they are not going to pay more but will hire people and train them. How does the staff think about that kind of business response in its analysis of potential output, productivity, the NAIRU, those sorts of things? Second, the staff responds to questions about subdued wage behavior by referring to the notion of job insecurity. Is there any direct evidence of a shift in some variable in a labor supply function called "worker insecurity?"

MR. PRELL. On the first question, if this emphasis on training is a manifestation of poor quality of the labor force, then that presumably has some implication for potential output. In terms of the growth of the labor force, the effective growth is less than it would appear. That tendency can be made up for by investing to improve the quality of the labor force. Training presumably is a cost that would perhaps be an element in some markup over perceived unit labor costs if it doesn't show up as a form of compensation.

On the NAIRU, I suppose it's possible that this deterioration in the quality of the labor force, if that's what it is, could lead to a greater tendency toward mismatches in the labor market and some elevation of the NAIRU. But I don't think we have any sense that there has been a radical change in this. Employers have been complaining about the quality of workers for a good many years. I don't know that what you describe is an entirely different circumstance, but maybe the response is different. I alluded to this when I was replying to President Parry. We do hear these reports, and it does seem that there is this alternative response of taking a less qualified worker and making that investment in training rather than bidding for the scarce pool of well-qualified workers.

On the job insecurity question, I don't think there are any direct measures. There may be some opinion polls of which I'm not aware that might have asked people how they felt about this. One can look at some indicators, such as perceptions of job availability in the Conference Board survey, and relate that to actual unemployment and other labor market indicators to see if things are out of kilter. My recollection is that the number of people saying that jobs are in scarce supply is probably a little high relative to what one might have expected. We have tinkered with the question of whether there is a systematic influence by, for example, putting variables into a Phillips curve relation and so on. My sense is that we haven't come up with anything that is very persuasive.

MR. STOCKTON. We've attempted to use other measures of labor market slack such as survey measures of jobs and employment, the help wanted index, and a variety of other things that do tend to show readings that would suggest somewhat more slack in the labor markets relative to the unemployment rate. But none of those performed any better or any differently than does the unemployment rate.

MR. PRELL. I think one can make an inference from other expressions of dissatisfaction with the current situation in the economy and just anecdotal evidence from the press and so on that people probably feel that they don't have a lock on their jobs, even

in a well-established corporation, the way they once did. There is a sense that because of changing technology the loss of a job will incur the risk that the next job will pay a much lower wage than the current job and lower than might have been expected in prior years.

CHAIRMAN GREENSPAN. You might have the staff recalculate the average age of the capital stock as a potential technology variable just to try to capture this sort of thing. I don't know what the result will look like. I suspect it won't work, like most other things! In any event, the anecdotal evidence that is emerging at this stage does suggest that there is an insecurity issue and that it indeed has had a structural effect as President Jordan points out. That has to be the case if you consider that the workforce interfaces with the capital stock to produce goods and services. If the capital stock is turning over increasingly rapidly, meaning that the capital stock itself feels more insecure, [Laughter] it is reasonable to presume that the people who work with that insecure capital stock have to feel somewhat insecure about their jobs. The issue is how to measure it. In doing so, we have to be careful to put the job insecurity concept in its proper context. It is to a certain extent a level-adjustment issue because one can imagine what a normalized wage level might be under the standard Phillips curve or other wage equation model excluding the insecurity issue. What one would get is an upward trend. If we add in an insecurity variable, and insecurity at its maximum, the level would be uniformly lower. One must presume that as we move from the normal level down to the other level, there comes a point even at maximum insecurity where the wage level becomes a relevant concept, and if we are looking at the rate of change, then the insecurity has to have a diminishing effect. Job insecurity has been around for a long time at this stage, and it almost surely has had the effect of moving the level down from normal. We may soon be running into resistance to downsizing. At that point we will be back on the same growth rate pattern even though the level may be appreciably lower. This issue may be relevant in judging the price level, but after the one-time adjustment, it ceases to become an issue with respect to inflation as best I can see. Anyway, I'll take another look at that.

I just got the results on the average age of the capital stock, which I think may be used as a proxy for technology insecurity, and we will see if we even get the right sign. We know it has the right trend; it's just a question of whether it picks up anything in addition.

MR. PRELL. Mr. Chairman, I think you've made a very good point about these levels and changes. It certainly would be a possibility that as unemployment remains in a relatively low zone, though the average duration is remaining relatively long, people would become a little less concerned about their potential vulnerability so that that could alter the--

CHAIRMAN GREENSPAN. That would be even more extreme.

MR. PRELL. Exactly.

CHAIRMAN GREENSPAN. I'm just stipulating that they remain just as insecure.

MR. PRELL. Yes. Your point's well taken.

CHAIRMAN GREENSPAN. It is a decaying factor on the wage rate change. President Stern.

MR. STERN. Ted, would you elaborate a bit on the Daiwa situation and whether that's known in the market?

MR. TRUMAN. They announced today, Japanese time, that the head of their New York office had been making false trades for 11 years, which is hard to believe, and had lost roughly $1 billion in the process. They will take that loss in their fiscal half-year results. The news was released early enough to be in The Washington Post. You may not have seen The Washington Post.

MR. STERN. I heard something about it on the news this morning, but I didn't see any details.

MR. TRUMAN. Peter or someone else may have some more details. They called me last night. The announcement apparently did not affect their markets. The Nikkei, for example, was up 300 points in Tokyo today.

MS. PHILLIPS. What were they trading in?

MR. FISHER. The claim is that this high official of Daiwa's New York branch had been trading in U.S. bills and bonds in the straight bill and bond markets. He managed to lose between $1 and $1.5 billion over the last 11 years; that is the amount that is unaccounted for. It's a rather extraordinary tale. The relevant authorities in New York are looking into the matter.

CHAIRMAN GREENSPAN. You would think there would be enough derivative hedges to secure the position.

VICE CHAIRMAN MCDONOUGH. Maybe I could expand on this a little, Mr. Chairman.

CHAIRMAN GREENSPAN. Yes.

VICE CHAIRMAN MCDONOUGH. He was dealing in cash government securities and making up the losses by taking securities out of the custody account. He was in charge of the custody section of the Daiwa branch in New York and also was allowed to trade in government securities.

MR. STERN. They are a primary dealer, Bill?

VICE CHAIRMAN MCDONOUGH. Yes. His confession, which was written in mid-July when he paid a visit to Japan, indicates that he falsified the records, managed to set up a separate clearing account on his trading as compared with that of others, and suffered capital losses of about $850 million and losses of about another $250 million in interest that is now owed to the people who actually have rightful ownership of the securities that he sold over these many years. The facts are going to demand a good deal of time by our examiners and the U.S. Attorney. As Ted suggested, the tale as we know it as of now has certain apocryphal characteristics that I think are going to demand a

good deal of looking into. One of our principal concerns is that he confessed to the authorities of his bank in Japan in the middle of July and the Reserve Bank was not informed. According to the Daiwa Bank, the MOF and BOJ were not informed until Monday of last week. As all of you would immediately agree, we do not take kindly to the management of a bank that has this information and doesn't share it with regulators for two months. I think our kindness toward the Daiwa Bank will be somewhat less than

You will be happy to hear that the president and the chairman are going to take a 30 percent salary cut for six months.

SPEAKER(?). Does their chairman earn several billion a year?

CHAIRMAN GREENSPAN. Is there any evidence of a motive?

VICE CHAIRMAN MCDONOUGH. No. The confession is really extraordinary. It would lend itself to a great soap opera. He suffered losses that were small initially. He wanted to hide them because of the disgrace that it would bring to the bank. The pressure was so great that he went through a divorce. The confession implies that he made a mistake and that he got in deeper and deeper and deeper.

CHAIRMAN GREENSPAN. Why did he start in the first place? What was his motive originally? Was it personal?

VICE CHAIRMAN MCDONOUGH. No. The confession does not lend itself to an interpretation of personal greed. Obviously, that's one of the things we have to look into.

CHAIRMAN GREENSPAN. Is there any evidence in the way it was structured that he would be able to draw funds for his own account?

VICE CHAIRMAN MCDONOUGH. He certainly was in a position to do so because he was in effect running a separate bank that nobody, according to the confession, but himself knew about. Therefore, he certainly was in a position to siphon off funds for his own benefit very easily.

CHAIRMAN GREENSPAN. Why do we assume that this was not the obvious motive, and why are we looking beyond that?

VICE CHAIRMAN MCDONOUGH. At this stage, we're assuming that that could be the motive; we're assuming that he could have accomplices; we're assuming all kinds of things over and above that which this confession would lead one to believe.

CHAIRMAN GREENSPAN. Supposing that were a motive, and obviously we don't know, and say hypothetically that he had succeeded and replenished all the relevant funds and the like, would there be any supervisory mechanism to detect that?

VICE CHAIRMAN MCDONOUGH. The answer is, I don't think so but--

CHAIRMAN GREENSPAN. I would conclude that we have no evidence that there may not have been other significant successful

endeavors by people throughout history that were never uncovered. My own judgment is that there is a limit to what the most assiduous bank examiner can do in a situation where somebody engages in a practice in which he trades for his own account, wins, replenishes, and we never hear of him.

VICE CHAIRMAN MCDONOUGH. I think the ability of somebody who was as successful as this guy was at fraud--a lot more successful than he appears to have been as a securities trader--

MS. MINEHAN. His teacher was an accountant!

VICE CHAIRMAN MCDONOUGH. According to the confession, he managed to lose money whichever way the market went. [Laughter] I think that a very successful dealer/operator of a fraud could go on for a very extended period of time and never be caught.

MS. MINEHAN. That's why separation of duties is so important.

CHAIRMAN GREENSPAN. Exactly, and I think that is all the more reason why we have to be very assiduous in our evaluation of internal auditing processes and of apparent internal conflicts of interest built into the system. Unless we can do that, I don't know what we can do. Even with that, somebody is always clever enough to figure a way around it. It's a constant ploy.

VICE CHAIRMAN MCDONOUGH. In three examinations that were done by the New York Bank on the Daiwa branch, the constant theme was that the audit controls were not adequate. We actually got them to improve the audit controls very considerably. Just an interesting anecdote: They had two locations, one in the World Trade Center and one in Rockefeller Center. According to their permissions from both the MOF and the State Banking Superintendent of New York, they were supposed to be doing the government securities trading only from the midtown branch. Mr. Iguchi, the culprit, was at the downtown branch. When we did the inspection in 1992, they took all the dealers from the downtown branch to the midtown branch, turned out all the lights in the downtown trading room, put a bunch of boxes in it, and told our examiners that it was a storeroom.

CHAIRMAN GREENSPAN. That's nice.

VICE CHAIRMAN MCDONOUGH. It's a little difficult to believe that nobody had a clue as to what this guy was up to when that sort of thing was going on.

MS. MINEHAN. This organization has no claim to be a primary dealer.

MR. FISHER. They are not a primary dealer, excuse me. This is the bank. The securities firm is an entirely separate legal entity.

MS. MINEHAN. Okay.

MR. FISHER. The securities firm is the primary dealer. This is a branch bank trust department.

MS. MINEHAN. Okay, that's good.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. I was going to raise a question about job security, but I'm not sure it's appropriate. [Laughter]

CHAIRMAN GREENSPAN. We know one person whose job security is--. Has he been fired?

VICE CHAIRMAN MCDONOUGH. He has been fired as of the 25th of September. Officially, we do not know where he is, but we are reasonably certain he is in the hands of the U.S. Attorney.

MR. BLINDER. If I'm not mistaken, the duration, or the amount of long-term unemployment, is high at current unemployment rates. This has to mean by the laws of arithmetic that the amount of turnover and of short-duration unemployment are low. I guess my first thought would have been that job insecurity comes from turnover; you worry about losing your job. Isn't that right?

CHAIRMAN GREENSPAN. No.

MS. MINEHAN. You can get it back.

MR. BLINDER. Yes, that's right. I said that was my first thought. Maybe it's wrong. Maybe it's duration.

CHAIRMAN GREENSPAN. No, if I feel insecure, I'm not going to leave.

MR. PRELL. Moreover, for any given amount of unemployment, if it were disproportionately short term it would suggest that people were able to find jobs relatively quickly.

MR. BLINDER. It's disproportionately long.

MR. PRELL. But when there's a lot of long-term unemployment, that would suggest there may be some difficulty for people who have been displaced, for example, with all the restructuring.

MR. BLINDER. The separation rate and the rehire rate are relatively low, right?

CHAIRMAN GREENSPAN. That's correct.

MR. BLINDER. Yes. Certainly, the hypothesis for years was that the separation rate matters most. Firing was the key thing in job security. That may have been wrong.

MR. PRELL. I think that was the leading hypothesis for a long time.

MS. YELLEN. We don't know the facts.

MR. BLINDER. Right. It was an economy move by the BLS to stop collecting those data. Now, they are going to economize more, too!

CHAIRMAN GREENSPAN. That was a long time ago.

MS. YELLEN. 1981.

MR. BLINDER. The other question was for Ted. Should we be reading recent events as an escalation of the anti-EMU campaign? This is a two-part question. Should we expect that to continue to weigh against the dollar? There seems to be no inherent reason why that should be anti-dollar, but in practice it always seems to weigh on the dollar.

MR. TRUMAN. Peter has some comments. Let me give you mine. What I tried to suggest in my briefing is that this is a process that is going to go on for years. It's going to be up and down and up and down. As different countries and institutions within the countries jockey for position, there will be, I think, a heightening of the debate about the EMU and whether individual countries are ready for it. You saw, for example, how Mr. Arthuis got beat up on Thursday by Mr. Waigel who came out at Majorca and said that maybe we just ought to postpone the EMU for a couple of years. Now, that's not necessarily anti-EMU, but it changes the whole timetable. The debate is heightened as the time for various kinds of decisions comes closer. The effect on the dollar, it seems to me, is largely secondary. It partly depends on what you mean by the dollar. The dollar tends to weaken relative to the deutschemark the less likely the EMU appears to be and therefore the more likely the deutschemark will be free to rise relative to the dollar. Then, the ebb and flow of discussion does tend to affect the dollar: The way I think of it is that for people who have liquid assets it is easier to get out of dollars into deutschemarks to cover positions than to get out of Swedish kronors into deutschemarks. So, you have a backwash effect on the dollar, at least in the short run.

MR. FISHER. I'll just insert there: A number of the European countries continue to prefer to hold a relatively large portion of their reserves in dollars for investment purposes. But in a crisis, they want to convert those into marks to be able to defend their own currency. There are two effects on the market that in the very short run can create this sort of disturbance. Even the expectation of it can create the disturbance.

CHAIRMAN GREENSPAN. That shouldn't affect the level of the dollar in the long run.

MR. FISHER. No, it shouldn't.

CHAIRMAN GREENSPAN. You have the accumulation of those dollars to begin with.

MR. FISHER. Yes. I'm referring to a very short-run effect. Countries have a tendency to hold large quantities of dollars and then convert them into marks to defend their own currency. They also have a preference for acquiring reserves that way. Even if their ultimate goal is to acquire marks, they will try to move into the dollar out of their own currency and then into marks in the event of a crisis. The other very short-run phenomenon, which certainly hurt us last week, occurs when the situation that Ted was referring to becomes acute. As Europe closes up for business and investors are looking to defend

themselves, then they really have to go into the dollar/mark because they simply can't get liquidity in the Paris/mark or the peseta/mark in the New York trading day after Europe has gone home. This then tends to accelerate the movement in dollar/marks in the very short run. It's very short run but it's very pronounced.

CHAIRMAN GREENSPAN. Is there concern that the dramatic shift in funds that has been going on in recent weeks could erode German political support for the EMU to a point where it would be difficult, if not impossible, to implement the EMU on schedule? I am referring to the shift from deutschemarks by German investors into Swiss francs that has been showing up, I gather, in falling sales by German life insurance companies. We are getting moves out of Luxembourg accounts into Swiss franc accounts in Switzerland. I guess two-thirds of the people surveyed are against eliminating the deutschemark in Germany.

MR. TRUMAN. It's certainly a possibility. How big it is, I don't know.

MR. FISHER. I think the support of the Chancellor for the process is really the only thing standing in the way of the deluge of public opposition.

CHAIRMAN GREENSPAN. He took a position as I read it that didn't say what he said; or if he said it, he didn't mean it; and if he meant it, he shouldn't have.

MR. FISHER. All of the above!

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. This is a question on a different subject entirely, the fiscal situation. Going out to 1997, Mike, I noticed that the Greenbook forecast showed real GDP growing at 2 percent in 1997. The reduction in government purchases seemed to have a big impact on GDP going out that far. I really have three questions: Is this viewed as a permanent change? What assumption are you making about the steady rate of GDP growth under that type of fiscal scenario? Do you see any offsetting private-sector spending to compensate for this reduction in federal purchases during this period?

MR. PRELL. I think it ultimately depends on what monetary policy you pursue. In essence, given our assumption of little change in the federal funds rate--we have just a little ticking down at the end of next year--we don't see here an aggressive effort to offset the ongoing fiscal restraint. We have specified a three-year reduction, but the presumption would be that Congress is going to pass something that goes even beyond that. So, fiscal restraint would be an ongoing force in the economy, though diminishing. As we have it, the biggest degree of fiscal restraint is imposed in 1996. Some of the restraint that flows from earlier actions--over 1993, for example--disappears and the smaller increments from our assumed new fiscal package are what is left. So, on our assumption, the degree of fiscal restraint really is diminishing a bit as we move out in time. We felt that, (1) we wanted to stick to the steady policy assumption for the baseline, and (2) this produced in our analysis an outcome where resource utilization rates eased only moderately and created a situation in 1997 where there was only a small degree of slack in the system.

Given the enunciated goal of moving toward price stability, that seemed to be reasonable to present to you. As you move on out, unless you wanted to accelerate the progress toward price stability, if the tendency was for that gap to remain and for the unemployment rate to continue drifting up, you might want to pursue a somewhat more stimulative policy for a time to at least stabilize things at a comfortable level of resource utilization. It's a question in this mechanical fashion of just how fast you want to move toward price stability.

MR. MOSKOW. But if you kept monetary policy steady at its current level during this period, is there a wealth effect that would increase private-sector spending to compensate for any of this reduction through lower taxes or anything like that?

MR. PRELL. In our forecast we don't anticipate that there will be any favorable wealth effects as we move beyond this year.

CHAIRMAN GREENSPAN. Further questions?

MR. BROADDUS. Could I follow up on that last question? Mike, I would think that the impact on the economy of any particular budget would depend heavily on the degree of substitutability between government products and services and private-sector products and services. Have you looked at that issue?

MR. PRELL. There are some very obvious questions, for example in the area of medical care. We have not specified our package in a way that calls for staking out any position on this. But it's quite conceivable that people of reasonable means, if they were called on to pay a larger Medicare premium or to have some deductible or something, might continue to consume roughly the same amount of medical care and save less in the short run. As I suggested, the package being discussed now includes lots of changes in programs that are very fundamental--for example, the welfare program. There are potential labor supply responses that we will have to come to grips with. If legislation is enacted in the next few weeks, we may not be able to put that off for very long in our analysis for the forecast. I don't think it's going to be a big deal over the next couple of years even if there is a phasing in and so on. But over the longer haul, there could be effects on saving behavior; there could be effects on labor supply behavior and maybe many other effects. We'll have to look very carefully at what are pretty radical changes that are being discussed in some of these programs. Regarding the transfer of programs to states and the block grants, we have assumed that there will be some short-run cushioning for states and localities in cases where there were cutbacks in funding to absorb some of those cutbacks and maintain benefit levels. But over time that would change, too.

CHAIRMAN GREENSPAN. Okay. Would somebody like to start our roundtable discussion? President Forrestal.

MR. FORRESTAL. Thank you, Mr. Chairman. As I reported last time, the economy of the Sixth District is generally quite healthy. Activity is continuing to move along the path of moderate expansion and moderate inflation. Retailers are reasonably optimistic. Tourism continues to be a stimulative in the economy, and construction is improving. One of the weak spots, if I can call it that, is

manufacturing activity, which has been a bit sluggish. I had not thought about this, but maybe it's because of the insecurity of the capital stock! [Laughter]

Looking at the individual areas very briefly, reports from retailers around the region parallel the discussion that's in the Greenbook. Most saw very, very good if not excellent back-to-school sales. Demand for home-related products continues to improve along with home sales. Several merchants did note that their inventories are a bit heavy, but they do expect very good holiday sales, and they think such sales will bring them back to more comfortable inventory levels. Sales of 1995 automobiles from inventories are coming at the expense of dealer profits and manufacturers' incentives. On the travel side, tourism actually is stronger than it was at this time last year even though Florida, particularly south Florida, saw a drop in the latter part of August due to tropical storms and hurricanes. But that seems to be a very temporary thing. Foreign travel continues to be strong. The only disappointing area here, and I was a bit surprised to find this, is that the cruise industry has very soft bookings, and they are now offering discounts; 20 percent discounts seem to be typical. So, the improvement in tourism is not extending to ships.

Our manufacturing survey, as I indicated, showed some softness in August, and factories remain very, very cautious about hiring. There has been little change in the outlook for capital spending and expansion continues as the District benefits from relocations and diversions of production from other domestic sites. In the energy sector, the rig count in Louisiana in July was at its highest level in over four years. Single-family sales improved last month, although they were below the very strong levels of a year earlier. Retailers are quite optimistic, and they cite favorable mortgage rates and healthy job growth. The multifamily sector in our District is quite strong, and I think that's in contrast to the rest of the nation. Commercial real estate markets also are continuing to strengthen throughout the region, and we are seeing some speculative office and industrial projects either under construction or in the planning stage. It's interesting that bankers are now becoming much more cautious about financing these activities, which I guess is good news. Bank lending remains mixed with the strength being in the business area. Wage increases remain stable, and the reports of shortages of labor are becoming less frequent than they were even six months ago. Prices for finished products were flat in August, although prices of materials in many industries did post some increases. The general information we are getting from business people is that it is still very, very difficult to pass along price increases. So the situation in the District continues to look good.

On the national economy, we have not changed our forecast significantly since the last FOMC meeting. However, we did incorporate a further 25 basis point drop in the federal funds rate and that produces somewhat faster growth later in 1996 and in 1997, with the unemployment rate not drifting any higher and not much further improvement occurring in the pace of inflation.

As I look at the national economy, Mr. Chairman, I feel reasonably happy with the result that has been attained, particularly on the inflation side. The concern that I have is that there may be

more softness out there than is indicated in the numbers, and I am getting that sense in the anecdotal information from directors and other business people. As we consider our policy action, I think it might be well to begin to question whether potential in the economy is actually somewhat higher than we think it is and the NAIRU somewhat lower. Along those lines, I am also a little concerned that the Greenbook forecast shows a level of growth throughout the forecast horizon that is somewhat below potential as now defined or what we think is potential at about 2-1/2 percent. That obviously has all kinds of policy implications that I'll save for the next go around. Thank you.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, economic growth in the Twelfth District picked up this summer. The annual rate of job growth in California has accelerated by about 1 percentage point--from less than 1 percent this spring to about 2 percent currently. The early 1995 declines in manufacturing employment have been reversed and locally oriented sectors such as retail trade have shown increases. Also, retail sales have been running well above a year earlier. Elsewhere in the West, some of the most rapidly growing states in the nation have resumed their quick pace of expansion. In Utah, manufacturing jobs expanded rapidly this summer, and construction employment surged in both Oregon and Nevada. In contrast, payroll jobs continued to decline in Hawaii. Other District state economies are slowing but appear resilient. In Washington State, fast growing industries like software development, most notably of course Microsoft, are offsetting the effects of the large job losses at Boeing. In Idaho, the rural areas dependent on agriculture or forest products are weak, but high-tech manufacturing such as that at Micron Technology has been holding up growth in the Boise area. The previously rapid growth in Arizona's manufacturing economy was stymied earlier this year by the drop back in exports to Mexico, but the overall Arizona economy continues to expand.

Turning to the national outlook, real GDP growth has picked up to a moderate pace in the current quarter, following the inventory correction in the second quarter. Our forecast shows GDP growth of 2-1/4 to 2-1/2 percent through the end of next year as inventory investment stops declining and housing picks up briskly. A downside risk to the forecast, one very similar to that mentioned by Mike Prell, is that equilibrium real interest rates may be shifting down in response to prospects for lower federal deficits, making our current policy stance tighter than it would otherwise be. Recent inflation news also has been favorable and market inflation expectations seem to have come down a bit. For the future, the speed effects from the slowdown in the economy in the first half of this year should restrain inflation late this year and in 1996. As we have discussed, labor costs have come in below expectations. But before euphoria sets in, I don't anticipate any progress unfortunately this year and next in reducing inflation below last year's rate. Despite favorable inflation numbers, both CPI and PPI inflation so far this year are above last year's rates. The unemployment and capacity utilization rates indicate that it is unlikely that there currently is any excess capacity pushing down on inflation. Overall, under the assumption of a roughly constant federal funds rate, our forecast shows CPI

inflation at 3 percent or slightly less in 1995, 1996, and 1997--somewhat above last year's 2.6 percent rate. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. I think it's fair to say that we have not had any dramatic changes in business conditions in our District, but on balance my sense is that overall conditions in the District are a little stronger than they were at the time of our last meeting. We conduct monthly surveys, as some of you may know, of activity in manufacturing, retailing, and the services sector. Our manufacturing index--the last one went through August--showed a significant jump over July. Shipments, orders, order backlogs, employment, and the workweek all rose appreciably according to that survey. More broadly, I sense that general business confidence is increasing in our region. I am not sure this greater confidence is very deep yet, but at least it's there for the time being. If I were to highlight one feature of the District economic situation, I think it would be recent wage developments. We have had comments on that already, and I think my comment might go a little in the other direction. The manufacturing survey I just mentioned has a question about factory wages. Our last survey--again for the month of August--clearly indicated significant upward pressure on wages over the last six months as a whole. That survey result is reinforced by some of the anecdotal information we are hearing. We had our small business council meeting last week, and typical comments came from a member from Charlotte who reported that nobody in that market was paying the minimum wage and that over the last six months entry-level wages had increased by anywhere from $.50 to $1.00 per hour. Several other members confirmed his comments. I don't want to make too much of this. Again, a majority of the comments along these lines were from people in the Carolinas where labor markets are exceptionally tight. It appears that this phenomenon is mainly concentrated in the skilled and semi-skilled segments of the labor markets--the mechanics, construction workers, and others. But the comments were very striking, and I think they are consistent with at least some of the national wage data that suggest that a gradual upward trend in the growth of wages may bear watching.

With respect to the national picture, we certainly don't have any quarrel with the Greenbook forecast. One of our people summed it up by saying that the economy had landed softly and the Greenbook was projecting a long runway. I do believe, though, that the risk of error in the forecast has shifted perceptibly. Earlier this year as you may recall, I was a bit concerned about the downside risk in the outlook. Then, as we got into the late spring and early summer, it seemed to me that the risks were a little more balanced. Now, I think the outlook has shifted again, and it seems to me that the risk is more on the up side than it has been for some time. The economy looks pretty healthy to me right now. I thought the rebound in automobile sales in August was impressive. Overall consumer spending and consumer confidence, it seems to me, have been more firmly maintained in a sense than we might have anticipated a few months ago when we had lots of comments about the possibility of a recession. Also, I think the recovery in housing has been exceptionally solid. We got a lot of anecdotal comments to back up that view. As was pointed out in the Greenbook, we may not yet have seen the full impact of earlier reductions in mortgage rates. So, again, the economy looks quite solid to me at this stage. It seems to me that the risks of error in

the forecast may have shifted a bit to the up side since our last meeting. That makes me a little nervous since we are operating at close to full capacity in many industries and sectors.

Finally, Mr. Chairman, I'd like to make a quick comment on the fiscal situation and its bearing on the outlook. I gather that anticipated fiscal restraint is a damping factor in the Greenbook's projections, and that's perfectly reasonable. But I hope that we will not give this factor undue weight in our deliberations today and in the near-term future. The final budget outcome is still uncertain. The impact of any particular outcome on the behavior of the aggregate economy is very difficult to predict. Moreover, as is often the case with monetary policy, I think there is a credibility issue here. There is a real risk that if the public and especially the financial markets perceive that monetary policy is being driven to any significant degree by fiscal considerations, we could lose credibility. So, I hope that we will continue to focus primarily on aggregate variables--GDP, employment, and the price level--which over time should reflect whatever impact fiscal developments are having on the aggregate economy.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Recent data and anecdotal evidence indicate that the economy in the Philadelphia District is growing, but not strongly; growth continues at less than the national pace. Manufacturing has reversed course after a weak first half and is growing again. Residential construction has stabilized after a period of weakness earlier in the year. Nonresidential activity is up some around the District, driven by distribution and retailing facilities plus some hotel and entertainment-related construction. Retail sales are up a little. Banks report that loan demand generally is flat; where there is some increase, it tends to be on the consumer side rather than the commercial side. Employment levels that had been declining earlier in the year have stabilized and are rising, particularly outside manufacturing--in the service areas.

Turning to the national economy, of the three broad categories of slower, faster, or moderate growth outlined by Mike Prell, I am in the moderate category. I think that we are likely to head into a period where sales and production will grow at a sustainable pace in 1996. I must say, however, that as I travel around the District--and I do a lot more listening than I do speaking --I sense that the better business confidence is probably broader than it is deep. If one just listens, one gets more of the tone that it's to the slower side. Now perhaps that's the District. If one probes, then, yes, things are better; the third quarter is better than the second; the fourth probably will be still better, and 1996 looks okay. But one does not get the same sense of optimism in the business community generally as when one listens to economists and professional forecasters. Phrases like "it doesn't get much better than this," just don't ring true, I think, in the business community. Maybe it's just human nature; maybe it's our part of the country; but there just isn't that underlying enthusiasm about the future that one would hope to see.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Thank you, Mr. Chairman. The Tenth District economy remains really strong, with only a few signs of weakness here and there. The improvement observed at midyear has been sustained, with strength reflected across several areas. Employment has posted healthy gains over the last few months in our region. Manufacturing staged a pretty good rebound in August from what we can tell, especially in the durable goods area including automobiles. And the nondurable goods area, which had been a little weak in our area, is now holding pretty steady as we go forward. In fact, some of our directors report that homebuilding activity has increased but housing construction still can not keep pace with the strong demand in some parts of our region. We are anticipating some improvement in commercial building activity in the months ahead as indicated by lower office vacancy rates in most of the metropolitan areas in the District. Activity in our energy industry has picked up a bit, especially in Wyoming. On the other hand, the District farm economy continues to be weak; it is hurt especially by the cattle industry which is particularly important to our region. The recent weather in the northern and western parts of the District may have hurt some crop yields, but we don't expect a big fallout from that. Growth in bank credit has slowed as is true elsewhere in the country, and we think that may reflect the effects of inventory adjustments. While the District economy generally appears to be strong, wages and final goods prices show no persistent signs of accelerating, though we are finding that some labor markets remain tight. And we are getting indications from our manufacturers that prices of materials are continuing under upward pressure.

Looking at the national economy over the remainder of this year and into next year, I expect growth to remain slightly below trend, but in the 2 to 2-1/2 percent range, which is similar to the Greenbook forecast. Now, I think such growth is appropriate, given where the long-run potential seems to be and given the current level of resource utilization in the economy. And that brings me to the issue of inflation. I am still a little less optimistic than the Greenbook. While it seems likely to me that inflation will be capped, I question whether the overall core inflation rate will drop much in the next year, in 1996 at least.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. Mr. Chairman, you probably remember from the board meeting that you attended a week or two ago at the Boston Fed our characterization of the New England economy since the summer as a tale of two sections. Overall, the region's jobs grew just about 0.8 percent during the year ending in July--that compares with national growth of better than 2 percent--but there were distinct differences between northern and southern New England. The northern states of Vermont, New Hampshire, and Maine are all experiencing growth in employment, sometimes even in manufacturing jobs which is welcomed. They have lower rates of unemployment and their employment levels have returned to or near their pre-recession peaks. On the other hand, the southern states--Massachusetts, Connecticut, and Rhode Island--have not returned to their pre-recession employment peaks and are not expected to do so anytime soon. I must say, though, that job growth in Massachusetts is much stronger than in either Rhode Island or Connecticut. Rhode Island in particular currently has a level of employment that is below that of a year ago and has lost jobs in each

of the last three months for which we have data. The state is undisputably the biggest basket case in New England, which probably makes it the undisputed winner of that prize for the country as a whole. Rhode Island is now edging out Connecticut, which up until recently was winning this contest. In terms of job types, growth as in the past is largely in trade, services, and construction. Defense industry cutbacks continue. New England fared relatively well in the last round of base closings, losing only one major base and about 1,000 jobs, but the region overall lost 32 percent of its military base employment in the years 1989 to 1994 as compared with about half that rate for the nation as a whole.

I am coming to believe that the anecdotes we hear when talking with business groups around the District are almost diametrically opposite the standard economic data that we get for the region as a whole. Again, there may be some self-selection process that is going on here. Two local business confidence indexes show marked improvement over recent data, though they are somewhat below their levels a year ago. Our Beigebook contacts and members of our New England advisory council both report higher manufacturing sales than a year ago. However, there is a dichotomy between healthy sales growth and sales prospects and indicators of future employment. Business plans and actual sales have been upbeat, but expectations as to job growth are not. Businesses apparently are willing to continue to try to succeed with a proportionately smaller work force than before, perhaps because of the effect of capital investments over the last two or three years. In addition, many business executives--representing small and large firms--continue to report an inability to raise prices even in the face of rising demand. Competition remains too keen.

Turning to District lending, I reported earlier that we had slower rates of loan growth in the First District than the country as a whole. That situation has corrected itself, not because we have had faster credit growth in New England but because the national pace has slowed. New England's rate of loan growth at its large banks was about 6 percent in the last quarter, about the same as the current rate for the nation as a whole, but the latter is down from a considerably stronger pace earlier.

On the national scene, I don't find too much to take issue with in the Greenbook. We could argue, given the projection for output, that unemployment might turn out a tick higher than the rate in the Greenbook. We could question the projected rates of growth abroad, and I think Ted Truman reflected some concern on the down side with regard to foreign growth. We could look at consumer durables and wonder whether the projections for slower auto sales in the Greenbook really will be offset by consumer buying in the housing area. And while we don't know any more about inventories than anybody else, it is reasonable to be agnostic about any specific projection there. However, while all of this does suggest some downside risk to the forecast, it really is nitpicking. In the context of a fairly low rate of unemployment and the impetus that could come from financial markets, the fact that there may be some downside risk in some of these factors does seem to us to hold out the promise of economic balance moving forward--that is, a tendency for the various factors to offset one another.

In sum, our view is that the data reflect a mixed bag of economic information and that is probably just what we would hope for to keep us on target with moderate growth, low unemployment, and relatively low inflation. Risks to the forecast seem balanced or perhaps slightly tilted to the down side. But if downside risks emerge, they can be easily addressed. For now, economic conditions seem pretty good and, given all the uncertainties, I at least am drawn to the idea that they may be about as good as we are going to get.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Mr. Chairman, we are in general agreement with the Greenbook forecast, so I'll focus my comments on developments in the Seventh District.

Overall, it appears that District economic activity has been picking up in the third quarter. Consumer spending seems to have strengthened in September. Retailers in the District generally report that while the hot, humid weather adversely impacted sales in August, sales have improved this month as the weather turned cooler. Retail inventories are reported to be at generally satisfactory levels. Another area where we are getting reports of a pickup in activity is in homebuilding. Sales of existing and new homes have been on an uptrend for a while, but it is only recently that the signs of a pickup in construction activity have emerged. We did have reports, however, that the hot weather in August slowed some construction work temporarily.

In the auto industry, sales of light vehicles have fluctuated considerably in recent months in part due to relatively sharp swings in fleet sales. In July and August, sales were at an average annual rate of 14-3/4 million units, and recent reports we received suggest that September sales may come in a bit stronger than this average. Measures of overall days' supply moved down toward desired levels in August, but the overall numbers mask sizable differences among producers and among models. The Ryder truck strike has led to some accumulation of cars and trucks at plants and shipping points. However, the strike is not expected to have any impact until October. Better selling models may then be at risk, and in particular light trucks and fleet sales could be depressed. Members of our advisory council on small business reported that dealing with the Ryder strike is being complicated by the unavailability of rail cars to pick up the slack in our District. In the last few weeks we had discussions with each of the Big Three auto makers regarding their estimates of the long-term demand for motor vehicles. In each case, they have reduced their estimates of the long-term trend rate of motor vehicle sales. The primary factors contributing to this reassessment are the higher quality and greater durability of new vehicles and the shift from cars to light trucks, which tend to last longer.

District manufacturing output stabilized in June and July and now seems to be rebounding from a weak second quarter. We are seeing a shift from earlier this year. Producers of consumer goods such as autos and appliances are now reporting increasing output while producers of capital goods are the ones indicating a slowdown in activity, although reports from key capital goods industries are now suggesting that the second half of 1995 is actually holding up better than anticipated. For example, orders for machine tools have slowed

but still seem to be running ahead of earlier expectations, in part reflecting strength in orders for small machines. Steel production in the District increased considerably from July to August and that pickup continued into the first part of September. Shipments of appliances to dealers were quite strong in August and early September, and it now appears that the expected shortfall from last year's record pace will be smaller than anticipated at the beginning of this year.

In Iowa, problems in accessing rail cars have left some grain elevators still full even ahead of this year's harvest. The rail car problems may have been exacerbated by this year's surge in grain exports, which contributed to longer shipping distances and slower turnaround times for rail cars as well as the transitional problems associated with the merger between the Union Pacific and the Chicago Northwestern railroads. Weather-related crop damage this year is turning out to be worse than expected for vegetables and corn, and it now appears that an early killing frost may prematurely end the development of some late-planted fields, especially soybeans. While the grain harvest is now expected to be about average, it falls short of the record demand for grain observed over the past year. Grain prices have risen sharply and will remain high until there is evidence that demand and supply are moving into better balance.

District labor markets remain tight and wage pressures continue to intensify at the low end of the wage scale. In both June and July, the average unemployment rates in the five District states were 4.6 percent, a full percentage point below the national average. Finding qualified entry-level and skilled workers was cited as a serious problem by virtually all members of our small business and agricultural advisory councils when we met with them earlier this month. After slipping somewhat during the summer, help wanted ads in the region picked up in early September. Union leaders I speak to emphasize the insecurity factor that we discussed before in explaining wage increases. They emphasize the fact that corporate restructurings have continued even though the economy has recovered, so there is constant concern about losing one's job even though the economy is doing well. Reports on prices have been mixed but they generally continue to indicate receding inflationary pressures in input prices. Price increases for packaging materials have dissipated after the rapid increases last year and earlier this year, and price index components of the various District purchasing managers' reports continued to move lower through August. However, several contacts noted upward pressure on building materials prices resulting in further increases for gypsum wallboard and cement and renewed hikes in lumber prices.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Over the past few meetings I have been reporting that the Eleventh District economy has slowed from its very strong growth in 1994 to something a little less strong this year. This month's Beigebook singled out Dallas and New York as the two Districts whose economies have slowed. I should emphasize that the slowing is from growth at a very strong pace to a more moderate pace and not a decline. For example, in Texas which makes up the bulk of the Eleventh District economy, employment growth is running at 3.4 percent, only slightly weaker than the 3.8 percent posted over the preceding months. Industrial production increased at a 2.1 percent

annual rate in July, as manufacturing output rebounded from four months of weakness. The housing picture has improved. Single-family permits are 7 percent above last year's level, and last year was a very good year. Gross state product increased at an annual rate of 5.3 percent in the first quarter according to our estimate, and we expect a pretty good number for the current quarter but probably not as high as in the first quarter. Mexico continues to exert a significant drag on the District economy, but not enough to turn the overall picture sour. And in fact, lost exports to Mexico have been largely made up by a surge in exports to other parts of the world.

Last Thursday, we had a joint meeting of our Houston board and our small business and agricultural advisory council, and the members generally supported the view that overall business activity is in pretty good shape, although they reflected diminished confidence about the future. They seem to be in somewhat of a funk about the future. All the signs are indicating that we are having a huge turn in the Eleventh District in that our economy is remaking itself very significantly. We are moving from cow chips to computer chips! [Laughter] To give you some anecdotal indications of what is going on, AMD and Motorola have each just finished billion dollar semiconductor plants in Austin. Applied Materials, which manufactures equipment used in chip production, has added 1,000 jobs in Austin. Texas Instruments is speeding up construction of its new microchip factory in Dallas. National Semiconductor is doubling the capacity of its Arlington plant and will spend $600 million annually over the next five years to expand capacity. Dell, Compaq, and Hitachi are all seeing strong growth. This is all computer-related activity, but we also are seeing big advances in other high-tech areas such as telecommunications. Ikea is building a second plant in Fort Worth. Ericsson was just awarded a $300 million contract to build an advanced wireless communications technology facility and will be hiring 800 people within the year. PCS Prime, a telecommunications company, is putting its national headquarters in Dallas. These are some of the "biggies" and there also are a number of small companies expanding or moving into the area. Very strong global demand for high-tech products continues to stimulate demand for Eleventh District exports. Thanks to the remake of the District over the past decade, we not only are relying less on cows than we were but also less on oil and gas. The share of the oil and gas sector in the Texas economy has declined from roughly 18 percent in 1982 to about 6 percent today. Our health services industry is now almost as large as the oil and gas industry. In short, a lot of activity is going on that is adding a lot of stimulus to our regional economy, and all that is in addition to the stimulative impact we expect to get from Deion Sanders when he arrives. [Laughter]

On the national economy, the slowing of inflation has been very welcome, and I think the probability of a recession has receded significantly. The economy probably could take some stimulus without an acceleration of inflation. On the other hand, the situation is right for a further ratcheting down of inflation. I believe that policy decisions at this juncture probably depend more on the priority we give our goals than on the state of the economy.

CHAIRMAN GREENSPAN. Thank you. President Melzer.

MR. MELZER. Thanks, Alan. The Eighth District economy continues to grow at a pace largely unchanged from recent reports. In general, negative news appears to have been mostly offset by plant expansions, new hiring, and sales gains. Reported layoffs from downsizing and plant closings are scattered throughout the District, and such layoffs are somewhat more concentrated in durable goods producers than in other industries. But sales at firms in many industries--this is based on anecdotal reports--for instance, prefabricated metal buildings, electric motors, brick manufacturing, and scrap metal, are up on average between 7 and 15 percent so far this year. District payroll employment is up about 1-1/2 percent year-to-date, about the same rate of increase as in the nation as a whole. The transportation equipment sector is the District's strongest, having grown consistently for nearly two years. District automobile production is expected to jump considerably in the months ahead; planned fourth-quarter production is estimated at about 338,000 units, up nearly 29 percent from the second-quarter level. That has to do with some new lines that are opening up, particularly for the production of light trucks.

A survey of 225 small businesses in the District found that most expect little change in business conditions over the last half of 1995. About 20 percent of the responding firms said they expect to raise prices over the next three months, while less than 3 percent are planning to reduce prices. These District price trends mirror the national outlook. Private forecasters predict that inflation in 1995, a year of trend growth in real output, will be higher than inflation in 1994, a year of rapid growth in real output. Over the next 18 months the most optimistic forecasts, including our own Greenbook, place CPI inflation at its current level, while the more pessimistic forecasts see CPI inflation rising to 4 percent. The central concern of this Committee should be progress toward price stability, and there seems to be little prospect that substantial gains will be made anytime in the foreseeable future. Inflation forecasts with horizons of five years or more indicate that market participants do not expect inflation to decrease from current levels.

On the national level, the economy is recovering from the slowdown in the second quarter. Payroll employment jobs have increased at a fair, if uneven, pace over the summer and seem poised to resume a more stable growth path through the autumn. One concern in the national outlook is the stance of fiscal policy. I would like to associate myself with what Al Broaddus said before and reiterate my view that monetary policy should focus on price stability and not try to offset temporary effects of deficit reduction on aggregate demand. The suggestion that the Committee can effectively do more than that is in my view overselling our abilities, given uncertainties about the magnitude and timing of the effects of deficit reduction as well as of our own policy actions.

Let me conclude with a few comments on financial indicators. Total bank loan growth has been rapid over the last two years and, along with solid growth in M2 since the beginning of 1995, seems to indicate continued strength in the national economy. In the Eighth District, total bank loans have been growing at double-digit rates since mid-1994. At the same time in the nation as a whole, total checkable deposits and total reserves, which grew at rapid rates throughout 1992 and 1993, have been subject to a marked runoff since

the beginning of 1994. In my view, which I think you all know, narrow monetary aggregates such as total reserves and the monetary base adjusted for changes in reserve requirements are important indicators of the stance of monetary policy over longer periods of time. However, the adoption by depository institutions of sweep accounts suggests the need to interpret these indicators flexibly in the near term. Estimates by the St. Louis staff, which are consistent with what is in the Bluebook, suggest that sweep programs could be adopted by depositories holding as much as 3/4 of required reserves and 80 percent of aggregate reserve balances. I think it is essential that we continue to monitor these programs because even with all the controversy in interpreting the various monetary aggregates, the provision of an appropriate supply of reserves relative to demand is the core of the implementation of monetary policy.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. The Ninth District economy remains strong. Labor markets are tight. The rate of unemployment in Minnesota is at or near an all-time low. Particularly bright spots in the economy are construction, both residential and commercial, mining and energy output, and forest products. The only major exceptions to this generally favorable picture are cattle producers, who are being adversely affected by low prices--but that is coming off seven or eight pretty good years--and tourism, where apparently the summer season turned out to be mediocre; again, that is coming off several back-to-back very strong years.

As far as the national economy is concerned, I have no problem with the general path of the Greenbook forecast, and I am hard pressed to identify a particular bias in the risks. Our model forecast is more optimistic than the Greenbook--more optimistic in the sense that we have slightly more growth in 1996 and 1997 and slightly less inflation. In fact, we have a deceleration of inflation. Given our inability to be precise about these things, I would judge either outcome to be acceptable.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, broad measures of employment suggest that economic growth ticked up in recent weeks in the Second District. If, however, as President McTeer suggested, our two Districts are the weak Districts, I'd like to merge immediately. In August, payroll employment rose at an annual rate of 2 percent in New Jersey and 0.7 percent in New York. Mergers, closures, and layoffs continue to monopolize the headlines and to affect confidence adversely. In fact, new business formations continue to exceed closures and the number of firms increased by about 2-1/2 percent in the second quarter in New Jersey and about 1/2 percent in New York. That suggests support for a slow-to-moderate expansion in regional employment and renewed confidence among regional businessmen. On the other hand, consumer demand appears to have weakened. Our contacts reported that existing home sales in August were 10 to 15 percent below a year ago while permits for new home construction declined significantly. Senior loan officers reported a marked deterioration in consumer loan demand, and our retail contacts reported disappointing August sales. The newspapers are full of clothing

advertisements. The decline in August tax collections tended to confirm our survey results.

On the national level, assuming an unchanged policy, our forecast agrees so closely with that of the Greenbook that our slightly higher forecast of CPI inflation next year--3.1 percent as compared to 2.9 percent--has little significance and is more in the category of a rounding error. We do believe, however, that the risks to the forecast are somewhat slanted to the down side, in part because the remaining level of manufacturing inventories seems to be higher than desired by manufacturers. We also wonder whether business fixed investment could be somewhat weaker in 1996 and 1997 because of some recent weakness in sales of durable goods. We are not so concerned about this downside risk that we think it requires immediate action on monetary policy, but we do think that the risks we had deemed to be about balanced are now noticeably shifted to the down side. Thank you.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. At a recent joint board meeting, one of our directors whose firm employs a lot of people in four of the states in the region listed a number of the major metropolitan areas and said the employment situation was very bad there. I interrupted to ask him to clarify what he meant and his reply was that he could not hire anybody. [Laughter] His firm runs ads and nobody applies. There had been a general feeling in the spring, among large and small businesses, about what was described as the "hitting the wall" phenomenon, and that is largely gone. People generally have overcome their earlier worries about the outlook. We get reports that residential construction, both single-family and multifamily, is quite good throughout the District. Commercial real estate is doing very well. There are persistent comments about tight labor markets everywhere except in western Pennsylvania. We even heard one report of bounties to hire people where employers tell existing employees that if they bring in somebody--a friend, a relative, or anyone--who applies and gets a job, the existing employee will get a bonus. That's a novel approach for the labor market. We have reports that college enrollments, both public and private, are at record levels, though there is some discounting on tuition in order to attract students to smaller private schools. The only sector of clear weakness throughout the District is health care; there are continued comments about downsizing of the health care labor force.

I want to make a couple of comments about the fiscal situation. I don't know what the Wall Street view is--I'll leave that to Peter Fisher or somebody else--or the foreign portfolio manager view, but I think there is a different view on Main Street than in the financial markets. If you were to walk down the streets of Wooster, Ohio and tell people that the government might decide to cut the growth of government spending, reduce the budget deficit, maybe with some tax elements in the fiscal package, and that this was going to have a bad effect on the economy and that monetary policy would need to do something to offset it, they would wonder what planet you came from! Whatever people in effect think about the size of fiscal multipliers, let alone what their sign might be or their timing, I think we need to be very careful not to communicate the idea that anything that is done on the fiscal side is somehow negative and that

this undesirable event will require an offsetting or compensating monetary policy action. I don't think that is going to play very well out there on Main Streets across the land.

On the Greenbook forecast, I have given a lot of thought to this issue of what the level of the funds rate implies with regard to either economic growth or inflation. I have reviewed the experience of the last couple of years. Two years ago at this point we thought that the head winds might be diminishing. The federal funds rate was around 3 percent and as late as December 1993 the Greenbook was projecting continued anemic or subpar growth and actually an increase in inflation in 1994. Of course, what happened is that the funds rate went up a lot in 1994; real growth was very strong; and inflation came in below what had been projected in the Greenbook. In August 1994, we increased the funds rate from 4-1/4 to 4-3/4 percent and many thought a rate of 5-1/2 percent might eventually be the right level. In November we boosted the rate another 3/4 percentage point and last December's Greenbook talked about taking the funds rate up to 7 percent by the middle of this year just to try and keep a lid on things so inflation would not take off. Of course, what has happened is that we have a funds rate that is over 100 basis points below that level and the inflation outlook is better than it was expected to be. The lesson for me is that we can have errors in our forecasts of output growth and inflation in both directions, and they don't necessarily go together. When I look at something like the Blue Chip forecast or other forecasts, they tend to indicate that the more growth we have, the more inflation. That simply is not the experience; we are not in a world that says more growth causes higher prices and vice versa. So, I think we need to be very careful about how we talk about the relationship of the funds rate and the growth in output and any implications the latter might have for the purchasing power of money. I do agree with the emphasis of some people that this is the right time to keep a long-term focus and not be perceived as reacting to events either in the economy or fiscal policy.

CHAIRMAN GREENSPAN. Governor Yellen.

MS. YELLEN. Mr. Chairman, my opinion about the national economy has changed very little since our last meeting. Although the inventory adjustment may not be entirely behind us, the various sectoral reports on spending seem consistent with continued growth over the next year or so at a pace close to trend. I interpret recent inflation reports as confirming that prices remain well contained. At this stage I think the biggest single risk to the outlook comes from the fiscal situation. Although the odds of a train wreck remain low, a default on the government debt could touch off financial repercussions that would greatly upset Greenbook types of projections. But, of course, on that score we will just have to wait and see what happens.

The longer-term problem that confronts us at this stage, though, is gauging whether the federal funds rate remains above the level that is needed to achieve trend growth further out in the forecast period, and I mean in late 1996 and 1997 and beyond. That seems a long way off, but the Greenbook simulations reveal what we already know, namely, that the lags in monetary policy are sufficiently long that any policy changes that we might undertake over the next months would have their maximum effect in 1997. While it is

looking into the distant future, I don't think it's entirely premature to be thinking that far ahead. What I think the Greenbook projections suggest is that the real funds rate is a little too high to support trend growth with the assumed degree of budget contraction, and it may turn out that the budget contraction will be greater; we will see.

In this sense I think we have what Charles Schultz dubbed a "termites in the basement" problem, although he was using that phrase to talk about the federal deficits of years ago. A "termites in the basement" problem is a nagging, chronic little problem that can eventually cause a lot of grief if it is not attended to. Termites nibble away slowly so the problem just creeps up and there is no great sense of urgency that one absolutely has to deal with it on one day as opposed to the next. That is how I perceive the Greenbook outlook. I think there appears to be a problem there. It starts as a small problem, but unless it is attended to it will grow into a more significant problem. Simulations that we have done with the MPS model reveal that after 1997--I know that is a long way out--the problem really begins to snowball into a crisis. The MPS simulation suggests that if the budget is balanced by 2002, the real funds rate would need to decline from roughly its present level of about 2-3/4 percent to about 1-1/4 percent. If the funds rate stays where it is, the economy is not likely to remain on an even keel. I would also note that the Greenbook and the MPS model are not alone in reaching this conclusion. Many outside forecasters are predicting an eventual decline in the funds rate. That also seems to be the conclusion of participants in financial markets since longer-term yields apparently embody an assumption of declining short-term rates. I think that adjustments in long-term market rates could easily suffice to keep the economy on course, but they are predicated on at least an eventual adjustment in the federal funds rate. Again, as the Greenbook suggests, I think the outlook for the near term, next year and even the next two years, looks good. I don't view this as a crisis, but I do believe there is a "termites in the basement" problem.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. I can't top that! On the fiscal situation, the Greenbook now assumes that the Congress ultimately will pass 85 percent of the reductions called for in the Congressional budget resolution. Believe it or not, I think that assumption is still a little too low. I think it will be more like 95 percent, but at least we are getting closer and at this point I see no reason to quibble. The net effect of that is a negative fiscal impulse for 1996 of 3/4 percent of GDP. I want to talk about what that means for the forecast in just a second, but there were two comments related to the fiscal situation that I would like to return to. I forget--what town in Ohio?

MS. MINEHAN. Wooster.

MR. LINDSEY. Wooster. Well, I didn't hear it right.

MR. JORDAN. I said that for Don Kohn's benefit.

MR. LINDSEY. The question I would pose is what would I hear if I were to go to Wooster, Ohio just after Thanksgiving. Everyone has come to grandma's house and a cousin, who unlike all other federal

workers is a good worker, [Laughter] has been laid off and tells his tale at the Thanksgiving table. I think there would be a perceptible view that federal spending will indeed slow down and that if even this hard working person with the safest employer has lost his job, whose job is safe? So, I do think that in spite of what people believe, and as you know I am hardly an advocate of big government, the transitional effects of moving people from the public sector to the private sector are real. I think the people in Wooster will know it after Thanksgiving.

With regard to the role of monetary policy, I completely concur with the view expressed by some that what we should look at is not fiscal policy per se but its effect on aggregate demand. On that point I would note that the Greenbook has projected nominal GNP growth of 4.4 percent in 1996 and 3.9 percent in 1997. Two years ago I didn't think we would see 3-point-something percent during my term as a governor despite our pursuit of price stability unless we had a major recession. Frankly, 3.9 percent is below what I would think of as an appropriate target for nominal GDP. So, I don't disagree with your theory. I would say 3.9 percent means that we are at price stability in effect. That would be, say, a 2-1/2 percent trend rate of growth and 1.4 percent inflation. That sounds like a definition of price stability to me. So, we are there.

Returning to the question about the fiscal impulse, if we did have a negative 3/4 percent fiscal impulse, it would mean that to get 2-1/4 percent growth next year the rest of the economy should have a trend growth rate of 3 percent in it. That does not seem plausible to me, particularly when we are at 5.6 percent unemployment already. There is another alternative, and that is that we have had a completely painless and seamless transition from fiscal contraction to private sector expansion; but I don't think that comports with reality. So, let's go back to the possibility of 3 percent growth of the private economy as the underlying assumption here. If we look at what has happened to the incomes and wages of people, the reason that we are not seeing inflation accompanying the low unemployment rate is that structural changes have occurred in the labor market. They are manifest in the fact that the wage share of personal income has declined dramatically. In 1989 at the last business cycle peak that share was 59 percent; in July it was 57 percent. At the margin in the last 12 months, wages have accounted for only 50 percent of increased personal income. It is not hard to understand how we can get both lack of inflation and an improvement in the unemployment rate when in fact wages are being suppressed. The problem is that we cannot have wages that continue to be depressed and have a 3 percent expansion of the real private economy; it just does not add up. One of two things can happen: In one, workers get restless, wages go up, the profit share falls, and there is upward pressure on inflation. That is scenario "one" that Mike described. Or we get scenario "two," where the demand is not there, we do not in fact have 3 percent expansion ex-government in the economy, and we get slower growth than the Greenbook is forecasting. My own bet is that the second result is more likely than the first. Certainly, when we are talking about 4.4 percent nominal GDP growth going down to 3.9 percent nominal GDP growth, I hesitate to think what the trend is going to lead to. Clearly, we have a real federal funds rate that is too high. I guess I couldn't camouflage myself as a termite, but I end up tearing down

the house just like the termites do in Governor Yellen's story. Thank you.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. I am not going to try to pick up on that analogy!

CHAIRMAN GREENSPAN. I appreciate your not doing that.

MR. KELLEY. Let me make a brief intervention because like so many others and the way Mike Prell started this morning, I see very little change from where we were in August. Relative to the Greenbook, I continue to believe that the risks, if that is the proper word, are on the up side and I am in the camp that would be closer to the more bullish of the three scenarios that Mike Prell presented this morning, for all the reasons that he discussed.

I would like to offer a thought or two about the fiscal deficit situation. First of all, 1996 is an election year, and we are talking about deficit reductions that would be put in place by legislation that is not yet passed, although the new fiscal year is upon us. Assuming they do get passed, it will take some time to get them largely in place. So, I would be surprised if it turned out that there was a great deal of additional fiscal drag in the year 1996. It also is worth noting that in the last three fiscal years the deficit has come down from a level in excess of $280 billion to probably less than $160 billion in fiscal 1995. That is a lot of deficit reduction in a 3-year time period. And yet we had 3 percent plus real GDP growth in 1993 and 4 percent plus growth in 1994, and 1994 was the year when the biggest part of that deficit reduction took place. Deficit reduction has a lot of positive impacts, and in the aggregate whatever deficit reduction does take place--and I hope a program will be enacted--I think there is every expectation that its negative effects can easily be overcome by all the positive impacts that get thrown off from it. In August I remarked on what seemed to be an exceptional number of rather basic questions that, taken together, are largely going to dictate the nature of monetary policy in the years to come. They include issues concerning the trend in fiscal policy, the level of the NAIRU, the need for improved measurement of the inflation rate, the trend of productivity, the longevity of this absence of wage pressures that we see today, and the persistence of household debt formation. It is going to take a while for a lot of these things to play out, but I do think we are in a good position right now to wait and see how all this evolves. Thank you.

CHAIRMAN GREENSPAN. Thank you. Governor Phillips.

MS. PHILLIPS. Thank you, Mr. Chairman. My remarks will be short this morning. In view of the revised GDP number that we have received since the last meeting and the somewhat mixed economic signals that we have been getting and certainly have discussed around the table today, I think it's fair to say that the inventory cycle may have flattened out to some extent. Inventory adjustments are likely to stretch more into the future. Except for this shift in the inventory adjustment process, the situation seems to be working out much the way that was discussed at the last meeting. Demand has held up. We didn't slip into a downward spiral coming out of the inventory

adjustment process. Specifically, consumer spending and housing have shown improvement. And although business investment growth is slowing somewhat, we all recognize that the previous rates of expansion were not sustainable. Employment is holding fairly steady. People appear to be learning to live in this newly re-engineered world. New businesses are starting up and are absorbing some of the displaced workers. I think the financial markets since our last meeting have reflected the resolution of the inventory situation. They generally have improved--the dollar, the stock market, the bond markets. This means a continued availability of relatively low cost capital, which bodes well for the business investment outlook. In this environment we have had good news with respect to inflation, which appears to be reasonably well controlled. However, I would point out that we have a distance to go on getting the inflation rate down, and it is going to be harder and harder to make progress.

I guess I am having a difficult time signing on to the stories that are floating around about significant upside risks, one of Mike Prell's three scenarios. With employment remaining a continuing concern, while this is a positive influence for inflation, job uncertainty means that we are unlikely to see significant expansion in consumer spending. Continuing inventory adjustments in the face of fairly steady demand are probably going to make businesses a bit leery of expanding significantly. We have talked a bit about the pending train wreck and how much of a fiscal drag that is going exert. I think that under any circumstances there is going to be some kind of a drag, but the question is what kind and how much. I am not sure that we have a good handle at this point on what kind of fiscal drag we will see.

In sum, I think the outlook is for slow growth in the near term. I do think there are a couple of major unknowns. The train wreck scenario is one and we don't fully understand the implications of a potential train wreck. On the down side, it could produce a lot of uncertainty in the financial markets, and it's hard to know what kind of uncertainty that might engender in the general economy. The second unknown relates to the fact that most people seem to be focusing on an outlook of 2 to 2-1/2 percent growth in real GDP, with 2 percent suggested in the Greenbook for 1997. I would point out that we are going into an election year, and I wonder whether 2 to 2-1/2 percent is going to be deemed politically and socially acceptable. I suspect that there might be a lot more pressure building in the upcoming year for a stronger economy. Even though economists are saying this is about as good as it gets, I wonder whether folks on Main Street will see it that way.

CHAIRMAN GREENSPAN. Thank you. Governor Blinder.

MR. BLINDER. Thank you, Mr. Chairman. There are two basic reasons for revising a forecast from one meeting to another. One is that you receive news that makes you change your mind; the other is that you goofed the last time. I don't think either one is true in this case. I don't think the staff goofed the last time. I see the news that has come in since the last FOMC meeting as being entirely consistent with the staff forecast, as I think Mike does. The economy has been following the script laid out in the previous Greenbook--toward the much hoped-for soft landing. So, to me, the epsilon in the news has been roughly zero in the last five weeks; and, appropriately

the Greenbook forecast has changed very little--negligibly in fact. Indeed, as I read over the minutes of the August 22 meeting last night, I had a strong sense of deja vu. I thought I was reading the minutes of this meeting and it had not yet occurred! I suspect that when Norm drafts the minutes for this meeting, they are going to look a lot like those for the August meeting. In fact, he won't have to do much work.

CHAIRMAN GREENSPAN. He can just xerox last meeting's minutes!

MR. BLINDER. Yes. A number of us observed last time--fewer of us today maybe because we are getting used to the idea--that this scenario is too good to be true. Almost everybody said that last time; very few people said it today. To be sure, it is five weeks closer to coming true than it was five weeks ago; but it's still a little too good to be true. [Laughter] I believe, as Sue Phillips just mentioned and others too, that the biggest risk remains the step into the unknown that Capitol Hill and the White House are about to take. It could all work out fine, or it could work out to be a catastrophe. There is no way to predict that. But to me it presents a downside risk, not an upside risk. It's hard for me to see it giving a big boost to the economy.

Last time, I called attention to a feature in the Greenbook forecast that you could barely see. You almost needed a microscope to see it. That feature was that by the end of the forecast, which was then the fourth quarter of 1996, a small gap had opened up between actual and potential GDP, and that gap was growing slowly. So, if it was extrapolated beyond 1996 one would see an uptrend in unemployment and a downtrend in inflation. In the current Greenbook forecast, which has now gone out one more year, this gap is more visible; but it still is not very dramatic. The real growth rates for the years 1995, 1996, and 1997 of the forecast period read 2.1, 2.2, and 2.0 percent--all, as Bob Forrestal and others have noted, below the growth rate of potential. Consequently, the annual average unemployment rates of those three years go 5.7, 5.9, and 6.1 percent. That is where the Greenbook stops. But that is not where the world will stop. The core CPI inflation reads 3.1, 2.8, and 2.7 percent. So we see a pattern of declining inflation in the data.

The reason it is there now is the same reason it was there five weeks ago--which is that, if inflation is indeed capped at or below 3 percent as the Greenbook says and as I believe, the actual real federal funds rate is almost certainly above the equilibrium real federal funds rate. Several people have observed this, and Governor Yellen in particular has emphasized it. That means that by some reasonable definition--I guess my definition of a reasonable definition is that I can't come up with a better one--monetary policy is restrictive. It is very hard to define the "zero" on monetary policy, but this is as good a way as I know. And that monetary restraint--that is to say the gap between the actual real federal funds rate and the equilibrium real federal funds rate--probably will be greater the more fiscal restraint there is.

This is a process that naturally snowballs. I am sorry, but I am making tacit reference to termites here, though I wasn't going to use the term. You start with a real funds rate that is a little too

high; that opens up the gap; that leads to lower inflation. If you hold the nominal funds rate steady, the real funds rate gets higher because monetary policy is not standing still but actually is tightening as inflation declines; and that leads to a larger gap and so on. You will recognize that this is exactly the argument that was used, correctly, on the up side against rising inflation in the 1960s and 1970s to explain why it was foolish to target the nominal interest rate. It's just as foolish to target the nominal interest rate on the down side, and I don't think we are doing that.

I had asked the staff, and Governor Yellen mentioned this, to use the MPS model to run the Greenbook forecast out further, holding the nominal fed funds rate at 5-3/4 percent, because you can just barely see what is going on by the fourth quarter of 1997. When the staff did this, they assumed that we would reach a balanced budget by the year 2002. I don't remember that I specified that. I might have, but I don't recall doing so. In any event, it has the consequence of calling for the dramatic reduction in the equilibrium funds rate that Janet Yellen mentioned earlier. When you look at the paths that come out of that simulation, the unemployment rate rises from 6.2 percent in the fourth quarter of 1997, which is where the Greenbook turns off, to about 7 percent a year later and about 8 percent a year later than that. And then it just keeps on going up because the economy is on an unstable path in this forecast. By the year 2002, you don't even want to think about the unemployment rate. The inflation rate falls from where it is now, around 3 percent, to about 1 percent by 1999 in this path. Then it, too, keeps going; and by the year 2002, when the budget is balanced, the economy is experiencing a heavy deflation that makes the current Japanese standard look wildly inflationary.

Now, that is not a forecast. Nobody should take this particular model literally and nobody does. I think not even the proprietors of the model take it literally. I certainly don't and I don't worry that people around this table will. Furthermore, we would not let it happen. The economy is not going to go to minus 7 percent inflation and 10 percent unemployment. The point of the exercise is to indicate whether the path we are on is a sustainable path or a nonsustainable path. It suggests that the current real federal funds rate is probably unsustainably high. And it shows us that the effects of this discrepancy start very small, so we don't really see them, but they build.

I am now in what will appear in the transcript as the last paragraph--into policy, though just a little--in anticipation that this month's policy discussion may go like last month's policy discussion. [Laughter] This observation does not imply that we have to cut interest rates today. It certainly does not, and I would not in fact argue for that. But it does strongly suggest that we need to ease policy sometime, especially if there is a large fiscal contraction--and regardless of public opinion in Wooster, Ohio as to the effects of fiscal contractions on aggregate demand. More importantly, it suggests that we need to think about a long-term strategy for monetary policy. What we do today will have essentially nothing to do with the next two quarters. But what we do, not necessarily today but, say, in the coming six months, is likely to have a great deal to do with how the economy looks 1-1/2, 2, 2-1/2 years after that, and that's what we ought to be thinking about. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Thank you. Shall we have coffee?

[Coffee break]

CHAIRMAN GREENSPAN. Mr. Kohn.

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

CHAIRMAN GREENSPAN. Questions for Don? Yes, President Melzer.

MR. MELZER. Don, I would like to ask about these sweep accounts--a couple of different aspects. One stems from an inquiry that we had just this week from a bank in our District. My sense is that knowledge of this is spreading like wildfire through the banking industry, and I think banks are looking to the Fed to take some position on this; they are asking whether the practice is legal and so forth. I presume somebody is out there peddling the idea, or the software that supports it, or whatever. So, one question would be what can be said about these arrangements and maybe this discussion should be continued later at lunch if that is more appropriate. My other question is whether we have the capability to publish data that, without violating any confidences in terms of individual institution data, would give the public a better handle on what is going on. Clearly, some people are misinterpreting the stance of monetary policy because they don't have this information.

MR. KOHN. With regard to the first question, President Melzer, our Legal Division has written a number of letters to institutions that have inquired. The letters lay out the criteria for a sweep arrangement that conforms with our Regulation D. My understanding from Reserve Banks is that many of the inquiring banks already have in hand copies of the letters that the Board's Legal Division has sent to other banks. So, there are guidelines out there from our Legal Division. There has been an attempt to circumvent the regulation with sweeps that are entirely sleight of hand bookkeeping. A bank has to have a real sweep account. I don't know all the legal ins and outs; we could explore that later if you wanted to.

With regard to the second issue, we are exploring that. I agree with you that it would be good to get these numbers out somehow, but there are two difficulties. There is the one you mentioned: if we publish a monthly series, in some earlier months and even in some earlier quarters only one bank or two banks had introduced such accounts. Publication would give information to their competitors, and we try to avoid that. That has not been true in the last few months when many banks have introduced sweep accounts, but that would not be the case for the early part of the series. I think there may be ways we can publish the series using quarterly or semi-annual data at first or something of that sort, and we are looking at that. We intend to publish. The second difficulty is one of interpretation. All we know are the initial impacts of these sweeps; that is what we get through your data departments, your accounting people, and our edit checks. We don't know what happens subsequently, and I think we have to be very careful in looking at these numbers to resist simply adding them back to M1 and assuming that we are getting what M1 would have been otherwise or what the monetary base would have been otherwise. When we do put the series out, I think we need to take a

lot of care in how it is put out and hopefully lead people away from misinterpreting what they have. They need to understand the very limited nature of the data that we have, but we are looking at ways to publish them.

MR. MELZER. Could it be a phenomenon that's big enough that we need to collect additional data to be able to interpret it correctly?

MR. KOHN. We have given some thought to that as well.

CHAIRMAN GREENSPAN. There is one other aspect in the interpretation of these data that we have to be careful about. While it is true that in a technical sense these accounts are changing, they are not perceived to be changing by the holders of the accounts. So, you can not make the argument, which some might make, that what in fact is engendering a change, for example in M1 or some other aggregate, is relevant in terms of the macroeconomic effect. That is not the case, or should not be the case, if the holders of these accounts are not aware that anything is going on, which indeed they are not except to a marginal extent. So, you can't argue that people are holding certain types of balances voluntarily and acting on those irrespective of how those balances got created. There is a significant lack of awareness among the holders of the accounts that reserve balance adjustments are taking place. And they don't perceive that their NOW account has gone down or been shifted over to MMDAs and therefore one can't argue that their behavior should be altered.

MR. LINDSEY. But they are held harmless from change.

CHAIRMAN GREENSPAN. Yes.

MR. MCTEER. Another part of the monetary base's behavior, of course, is that currency and bank reserves have been declining for a good while. Currency was growing very rapidly earlier, but now something is happening to it. Can you tell us what it is and whether it has any implications for anything?

MR. KOHN. The currency flows to foreign countries have slowed substantially. We have a lot of data on the flows, but we can only guess at the total. The shipments data we get through the Federal Reserve Bank of New York suggest that for the last several months the amount of currency outside the country has been fairly steady, and in the last few months it may actually have gone down with net shipments back to the United States. Now, it is very hard to figure out what is going on. One story, as Ted just mentioned, is that the situation in Russia has stabilized to a certain extent. It is hard to see that in the direct shipments to Russia, but a lot of currency gets to Russia through Switzerland and other countries, and we have seen a slowdown there. The other area where we have seen a slowdown, and perhaps I should turn to Ted and Peter on this, is in lower shipments to, or even a reflow of shipments from, Latin America. For a while we thought we had an Argentina story--that is, that there were huge volumes of shipments early in the year, partly after the financial crisis in Mexico, in preparation for something awful that would happen in Argentina. The something awful never happened and some of that currency came back. But I think the reflows have been wider than just those from Argentina; we are getting some shipments

back from the rest of Latin America. In summary, I think an important part of this currency story has been the growth in shipments abroad early in the year--a lot of which were to Latin America and shipments destined ultimately to Russia--and the slowing since then.

CHAIRMAN GREENSPAN. Further comments? If not, let me xerox my comments from the last meeting because, as Governor Blinder pointed out, a good thing that can happen to somebody who likes to talk about the business outlook is that things go the way that you expected them to go. It is not usually that way. Let me just point out, however, something that has not been stated--namely, that economic activity, income creation, and the like are still undergoing a suppressing effect from a reduction in inventory investment. It is not overly clear in the data, but as you poke around here and there, it is pretty obvious that the pressure to reduce inventory-sales ratios is still out there and that the retrenchment or stabilization of lead times is exacerbating this process. It is not sufficient merely to look at final sales, largely because inventory numbers are not passive. There is a dynamic element involved in how inventories are managed, and by affecting the level of income they also affect the level of final sales. So, we do not yet have a sense of how all this is coming out.

There is evidence that the probability of continued weakness is receding. This is not inconsistent with the comment made by several of you that the risks are on the down side. It's just that the downside risks are not immediate; they arise as we get into 1996 and are the result to a certain extent of the fact that the business cycle is aging. To whatever extent the accelerator works in the capital goods markets, one must presume that that will have some slowing effects. And while I would have a minor quibble, which I will get to, with Governor Blinder's scenario of the federal funds rate being higher than where the long-term equilibrium should be--a view with which I generally agree and one that I think you have all commented on in the past--I would just caution that we should be a little careful about the use of the various models out there. To repeat what I have said in the past to this Committee, those models give forecasts that are marginally laughable if the "add" factors are not judiciously applied. Simulations of these models tend to employ a fixed level of "add" factors that become less and less usable as you go out farther, and we have to be careful about presuming that these simulations are any more accurate in capturing what is going on in the economy than "unattended" projections of these same models--unattended meaning that the add factors are just allowed to run by some mechanical process. Those results are poor and the conclusions that we would get from simulations must of necessity be of the same nature. However, having said that, I think it is correct to argue that we are probably at a real funds rate level that is higher than the long-term equilibrium. I think the argument that Governor Blinder makes--namely, that we get a progressive effect in that as the inflation rate falls the real funds rate rises even though the nominal rates holds stable, is probably an accurate description. I just want to make certain that we don't go overboard and assume that the simulations we make are all that useful in this regard.

I think this basically leads to the conclusion that it is probably unwise to move today essentially because of the budget debates that are involved. I think it would be very difficult for us, no matter how craftily we constructed our rationale for moving, to

disassociate a move from the train wreck scenario. There is, however, one issue about this that disturbs me, which Don Kohn raised. We have to be careful not to allow monetary policy to be frozen in place by a process that could go on for months and months. Policy should not remain frozen if we determine that the economy is in a state where we have to move. I don't know whether that will be before or after November 15, but our next move certainly will be at a time when this Committee is meeting--either here or on a telephone conference--because the move is probably going to be a sensitive issue. So, I would suggest that it be done with the Committee's concurrence.

As far as our decision today is concerned, I would conclude that policy should be unchanged and symmetrical. In my judgment, it would be wrong to move today, and if we are to take action in the period ahead it should be in the context of considerable discussion about its implications and the decision should be made by the full Committee. So, I put on the table "B" symmetrical. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, I support both your conclusion and the reasons that you gave for it.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. I, too, support your conclusion and the reasons that you gave for it. As I said earlier, I am drawn to the view that the economy is doing well both currently and prospectively. So in terms of prescriptions about policy, I look to the old physicians' oath of "do no harm" and look at "A", "B", and "C" as to where the harm would be done if we did anything right now. I think it would be more harmful right now to raise rates than to lower them. Lowering them may be the next action, but I agree with the timing points that you made. I don't think that waiting right now, in view of everything that is happening on the fiscal side, prejudges whether or not we would wait in the future if the budget debates really drag out. So, I am comfortable with using timing as an argument right now, although I do agree that we should not have our hands tied at all as to future monetary policy actions.

Finally, I would quote some people with whom I ate breakfast yesterday. Their advice with regard to monetary policy was: "Don't just move, stand there."

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. I agree with your proposal, Mr. Chairman.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I hate to break the trend that seems to be developing here. Your argument is highly reasonable and I hesitate to disagree with you, but I will anyway. For many of the reasons that have been advanced, I think we ought to move and we ought to do so today. First of all, we all apparently agree that interest rates are high by historical standards, and if maintained I think they are going to be contractionary in the long term. Governors Yellen and Blinder have articulated that theory very well. There is a trend that is building, and I think we ought to arrest it at this point.

In spite of the fact that we have a very dynamic economy in the Sixth District, as I indicated earlier, there are business people who are reporting to me that softness is beginning to develop. So, the economy may not be in as good shape as the statistics are indicating. Again, as I said earlier, the Greenbook forecast is placing growth below what is currently considered to be potential. I think potential is higher than indicated in the Greenbook and therefore that the gap between actual growth and what I consider the real potential of the economy is greater than that in the Greenbook. That might give us trouble down the road. Inflation is certainly well behaved and whether we are at price stability or not I guess is a matter of definition. But I certainly don't see any deterioration in the inflation rate. Finally, I think the Fed's credibility is such that we are in a position where we can move today. Now, my preference along these lines is irrespective of the fiscal situation, and I certainly respect your view regarding the timing. On the other hand, I do think that today may be as good a time as any to move. It may be a less sensitive time than it will be later. So, my preference would be to move by 25 basis points today.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I think we adopted a strategy earlier this year to wait and see how things play out. I may have preferred a different strategy, but I think that one we adopted is reasonable. Having selected this strategy, our tactics should be consistent with it, and in my view what you propose is consistent. I think we are going to have to rethink the overall strategy, though--if not at the November 15th meeting then in December as we learn more about the economy. So, I support your proposal for now.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I support "B" symmetric. I think we indeed have to take into account the fiscal side, but I don't know what to take into account at this point. So, we ought to wait on that. Almost surely we will have to adjust policy at some point in coming months, but I don't sense any pressing need today. So, I think your basic arguments are correct and I support them.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Alan, I favor "B" symmetric as well. I view policy as being somewhat restrictive, and I think that is quite appropriate. First of all, I think it is a hedge against the possibility that we have not in fact capped inflation in this cycle; I hope we have, but I don't think we know that. Secondly and perhaps more importantly, I would like to see the trend rate of inflation move down and certainly more quickly than is evidenced in any of the forecasts that I have seen. Perhaps when we see evidence that longer-term inflation expectations in fact are moving down, rather than the flat picture we are looking at now, it might be appropriate to consider an easing, but for credibility reasons I would be very careful not to ease before we saw some evidence along those lines.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I also favor "B" symmetric.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I agree with your recommendation of "B" symmetric. The reasons for me, however, are that I think the projections on the growth of the economy are reasonably accurate, and as I said earlier I am not quite as optimistic about the inflation outlook as the Greenbook. I think we are in a good policy position. As for the fiscal outlook, though both the Greenbook and our own projections view some fiscal restraint as possible, we don't know whether it will be more or less than we are assuming and we won't know for some time. So, I am very comfortable with where we are right now.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I support your recommendation for Bluebook alternative B. I think we have pretty solid evidence that the economy is growing at a faster rate than in the second quarter,and it looks as though the economy is going to continue to grow at an acceptable rate in the future as well. Although we have seen a modest fall in inflation and a modest increase in the real funds rate, I don't think there is much evidence that inflation will be on a declining path. Therefore, I would be reluctant to cut the funds rate at this time.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I support "B" symmetric. We should have some room to ease sometime this fall, but I think we should wait and see how things develop. Symmetry seems most appropriate to me, because I think it is clear that we probably would not move in the intermeeting period without a discussion. It seems to me that if we were going to adopt an asymmetric directive, we should definitely have a move in mind and should only be thinking about its timing. So, I would go with "B" symmetric.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mr. Chairman, I support your proposal for the reasons that you mentioned, but also for some of the reasons that Tom Melzer and Bob Parry noted.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. I support your recommendation, Mr. Chairman, for many of the reasons that were mentioned by Presidents Melzer, Parry, and Hoenig.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Just for your information, a little arithmetic exercise I did--if we have CPI increases that average two-tenths of a percent each month through December, the December-to-December rate would be 2.8 percent. I support your recommendation.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I support your recommendation, Mr. Chairman. One of the things that you pointed out in your comments at our August

meeting still needs to be kept in mind. There is a risk--and different people can put different probabilities on it--of fiscal fizzle. There would be a lot of disappointment if nothing happens here, and we could have an adverse effect on psychology across the country.

CHAIRMAN GREENSPAN. Governor Yellen.

MS. YELLEN. I support your proposal for "B" symmetric, although I do find myself very much in sympathy with President Forrestal's analysis. I think he has made a case for moving today, but on balance it seems to me that the timing isn't urgent, and I am quite content to wait.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. I also support your recommendation, Mr. Chairman, although as Governor Yellen does I find myself in considerable sympathy with Bob Forrestal's argument. I think for the reasons Jerry Jordan, Ed Boehne, and others have stated, that this is a good time to wait. We don't quite know what is going to happen. I simply want to state as a matter of principle, one that most people believe but a few have argued against, that fiscal policy is a relevant consideration in setting monetary policy. It doesn't mean that we have made our policy hostage to fiscal policy in any sense. But it is true that we don't know what the fiscal policy is going to be.

CHAIRMAN GREENSPAN. We are reading from the same page as last time.

MR. BERNARD. It's on page 15 of the Bluebook: "In the implementation of policy for the immediate future the Committee seeks to maintain the existing degree of pressure of reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful considerable to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth in M2 and M3 over the balance of the year near the pace of recent months."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Blinder	Yes
President Hoenig	Yes
Governor Kelley	Yes
Governor Lindsey	Yes
President Melzer	Yes
President Minehan	Yes
President Moskow	Yes
Governor Phillips	Yes
Governor Yellen	Yes

CHAIRMAN GREENSPAN. The next item on the agenda is Senator Connie Mack's bill, the Economic Growth and Price Stability Act of 1995. When I reported to the Senate Banking Committee last week, I was not asked very specifically whether I supported the bill as such. I repeated the statements I had made previously, namely that I thought the primary purpose of monetary policy was long-term price stability, and I didn't get queried much beyond that. However, this bill has a very large sponsorship. Indeed, the last report I heard indicated that virtually all the members on the Republican side of the Senate Banking and on the Joint Economic committees were co-sponsors of the bill. So, it strikes me that we will be asked to testify on this bill at some point or another. Despite the strain of the current legislative calendar, it is likely that Senator Mack will be successful in squeezing in a hearing on his bill at some point, and it would be quite useful to get at least preliminary views from the members of this Committee on how we should respond to that bill. I will be testifying as the representative of this Committee and of the Board, and I will try to fend off wherever possible any requests on their part for my personal views. It strikes me that even if my views coincide in all respects with what this Committee might be saying, the Mack bill involves a potential change in the nature of what this Committee is doing and it is the Committee that should be speaking in that regard, not the Chairman. A lot of the provisions of this bill essentially would sanction what we have have been doing in any event, but there are aspects of the bill that are different. So, I think it is important that all of you, to whatever extent you have been able to focus on the provisions of the bill, at least give your preliminary views. The transcript that we will have of our discussion will be helpful in formulating official testimony in response to a request for us to appear and give our views. So, if anyone would like to comment --President Parry.

MR. PARRY. Mr. Chairman, I believe that the Mack bill has much to recommend it. The bill would clarify our goals and place the primary emphasis on price stability. I also like the fact that it requires a numerical goal, which would add to the public's understanding of monetary policy and hopefully enhance our credibility over time. At the same time, the bill gives us the freedom to define the numerical inflation goal and the timeframe for achieving it. Finally, I like the fact that the bill removes the requirement that we establish and report on ranges for the monetary aggregates, which have become only a minor part of our deliberations. Overall, I think the Mack bill would be a big improvement on Humphrey-Hawkins.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. I have expressed my belief that we need something like this so often that I am sure you don't want to hear it all again, and I won't repeat my views in any detail today. Briefly, I like this bill very much. I like it both in general and with respect to its particulars, many of which Bob Parry just covered. It certainly is true that we have made a lot of progress in reducing inflation over the last decade and have done so without a mandate like this. I think we have every right to be proud of that achievement, but it has not been easy. Basically, it has been a game of trying, by both our words and our actions to build and hold our credibility as we have gone through this period. We have managed to build credibility, no doubt about it, but my own instinct is that our credibility is not

terribly deep and that it rests on a relatively fragile foundation through no particular fault of our own. I believe Americans should think about these issues. Certainly, financial market participants are well aware of the limits to the Fed's ability to pursue a price stability objective in the current institutional environment under current law. Because of this, I am not sure we can ever achieve full credibility, or even reasonably full credibility, under current law. The best evidence of that is what I often refer to as the periodic inflation scares in the bond markets. This bill would help us to deal with this credibility problem, and I certainly hope the Committee and the System will vigorously support it.

I would add just one other point, Mr. Chairman. Recognizing that the bill even with its current political support still faces uncertain prospects, I would not want to see us tie our own longer-run strategy too firmly to this particular bill. In particular, we still need to be thinking about how we will deal with the Humphrey-Hawkins reporting problem that we are going to face whether this bill passes or not. We discussed that problem a couple of meetings ago.

CHAIRMAN GREENSPAN. Governor Yellen.

MS. YELLEN. Let me begin by saying that there is a great deal about this bill that I can endorse. I think the focus on price stability as the single appropriate long-term goal of the FOMC is correct. I endorse the repeal of the Humphrey-Hawkins Act. I think those numerical target reporting requirements are unrealistic and counterproductive. I like the idea that we should be asked to define price stability and report to Congress on how we intend to achieve it. I like the bill's recognition of the fact that the attainment of price stability is not costless in terms of transitional losses in output and employment, and I like the fact that it explicitly directs us to take these losses into account in the transition period. So, I think this bill moves us in a good direction.

Having said those positive things, I do have two qualms about this bill. The first is that it does not positively endorse stabilization policy as an objective. Its tone is quite negative and by inference it suggests that if we have just one tool of policy we cannot focus on more than one goal. I have said previously that I think that stabilization of economic activity is an important goal in its own right, and I think it will remain so even after price stability is attained. I recognize that one could make the argument that the actions that are appropriate to stabilize output and employment are going to coincide with what one needs to do to stabilize the price level, namely, to lean against the wind. The problem is that the world is more complex than that, and these two objectives will not always go hand in hand. There are apt to be tradeoffs between the variability of output around its trend and the variability of inflation around a level of zero. That does not mean that I reject in any way the natural rate hypothesis. So, I think our policy ought to be directed to the pursuit of two goals, not one; and as I previously argued, something along the lines of the Taylor rule provides a formal way of thinking about how we could use policy to pursue multiple goals without in any way sacrificing the goal of long-run price stability. On the other hand, I do agree with the point that multiple goals have created uncertainty in the minds of the public and Congress about the aims of monetary policy, and I agree

with Alan Blinder that we need a systematic way of clarifying what we are doing.

The second concern I have is that not only does this bill not positively affirm a stabilization objective, it actually repeals a key portion of the Employment Act of 1946. It goes much further than the repeal of the Humphrey-Hawkins Act. It repeals that part of the Employment Act that was a declaration of the responsibility of the government. I won't quote the whole thing, but it says in part that the government should "use all practical means...for the purpose of creating and maintaining conditions which promote useful employment opportunities for those able, willing, and seeking to work." There are two questions. The first is whether the Employment Act of 1946 has implications for the Federal Reserve. One might say that this Act is just a declaration of government policy and that it has no specific meaning for us whatsoever. A little bit of legal research that we did suggests that that is not the case. We uncovered a 1971 memo from the Board's General Counsel, Mr. Hackley, who wrote, "The declaration of Congressional policy set forth in Section 2 of the Employment Act unquestionably applies to all agencies of the federal government including the Board, since the Board as well as the Federal Open Market Committee is part of the federal government." This fact has been expressly recognized by three Federal Reserve Board chairmen--Chairman McCabe, Chairman Martin, and Chairman Burns. What Mr. Hackley concluded was that this broad mandate certainly did govern the general policies of the Board, although we did not have the specific obligation to pursue the particular goals set out in the Economic Report to the President. So, I think it does have implications for the Board, and even if the Employment Act of 1946 had no implications for the Federal Reserve at all, I would oppose repeal of this feature of the Employment Act because it has implications for the federal government more broadly.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Alan, in the ten years that I have been directly involved in this process, this has to be the most significant potential institutional development that I have seen come forward. Needless to say, from what I have said in the past this bill is something that I would strongly support. I think price stability is the appropriate focus for the FOMC and the Federal Reserve more generally. It is the one thing we can deliver in the long run. That is where we ought to be focused, and if we do it successfully, it is going to enhance the performance of the real economy, and it is going to result in lower longer-term rates.

I like the way this bill is structured in terms of articulating the general focus and leaving the details to the central bank. Clearly, a lot of work and thinking would have to be done to implement this bill, and it would not be easy, but the structure is quite appropriate in terms of having a direction set by legislation and giving us the opportunity to focus on the details of how to get that done. I think a numerical definition of price stability is very important from a credibility point of view.

There probably are some things in the language of the bill where we want to consider certain technical modifications. In some places, the bill talks about the Board and in other places it talks

about the Board and the FOMC. One would have to ask in the context of monetary policy whether some reference to the Reserve Banks needs to be in there as well because of the role of the Reserve Bank boards of directors in setting the discount rate. In any event, I think the bill needs consistency in terms of how that sort of thing is described. Don Kohn mentioned in his briefing that there was some ambiguity in the bill's language with respect to our taking into account the tradeoff between output and inflation. The way I read the language, it implied a tradeoff during the initial transition period. That is not an unimportant issue in terms of credibility. If that wording is read in effect as giving us latitude to engage in short-term fine-tuning on an ongoing basis, I think that is going to undercut our credibility and will remove some of the value that is inherent in an approach like this.

I have just two final thoughts. As I said, a lot of work is necessary prior to implementing this legislation. I don't disagree with what Bob Parry said about removing the obligation to report on monetary targets, but I think we ought to recognize that if our long-term objective has to do with prices, there is no way around the fact that inflation is a monetary phenomenon. We have to focus on what is happening with our balance sheet, how that influences money, and how money relates to inflation. There may be implications of a very fundamental nature in terms of how we think about what we do or at least in terms of what we look at in doing it. Finally, I agree with what Al Broaddus said with respect to not tying ourselves strictly to this bill. We need to think about how we can continue to reap benefits from the course that we have been on and what steps we can take to enhance our credibility further. One idea that has been kicked around in this room has to do with longer-run forecasts of inflation. There are things like that that I think would be very helpful in communicating our longer-term intentions even in the absence of a bill like this. The reason I think this is so important, frankly, is that it is very hard to quibble in a general sense with the performance of monetary policy in the 1980s and the 1990s, but in my opinion that has had everything to do with the people around the table and particularly the kind of leadership we have had. It has very little to do with the sort of direction we are given in the institutional structure. I guess I view the latter as a very dangerous situation in terms of the potential for the future. We could revisit the 1960s and the 1970s very easily with a different perspective in terms of leadership and membership.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. In many ways the Mack bill conforms to how we have carried out policy in recent years. So, I see it as legislation that is catching up with the experience and the progress. There are some advantages to the bill. I think it is useful to formally make price stability the primary objective over the long run. The proper way to look at it from my point of view is that price stability is a means to an end, not an end in itself. The ultimate end of all economic policy is higher standards of living and growth and that sort of thing. So, as we explain our role, and I think the Mack bill does this, we need to focus on price stability as the primary objective but as a means to a larger end. I also like the flexibility that the Mack bill gives the FOMC in the pursuit of this longer-term objective. It realistically allows us to take into account short-run factors like

fluctuations in demand, recessions, financial shocks, etc., but the short-run actions need to be anchored in this longer-run objective. In other words, whatever we do in the short run ought to be consistent with this longer-run objective, and I think the Mack bill does give us that latitude. It does open up the question of what the strategy is. It is easier on paper to explain that we are going to move toward stable prices year after year until we get there. In practice, I think we have to take into account the business cycle in getting there. We got ourselves into this inflationary problem cycle to cycle. We have gotten out of it marginally cycle to cycle, taking advantage of cyclical developments. So, as we go forward, if this bill becomes legislation, we need to take into account the cycle-to-cycle progress even though it can be more difficult to explain. So, as a general proposition, I would support the thrust of this proposed legislation.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. This bill came out of the hopper vastly better than I and many other people expected. Nonetheless, I find I can't support it as it is. Let me explain why very briefly because in some sense I can say, "Please read Governor Yellen's remarks into the record a second time." She got to go first, so I'll be very short. I, too, would prefer a much more symmetric treatment, or I guess I should say, in light of what Ed Boehne was just saying, explicit recognition of the stabilization role of monetary policy. There is nothing whatever wrong about the phrase that says the "primary long-term goal" is price stability. In fact, it is one hundred percent right. That is what we do now. It's exactly correct, and I am perfectly happy with that in the law. You might even argue that it is the <u>only</u> long-term goal; I am not sure what else we can do in the long term. But, in the short term, there are other goals. I am worried about the applicability of the "taking account" phrase that Don mentioned, just as Tom Melzer was worried about it--but for the opposite reason. It looks ambiguous to me the way it is dangling in the bill. I would like to see the ambiguity removed, as would Tom, but in the opposite direction.

The reporting accountability aspects, I agree, are a vast improvement over what we have in Humphrey-Hawkins. I don't have any real problem with them except that I would like to point out one thing, which is what Don Kohn pointed out in jest just a while ago. But for me it is not in jest. We have a choice under this bill of reporting to the Banking committees that the answer is "one or two more recessions" or, say, of giving them a 5-year projection in which we have enough slack to put in, depending on the definition of price stability, say 4 point years of unemployment above the natural rate over the next 5 years. Now, if we want to live with that or do that, that's okay. I think that is a debatable proposition. I am not necessarily negative about it, but we ought to realize that, in the court of educated public opinion, we will not be able to get away with an airy-fairy forecast that says that everything will be perfect and, in particular, that full utilization of resources will be maintained as inflation tracks down to zero. We just won't. So, we ought to go into that process with our eyes open.

I think that could be done, and I think almost all the other mandates in the bill could be done. However, the killer provision for

me is the line in there that abolishes the Employment Act of 1946. I am simply unalterably opposed to that; I could never, ever support any bill that has that as a clause.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. In general, I am in favor of this legislation. I think it is the right direction to move for the reasons that a number of people, including Ed Boehne, cited. This will get us toward our largest contribution to economic prosperity over time. Having said that, I would agree--this may seem unusual--with both Tom and Alan. If we start thinking about the implementation issues, they are rather daunting. As Don Kohn mentioned, this would join the issue of whether we really want to achieve price stability in an opportunistic sense or whether we want to go with something like alternative C irrespective of how things stand at the moment. My judgment would be that there would be no escaping those kinds of questions if this legislation were put in place. So, I think that would likely be a very challenging environment. That does not mean that we should not go this route, but I do think some issues that we have been able to finesse in recent years will be joined rather directly if we go down this path.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I am pretty much where Gary Stern was but maybe in terms that are a little different. I certainly support the thrust of this bill unequivocally in that it gives primacy to price stability as a means toward a larger end. But I am not totally comfortable with virtually any hard-wired legislation that I can think of, even with legislation that is as flexible as this bill appears to be. The good news is that it is consistent with what we have been doing, what we foresee we would like to do, and it eliminates the onerous provisions of Humphrey-Hawkins. I am a little concerned that over time, in ways that we can't foresee, we might very well have some combination of economic and possibly political circumstances that could inhibit us in the pursuit of an appropriate monetary policy if this legislation were in place. The alternative would be to get us back into a situation where we might have a law that we would have to ignore as we have ignored certain aspects of the Humphrey-Hawkins law for very good reasons. I think ignoring a law that remains on the books over a long period of time is completely unacceptable, and I would hate to remain in that situation in the context of new legislation.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I support the thrust of this bill and most of the specifics. I agree with the premise on which this bill is based, and that is that by promoting long-term price stability monetary policy supports long-term economic stability as well. So, given that premise and given that belief, I support the bill. I also think that the proposed bill does give us flexibility in terms of the short-term effects of our policy and it gives us room to maneuver generally. I would like to see more specific language that takes into account supply shocks or other factors. One can rationalize doing that with the proposed language, but I would feel more comfortable if those types of shocks were specifically recognized in the legislation to give us a little more wiggle room in terms of policy actions that

we might need to take in the short term. But otherwise I do support the thrust of this bill very much.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. Well, like everyone else I think that the idea that price stability ought to be the long-term goal of the central bank is completely consistent with the contributions a central bank can make to economic growth over the longer run. But the autopilot aspects of this legislation really worry me. It may be that some of the language will permit us to finesse all of that, and the bill certainly would allow us to set the details rather than have written in law that we must report on a set of data that seems to be important at one point in time but may not be at another. I think it is quite helpful to have some options in terms of the details in achieving this longer-run goal. But I have some concerns on the opposite side from Tom Melzer. Frankly, I think we have done a good job over the 1980s and the 1990s precisely because the institutional setup has allowed people of some wisdom, arguably less or even more from time to time, to take the right actions given a variety of circumstances that were impossible to know or to forecast at the beginning of the 1980s. The idea of single-mindedly approaching something through several business cycles in a way that has some autopilot aspects to it gives me concern. It may be that the language allows more flexibility than that and the reality will be less onerous than that, but it really concerns me.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I have felt for a long time that Humphrey-Hawkins was outdated and needed to be revised, and I expressed that opinion in this Committee several times. I think this bill is a vast improvement over Humphrey-Hawkins, but I have some of the same concerns that were expressed by a number of people, notably Governor Blinder and Governor Yellen. Clearly, the responsibility and the objective of a central bank in the long term should be price stability. But this bill does not emphasize the other aspects of the central bank's responsibility, namely economic stabilization, to the extent that I would like. To the degree that this bill is codifying what we have been doing, I ask the basic question: Why do we need it? I just don't think this kind of thing should be enshrined in legislation. I am a little concerned about the view that the language can be finessed. That is not what we ought to be doing with the statutory language. We should not be in that kind of position. The Committee has been operating for several years toward the goal of price stability, and I think any Committee group, however it is constituted, would have the same goal. Again, I come back to the fundamental threshold question I have had from the beginning: Why have the bill at all?

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Mr. Chairman, we currently seem to have the luxury of a great deal of flexibility because the goals established for the Committee are ambiguous and in some cases contradictory. But I think we are moving past that point. Once this issue is raised to the level of a serious discussion with hearings and so on, we are going to have to change. We have been in the process of becoming much

more accountable in terms of the announcements that we make after each meeting, in terms of the publication of the transcripts, and our more open disclosure process generally, and I support all of those things. But the world clearly is changing, and there is increasing pressure on us to clarify our longer-term objectives. So, I support the thrust of this bill, although I have one major caveat. I like the fact that it repeals the Humphrey-Hawkins bill. My reaction at the time it was enacted was that members of Congress voted for it mostly because of emotional ties to Hubert Humphrey, not because they really supported what the bill actually said. I like the emphasis on price stability. I think it is clearly, as Governor Blinder said, our primary objective and where we have the most impact. I like the flexibility that the bill would give us. If we go down this road, I think it is written about as well as we could expect it to be written. It can provide a major public education role for us as well, an opportunity for us to educate the public. In that respect, I think it will have a useful side benefit.

The caveat is the repeal of the Employment Act of 1946. I must confess that I haven't reread the Act, and I have to go back and reread it now since Governor Yellen raised this as a point. But in general I support the thrust of the Mack bill.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I am not sure this issue is ready for prime time. Certainly, the intent of Senator Mack and his co-sponsors is the very desirable goal of clarifying the role of economic policy and especially the role of monetary policy. But it is not obvious to me that that is going to be the outcome of the hearings process. Two years after we ended Bretton Woods in 1973, people went to instrument monitoring--monetary growth targeting--as a sort of interim device to try to set the boundaries for what economic policy, monetary policy in particular, was supposed to do. I think that approach has certainly run its course, and it is time to move on to objective monitoring--to set an objective and initiate a process of oversight to see how well we do in achieving the objective.

Listening to some of this discussion, however, just enhances my concerns about what will happen in the hearings. We will have a lot of very well respected, well-known academic, Wall Street, and other private-sector economists appearing before the Congressional committees. And instead of educating the members of the Senate and the House--and through them maybe the American public a little--about the contribution that a stable currency can make toward the full employment goal of the Employment Act of 1946, they will speak mostly about the notion that stabilizing the value of the currency depends on maintaining a minimum army of unemployed, or maintaining slack, or holding growth below some notion of potential. As I read the legislation, I think it does not repeal the full employment goal of the Employment Act of 1946; in fact, the Mack bill clarifies that goal in very clear terms. It says in Section 2, Paragraph 8, that price stability is a key condition to maintaining the highest possible levels of productivity, real incomes, living standards, employment, and global competitiveness. Under the statement of policy, the bill says that an environment conducive to both long-term economic growth and increases in standards of living is fostered by establishing and maintaining free markets, low taxes, respect for private property, and

the stable long-term purchasing power of the currency. So, I think that the intent of the legislative wording is that the contribution of monetary policy toward achieving the goals originally set out in the Employment Act almost fifty years ago is to stabilize the value of the currency. I simply am afraid that that is not what people would be hearing from a lot of our colleagues in the economics profession because they have a different model in mind.

CHAIRMAN GREENSPAN. Governor Blinder and then Don Winn.

MR. BLINDER. To clarify what I said, if you read the fine print, there is a section in the bill that calls for the repeal of outmoded or obsolete provisions, or something like that. One of them is Section 2 of the Employment Act. That's why I said what I said.

MR. WINN. I spoke with one of Senator Mack's staff yesterday afternoon with respect to the hearings schedule, asking what the likelihood was. I got no specific answer to that question. But in the course of the conversation, I did bring up this issue with him as to what their intent was in terms of the Employment Act of 1946. Had they intended to wipe out the employment objectives of the Employment Act? The impression I got was they had not realized that they had eliminated the "maximum employment" objectives of the 1946 Act. Their response was that they had intended to repeal Humphrey-Hawkins and the various aspects of the Humphrey-Hawkins Act that amend the Employment Act of 1946 as well as the Congressional Budget Act; they had intended to take out those pieces from the Employment Act of 1946. On the other hand, they also said that they had substituted new policy objective language, which I think is on the bottom of page 3 in the copy of the bill that I circulated. I mentioned to them that there was no reference to employment in that provision, which relates to the objective of price stability, and it appeared that they had not realized that. They seemed to indicate that that had been an oversight on their part. There is some indication that they would be willing to make some changes. Of course, I was speaking with only one staff person; I don't know how representative that conversation was of the views on the Hill.

By the way, on the hearings issue, they really have not planned what they are going to do next. They could have more hearings in the Joint Economic Committee or in the Senate Banking Committee; the timing really has not been decided. I asked if there is a likelihood of a hearing before the end of the year. They said there is a distinct possibility of that.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. I support the Mack Bill.

CHAIRMAN GREENSPAN. Vice Chairman McDonough.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, I think the single most important thing about the bill as proposed is probably that it repeals Humphrey-Hawkins. I, like Governor Kelley, am very opposed to having statutes on the books that we are supposed to be following and that we cannot follow. I think that maintaining such legislation creates something of a contempt for law in society, which is very counterproductive. I believe that long-term price stability is the

appropriate goal of monetary policy. But monetary policy with long-term price stability as a goal is really a means to achieve an end, which is maximum sustained economic growth and maximum creation of employment. I know that I have on occasion caused some eyes to cloud over when I have expressed the view that the reasons for that are at least as strongly social and political as they are economic. I think a democratic society is not stable by its very nature, but rather that it can be made stable if the people in the country feel that they really have a reasonable opportunity for a better life ahead. We need sustained economic growth to do that. Therefore, price stability is a wonderful thing, but as a means to an end, not an end in itself.

It follows that I do not have any particular interest in associating myself, nor do I think we should associate the Federal Reserve, with the hair-shirt school of price stability--namely, that price stability is such a wonderful thing that we should achieve it at whatever the cost to society. I share President Jordan's concern about some of the nonsense that one could hear at committee hearings from people who do believe that, and I would be worried about the effect that they could have on the general societal view of what monetary policy is all about, since I think that would get the more exciting headlines. I think that the best legislation would say that the goal is to achieve price stability and would leave the definition of price stability up to the central bank. It would not ask the central bank to define price stability numerically from time to time. I think we would have great difficulty in doing that in a reasonable way and still have the flexibility that we need to deal with the business cycle and with external shocks. It also would create an absolute zoo for the people who are of the hair-shirt school to appear not just once while the bill was being considered, but semiannually. It is likely that after the Chairman concluded his testimony, he would be followed by a group of learned types whose opinions on whether their view of the numerical goal for inflation was better than our view of the numerical goal would be given almost equal weight at least by some members of the Banking committees. I think that would be a terrible contribution to public policy.

So, I am in favor of the bill, but I would like the bill to make it even more clear, although it does make it reasonably clear, that price stability is a means to an end. I don't like the requirement that the Federal Reserve establish moving numerical goals for the level of prices. I also would want to improve the language to make it clear that the Federal Reserve does include twelve Federal Reserve Banks and that the boards of those Banks have a role to play in the formulation of monetary policy.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I generally support the thrust of the bill. I think that it is useful to clear out some of the clutter in the current Humphrey-Hawkins Act. One of the major positives of the bill is the clear focus on price stability and the purchasing power of our currency. But I, too, would like to see a recognition that this focus is not inconsistent with economic growth. In fact, this is how monetary policy specifically can contribute to economic growth. I like the at least perceived flexibility that is in the bill in terms of calling upon us to develop definitions and to construct the required reports. I think a great deal of work would need to be done

on our part to figure out how we would want to structure these reports. Perhaps we should give some thought as to how much clarification we want up front or how loose we want to make it. I, like others, am concerned about this question as to how tightly we would be wired to price stability at all costs and whether we would have the flexibility to make adjustments to business cycles and supply shocks. I do support the thrust of the bill, but I hope that we can preserve a good deal of flexibility to manage policy depending on the circumstances.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Everyone here dislikes Humphrey-Hawkins--good riddance--and we basically like long-term price stability. What we also don't like is having legislation defining what we should do. Frankly, I think the crux of the issue comes back to that. We could wish that the Congress of the United States, which created this institution, would stay away and not give us instructions. That's not going to happen. Given that's not going to happen, we are going to get legislation telling us what to do. What is that legislation going to say? At worst it produces some horror like Humphrey-Hawkins; at best it produces something like the bill we have before us. It is not ideal.

The key here is that we get to define and redefine what is meant by price stability. For example, one issue is the time period over which we are measuring prices. Questions have been raised about supply shocks, and I agree that is a concern. Do we mean that the CPI has to be reported at 0.0 every month? Certainly not. Or even 0.0 in a year? Certainly not. The goal is long-term price stability. The other issue is what price measure do we use. Here I am going to go back to the misfortune that a good Virginia boy like me had in the First District. We had something called the Massachusetts miracle. Now, I bet that the CPI for Massachusetts, if we had such a thing, was not much different from the national CPI and was pretty stable. But everyone knew the New England economy wasn't stable; we had a bubble going on. In retrospect, that's obvious. I don't know why our definition of price stability in the report would not include sectoral monitoring. If we observe bubbles occurring in the economy we know that they are destabilizing, no matter what the price level might be, and ultimately inconsistent with long-term price stability. I really don't see how our hands are being tied. If we are allowed to define and redefine what we mean by price stability, what measure we are looking at, and over what time horizon we are focusing--and given that Congress will not go away--I think we have gotten the best deal that we can get.

CHAIRMAN GREENSPAN. Okay. Don Winn, did you want to say anything further on this that you haven't communicated already?

MR. WINN. You made the point earlier that in terms of support for this legislation it appears that all of the majority members of the Senate Banking Committee and the JEC seem to have lined up behind this bill. A committee staffer told me that after yesterday they also have as sponsors the Chairman of the Senate Finance Committee, the Chairman of the Senate Budget Committee, and all of the members of the Senate Republican leadership. So, at least in terms of support on one side of the aisle, they feel that they have key members

of the Senate supporting the legislation. Now, obviously the detail of the sponsors' knowledge of this bill is something that has to be considered. But in terms of an initial push for this legislation, Senator Mack and his staff are quite pleased by the response they have gotten so far.

MR. PARRY. Have you had any input from the Administration recently?

MR. WINN. We have not heard anything.

CHAIRMAN GREENSPAN. I don't think you will unless it looks as though it is a bill that has legs.

MR. WINN. There clearly will be opposition from some important Senators on the Democratic side. Senator Sarbanes probably will not be supportive of this legislation.

MR. KOHN. Mr. Chairman, I think that Governor Lindsey raised an important point in his last comments on the issue of flexibility. When Don Winn and I have talked to Hill staffers and asked them about this issue, one of the major points they make is that the Fed is defining price stability and defining the conditions under which you are getting there. Certainly, they would expect you to tell them if there is an adverse supply shock, so that getting there might be delayed. They viewed the provisions cited by Governor Lindsey as affording us flexibility. When I asked about the sentence, "the Committee shall take into account the potential short-term effects" and what it was meant to apply to, I was told that it was pretty much deliberately ambiguous. They were trying to cut between certain factions that they were dealing with. They could see that the literal wording did not apply just to the transition period, but the sentence still could be read as applying to the transition period because of where it was in the bill. I think their view was that the Federal Reserve would have quite a bit of flexibility under this legislation, although they admitted that wasn't unambiguous.

MS. MINEHAN. That is the concern that I had. If you read the language in that paragraph absent the comments of the Congressional staffers, you do get the sense that we have this one-time transition period during which we could take these factors into account. After that, it is like a cruising 747; we don't touch the controls. Isn't that kind of language something totally unrealistic and unresponsive to the success that we have had over the last 10 or 15 years? It is hard to understand, given the success that almost everyone thinks that monetary policy has achieved, why we need this now.

MR. LINDSEY. I think that may be spelled out in the report language. A bill has to be short and understandable.

MS. MINEHAN. I am not suggesting that this one is not understandable in terms of its long-run intent.

MR. LINDSEY. I don't think clarifying it in the legislation is the way to go. The ambiguity is best left to the report language.

MR. BOEHNE. Ambiguity is necessary for flexibility.

MS. MINEHAN. That's true, but this bill seems to have less ambiguity in the sense of that paragraph really referring to the transition period.

MR. BOEHNE. I must say that I didn't read it that way. I read it that we had flexibility during the transition and that we had flexibility thereafter.

SPEAKER(?). I agree.

MR. KELLEY. If flexibility is the objective, then ultimate flexibility would be not to have any legislation at all.

SPEAKER(?). That will never happen!

CHAIRMAN GREENSPAN. It is getting quite late. [Laughter] Why don't we adjourn this meeting? If you want to have an informal discussion later today on these issues after Don Winn brings us up to date on overall legislative developments, we can do that. I think this has been a very useful presentation by all of you. It clearly suggests to me the sort of language we can put together for the hearing should such a hearing take place. Obviously, the draft testimony will be circulated to you in advance. Finally, let me just say that our next meeting is Wednesday, November 15th. It promises to be an exciting meeting not because of what we will do but because of what other people will do at that time.

MR. BOEHNE. The ides of November. [Laughter]

END OF MEETING