

Meeting of the Federal Open Market Committee
May 15, 2001

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, May 15, 2001, starting at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Ferguson
Mr. Gramlich
Mr. Hoenig
Mr. Kelley
Mr. Meyer
Ms. Minehan
Mr. Moskow
Mr. Poole

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

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

Mr. Kohn, Secretary and Economist
Ms. Fox, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Ms. Cumming, Messrs. Fuhrer, Hakkio, Howard, Lindsey, Rasche,
Reinhart, Slifman, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

Mr. Etlin, Deputy Director, Division of Research and Statistics,
Board of Governors

Mr. Simpson, Senior Adviser, Division of Research and Statistics,
Board of Governors

Messrs. Connors, ¹ Madigan, Oliner, and Struckmeyer, Associate
Directors, Divisions of International Finance, Monetary
Affairs, Research and Statistics, and Research and Statistics
respectively, Board of Governors

Mr. Whitesell, Assistant Director, Division of Monetary Affairs,
Board of Governors

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

Mr. Kumasaka, Assistant Economist, Division of Monetary Affairs,
Board of Governors

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

Mr. Connolly, First Vice President, Federal Reserve Bank of Boston

Messrs. Beebe, Eisenbeis, and Goodfriend, Mses. Mester and
Perelmuter, Messrs. Rosenblum and Sniderman, Senior Vice
Presidents, Federal Reserve Banks of San Francisco, Atlanta,
Richmond, Philadelphia, New York, Dallas, and Cleveland
respectively

Mr. Sullivan, Vice President, Federal Reserve Bank of Chicago

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

¹/ Attended portion of meeting relating to staff briefings

Transcript of Federal Open Market Committee Meeting of
May 15, 2001

CHAIRMAN GREENSPAN. Would somebody like to move approval of the minutes of the March 20th meeting, which also cover the conference calls of April 11th and 18th ?

VICE CHAIRMAN MCDONOUGH. So move.

CHAIRMAN GREENSPAN. Without objection, they are approved. Dino Kos, you're on.

MR. KOS. Thank you, Mr. Chairman. I will be referring to the charts that were distributed this morning.¹

The top panel of the first page depicts U.S. cash and forward 3-month rates. The cash rate is down about 3/4 of a percentage point since the day before the Committee's intermeeting move on April 18th. The 3-month forward rate has declined a bit less, by about 40 basis points, and the 9-month forward rate is roughly unchanged. The 3-month and cash rates are roughly on top of each other as we speak, and the 9-month forward rate is actually above the cash rate for the first time since last September. Perhaps the market is looking forward to the end of the easing cycle.

Moving to the center panel, cash and forward rates in the euro area have exhibited a saw-toothed pattern, as the market first became convinced that the ECB would ease after the March IFO survey and then reversed its view after the ECB convinced the markets it would not ease. Of course, that was just in time for last week's 25 basis point reduction in the refinancing rate!

The bottom panel reflects the downward pressure on Japanese money market rates across all tenors since the March 19th change in the Bank of Japan's (BOJ) operational target. But it's not just money market rates. The two-year Japanese government bond (JGB) yield is currently yielding 6 basis points.

Moving to the second page, the top panel shows the 2-, 10-, and 30-year U. S. Treasury yields since December 1st as well as the target fed funds rate. The 2-year rate has come down more than 100 basis points while the 30-year has drifted up and the 10-year is roughly unchanged. That has led to a steepening of the yield curve on the one hand, and also to a situation where

^{1/} Copies of the charts are appended to this transcript.

the 10- and 30-year yields are above the target fed funds rate for the first time since May of 2000.

The chart in the bottom panel depicts the fact that this is not just a Treasury yield curve phenomenon. The U.S. swap curve has steepened substantially as well since last December, as have the U.K. and Canadian yield curves, although by a lesser amount. The euro-area swap curve has remained more or less unchanged, although it also has steepened in the last day or two.

Moving to the third page and taking a somewhat longer-term perspective, I have shown the 2- to 30-year spread from January of 1989 through March 11th of this year. The shaded areas represent periods when the Fed was easing policy. The sharp steepening of the curve from about -50 to +150 basis points in the last few months has put the curve at its steepest since January of 1994. As the bottom panel shows, despite that steepening and the backup in yields, the absolute level of 10- and 30-year yields is only slightly above the cyclical low, which was reached in 1998.

The chart at the top of page four shows domestic credit spreads to U.S. Treasuries of comparable maturities. The red line is the Merrill Lynch high-yield spread, which is on the left-hand scale. The A2 industrial corporates, the U.S. 10-year interest rate swap, and the 10-year Fannie Mae benchmark are on the right-hand scale. In general, spreads have been narrowing since January 1st, although high-yield spreads are still wider than they were last summer, perhaps affected by the weak equity market and the higher risk premium that companies with more leveraged balance sheets are being charged. Nevertheless, issuance remained strong in the first quarter, especially in the investment grade sector.

The bottom panel shows the spread between A1/P1 and A2/P2 paper, which has been drifting lower for both 30-day and 90-day issues. In part, that may reflect a bit less risk aversion. But it may also reflect in part the fact that some of the weaker A2 borrowers are having trouble rolling over their commercial paper and have drawn on other sources of credit, such as backup credit lines. Or more likely they have issued high-yield debt, a vehicle that has remained open for many of these borrowers.

Turning to the next page, I thought I would provide a quick review of the tax season, now that it's mostly behind us. In the top panel, the blue bars show the growth of tax receipts for the last three tax seasons--that is, for April and May. The red bar is the forecast for the current year, which is inclusive of actual data through May 11th and thus actually reflects most of the period. The growth this year has been a bit slower than last year, but it is slightly above what we saw in 1999.

In the bottom panel, the red line depicts the Treasury's general balance between April 2nd and May 11th of this year. The Treasury's general balance topped out at about \$70 billion in early May, but it remained comfortably below TT&L capacity. Therefore, we were able to avoid the large reserve drains and the associated buildup in the Treasury's Fed balance that had become the norm in the last few years. In fact, we looked back at historical data and found that this was the first time in at least 15 years that the general balance did not exceed the TT&L capacity and therefore spill over onto the Fed. There were two reasons for this. One was that the Treasury made more efficient use of cash management bills; secondly, the Treasury and the St. Louis Fed successfully campaigned with banks to bring additional collateral into the TT&L program and thus raise capacity.

Finally, on the last page I thought I would give the Committee a quick update on our outright operations. It has been almost a year since we established single-issue limits for SOMA holdings. And as the top panel shows, we've had an increase in our outright operations. The blue portions of the bars represent net portfolio expansion. The gray portions represent the amount that has been purchased to offset the effects of redeemed securities. As you can see, before 2000 redemptions were relatively infrequent. But with the sharp reduction of the size of auctions combined with our single-issue limits, SOMA is having redemptions basically every month. In 2000 and in 2001 to date, as well as in our projection for the rest of the year, more than 50 percent of our outright purchases are to offset the effects of redemptions.

The bottom panel depicts the number of outright operations that our Desk has conducted since 1996. We are now operating on nearly one out of every three business days. Performance is holding up; the bid-to-cover ratio on our operations has stayed at 6 or higher. But the scale of the Desk's activity is growing at a time when the size of the market is shrinking, and that is placing somewhat of a burden on our outright operations. We will be looking in coming weeks at ways we can ease that pressure on our outright operations, with one of the most likely ways being the expanded use of long-term repos. For the time being we're planning to maintain the size of the repo book at \$12 billion but we will be examining the scope for expanding that, and I will report back to the Committee after we conclude our analysis.

Mr. Chairman, there were no foreign exchange operations in the intermeeting period. I will need a vote to ratify domestic operations, and I will be glad to take any questions.

CHAIRMAN GREENSPAN. Questions for Dino?

MR. PARRY. Mr. Chairman?

CHAIRMAN GREENSPAN. Yes.

MR. PARRY. This is a question for Dino or for Don Kohn. As shown on page 2 of Dino's handout, the yields on 10-year and 30-year Treasury bonds actually hit a low point at roughly the time of the March FOMC meeting and, of course, have moved up since then. It's rather interesting that since that time in March the Greenbook forecast--and also I think most private forecasts--has become a little more pessimistic about the economy's prospects, at least for the shorter term. Does this mean that the movement in rates is really due to a reevaluation of longer-run expectations for inflation?

MR. KOS. Especially recently, with the steepening of the yield curve, there has been chatter in the markets about that as a possible explanation. I don't know that forecasts of inflation are actually rising. At least in my reading of the research and commentary, I haven't seen that people are raising their expectations for inflation. But it may be that they're using that explanation to explain a steepening of the yield curve that they otherwise can't quite explain.

MR. PARRY. Well, usually there are two reasons. Your answer implied one, which is that the decline in the funds rate raises the prospects that the economy will recover. And the other is the possibility that inflation could become more of a concern.

CHAIRMAN GREENSPAN. There is a third, which may in fact be relevant here. Since our March meeting, if one listens to the discussions coming out of Treasury and the White House, the presumption of eliminating the Treasury debt is becoming less vocal and more attenuated. Hence, the reduction in yields attributable to a scarcity premium is very clearly changed. That doesn't eliminate the possibility of increased inflation premiums. Indeed, we see some of that in the TIPS yields.

MR. PARRY. Right.

CHAIRMAN GREENSPAN. There may be more involved in that issue than we know.

MR. KOHN. I think there has been an interesting disparity over the intermeeting period between the views of the markets and the views of economists. The markets seem to have become more optimistic about where the economy is going and its potential for recovery, whereas the economists--not just the economists in this building, but those on Wall Street as well--have become a little less optimistic. The market has built in a bottom for the federal funds rate of somewhere between 3.75 and 4 percent. The market participants are not even sure that you'll need to do the extra 25 basis points and move to 3.75 percent, should you do 50 basis points today. But if one looks at the forecasts of economists, many of them have the funds rate going down to at least 3.75 percent; very few see the FOMC stopping at 4 percent. There are many at 3.75, many at 3.50, and some as low as 3 percent. I think this difference between market participants and economists has opened up quite a bit over the intermeeting period. I believe the market view has been encouraged to a certain extent by the earnings reports of businesses, which at least were not worse than the downward revised expectations they already had built in. They've reacted a little, as you saw last Friday, to what they viewed as positive news on sales and consumer confidence. So they seem to be looking for the plus side of the news for a change instead of the minus side, and they've raised their estimate of the low for the funds rate. I think the rise in rates reflects both real factors and inflation expectations, and that would be perfectly consistent if the economy is going to be stronger. Particularly if you look at the TIPS spreads, markets had built in a decline in inflation when they were especially gloomy about economic prospects, and they've taken that decline out. I'm not sure they really are expecting inflation to rise from here, but I think they've taken out what they previously saw as good odds on a decline.

CHAIRMAN GREENSPAN. Remember, there was a bulge in the spread against the staff's off-the-run synthetic yield measure in April of last year and it then came all the way down.

MR. KOHN. Right.

CHAIRMAN GREENSPAN. We're just back to where it was.

MR. PARRY. Of course, the Greenbook forecast would suggest that the price pressures, if anything, are likely to be a little less.

MR. KOHN. Right, but that's part of that disparity we're talking about.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. Further questions for Dino? If not, Vice Chair.

VICE CHAIRMAN MCDONOUGH. Move approval of the domestic operations, Mr. Chairman.

CHAIRMAN GREENSPAN. Thank you. Without objection, they are approved. Dave Stockton and Karen Johnson, you're on.

SEVERAL. We need another motion.

MR. KOHN. We have one more issue to consider--currency swaps.

CHAIRMAN GREENSPAN. Oh, I beg your pardon. Not that I wish to get beyond that issue! [Laughter]

VICE CHAIRMAN MCDONOUGH. A little psychology here.

CHAIRMAN GREENSPAN. Well, if we move fast enough, maybe nobody will notice! [Laughter]

VICE CHAIRMAN MCDONOUGH. Unfortunately, we need a motion!

CHAIRMAN GREENSPAN. Sorry about that. Dino, why don't you explain the issue?

MR. KOS. Thank you. I'll try to be quick. I circulated a memo late last week with some housekeeping items relating to our foreign currency reserves. Two items were for information. One item--the renewal of our swap lines with Canada and Mexico--requires action by the Committee. I think everybody will remember that all of the other swap lines that we had with the European central banks, the Bank of Japan, and the Bank for International Settlements were discontinued coincident with the launch of the euro. The two that were retained were with our NAFTA partners, Canada and Mexico.

With the change in Administration, Karen Johnson and I initiated conversations with Treasury officials to ask them about their view of the swaps and the utility they saw in the swaps. They were very open to the idea of having discussions with their counterparts in Mexico and Canada to see whether they could perhaps be cajoled into viewing the swaps in the same way that many people here and some at the Treasury do--namely, that perhaps they have outlived their usefulness. The Mexicans in particular have some difficulties with ending the swaps this year, although in principle they were open to the idea that the day may soon come when the swap arrangements are no longer needed. The Canadians are still having some internal discussions about the swap issue, but I think there's a good chance that they may come around to that view as well. So it seems that some more discussion is needed until everybody agrees. I think we may be close, with "close" measured in months rather than weeks. So we may be there soon. Karen, do you want to add anything?

MS. JOHNSON. Yes. I think your comments summarized the situation. I would just add that the Mexicans want the ending of these swaps to be part of a series of actions they are

planning, having to do with some internal reforms they're attempting. Their hope is to get a CCL relationship established with the IMF, which would be a very logical and natural point to end the swaps with us rather than have their demise hit the markets out of the blue as an isolated event. The Mexicans are not yet at that point, but we're agreed that that is where they are headed and, hopefully, they will get there fairly soon.

We don't have a firm commitment from either the Mexicans or the Canadians on discontinuing the swaps. So in some sense it's not a done deal. But there's a shared objective. I think it's simply a question of getting it done as opposed to trying to persuade them to do something that they fundamentally don't want to do.

CHAIRMAN GREENSPAN. Yes. In my conversations with the Mexicans, I was not surprised at their position. Indeed, it's fairly clear that they're willing, though obviously reluctantly, to unwind this. And they understand where we're coming from. I found the Canadian position really a surprise, given their floating exchange rate--

MS. JOHNSON. I think it differs among the various people involved in the Canadian situation.

VICE CHAIRMAN MCDONOUGH. Absolutely.

CHAIRMAN GREENSPAN. Well, I have not had a chance to speak to Paul Martin on this, but I cannot imagine that he would resist this. They don't have a fixed exchange rate. They don't have a need for very large interventions that they can't support. So the logic of retaining the swaps just seems to be utterly missing.

MS. JOHNSON. Well, from the point of view of those in the central bank who were described to me as having at least paused when this was suggested, the swap could be a useful

instrument. If they never used it, that was fine. But the view was: Why give it away if they don't have to?

VICE CHAIRMAN MCDONOUGH. And there's the change of central bank governor. This issue has come up at a time when he's adjusting to his new job and I think he doesn't want to change anything right now.

CHAIRMAN GREENSPAN. He's dodging all bullets. [Laughter]

MS. JOHNSON. I wouldn't lay it at his feet. As I understood it, the hesitation came more from the operational people--those who carry out policy--rather than those who make policy.

VICE CHAIRMAN MCDONOUGH. Right.

MS. JOHNSON. They see the swaps as an extra source of funds they can use if they ever want to, so why give that up? I don't believe there's really any thoughtful resistance.

CHAIRMAN GREENSPAN. It's just not credible. You may recall that when this issue came up a year ago, we indicated that with a new Administration we'd have to get it readdressed because the old Administration raised obstacles in certain regards. As far as I can judge, the Treasury has been very much engaged with us on this and I think we will finally put it behind us. And I won't have to dodge another item on the agenda!

VICE CHAIRMAN MCDONOUGH. So even though there is no great ideological purity in our position, but rather a need to renew these swaps for another year while the negotiations take place, we do have to approve them again.

CHAIRMAN GREENSPAN. Yes. Any comments, questions, or concerns that anybody wishes to raise?

MR. BROADDUS. I just want to get some sense of the time frame we're talking about. You said it would take several months. Can we anticipate--it's such a wonderful opportunity and I'd hate to see us--

MR. KOS. I don't want to make a forecast. In part it may depend on how quickly the Mexicans can negotiate a CCL with the IMF, and that's very difficult to judge. The Canadians need to have their own discussion. So again, I wouldn't make a forecast in terms of weeks; I think it may take longer than that. But I believe we all three--ourselves, the Canadians, and the Mexicans--are on the same plane in that the time has come or will soon come to end the swaps.

VICE CHAIRMAN MCDONOUGH. The Mexicans have to get a fiscal reform through their congress, and that has been slowed down a bit. I think they are still likely to get that done, but they certainly would not want to move on this as an isolated event until that happens.

CHAIRMAN GREENSPAN. Okay, would somebody like to move renewal of the reciprocal currency arrangements?

VICE CHAIRMAN MCDONOUGH. So move, Mr. Chairman.

CHAIRMAN GREENSPAN. Are there objections? Hearing none, I will assume it's by acclamation, though not exactly. Now we turn to Dave Stockton and Karen Johnson.

MR. STOCKTON. Thank you, Mr. Chairman. In reading our discussion in the Greenbook of the multiple sources of revisions to our projection this round, you might have sensed a desire on our part for you, as policymakers, to share our pain, as economic forecasters. We did, indeed, have to cope with many significant developments of consequence for our projection: a heavy flow of data releases, crosscurrents in financial markets, changes in monetary and fiscal policy settings, and new information bearing on our estimate of structural productivity growth. Rather than inflict that discussion on you again, I thought I would simplify and focus my remarks this morning on two principal messages. First, we believe that the economy, at present, is very weak--not in recession, but not far from it either. And second, in both current

economic developments and policy actions, we see the seeds from which an economic rebound could emerge later this year or in 2002.

As has been the case since last fall, the most intense weakness remains centered in the factory sector. Yesterday, we published IP, which showed another 1/4 percent fall in manufacturing output in April. That drop comes on the heels of some hefty downward revisions to previous months that now show output as having declined 7-3/4 percent at an annual rate in the first quarter. Despite sizable reductions in production and, in some cases, outright liquidations of inventories, many manufacturers still find themselves with stocks that are too high relative to the recent pace of sales. Even the automakers, who had managed to make substantial progress in bringing stocks into better alignment with sales, seem to be backsliding a bit, especially with respect to light trucks. In the technology sector, producers of computers, communications equipment, and semiconductors have been slashing production, but soft demand and excessive inventories continue to be a problem. Whereas we had earlier anticipated that the production adjustment in manufacturing would be complete by midyear, our current projection does not anticipate an upturn until the fall.

While the weakness may be centered in manufacturing, there are now signs in the labor market that we may be seeing some spillover to the broader economy. The drop in private payroll employment of 261,000 in April was still heavily concentrated in goods-related sectors. However, the services industry also experienced a drop last month, even abstracting from the decline in temporary-help employment, much of which is supplied to the factory sector. As the growth of real output shifted down after the middle of last year, employers moved quickly to curtail hours by cutting workweeks. With the period of sub-par performance proving to be more persistent than many initially thought, firms now appear more willing to shed workers.

To be sure, we think the April figure overstates the degree of weakness in labor markets. Seasonal adjustment difficulties, especially in construction, may have been a factor. But most of the labor market indicators that we look at have softened appreciably in recent months. Survey measures indicate that households perceive a deterioration in labor market conditions, and employers report fewer difficulties finding qualified workers. In addition, help-wanted advertising has plunged in recent months. Our most timely indicator, initial claims, has averaged more than 400,000 in recent weeks, a level that we estimate would be consistent with ongoing declines in payroll employment. The unemployment rate, at 4.5 percent, already has moved up more than 1/2 percentage point, and unless the economy reaccelerates much more rapidly than we, or virtually anyone else anticipates, it is difficult to envision how the jobless rate will not move higher in coming months.

With labor income weakening, consumer sentiment still down noticeably, and, by our estimates, the wealth effect likely to be exerting considerable restraint, we are projecting only a meager gain in consumer spending this quarter. We were not impressed by last Friday's report on retail sales. The 0.7 percent gain in the retail control category was likely inflated by a steep rise in gasoline prices, and there were some large downward revisions to the estimates of previous months. All told, real spending in this category in April was a bit below the first-quarter average and consistent with our projection. Moreover, after last quarter's surge, motor vehicle sales softened in April and early May. Even services consumption has slowed of late, and we expect only small gains, on average, over the next few months.

The biggest surprise to us on the spending side over the intermeeting period was the weakness in capital spending. The "high-tech recession" that we had highlighted as a risk in our March projection is now our baseline forecast. Orders for nondefense capital goods fell virtually across the board in February and March, and shipments of these goods were also down, on net, over the two months. As a result, we now expect real E&S spending to decline again this quarter. The bulk of the markdown in our forecast was in high-tech spending, but we also deepened and extended the declines we are expecting for spending on other types of capital equipment. These series are so volatile that even two months of data form a shaky basis for a significant revision in the forecast. But other readings on investment demand paint a similar picture. The purchasing managers in their semiannual survey reported a substantial downward revision in planned investment spending by manufacturers, and anecdotes on capital spending, especially for high-tech equipment, remain downbeat. In the end, we believe the downward revision that we have made to investment spending better balances the risks to the projection.

Putting all of the pieces together, we now anticipate that the current period of weakness will extend through the third quarter. However, there are several reasons for anticipating a pickup in the pace of activity later this year.

For one, inventory dynamics are likely to support an acceleration of production at some point in the next few quarters. While many industries are struggling with bloated inventories, the evidence suggests that production cuts have been large enough to produce an outright liquidation of stocks in recent months. Inventory liquidations are self-limiting, and at some point, the level of output will move back closer to that of sales, providing a lift to production and employment with further positive feedback to sales. We expect this dynamic to be shifting in a favorable direction in the second half of the year, though that pattern is a bit difficult to discern in our projection because of the drawdown of inventories that we projected to accompany a tax-induced surge of sales in the fourth quarter.

And that brings me to our fiscal outlook--another positive for growth. I'm not sure I can recall an element of our forecast going off track as quickly as the fiscal policy assumptions that we incorporated in this Greenbook. Recognizing the uncertainties, we waited as long as we could in the process and then took our best shot. Unfortunately, our elegantly constructed fiscal program had a half life of about 36 hours. As you know from reading the Greenbook, we coupled a more generous permanent tax cut than we had previously assumed with the introduction of a sizable tax rebate to be delivered later this year; such a package is consistent with the budget resolution.

Although the uncertainty is still far from resolved, developments immediately subsequent to the Greenbook suggest that political sentiment may be shifting toward a larger permanent tax cut and no temporary rebate. If something like the plan introduced by Senators Grassley and Baucus last week were implemented, instead of a program that employs tax rebates, the consequences for our projection would be more one of timing than magnitude. We would likely trim growth of real GDP a bit in 2001 and boost it by a similar amount in 2002. But the point to be stressed is that, regardless of which approach is finally adopted, fiscal policy is likely to be more stimulative than we had incorporated in our March forecast, and it almost certainly will provide a noticeable boost to activity going forward.

The same is true for monetary policy. To be sure, the strength of the dollar and the weakness in stock prices have likely acted to offset some of the stimulus that you might have expected from your actions this year. Of course, it is precisely these kinds of developments that cause policy lags to be long and variable. While one needs to be cautious about interpreting the calculations of the equilibrium real interest rate that were displayed in the Bluebook, I think it's fair to say that with the additional ease we have assumed, the funds rate is likely to be in territory that implies a considerable stimulus to economic activity over time. One already can identify some of the channels through which easier policy is setting the stage for a pickup in activity. Businesses and households, for example, are taking advantage of lower rates to shore up balance sheets, and any softening in construction and spending on durable goods has been limited by the drop in interest rates. As overhangs of inventories and capital goods are worked off, a favorable cost of capital can be expected to encourage a rebound in these forms of capital spending.

The magnitude of the reacceleration in real GDP will depend importantly on the course of technical progress and structural productivity. In that regard, we are still anticipating that ongoing improvements in structural productivity will support a return to more vigorous growth in household and business demands. That said, we have reduced our forecast for structural productivity this round. In part, we were responding to the smaller

contribution from capital deepening implicit in our lower trajectory for business investment. But we also took on board the smaller gains in multifactor productivity apparent in the recently published data for 1996 to 1999. This supply-side revision to our forecast affects aggregate demand relatively promptly through a reduction in expected growth of household and business incomes.

The reduced pace of structural productivity also underlies the upward revision that we have made to our inflation forecast. In essence, the increases in nominal compensation that we are projecting imply more price pressure than we had previously forecast. In that regard, the incoming data on wages and prices have just about uniformly been to the high side of our expectations. The quarterly figures can be noisy, and we have not read these data as signaling a marked deterioration in the performance of inflation. But the recent data suggest some upside risks to the inflation projection. We still expect that inflation will slow between this year and next, as resource utilization loosens up and energy prices retreat. But the level of inflation is a bit higher throughout the projection period than in our previous forecast.

The risks around our baseline projection remain large, but they seem to us to be reasonably well balanced. We highlighted a number of these risks in the Greenbook; I'd just like to mention two. On the up side, final demands may not be as weak as we are projecting. If that is the case, then more significant progress is being made on the inventory front, and the positive inventory dynamics that I laid out before could lead to a sharper snapback in activity not that far in the future. Coupled with the stimulus we are expecting to show through from monetary and fiscal policy, a more rapid recovery of demand could provide quite a kick to activity next year. This type of outlook would seem to be consistent with market expectations of substantial tightening of policy over the course of 2002.

On the down side, if the substantial near-term cuts in payroll employment and the accompanying rise in the unemployment rate come to pass, consumers may finally throw in the towel. The "delicate balance," as we called it in the Greenbook, may not hold. A significant retrenchment in household spending would feed back to an already weak business sector and could significantly prolong the period of below-trend growth or possibly push the economy into recession.

While the risks remain considerable, I would like to conclude with a pitch for the general thrust of the Greenbook--that is, a period of small increases in real output without a true cyclical downturn. The economy has already absorbed several blows over the past year that have not yet triggered recession, among them: a large downturn in the stock market, a

run-up in energy prices, a pronounced inventory correction in the manufacturing sector, and a severe slump in the technology sector. Of course, these shocks have not fully played out, and the recent softening in the labor market will add further strain. Still, the resilience of the economy over the past year in the face of some pretty big negatives has been impressive, and we remain cautiously optimistic that it will continue.

Karen will now continue our presentation.

MS. JOHNSON. Our outlook for real output growth abroad this time has been revised down, particularly in the very near term, as data for several key regions suggest more weakness than we had previously incorporated in the forecast. We still look for the projected rebound in U.S. real GDP growth, along with past and prospective stimulus from macroeconomic policy abroad, to contribute to strengthening growth later this year and next in other regions of the globe.

There are important differences in the risks we see in our forecasts for several countries or regions, and my remarks this morning will highlight the vulnerabilities we see as looming in some cases and the upside risks we see in others.

The staff's forecast for Japanese real output growth remains pessimistic in this Greenbook. The latest indicators of economic activity, including industrial production, machinery shipments, and new car registrations for March, suggest that the Japanese economy is stalling. The momentum necessary for strong private investment to be sustained has not developed, and the March Tankan survey showed further declines in business sentiment, especially in the manufacturing sector. Consumption spending has shown some resilience, but not enough to spark real recovery in domestic demand. With global demand softening, the outlook is for export growth to remain weak until late this year or next year.

That said, there are developments in Japan, both on the economic and political fronts, that we are uncertain just how to factor into our forecast. The spate of bad economic news triggered yet another round of policy announcements by Japanese officials, including the moves taken by the Bank of Japan on the day before the March FOMC meeting. And public support for reform appears to be the reason for the surprise election of Koizumi as the new head of the LDP and prime minister. He faces a daunting challenge in moving the LDP and the government bureaucracy to embrace and actively implement aggressive reform. With an Upper House election looming in July, he appears to be pushing for the reform agenda but has yet to provide details of what is to be done and when.

Meanwhile, we remain of the view that the measures announced by the Bank of Japan will not by themselves boost growth securely into the positive range soon. Overnight interest rates have returned to zero, but the BOJ is experiencing difficulty injecting its targeted level of liquidity through repo auctions. With banks underbidding the desired repo quantity, the BOJ will have to consider using outright purchases more intensively.

We do not see these latest political developments and policy plans as providing any basis for a significantly more optimistic forecast for Japanese real GDP growth over the next year and a half. And we have revised our outlook for the quarterly pattern this year while leaving growth on balance in 2001 near zero. In 2002, it strengthens slightly. However, Koizumi's arrival on the scene does widen the confidence band about our outlook. On the up side, progress on reform might now be more likely and, in turn, could spark a revival of confidence on the part of households and firms, encouraging them to spend. On the down side, aggressive reforms, when implemented, would force bankruptcies and restructuring that over the forecast period could yield an even more negative outcome for Japan than we now project. The direct beneficial effects from any reforms will no doubt take some time to appear.

We have revised down our outlook for near-term growth of real GDP in the euro area, as weaker confidence measures and declines in orders confirm that the global slowdown will not leave the euro area unscathed. The surprise cut of 25 basis points in the official lending rate of the ECB last Thursday was a bit sooner than what we had incorporated into the Greenbook forecast but not so soon as to require a revision to our forecast. European stock markets showed considerable volatility as equity prices, particularly for the high-tech sector, came down and earnings expectations in that sector plunged. Nevertheless, the output of high-tech industries is such a small portion of total production in the euro area that we do not expect the global weakness in high tech to have a major effect there. Although we have adjusted down the numbers for Germany a bit, we still see euro area growth next year as rebounding to about 2-3/4 percent from about 2 percent this year.

Among the emerging market countries, the greatest uncertainties surround the outlook for Argentina. A new understanding has been reached with the IMF for proceeding with the existing support program; it is scheduled for approval by the IMF Executive Board next week. In the meantime, Argentine officials have been working toward a proposed swap of around \$20 billion of outstanding debt with the private sector in order to lengthen the maturity of government obligations and to create a more sustainable amortization time profile for 2002 and beyond. Market indications raise serious concerns about whether the swap will be

workable, given the high levels of interest rates currently. The rating agencies have downgraded Argentine government debt and banks in recent days. The latest tax revenues have disappointed on the low side, despite the new tax on financial transactions that was just introduced.

We see the Argentine situation as precarious. It is not hard to imagine a sequence of events that would force some discrete response, perhaps default or some kind of unilateral debt restructuring, perhaps devaluation, or perhaps both. It is impossible for us to know just when such events might occur or precisely what their implications will be. Recent exchange market pressure on the Brazilian real suggests that Brazil is vulnerable to some contagion. To date, Mexico seems much less vulnerable. We have not attempted to incorporate a breakdown in the Argentine situation into the Greenbook forecast, but we have posited weak growth in Argentina throughout the forecast period and have revised down somewhat our growth outlook for Brazil, owing to a tightening of monetary conditions by the central bank in response to the inflation risk posed by the exchange rate pressures.

Some progress has been made in Turkey, but serious doubts remain. Agreement on a Letter of Intent has been reached with the IMF for a revised program. Together the IMF and World Bank will provide an additional \$10 billion, for a total of \$19 billion. Success in arriving at terms for privatizing Turk Telecom has been achieved, but at considerable political stress. The current government seems to be less than secure. With the extent of fiscal restraint contained in the program substantial, it is easy to doubt whether the fiscal objectives can be reached. As of now, it does seem that the spillover effects from yet another failure of the Turkish support program would be limited, with little effect on our outlook for the U.S. economy.

CHAIRMAN GREENSPAN. Questions for our colleagues? President Broadus.

MR. BROADDUS. David, you pointed out, as is well known, that spending on equipment and software has been very weak and continues to be weak. But I noticed in going through the Greenbook that nonresidential construction outlays are still quite strong. I know some of that reflects drilling activity and, of course, the investment process has a lag that is different from spending on equipment. But the difference still struck me as an anomaly. How do you evaluate that? Does this present some significant downside risk going forward?

MR. STOCKTON. Well, the continued strength of those data has been a bit of a puzzle. As you point out, some of it is explainable by the surge in drilling and mining activity that has accompanied the run-up in oil and gas prices. We are not expecting that current pace to continue going forward. We anticipate a rather significant slowdown in nonresidential construction activity, and a lot of that slowing occurs in the office sector where some tentative signs give us a sense that that market is beginning to top out. However, it is still the case that in general the overall health of the construction sector in the nonresidential area has been reasonably good and we're not expecting declines going forward. But I think it's a risk.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. David, I have a question for you. You started out your comments by saying the economy is very weak, though not in a recession. And then I think you said we are not far from a recession. Yet when I look at the alternative simulations in the Greenbook, none of the downside scenarios appears to put us into a recession. In fact the most negative in terms of an impact is a productivity slowdown where monetary policy has less of a positive effect on the outcome. So I was just wondering whether you could be a little more specific about what it would take to push us into a recession?

CHAIRMAN GREENSPAN. A new model! [Laughter]

MR. STOCKTON. Gee, I was going to say that, Mr. Chairman! I would caution that in some sense we can make the model produce a recession. That is, we can give it a large enough shock to push the economy into recession. But, in fact, I think it is a feature of most linear models of the economy that they do not capture the kinds of processes that occur as the economy goes into a true recession. One can take a look at the pattern of forecast errors around recessions, and it is almost always the case that the recessions are steeper than models can

explain. So, the recession often occurs because there is a collapse of confidence that accompanies them. Part of what I was trying to convey in my remarks was that one thing that might push us into recession would be that, as the unemployment rate rises, we start to see a period of more significant layoffs and payroll employment declines. That tends to trigger a real pull-back in consumption. It is more than might be suggested just by the lagged effects of past income growth or a pull-back in investment spending in the face of uncertainty. It is greater than would be expected on the basis of output growth or the cost of capital. So I see those risks as being genuine and I see our model as probably not being able to capture those risks adequately.

MR. MOSKOW. So the most likely scenario would be higher unemployment that triggers weaker consumer confidence, which feeds into weaker household demand than is actually shown here?

MR. STOCKTON. Yes. And that, combined probably with some retrenchment in business spending and some more significant cutbacks in production, could lead to something that is a genuine cyclical downturn.

MR. MOSKOW. So the missing factor is consumer confidence?

MR. STOCKTON. Confidence, one way or another. It could be business confidence. Another possibility is that the high-tech "meltdown"-- we're going to have to start inventing new names for these phenomena as we revise down our forecast more and more--does not produce a recession, but leads to a shift in business confidence. And that in turn could lead to a more significant retrenchment in investment spending than the model suggests. So it could be either consumer or business confidence. I did want to highlight the fact that we're entering a somewhat new period here in the forecast with payroll employment declining. We've had a rise in the unemployment rate so far that has been associated with a slowdown in employment growth. We

think that over the next few months we will see outright declines in employment and a continued rise in the unemployment rate. And that at least raises the possibility of a more significant negative effect on consumer confidence. That's not our projection. In fact, we think consumer confidence has fallen so much already that it looks consistent with this period of payroll employment declines. But there does seem to be a real risk that confidence could deteriorate.

MR. MOSKOW. Thank you.

CHAIRMAN GREENSPAN. Is it correct to say that we just don't have enough episodes of recessionary periods to be able to infer what happens to the coefficients and nonlinearity, as you put it, during those times? I gather that is correct, is it not?

MR. STOCKTON. Well, that would certainly be one reason why a recession is very difficult to forecast. We really think of each recession as being only one data point, and there aren't that many recessions in the postwar period to begin with. Another factor just may be the types of quantitative models that we're dealing with. Our models, at least, are not able to fully capture the psychological effects and confidence-type effects that seem to play an important role in business cycles. That's not to say that we couldn't discover data sources or ways of measuring that going forward. But I don't know how we would do that currently.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Karen, I have a couple of questions about Japan. The Greenbook projection indicates that by the end of 2002 consumer prices will have declined in Japan in each of the preceding four years. And the quarterly table has consumer prices declining in every quarter over the three years through 2002. What would you say are the implications of such an outcome for the banks in Japan, given the problems they face, and for the equity markets? Have

policies been put in place that will end this downward spiral? If not, what do you feel the Japanese should do?

MS. JOHNSON. Well, as you saw in the Greenbook, we think this deflation will continue for at least the six quarters that remain in our forecast horizon. There aren't too many more steps that the Bank of Japan could take in a monetary policy sense. And I am impressed by the fact that they have basically driven the cost of liquidity to zero in that economy. We could see that in many different ways. One avenue, of course, is the exchange rate. That is, this liquidity could have as a consequence further declines in the yen, which could at some point help in this respect. We got a bit cautious I suppose--or took a middle course--in thinking about the dollar this time and we have basically extended both the yen and euro at a fairly flat rate. We are just very reluctant to put into our forecast at this point a big appreciation of the dollar and a big depreciation of the yen because there are so many reasons why that shouldn't happen. On the other hand, from the point of view of the Japanese economy there are many reasons why it should.

MR. PARRY. Right.

MS. JOHNSON. It seems largely caught up in market expectations on the one hand and the politics of the situation on the other. And the politics extend not just to the dollar/yen and U.S./Japan relationship, but to various trading partners and the concerns they express from time to time about what a big depreciation in the yen would do. We still see the fundamental problem in Japan as a need for serious reform on the structural side of that economy. We would like to see those reforms in some respect bring relative prices in Japan, particularly between traded and nontraded goods, back in line with the levels we see elsewhere--and yet for that to occur without furthering deflation because that does have consequences. But I don't have really

specific answers to offer you in terms of a solution and how they could bring that about. The banking system, consumer spending, and household incomes are all negatively affected by the ongoing deflation. We still see statements by Japanese officials that they can't do certain things or they can't do them quickly or they can't do them one way, they have to do them another way because of what they view as political constraints on the options they face. So, basically, I am inherently still pessimistic about how this will play out.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. Thank you, Mr. Chairman. I, too, was struck by the same distinction that Don mentioned earlier between the real economy as portrayed in the current Greenbook forecast and the real economy as viewed by the financial markets. The financial discussion in the staff briefing material we received last night was quite interesting in terms of the differences mentioned in how the Board staff and other economists see the economy versus how the markets see it. The financial markets do seem to expect a bottoming out and then an upturn. All that played into a question that I've been asking myself because depending on who is talking, particularly among our business contacts, we hear either a lot of doom and gloom or some sense of optimism. The feelings of gloom and doom seem in some ways--and I'd like your perspective on this--to be tied to where things were a year ago and how bad they seem now in comparison. And the optimism seems to be coming from people who have gotten over that and see that in fact some orders are coming in.

I was also struck by Chart 2 in the material we got last night, which showed manufacturing capacity growth rates in the high-tech area. That sector was adding capacity at an annual rate of 42 percent from 1994 to 2000. High-tech capacity now is expected to grow at a

rate of something like 21-1/2 percent--almost 10 percentage points better than the experience in the decade before 1994. So I'm wondering where it is that activity is really so slow. Or is it the comparison to how fast the economy was growing that makes the real economy seem so bad now? Is that tending to shade the way we think about things?

MR. STOCKTON. It could also be, as the economy has eroded so much, that the prospect of getting back to a more moderate growth path starts to look more reasonable, just because one would expect some rebound given how far production has already fallen. It's certainly possible that we're looking in the rear-view mirror--looking at developments in terms of where the economy has been--and maybe other economic forecasters are, too. Perhaps we are focusing on how we've been revising down our projection and viewing that in some sense as a sign of impending weakness, and maybe the markets are looking forward and seeing a much stronger rebound.

I could not in the end convince myself, given the recent data, that the best forecast is a more vigorous rebound in activity than we are currently anticipating because, for one, we are seeing still very significant cutbacks in the manufacturing sector. And we have seen more troubling signs that less progress has been made in getting inventories into better alignment with sales. Inventory-sales ratios have been hanging up more than we thought. In addition to that, with the rise over the intermeeting period in initial claims for unemployment insurance and other signs that the labor market is weakening, we came to the conclusion that the economy is currently in a very weak and somewhat vulnerable state. And as I indicated earlier, given that we can see these trends going on for a few more months, those vulnerabilities will continue to be there. We see a significant rebound coming, though in our forecast the economy still will be running below potential through most of the projection period. Another possibility is that we

have marked our productivity forecast down too much. It could very well be that many market participants are still seeing signs of strong productivity growth that are going to give even more impetus to a reacceleration of activity and earnings potential going forward. So, I see a variety of risks. There certainly are tensions between our view and the way that both the equity and bond markets have behaved in the intermeeting period. But we are still reasonably comfortable with our forecast of fairly weak growth, for at least the near-term period, followed by some recovery.

CHAIRMAN GREENSPAN. What would the productivity numbers in the first quarter and the fourth quarter of last year look like if the volatile pattern in self-employed hours had been smoothed?

MR. STOCKTON. Roughly they would be a little better than a percentage point in each quarter. And we are expecting a 3 percent increase in the second quarter.

CHAIRMAN GREENSPAN. What would that be with a similar smoothing?

MR. STOCKTON. I think that would be about 2 percent instead of 3 percent. So it would be a smoother pattern; obviously the data series was affected significantly by the very sharp swings in the reported hours of self-employed workers. Nevertheless, looking at the past four quarters, we've had 2-3/4 percent growth in nonfarm productivity in a period when three of those four quarters were quite weak in terms of overall activity. So, again, that is leading us to be on the relatively optimistic side about productivity going forward.

CHAIRMAN GREENSPAN. Any further questions for our colleagues? If not, who would like to start the Committee discussion? President Jordan.

MR. JORDAN. Thank you, Mr. Chairman. First, let me relay a comment by one of the bankers in our District who operates in quite a few states in the Great Lakes region. He said

that a year ago the bad news was that there was little e-commerce in the region. This year the good news is that there is very little e-commerce in the region. He also mentioned discussions he had with other bankers at a meeting on the West Coast--it was probably the Montgomery Securities annual event--for large banks. The typical question he was asked by other bankers, especially those from the western part of the country but even some from the East Coast was: How on earth did your Midwest banking company make any money when the economy in that region is in the tank? And he told them that his bank's profits are very good, its loans are very good, and that he felt people's perception about what is going on in the Midwest was quite different from the reality. Another director made a report that I would put in the silver lining category. He said that the golf course he occasionally plays is still charging the same \$250 green fees as it did last year, so there's no inflation there. But the course is not nearly as crowded as it used to be! [Laughter]

Last week there was quite a bit of news on the District. The Wall Street Journal had two front-page stories on our region, one about Cleveland and its labor market and one about the coal situation in Pikesville, or more generally eastern Kentucky. That latter article dwelled on the shortage of coal miners and the reluctance of younger people to consider coal mining as an occupation even at significantly higher starting wages than the alternatives available to them. The discussion then got into issues about how much technology is going into that sector. A director from the region said that the mining companies are expecting two years of good, strong demand for coal but they are unwilling to undertake investments that would require a longer period of higher coal prices and volumes.

The article about the Cleveland labor market gave a little different impression of it than our own so we called some of the people who were cited to check up on that. The article

generally gave the impression that manufacturing has lost more jobs than we can confirm and that the health-care sector has created more jobs than we can confirm. It is the case that manufacturing has been weak, but it is not continuing to worsen. And we have found notable expressions of optimism about the second half of the year and beyond. The health-care sector is investing heavily in new technology and the facilities to house it but it is not adding much in employment, in part because of tightness in the labor market for that sector. It was reported that just in the Cleveland metro area alone there are openings for over 1,000 registered nurses and that many staff support positions for health-care facilities also continue to go unfilled. For all of Ohio, state officials are now skeptical that the employment/unemployment numbers are accurate. The last two months for which we have data, February and March, showed the unemployment rate dropping to 3.8 percent and 3.5 percent respectively, the lowest since 1970 for the state.

Recreation destinations reported that this spring's attendance has been much stronger than even last year's record levels. But our contacts also speculated that because of the energy crisis people might be seeking their entertainment closer to home. So, oddly enough, they say the high attendance at these places might be a sign of some economic weakness.

Retailers were telling us that the story on imports is mixed. Some of them say that the long lead times in ordering abroad mean that merchandise they ordered last summer and fall is still in transit and that if they do see final demand weakening, they will cut domestic orders. They could then end up with a mix of goods that is different from what their customers want. But others have asserted that it is easier to cancel or postpone delivery of foreign-sourced goods than it is domestic-sourced goods.

So, where are we in the District? Residential construction remains very strong. Motor vehicle production is down from last year but is better than the manufacturers thought it would

be for the second quarter. Government infrastructure spending on roads, bridges, buildings, and so forth is well above last year's pace and is still constrained only by the limited availability of contractors, subcontractors, and workers. The health care sector is building facilities and seeking to hire people but the lack of available workers is a constraint. The general impression, based on what we hear and what we see in the news, seems to be that some other people someplace else must be having a hard time.

Let me comment on the national construction situation.

and he reported not only on the region but on his firm's experience and outlook from a national perspective. He said that this will be a record year for them and they expect 2002 to be even better. He noted that while there is some weakness in and around what he called the Rust Belt region, it is more than offset by strength elsewhere in the country and outside the United States. In the South and Southeast parts of this country, construction is booming. Those are areas where they have all the business they can handle in the construction of facilities for elementary and secondary schools, colleges, and universities due to very strong demographics and regional shifts. He said that health care facility construction is very strong nationally. And there has been no slowdown in spending on entertainment facilities; his company is building a number of museums, aquariums, and sports and fitness centers. He does expect a slowdown in professional stadium construction, given the fact that most major cities now have their two brand new stadiums. But he believes that is being more than offset by a rise in construction of sports facilities for colleges and universities, a trend he expects to last for about a decade. And he foresees continued strong bond issuance by construction companies such as his to finance the organizations that are building some of these facilities.

Let me turn to the national economy. Listening over the intermeeting period to the views of directors at our head office and branches as well as some advisory council members on what it's going to take to turn this economy around, I was struck by how different perceptions are on Main Street versus Wall Street. A significant minority of our contacts--not a majority but still quite a few fairly strong voices--have said that they think we have already gone too far in our policy efforts to promote recovery and stimulate growth at the expense of potentially higher future inflation. Roughly one-third of our advisory council members and directors indicated that no further easing actions were desirable. Of the other two-thirds, views seemed to be about evenly split between those who thought that an end to the easing should be near and those who thought that much more easing would be desirable. We can usually identify their policy preferences just by knowing which companies they are talking about; the latter view is especially true of metals manufacturers.

The current fed funds rate is now more than 30 percent below where it was four and one-half months ago. The Bluebook presented a range of estimates of where the equilibrium overnight rate should be, and I hope the staff continues to refine that framework; I found that very useful. So far what it says is that we have dropped the overnight rate in lock step--with only a very short lag--with at least an implicit notion of where the equilibrium real rate is. And the current rate is now at or even a bit below the bottom of that range of estimates. That says to me that from this point forward extreme caution is warranted in contemplating further easing actions. Thank you.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Thank you, Mr. Chairman. I have had an opportunity in the last several days to talk with different groups, including our economic advisory council and our

board of directors, and I would say that the view is still that economic growth in our District remains sluggish. Businesses have been putting some of their capital spending plans on a wait-and-see basis, not because they can't find funding but because they want to see how things develop. There was very little talk of recession in the discussions with our contacts. I was also a bit surprised by the fact that a minority of those individuals commented that they wondered whether additional discount rate cuts would really help with our problems, which are related to energy and over-investment in some high-tech and telecommunications industries. So there was a sense of how far the easing has gone and a question of whether it's perhaps enough or more than enough.

More specifically, turning to our manufacturing survey, that sector continues to be weak. The production index, though, did rise slightly from its January low. And on an anecdotal basis, a minority of manufacturers talked about having made some very fast and harsh cutbacks early on so that their operations are now profitable again and they are more optimistic going forward.

Consumer spending is mixed in our region. Retailers report that sales of big-ticket items have been weaker than desired, which has offset the moderate strength they have seen in sales of other items. The attractive mortgage interest rate environment has underpinned residential real estate. There are some signs of slowing in the residential sector but very modest slowing, and prices are still rising--although not as rapidly as they were in our Denver market, for example. Commercial real estate remains strong but also is softening. And labor market conditions have eased obviously and noticeably. Energy remains our strongest sector, with further upside potential very clear. There is a lot of activity in that area and companies are trying

to get, as they say, iron and labor into the field. The farm outlook is unchanged from the last time we met, with grains still in surplus and cattle and beef very strong right now.

Let me talk briefly about the national economy. Obviously, as has been pointed out here, the economy has slowed and certainly will continue to grow slowly in this second quarter. There are also obvious downside risks, which have been pointed out. Maybe we will have further slowing in business fixed investment, for example. What are the effects of slower earnings growth, foreign demand, consumption, and so forth? And the psychology is negative. But there is no panic; we're not talking about an overall sense of gloominess. Perhaps more importantly, I believe, there is significant stimulus in the pipeline and with it I think the outlook for the nation is generally rather positive, despite the powerful crosscurrents affecting the economy. Accordingly, I would suggest that the staff's forecast is a little too pessimistic on growth and a little too optimistic on inflation. I would certainly acknowledge the existence of downside risks. But GDP growth in the first quarter was stronger than people had expected. Sales figures, despite the downward adjustments for March and February, have been better than people had thought. And a lot of inventory adjustments appear to be well advanced at this point. The outlook has been helped by our changes in policy. Our actions appear to have cushioned the deceleration in activity. The decline in short-term rates, the decline in risk spreads, and double-digit rates of growth in M2 are having beneficial effects in the short term. Moreover, our policy easing has yet to be played out fully and will be felt more completely as the changes in monetary policy kick in with a lag.

All this taken together leads me to conclude that the economy will strengthen during the second half of this year and into 2002, especially with the policy we now have in place. My forecast is indeed much stronger than the staff's. And financial markets, as we've discussed,

indicate that they also may be looking for a stronger outcome, given the steeper yield curve and the decline in credit risk spreads.

With that background, let me talk a minute about the inflation outlook. The gradual increase in core inflation over the past year is a concern to me. While much of the increase may reflect the pass-through of energy prices to core inflation, the current fed funds rate is accommodative, in my judgment, and that heightens my concern for the longer-term outlook. Even assuming that energy prices decline somewhat and that core inflation stays at its current level, our more accommodative policy may very well lead consumers, laborers, and businesses to ratchet up their inflation expectations. There is some evidence that this is already occurring, and it is likely to become more pronounced if we pursue policies that are increasingly accommodating and aggressive. For example, the Michigan survey saw, in the steepening of the yield curve that I mentioned, an early sign of this upcreep in inflation expectations. My judgment is that core inflation could rise later this year and next year as our accommodative policy moves forward.

For these reasons I think the relative risk between weaker growth and higher inflation has shifted since our last meeting. The economy remains vulnerable to downside risks in the short run. Certainly, the behavior of business investment and anecdotal reports about rising layoffs suggest that we are not out of the woods, and I'm not suggesting that we are. However, our prompt and aggressive policy actions have served to address these developments to an important degree, and the risks have begun to shift toward higher inflation as we move later into the forecast period. Because of this change in relative risk, I would prefer to shorten our strides and be more cautious as we take actions going forward. I have stated on previous occasions that I believe we should front-load our policy actions and make our aggressive moves early. And

after four moves of 50 basis points each over the last four months, I believe a more cautious approach may be in order this time. Thank you.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Thank you, Mr. Chairman. Economic activity in the Seventh District remains sluggish. Many reports are quite gloomy. Several contacts even told me that conditions in their sectors were as bad as they had ever seen. And these weren't the 25-year-olds at dot-com firms but people with 30 to 40 years of industry experience. In fact, a recent poll of the CEOs of Chicago's 100 largest corporations revealed a very sharp downturn in business sentiment. Nearly half the respondents expect an outright recession.

However, with inventories pared substantially, there are some tentative signs that the worst may be over for the traditional manufacturing industries whose difficulties have made the current slowdown especially severe in the Midwest. And consumer spending, though very soft in several sectors, has shown surprising resilience, providing some grounds for optimism. Unfortunately, there are also signs that the slowdown is having a growing impact on capital investment and commercial real estate. More-widespread employment cutbacks may be next on the list of difficulties, leading to a subsequent decline in consumer confidence as we discussed earlier.

On the positive side, the auto industry's significant inventory reduction and subsequent production rebound ought to provide some support for the rest of the Midwest economy. Of course, our Big Three contacts remain concerned about the rest of the year. They have been losing market share to imports and all expect sales to slow as the year progresses. But relative to a few months ago, the outlook for autos is much improved. And though published data continue to show deterioration in some of our other important manufacturing industries, contacts in the

steel, heavy truck, construction, and agricultural equipment sectors report at least some signs that conditions may be near the bottom.

The slowdown in consumer spending we've seen in recent months has shown up in many ways, one of which is slimmer periodicals and catalogues. Early last year I reported that printers just couldn't squeeze any more pages of advertisements into magazines. But postal statistics show that times clearly have changed. Total pieces of Class A and periodical mail are down and the total weight of such mail is down even more, with the difference due to the shrinking size of catalogues and periodicals. One well-known business publication is down to about 175 pages from 300 last year. Publishers even have been delaying their printing runs, hoping to book a few more ads before they go to press. Recently, however, a magazine executive reported the first glimmer of a pickup in advertising scheduled for fall publication. Though I guess mail carriers won't be pleased, this is probably a good sign since ads tend to track consumer spending fairly well. An even more hopeful sign was the improvement we saw starting in April in District retailers' reports.

Of course, the recent employment trends could still undermine consumer confidence and spending. We spoke with executives of two large temporary services firms headquartered in our District. Both confirmed that the recent employment reductions have been concentrated in manufacturing, especially automotive and electronic assembly; other business lines were holding steady or actually increasing. One also reported that the pace of contraction in their industrial business had slowed significantly, though client firms remained deeply cautious about expanding even temporary workforces. We also learned that the Manpower survey of hiring intentions, which will be released to the public on May 21, showed another drop. The new figure is the lowest since 1993 and the two-quarter drop is the largest ever outside a recessionary period.

Another worrisome sign is that commercial real estate seems to be succumbing to the slowdown. Suburban markets especially have weakened and a lot of new space remains in the pipeline, which has the industry in our region worried. Hijacking the Boeing corporate headquarters won't do much to alleviate these concerns. [Laughter] Sorry, Bob!

Finally, we made a special effort in our analysis of regional conditions to gauge the effects of the slowdown on capital spending. We found the picture mixed for retailers, with many going ahead with expansion plans but others behaving more cautiously. Almost all manufacturers, on the other hand, were reviewing, freezing, or scaling back capital spending plans. But even in manufacturing there were exceptions. For instance, one District manufacturer of agricultural equipment is going ahead with a very ambitious \$600 million capital spending plan for this year despite poor earnings recently. The reason is that investing in new technology was felt to be vital to the firm's long-term success.

Turning to the national outlook, the economic situation this quarter continues to be highly uncertain. On the investment side, most manufacturing and high-tech firms are continuing to scale back their investment plans for the year. In an environment where cost reductions are imperative, reducing discretionary expenditures is figuring prominently in many business plans. Internationally, the outlook for foreign economic growth and U.S. exports continues to deteriorate. Of great concern, the April employment report indicated significantly more weakness in the labor market than expected. If this continues, income growth will slow markedly and consumption may falter along with other components of aggregate demand. Admittedly, given our policy actions to date, our best assessment is that aggregate demand will rebound modestly later this year and approach the growth rate of potential next year. But the

risks continue to be skewed toward economic weakness and I think monetary policy should respond accordingly.

Having said that, like Tom Hoenig, I'm also concerned about future inflationary pressures. Today's appropriate policy may quickly become overly accommodating once the economy turns the corner. We will have to be mindful of that. Indeed, the futures markets have priced in policy firming at the end of this year, once the economy has rebounded. But today the greater risks are clearly weighted toward the possibility of further economic weakness.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, the Twelfth District economy has slowed considerably in recent months. District payroll employment expanded at an annual rate of less than 1 percent in the first quarter, a significant change from the near 3 percent pace reported in the fourth quarter. Slower employment growth has boosted unemployment rates in most District states in recent months. However, as of yet, slackening labor markets have not resulted in lower wage inflation in the District. Data from the March ECI showed that total compensation in the West grew by 5 percent over the past four quarters, a little above the rate for the prior four quarters and well above the rates of the other three U.S. regions. Still, District contacts report greater ease in finding qualified workers and a reduction in employee turnover.

The District's technology sector has continued to weaken in recent months. On top of the ongoing shakeout among dot-com firms, nearly every major high-tech manufacturer in our area has announced layoffs. A number of software firms have scaled back as well, especially in their demand for contract staff and temporary workers. High-tech companies increasingly are instituting forced furloughs and across-the-board wage reductions for remaining staff in an effort to control costs.

Because of the prominent role that high-tech firms play in many District states, slowing in the technology sector has begun to damp expansion in other sectors of the economy. For example, vacancies are up and lease rates are falling in a number of commercial office markets. And personal income gains have slowed noticeably. Data through the fourth quarter point to substantial slowing in personal income tax revenues, with additional weakening expected this year. Slower personal income growth and the decline in the stock market have begun to temper consumer spending and state government budgets. Retail sales in the West grew by about 3 percent in nominal terms during the first quarter, well off the 8 percent pace of 2000. Home price appreciation also has eased, with weaker price performance even in the District's hottest markets. And a number of state governments have announced that revenues in 2001 likely will fall below budgeted expenditures.

Turning to electricity, warm weather in California earlier this month resulted in the first rolling blackouts of the summer season. The California Independent System Operator, which operates the power grid for most of California, estimates that unless usage is curtailed the state could hit peak loads that exceed forecasted supply on 34 days this summer. That estimate is based upon assumptions that weather conditions and usage are similar to those experienced last summer. Other states in the District expect to have ample supplies of electricity this summer. However, spillover effects from California will push up the average cost of power for consumers in some states, especially those in the Pacific Northwest.

Turning briefly to the national economy, recent developments taken as a whole have led us to revise down our expectations for real GDP growth this year and next. Our current forecast is for growth of less than 1 percent this quarter, followed by an increase of around 2 percent for the third quarter. If we assume a further cut in the funds rate at this meeting, our best

estimate is that economic growth will rebound to the low 3 percent range late this year and next year. However, there are some significant downside risks. One of them relates to consumption. With consumer confidence and stock market wealth down from last year and the unemployment rate on the rise, consumers may wish to boost their saving, which could weaken economic activity. At the same time, business investment appears fragile and the perceived over-capacity of high-tech capital may damp investment more than we anticipate.

With respect to inflation, we expect increases in the core PCE price index of just over 2 percent this year and just under 2 percent next year, up from a 1.6 percent rise in 2000. That is certainly higher than I would like. However, any remaining upward pressure from tight labor and product markets is likely to have dissipated by sometime next year, setting the stage for an improved inflation outlook over the longer term. Thank you.

CHAIRMAN GREENSPAN. President Broadus.

MR. BROADUS. Thank you, Mr. Chairman. Our District continues to present the mixed picture I've reported at recent meetings, though it may be a little less mixed this time than earlier. There are some positive developments. Sales of nondurable goods and services were actually up a bit in April; they increased at a somewhat more rapid rate. Tourist activity in the early part of the holiday season and the summer season along the North and South Carolina coast has been strong. The new pandas at the National Zoo up the street are bringing an even larger number of people into Washington than is normally the case at this time of the year.

Overall though, I would say that the situation doesn't look so good. Automobile and other durable goods sales--sales of big-ticket items--have been quite soft pretty much across our region. Manufacturing activity weakened sharply further in April and in other recent months, according to the reports we get. Furniture manufacturing is a big industry in our District, as I've

said many times before, and it is very weak. Moreover, almost all the comments I hear from people in that business--and I get a lot of information from that industry--are quite pessimistic about the outlook. Labor markets have softened in our District as elsewhere. And we are seeing rising vacancy rates in the office sector, especially in northern Virginia. I gather that's also happening in some other parts of the country, and we certainly see it in our region. So on balance, I would say that conditions in our District are noticeably weaker than at the time of our March meeting. And generally I think attitudes and confidence, especially among our business contacts, are significantly weaker. A couple of months ago people thought: Yes, there's a big slowdown and it's going to take a couple of months to get out of it, but by the time we get to the second half of the year things are going to be moving up. We don't hear that view much anymore.

We surveyed approximately 35 firms in our District across a broad range of manufacturing and services industries about their capital spending plans. As elsewhere, companies are cutting back on these plans. Where investment is going forward, often it's because of stiffer environmental regulations rather than an improved economic outlook and more optimism about the future.

I've mentioned the weakness in manufacturing in our District, and I have to tell you that I'm becoming increasingly concerned about what I read and hear regarding the weakness in manufacturing nationally. Like others, I was encouraged by the progress in the automobile industry. It appeared that the situation in that sector was improving and inventories were being brought under control. But as the Greenbook pointed out, quite clearly there is a significant overhang in a wide range of other manufacturing industries, especially high-tech and other equipment manufacturers. The prospect of correcting this overhang any time soon strikes me as

not terribly good. Spending on equipment, of course, declined in the first quarter for the second consecutive quarter. As David Stockton noted, the latest data on new orders suggest that we'll have another decline not only in the growth rate of such spending but in the actual level of expenditures. Also, I was struck by the mention in the Greenbook of the purchasing managers' diffusion index for manufacturers' expected capital spending. According to the Greenbook, that's now at its lowest level since May 1982, which was not a very good month. It was the bottom of the deepest recession in the postwar period, so that particular statistic really got my attention.

All in all, I don't think there's a lot of evidence yet that the contraction in manufacturing is bottoming out. Some people apparently have a different view. But from my perspective at least, especially at the District level but also on the basis of what I read about manufacturing nationally, I don't see much evidence that it's bottoming out. More importantly though, as you pointed out, David, the sharp drop in overall payroll employment and the breadth of that drop across sectors and industries of the economy raise the prospects that the weakness in manufacturing is now spreading to other sectors of the economy.

So, like Bob Parry, I think the downside risk in the current situation is substantial. Of course, we've had some good news lately: The retail sales figure for April was better than expected and equity markets have stabilized. That to me suggests that the softness is being contained, at least to some extent. We're not in a free fall. And I think that's probably because of the aggressive action we've taken with monetary policy. But in that context I think we need to recognize and keep in mind that the reason we have been free to move as swiftly and aggressively as we have is that we've built up a substantial amount of credibility for low inflation in recent years. And I think it's precisely at times like these that the value of anchoring inflation

expectations is most evident. With this in mind, we need to be careful not to let our credibility and the soothing effect it has had on inflation expectations, to date at least, fool us into easing policy too much. We're already seeing some warning signs. Long-term Treasury rates have moved up by nearly 1/2 point since the March FOMC meeting, despite the further easing we've put in place. That rise in long rates probably reflects some increase in financial market expectations of stronger growth in the economy, as we have observed already. But the evidence from indexed bond rates suggests that inflation expectations may have increased recently. Either way, the market is telling us, I think, that we're at risk of overdoing it.

Boiling this all down, what it suggests to me is that we need to ease further today but we need to do it in the context of a clear vision of where we're going. Jerry Jordan's comments on this resonated with me. We need to think about the ultimate end of this process--what the end game is, so to speak. I hope we can return to this point when we discuss policy later. Thank you.

CHAIRMAN GREENSPAN. President Guynn.

MR. GYNN. Thank you, Mr. Chairman. As best we can judge, economic activity in our Southeast region has not changed materially since our March meeting. A general sense of caution and uneasiness about the yet-to-be-seen signs of improvement probably best characterizes the sentiment about the economy. Overall growth in the region continues to be underpinned by our largest and strongest economies, Georgia and Florida. But even there, recent state revenue data suggest some softening in activity. As elsewhere, subpar performance in manufacturing continues, with some further employment reductions. Our regional auto industry, including our now significant number of assembly and parts suppliers, is dealing with a slow April after having experienced relatively more strength in earlier months of the year.

We, too, made a special effort again this month to probe, through our directors, the strength of investment spending. The clear message is that it remains largely sidelined. A private breakfast meeting I had with the CEO of the large

drove home for me how business executives are thinking and behaving. That CEO told me he simply was sitting on several large and very strategic investment spending proposals that were on his desk. They involved spending for long-term infrastructure that the company will clearly need, but he just wasn't going to turn them loose right now. He went on to say that a year ago he would have gone ahead with that spending without any hesitation. Generally, what we're being told about investment spending is that it's not being postponed while waiting for further interest rate reductions but rather for signs that past rate reductions and other adjustments will revive demand. As one director explained, people are simply saying, "show me the orders."

Consumer spending has posted only sluggish growth, but we're not hearing any substantial concerns about inventories at the retail level. And our bankers, while continuing to worry about additional syndicated credits, are not reporting any new concerns about consumer credit quality.

Homebuilding continues to be one of the big engines of economic activity in our region. A recent report showed that the 17,000 building permits issued in the Atlanta MSA in the first quarter eclipsed by more than 5,000 the next largest permit growth among MSAs around the country. And residential construction so far has remained relatively strong. Having said that, and despite the fact that the inventory of unsold homes has not risen materially, we are now hearing some concern about a falloff at the high end of the market. In South Florida, real estate markets

are being buoyed by the influx of buyers from Argentina and Columbia who are coming to the United States because of fears of economic turmoil and/or political instability in their home countries. Those immigrants represent significant drains of both human and financial capital from those two countries.

In commercial real estate, the level of speculative activity remains low. We're also seeing some pressure on the office space market; some space has been turned back as companies tighten their belts. More than 2 million square feet of space have reportedly come back on the market recently in the Atlanta area alone. A large national commercial real estate broker and leasing agent with a regional headquarters in Atlanta reported that several large customers recently just called off their search for additional space. And the lead partner in that real estate firm told me that despite his own firm's recent merger and their need for more space, he has decided to hunker down and make do with existing space for a while.

Our important tourism industry remains reasonably upbeat, but our contacts are reporting some slowdown in business travel and some concern that future bookings may be flat and not sufficient to fill the substantial new capacity brought on in recent years.

The picture is obviously bright for our energy sector, but a large majority of the rigs at work are engaged in natural gas exploration and extraction rather than oil drilling. Interestingly, the support businesses of the oil and gas industry do not seem to be sharing fully in the energy boom since new exploration and extraction processes are more efficient and less labor intensive and, therefore, can do more with less.

Finally at the regional level, labor markets have continued to loosen and price inflation remains subdued with exceptions in a few areas, including nurses' salaries, pharmaceuticals, and health and insurance costs generally--areas we have heard about before.

At the national level, like others, I continue to push off until later in the year any significant turnaround and I now anticipate a longer-than-expected period of very slow growth. In addition to the inventory correction that still continues in some sectors and the dramatic investment funk that shows no sign of turning around quickly, we're now seeing an employment slowdown, and its implications for consumer spending are of concern. Of course the flip side is that the accumulating postponement of spending must be building a growing amount of pent-up demand, which will show itself at some point. Indeed, most of our forecasts as well as those of others outside the Fed look for a significant pickup late this year and early next year. And surely the very substantial and very aggressive easing that we've put in place over the last four months will help to fuel that rebound. Despite our continuing skepticism about whether fiscal policy actions can be timed to contribute to additional stimulus at the right time, that still appears to be at least a possibility.

I think one has to conclude that the near-term downside risks remain significant and probably have increased marginally since our last full meeting, and the Greenbook simulations did a nice job of helping us to think about those risks. Nevertheless, there seems to be little disagreement in the forecasts about the likely path beyond the next couple of quarters. While our longer-term inflation forecasts have not been anything to brag about--and I recognize that inflation is not many people's chief worry at the moment--I think we may soon find ourselves back to a more balanced set of risks. To be sure, the prospects for external shocks persist. Core inflation by many measures has continued to drift up and, given the liquidity that has been injected into the financial system since the first of the year, we may well have to give more weight to inflation risks as we contemplate our next policy moves. Clearly, there are arguments for still another aggressive easing move today, but a case can also be made that it might be the

right time to make our next easing move more measured and more modest. And at least for the moment, I am in that latter camp. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Santomero.

MR. SANTOMERO. Thank you, Mr. Chairman. There has been little change in the outlook for our regional economy since March. Economic activity continues to edge up overall and manufacturing activity is still declining. Our business outlook survey for May, which will be released this Thursday, shows little change from April, with the diffusion indices of general activity and new orders still showing small negatives. Manufacturers were continuing to cut inventories in May and more firms reported declines in employment and hours worked than increases.

Our May survey included a special question about firms' capital spending plans. Thirty-five percent of the manufacturers we surveyed said that they plan to reduce capital spending this year; 21 percent indicated "by a significant amount." Fifteen percent reported that they had raised planned capital spending since the beginning of the year, but for most not by a significant amount. Going forward, more firms reported that over the next six months they plan to increase capital spending from the current reduced level than to decrease spending. This is a slight improvement since April when the firms were more evenly split between increased and decreased spending in the six months from the survey date. Indeed, most of the indicators of future manufacturing activity in our survey picked up somewhat in May.

Retailers in our District have expressed some concern about their sales going forward. They reported some decrease in foot traffic at the malls in the region. April sales looked slightly better than March sales, but inventories have continued to rise and retailers are reducing their plans for inventories over the balance of the year.

The construction sector has been one of the areas of strength in our region. Residential real estate activity is fairly strong. Construction activity of all kinds continues at a high rate, as does employment growth--at least through March, the most recent month for which we have data. Given the sharp decline in national payroll employment in April, the region's overall employment picture is likely to worsen in the near term.

Turning to the nation, the economy appears to be in a more fragile condition than we thought it would be by this time. It turns out that the first quarter came in a bit stronger than we had expected, but economic activity is likely to be weaker in the second quarter. The most recent data suggest that retail sales and residential real estate seem to be holding up fairly well. And the mid-May readings of consumer sentiment were up. But those positive signs must be weighed against April's employment report, which indicated weakness across many sectors. In January I said that the one question we were facing was whether the economy in 2001 would behave more like the economy of 1995 or the economy of 1990. Prior to the April employment report, I would have said that the economy in 2001 would resemble that in 1995. But the most recent news on the labor market does raise the specter that the economy's performance will be more like that in 1990.

In our second-quarter survey of professional forecasters, which is scheduled to be released next week, on average respondents to our special question about the likelihood of a recession put the probability that the economy will fall into recession this year at 35 percent and next year at 20 percent. The employment report makes it hard to argue that the inventory correction is over. The strong drop in employment suggests that firms plan further cuts in production to bring down inventories. If consumer spending holds up, then this correction could

be finished relatively quickly. But how confident can we feel that the consumer, facing deteriorating job prospects, will continue to spend?

That said, I think the Committee has acted appropriately to forestall bad outcomes. We've cut the fed funds rate 200 basis points this year. That drop in rates was aggressive but not overly so, in my opinion. Indeed, a Philadelphia staff analysis suggests that the FOMC's recent behavior is consistent with its behavior in the past. We have lowered the funds rate substantially but that is a reflection of the speed with which the economic outlook and estimates of the output gap have deteriorated since the beginning of the year, not a reflection of more aggressive action than usual by the Committee in reaction to developments. In assessing the economy's outlook, however, we must remember the mantra of "long and variable lags." Analysis and experience suggest that we should only now be expecting to see the initial impact on the real economy of the interest rate reductions that we made at the beginning of the year. We need to remember--and we need to remind the public--that we will likely get several months of weak economic data even after the Committee has stopped reducing rates. We also need to remember that the Fed's long-term goal is price stability. I've become increasingly troubled by the slow upcreep in most measures of inflation over the past few years; it has occurred despite the strong upward trend in productivity growth. Those measures may reflect nascent signs of inflation becoming a concern. As short-term interest rates have fallen, long-term rates have increased. The steepness in corporate and Treasury yield curves suggests either that market participants are beginning to have some concern about inflation or that they view the current period of economic weakness as likely to be short-lived. Either way, it suggests that the Committee needs to be more cautious going forward and even more aware than usual of the need to balance concerns about near-term economic weakness against the longer-term goal of containing inflationary pressures.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. The latest evidence and anecdotal information suggest that the District's economy is not terribly different from what we've been hearing for some time, nor does it differ from the situation the national statistics have depicted. The picture is rather mixed. The manufacturing sector continues to contract. Labor market conditions appear to be easing and, as one looks around the cities and the countryside, the prevalence of help-wanted signs has clearly diminished. On the other hand, construction activity, both residential and nonresidential, remains strong. If anything, it has probably picked up a bit recently, with the announcement of another major project or two in the Twin Cities metropolitan area. Consumer spending appears to be growing modestly. The agricultural sector also would be described as mixed, depending on weather and, of course, on prices. In fact, it may be a little better than I would have expected because we are hearing scattered reports of some pickup in capital spending by producers; they are buying new equipment such as pickup trucks and so forth. And, of course, the energy sector has benefited from higher prices.

As far as the nation is concerned, my view of the prospects for the national economy is roughly similar to that of the Greenbook. I think the next couple of quarters will be slow as business firms continue to work through the inventory correction process. After that, I would expect a gradual improvement in the rate of growth but certainly no sharp acceleration, as best I can judge the outlook at the moment. If this pattern materializes, I would expect the unemployment rate to continue to move up gradually. And my view of the outlook for inflation is that it could well stabilize, with consumer price inflation in the neighborhood of 2-1/2 percent and the PCE a little below that.

I think the risks at this stage are roughly equally balanced. I say that because I don't consider the outlook all that ebullient and it's not difficult to imagine it being better than my forecast. On the other hand, I do believe there is some risk that we may encounter more inflation than I, at least, expect and hope for. In the short run, my concerns are focused on my reading of the compensation and ECI data for the last couple of years. But in the longer run, it's really going to depend on what policies we pursue. Having said that, I'll resist the temptation to say anything further about policy until later.

CHAIRMAN GREENSPAN. President Poole.

MR. POOLE. Thank you, Mr. Chairman. I think the overall message from the Eighth District is flat, flat, flat. Housing remains on the strong side and manufacturing on the weak side --no dramatic changes in either direction. Bank loan demand, depending on which banker one talks to, is either up a little or down a little. The bankers do say that lending standards are being tightened modestly, to some extent in response to pressure from regulators. But they are tightening them on their own as well.

My contact at _____ business is running about 10 percent below a year ago. On a year-over-year basis, April was down 9 percent and May so far was down 10 percent. Shipments of high-tech items— _____ of computer components--and auto parts have been particularly weak. The ground business is up; the company's customers seem to be substituting ground shipments for air express because of the lower cost. As for international business, U.S. outbound shipments are now negative year-over-year and inbound shipments are very low but still show positive growth. European business seemed to be holding up fairly well but Asian business was especially weak. _____ added surcharges because of increased costs. _____, of course, are faced with higher wages for pilots and mechanics as well as

higher costs for fuel. So, both companies are experiencing significant cost increases along with the declines in the level of business. The overall reaction was one of surprise about how weak things are. His firm had expected some resurgence but that doesn't seem to be taking place.

pointed out that he had been with the company for 27 years and despite all that experience he feels very surprised and concerned about the situation faces. Again, there are a lot of cost pressures--pilots, mechanics, fuel--and a declining level of business. Probably the best evidence of the the situation is that the company is really very much in a hunkering-down mode. It has deferred delivery of two new aircraft out of 17 that were on order and plans to park four older aircraft and take them offline until they are needed. He pointed out that a buyer probably can get a good deal from Boeing now because a lot of passenger airlines are also deferring or canceling orders. In terms of its management of the cutting back employment; the company has a hiring freeze and is not filling vacant positions. Capital expenditures are down. Special projects of all sorts are being delayed or on hold. Managers have tightened up on corporate travel and travel only on urgent need. As my contact put it, they are tightening the belt across the board--expense accounts, relocations, and all those adjustments that companies make when they experience a lot of pressure on profits.

The story from was quite different. sees problems in finding good sales associates, for example. Turnover is down significantly, perhaps because of the softer labor market, but the company is still encountering some labor market pressures. My contact said he found current demand conditions confusing, not consistent with the usual kind of recession or downturn pattern. In particular, the average size of a sales ticket is up 4 to 5 percent from a year ago and the split between what they call discretionary and nondiscretionary

expenditures is about unchanged. Nondiscretionary items would be things like toilet paper and diapers, I suppose, and discretionary items would be appliances and things like that. When people are under a lot of pressure, it's the discretionary purchases that get squeezed out.

very closely and has seen no change in that split. My contact sees the data as suggesting that the situation is not getting worse and is perhaps slightly better. What they see in their stores does not correspond with the very weak employment report that we got; consumer behavior doesn't seem to match that. He said that the company is debating whether to ratchet up ordering a bit to reduce the frequency of out-of-stock situations in certain goods they sell. They regard inventories as in very good shape; that's not an issue. Price pressures are minimal. They just price off the cost of goods, and vendor pricing has remained very well controlled. He did mention energy costs. Of course, everybody is affected by those costs.

On the national economy, let me try to make a couple analytical points. I think the downside risks are very obvious, but somehow it seems to me that the upside risks are not quite so obvious. So I want to talk about the upside risks--not as a certainty but as a possibility. I believe the staff forecast makes a lot of sense as a point estimate, but it is subject to risks in both directions and I want to discuss the upside risks.

We're all uncertain about the economy's potential growth. The Board's staff has marked down its estimate of potential growth a little, but we know that that number is subject to a great deal of uncertainty. If it turns out that potential growth is less than our current best guess, we could find ourselves pressing a lot of monetary stimulus into an economy that doesn't really have the potential to produce goods at that rate. That's in terms of the growth rate. In terms of the level at which the economy is operating, certainly five years ago we would not have estimated that 4-1/2 percent unemployment was above the natural rate, and we might still not want to make

that estimate. It may be that the labor market is in the process of converging to an equilibrium rate of unemployment that is, given the structure of the labor market, even higher than the current rate. And if we try to press, we're just going to get more inflation out of that situation and not, at the end of the day, more employment.

I think the output mix is clearly changing. We're probably going to see less investment--perhaps for some time to come--in the high-tech part of the economy and a lot more investment in the energy-producing areas of the economy. We know, for example, that a lot of new electricity generation projects are under way, and for very good reason--except in Texas, I gather, which has excess capacity. And coal is at capacity. I mean by that not only coal mines but coal miners and coal transportation. The chairman of our board runs a large electric utility. He says that typically they try to burn coal at night to save natural gas, which is much more expensive, in running the turbines. But coal is in such short supply that they're even burning natural gas at night. There is no available rail capacity to ship more coal from Wyoming to the Midwest at the moment; it's running just flat out. So there's going to be a lot more investment over time in that area and probably less investment in some of the high-tech areas. The change in the mix and the fact that there is a depression, if you will, in the high-tech area is not something that monetary policy can do anything about. That's a real adjustment that is going to have to take place over time. And if we press hard because of all the stories about the Dells and Compaqs and the dot-coms that are suffering hard times, at the end of the day we're not going to get more output out of those firms.

I think that's all I want to say at this point. My view is that we've got to be careful that the monetary stimulus doesn't spill over into prices. Several others have commented to that effect

already and I think that's a critical issue. If that should happen, our situation is going to be much more complicated a year or two out. Thank you.

CHAIRMAN GREENSPAN. Thank you. Coffee is available and I think it would be reasonable to recess at this stage.

[Coffee break]

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. Thank you, Mr. Chairman. I've been saying for some time that New England was not experiencing the depth of the national slowdown. This was occurring, I thought, for a variety of reasons: industry mix, the extreme tightness of regional labor markets, and even what turns out to be a powerful impact of a great ski season on local tourism, just to name three. It now appears, however, that New England is beginning to catch up--or is that catch down?--with the rest of the country, though in general the region continues to experience somewhat less softening than the nation as a whole.

Employment growth continued to slow in New England and the unemployment rate has risen since the March Open Market Committee meeting. However, the rate remains well below that for the nation. And Connecticut, with an unemployment rate of 1.9 percent, again recorded the lowest unemployment in the country. Indeed, the recent softening in the regional labor market was welcomed by many contacts and was seen as a whole new ballgame for hiring needed staff. One Connecticut manufacturer said that potential hires are now behaving in a more normal way--that is, not holding out for a BMW or other signing bonus! Manufacturing is the only sector cutting jobs in New England and, unlike the nation, business services in our area continue to expand, although at a slower rate than earlier. Within manufacturing, industries in which New England has a traditional concentration--industrial machinery and electrical

equipment--have slowed markedly in the nation as a whole but not so much in the region. Indeed, in Massachusetts these industries are still expanding.

Looking forward, however, the region's increasing concentration of information technology companies, software businesses, and particularly telecommunications and Internet-related industries does not bode well for a continuation of the region's comparative good fortune. Depending on the extent and depth of retrenchment in technology spending nationwide, New England, and especially Boston, may well experience an increasing severity in their downturn. Clearly, this is the region's largest area of vulnerability and uncertainty.

Business confidence in general dropped in April to a level not seen since 1993, after recovering some ground in March. The index, however, is sharply divided between current and future sentiment. The current index is below 50, indicating a negative assessment, while the index for conditions six months ahead, though lower than in March, has remained above 50. Most of the manufacturers contacted for the Beige Book are cutting or postponing capital spending projects, especially planned expansions of capacity. However, in research and development, expenditures are being stretched out, not eliminated. Belt tightening, either in the face of declining business or simply in anticipation of it, seems to be the order of the day.

Consumer confidence also dropped in April and is now much lower than it was a year ago. And unlike the view of business executives, consumers see the current situation as relatively positive, probably because of a continuing strong jobs picture, but the future has not looked as bleak to them since the early '90s. Retail sales in the region seem to have flattened out in recent months and retailers are cautious about the future. In this relatively high-income region, concern was expressed about the negative wealth effect of lower stock market values, but retailers did see continued support from New England's relatively low unemployment levels.

In short, while businesses may be holding off on spending, households may continue to be a source of strength in New England. The potential for this is clearest in the housing markets. Here prices continue to rise at rates above those of the nation. All six states experienced such increases, while a year ago three of the six lagged behind the national rate. Beige Book contacts saw regional real estate markets as strong in April, and inventory seemed to be a constraint, not weakness in demand. Indeed, the rise in consumer prices, as reflected by the Boston area's CPI, remained well above the national rate, largely because of increases in the housing portion of the index.

Since our March FOMC meeting, we at the Bank have held a meeting of our Academic Advisory Council and a series of meetings with bankers in the region, along with our usual directors' meetings. The academics were, with few exceptions, surprisingly unfazed by the current slowdown. They saw some resilience in the consumer and some likelihood that business capital spending might resume sooner rather than later, given the continuing pace of technological change. A few saw inflation concerns on the horizon but the majority agreed that the risks remained a bit on the down side. It was hard to see any sign of slowdown from the reports we heard in our meetings with bankers. Small banks in the region continue to benefit from the strong ski season, strong mortgage refinancing, vibrant housing markets, and good prospects for the summer season. In fact, one banker with the region's largest beer distributor as a customer noted that in times of serious economic problems, beer drinkers typically move down the food chain from expensive imports like Heineken to Bud or even Genesee. [Laughter] In that regard, he reported that cases of Heinekens still fly off the distributors' shelves.

Let me turn to the national data and the Greenbook projections. They should give Heineken distributors and drinkers some pause! Our projections are quite similar to those of the

Greenbook: a slow second quarter, hopefully above a negative number but likely below 1 percent growth; a slower second half than we had earlier projected; and stronger growth in 2002, though below our earlier expectations. Our estimate of the economy's potential remains a bit below that of the Greenbook, though less so since the Greenbook's downward revision in near-term structural productivity growth. Thus, our unemployment estimate ticks up a bit less than the Greenbook's, under an assumption of unchanged policy, and the CPI moves sideways.

It's also clear that the risks remain predominantly on the down side. The length and depth of the downturn in technology spending and the related technology investment overhang remain extremely uncertain. Rising unemployment and sideways stock markets cannot help but affect consumer spending. And the foreign picture is increasingly negative as well. Thus some further policy ease may well be necessary. But like others, I also believe it is time for serious reflection on the pace and size of policy easing--a consideration of how much is too much. I think this for at least three reasons. First, inflation is not dead. Recent data clearly are driven by energy costs, but the energy situation doesn't show signs of going away soon. In the near term such costs, along with rising benefit costs, may simply bode ill for profit margins and contribute to rising unemployment and lower stock market prices. In the medium term, however--nine months to a year out--if demand accelerates more than projected, inflation rising from its current levels may well be an issue. Indeed, the recent steepening of yield curves may reflect some rise in inflation expectations, though I realize that is by no means clear.

Second, even if higher inflation is not a concern, financial market excesses should be. As we saw in 1994 and in 1997-98, extended periods with interest rates that are arguably too low for too long or are perceived to move in only one direction can produce a predilection for one-

way market bets of one sort or the other. Concerns for the stability of growth in the period following the current slowdown seem to me to argue for some caution now.

Last but not least, I think the fiscal picture is a wild card. It has been a while since fiscal policy has been available for use as countercyclical tool. The Greenbook's estimates may or may not be right, but with both government spending increases and tax cuts in the mix going forward, I think a measure of uncertainty abounds here. Let me be very clear: I don't disagree with the Greenbook's assessment of current and near-term conditions. They do seem to be weaker than is optimal, even recognizing that the slowdown the economy is experiencing is one that was needed. Moreover, the slowdown now seems to be hitting the economy's primary source of earlier strength the hardest, namely high-tech investment. And that has a potential range of effects that go well beyond spending and perhaps into productivity. But now is also the time to begin to consider carefully the environment nine to twelve months out and to reflect on what the level of real interest rates should be to ensure that that environment is a good one. Some would argue that it's easy to reverse the final policy move if it seems to be one step too far. I think that is hard to do in part because so much of the data we see are backward-looking, not forward-looking. It could also be argued that we are one or two moves away from going too far. That may be true but, like others, I think the time has come for caution. Thank you.

CHAIRMAN GREENSPAN. Vice Chair.

VICE CHAIRMAN MCDONOUGH. Thank you, Mr. Chairman. The Second District's economy continues to perform rather well, especially in relation to the rest of the nation. It has expanded since the last report, though its growth has slowed somewhat. Inflation remains subdued and price pressures actually appear to have eased somewhat. Job growth tapered off in March but unemployment rates remained at or near cyclical lows, edging down to

4 percent in New York and edging up to 3.8 percent in New Jersey, or at least in our half of New Jersey. Retail sales were described as somewhat sluggish in April but noticeably stronger than in March. Retailers' selling prices, merchandise costs, and wages were little changed, but costs of employee health benefits and utilities have risen sharply over the past year. Purchasing managers noted some weakening in business conditions and easing in cost pressures in April. Construction and real estate have been mixed but remained generally buoyant. We had a moderate decline in single-family housing permits in the first quarter but that was more than offset by a surge in the multifamily sector. There has been a bit of softening in Manhattan's apartment market but prices are still up more than 15 percent from a year earlier. The New York office market slackened in the first quarter but demand and leasing activity remained fairly brisk and space is still said to be in fairly short supply. Local banks reported widespread increases in demand for home mortgages, further tightening in commercial loan standards, and very little change in delinquency rates.

Shifting out of the Second District, let me start with the international side and then work back to the domestic. I think the international situation is quite worrisome. I very much share Karen Johnson's observations on the subject, but let me add some of my own. Fortunately, I recently finished the last of my international trips as "sales manager" for the new Basle Capital Accord, visiting four countries in Europe about a week or 10 days ago. Although the slowdown in Europe's growth is attributable somewhat to the effects of the slowdown in the United States, the problem is that way too much blame for the weakness in Europe is being placed on the U.S. slowdown. That means that the authorities in Europe are not doing what they should be doing in terms of improving the structures of their own economies or making appropriate policy decisions.

In Japan, yes, we have a possibility of something different with the new Prime Minister, but the new Prime Minister is talking about using his political capital to bring about two changes. One is the direct election of the prime minister, despite the fact that a direct election of a prime minister in a parliamentary system is a sure formula for even less decisive, not more decisive, government action. The second is that he wishes to stop calling the military “self-defense forces” and to call them what they are--which is an army, navy, and air force. That proposal is a part of a considerably more nationalistic approach. One is hearing very little from the new Prime Minister about actually fixing the economy, which is desperately in need of fixing. After 12 years of a problem banking system, the net progress in improving that system rounds to zero. The level of problem loans is extremely problematic. The possibility of their taking aggressive action is actually in the talking stage, but it certainly does not appear very likely to hit the action stage. The exception is that some of the underlying collateral of the most troubled loans may be moved into the market in an effort to begin a very belated clearing of the markets. It is not easy to be optimistic about the situation there.

The beginning of a slight slowdown in China is reported in the most recent data. That is problematic for two reasons. One is the effect on China itself. Secondly, especially relative to other countries in Asia which compete with China in the export of consumer goods, the Chinese are very capable of solving their problem at the expense of their neighbors simply by dropping prices. They can do that easily and take market share, thus weakening their already weakened neighbors.

As Karen pointed out very well, the situation in Turkey demands a lot of thinking, perhaps even wishful thinking in terms of the success of their formula. It demands a degree of fiscal change that is very difficult to imagine taking place, even in a country with a very strong

government and a very disciplined population--for example, that their very deep banking system problems are going to be resolved in two years. That is highly unlikely. So we have a program that is possible, but very difficult to find convincing. The situation in Argentina is rather similar in that on paper it works, but it demands a degree of political leadership and political cohesiveness that also calls for a rather creative imagination.

Structurally, I think our new Administration is making the right decision in thinking that international problems like those of Turkey and Argentina should be tackled through the international institutions, particularly the International Monetary Fund. That is the approach the Administration has taken, and I believe correctly, in both Argentina and Turkey. However, in the last two or three weeks, senior managers of the International Monetary Fund have essentially announced that they are leaving, so we have a new managing director whose senior staff colleagues are leaving the organization within the next few months. That means that the key institution in international problem-solving is going to be looking for capable new senior executives and it's very difficult to imagine that the quality of the replacements will be as high as that of the incumbents. All of this leads me to believe that the international situation provides a backdrop of downside risks for the national economy.

Our forecast is rather like that of the Greenbook. We think it's very easy to exaggerate the importance of the IT workout, which probably will take several years. We believe that the rest of the economy can continue restructuring and move ahead, and that therefore a recovery in the latter part of the year, probably about the fourth quarter and into 2002, is the best forecast. But it certainly seems to me that the balance of risks is immensely on the down side.

Let me just talk about the up side. Yes, the economy could snap back faster than we envision. But if it does, we would be able to spot that quite early on. I don't think we would have to wait for the data to see that happening; we could discover it through anecdotal evidence. And certainly if it happens, we know very well what to do about it. We do not have a credibility problem with respect to this institution and this Committee being appropriately concerned about inflation. Nobody doubts that we're concerned about inflation. So we don't have to be raising a big flag saying we know inflation is a problem because everybody knows that we know that. I think they also believe that we know what to do about it. Remember, this is the same FOMC that doubled the fed funds rate between February '94 and February '95. Our track record of attacking inflation, including our doing so before it existed in the data, is quite robust. And our resolve to do that is something that I think the market assumes.

However, on the down side, as has been very clearly presented in the staff briefings, the forecast depends enormously on the willingness of the consumer to keep spending. Yet the historical data indicate that if there's anything to which consumer confidence is tied, it is the confidence in having a job, holding one's job, or finding a new one easily. And with a rising unemployment rate, it's not very difficult to envision that at some stage the consumer is going to think this is all too good to be true. It doesn't have to be quite as dramatic as Wile E. Coyote racing furiously along thoroughly optimistic until all of a sudden he realizes there's no ground below him. But it doesn't take a whole lot of change in the consumer's view about buying a new car, a new house, or the items to put in that new house to produce a very significant downturn in consumer spending. As Dave Stockton pointed out effectively in response to Bob Parry's excellent questions, our models don't work in assessing the effects of a loss of consumer confidence or a loss of business confidence. And in the current environment the latter is even

greater than the former. The level of business confidence, low as it is, is rather appalling. So it seems to me that the downside risks are very considerable indeed and our ability to model them is low. Accordingly, we will have to watch very carefully for signs that the downside risk is materializing, even if we do not judge its likelihood as high.

Let me talk a bit about the markets, which have their headquarters in the great City of New York. One of the reasons market participants think that the economy may be a little better is that they were in such an enormous funk about six weeks ago that they were thoroughly convinced that the end of the world would happen between the 1st and the 30th of April. Well, that burst of immaturity has been replaced by a swing in the opposite direction, which I don't think tells us a whole lot about what we should read from the market. Mainly what it tells us is that the market is volatile. Market participants are trying to figure out where the economy is going. They understand the upside and downside risks and they don't know what is going to happen. So they bounce the market around very rapidly, sometimes with a lot of volume and sometimes with very little volume. In my view the main message the market is conveying is that it is extremely uncertain. So am I. Therefore, I would caution that we should not read more into what the market is telling us than is really there.

In summary, Mr. Chairman, I think the downside risk is extremely serious. I hope very much that it will not materialize. But if it does, the outcome could be quite grim indeed. Thank you.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. When I look across the Eleventh District economy for signs that the economy is picking up, I'm hard pressed to find any. The bulk of the statistics and anecdotes suggest an economy whose growth rate is barely perceptible and not changing. To be sure, there

are pockets of strength, notably housing and energy. But the rest of the picture that emerges is far less encouraging. The unemployment rate has been edging up. And initial unemployment claims, together with an almost constant drone of layoff announcements, portend additional increases in unemployment in the months to come. Until recently, most laid-off workers were being absorbed, but the layoffs are currently swamping the demand for hiring. The rise of job search engines has probably reduced somewhat the impact of the job turn in this cycle in comparison with previous downturns in labor demand. So, even during a recession in the high-tech sector, information technology advances of recent years may be helping to cushion the impact.

For Texas and the rest of the Eleventh District, the first couple of sentences of our Beige Book report summarize the situation. Our January Beige Book was the most pessimistic report ever written by the economist who has been working on that document for the last dozen years. This time she reported that economic activity decelerated in March and early April and that contacts in most industries expect activity to remain sluggish throughout the year. Cutting through all the code words, our analysis suggests a no-growth regional economy in the second, third, and fourth quarters. She also noted that “there were more reports of price declines than price increases,” suggesting that the inflationary risks in the months ahead are somewhat minimal. The reports from many other Districts reflect a similar tone, so the Dallas District is not an isolated example.

Turning to the national economy, I’m struck by the reversal in Greenbook forecasts. The staff has been revising down its forecasts of economic growth in much the same manner as it was revising them up just a few years ago. I’m also struck by how the progressively worse outlook as reflected in the Greenbook is following the same pattern--with a lag--that appeared in

the anecdotal information in the Beige Book. As I look to the rest of the economy going forward, I don't see a lot of room for policy error, given the current state of the economy. We need more ease, and the question is only one of degree.

The international outlook continues to soften. Business investment continues to weaken. And personnel managers have been standing in the hallways in order to get the pink slips out faster. Under the circumstances, consumer spending is holding up reasonably well. The housing market is steady and refinancings have helped to offset some other negative factors for households and for investment grade corporations. The impact of our four previous easings should begin to kick in soon, together with an expansionary fiscal package.

Over the last week or two I had thought that lowering rates by another 1/2 point at this meeting would be going 1/4 point too far, given what we had already done and the way consumption spending was holding up. But the Greenbook commentary suggesting that consumption activity might already have started to weaken has caused me to reconsider my reconsideration. Perhaps my strong certainty as to the need and direction of a policy move and my less strong certainty as to the appropriate degree of easing suggest a different type of action this time. After what we've already done, maybe we can have a compromise that would reduce the fed funds rate by more than the discount rate, thus narrowing the spread and taking a small first step toward making the discount rate a penalty rate.

CHAIRMAN GREENSPAN. Governor Ferguson.

MR. FERGUSON. Thank you, Mr. Chairman. In reviewing the incoming data and market conditions in preparation for this meeting I, like others, was struck by the apparent disconnect between the marketplace and economists. Since our March meeting, with some zigzagging, equity indices--which are thought to lead the real economy--have in fact experienced

growth of 6 to 9 percent, perhaps signaling an expected turnaround in the not too distant future. The dollar also has remained strong, again suggesting that many think the United States is the place for their funds to be. Finally, fixed-income investors are demanding returns that suggest they have a more optimistic assessment. And, indeed, businesses are issuing bonds to fill their coffers. Therefore, one could argue that the markets actually are forecasting a somewhat brighter outlook than most economists. However, one must also ask what interest rate assumptions are conditioning market behavior, and for the answer I think one can turn to the fed funds futures market. That indicator suggests that the markets are expecting a decrease in the funds rate at this meeting on the order of 50 basis points. So if one is looking to the financial markets for some guidance on what the future is likely to be, it's also important to ask what interest rate assumptions are built in.

We should contrast this moderately more upbeat outlook from the markets with our own dour assessment, based on what I've heard around the table. Our economists have talked about the reductions in the Greenbook forecast and I've heard three or four Reserve Bank presidents suggest that their own forecasts have been marked down. It's always hard to go against the markets, but I think in this case the staff who produce the Greenbook and other economists probably have a slightly better sense of what is ahead of us. It is tempting to think that the bottom has been reached, but in my view it is far too early to have much of a conviction that the bottom is at hand or that the future is clear. Therefore, I find the Greenbook quite credible and I believe the downside risks described in the Greenbook should not be taken lightly.

Incoming data seem to indicate that the economic weakness that started with motor vehicles is now relatively widespread. Although motor vehicle production now appears to be holding up, there is indeed a risk that production in that sector will fall back later this year if

sales do not pick up. But it also appears that the output of high-tech industries and production in the remaining sectors of the manufacturing industry continue to be restrained by excess inventories. Indeed, the inventory/shipments ratio is up for manufacturing overall. This weakness in manufacturing in turn is holding down capital spending and capacity growth, both currently and probably for next year as well. As long as businesses are suffering from what is called a classic profits recession and they continue to withhold plans to increase capital spending, the only engine of growth seems to be consumers. The most recent retail sales numbers, with downward revisions to February and March, suggest that consumers may well pull in their horns a bit too, in response to the wealth destruction they've already experienced and the drumbeat of unemployment announcements that they are hearing.

By my estimation, the risk around the Greenbook forecast is also clearly to the down side. With an economy growing--and likely to continue to grow far below its potential--the risk of a shock, be it domestic or international, pushing the economy into negative territory is, for my taste, uncomfortably high. We cannot rule out a worse outcome than the baseline forecast, perhaps one approximating the "weak household demand" scenario described in the Greenbook. Given this outlook and the risk I believe we face, the obvious question is: What is the proper policy response? In answering that question, we should be clear about what we are trying to do and what we are not trying to do. We're not trying to stabilize unemployment at unsustainably low levels. Nor in fact are we trying to speed up the investment accelerator, because I don't think we can do that. The most I believe we can do is to cushion the economy to allow business plans to gel more firmly and to maintain some semblance of consumer confidence.

While I recognize that we have moved aggressively and have front-loaded our actions, I think we should not slow our pace of easing moves at this meeting. We must always act in the

context of our long-term goal of price stability. But I do not believe that there is a very great risk of an unmanageable outbreak of inflation during the relevant policy horizon. Indeed, as I look at market expectations and various surveys, the markets in general are telling us that they also don't expect inflation to pick up to unmanageable levels in the near term. However, we do need to have some guide or anchor and in that regard, like Jerry Jordan, I found the chart in the Bluebook very, very helpful. What that chart suggests is that with inflation expectations anchored around 2 percent, the current real interest rate is probably just about neutral. Given my outlook, which is not too dissimilar from the Greenbook's, and the balance of risks that I see, I think we should be willing to move to a slightly stimulative stance of policy at this meeting. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Governor Gramlich.

MR. GRAMLICH. Thank you, Mr. Chairman. Earlier in the year, there were various indications that the economy could have been on a sharp downward slide. By this time, we're probably past the time of greatest risk, but the economy is still in a very fragile state. The high-tech sector is in a state of over-capacity, with PC sales down, communications orders down, and fiber optic equipment sales down. Overall industrial production is down, capacity utilization rates are at 10-year lows, and inventories outside of transportation and high-tech are building up. As yet, consumption has not dropped much and the personal saving rate is still negative. The baseline forecast has personal saving turning around, in which case the growth of consumption is likely to soften. The scare stories may be over and there are certainly points of strength, but the domestic economy is still in a very fragile state.

I'd like to join Bill McDonough in talking about the international economy, but I want to focus on the relatively healthy economies. There is a haunting similarity between what is

going on in this country and what is happening in the euro zone countries, Canada, and the United Kingdom. Each country is in the midst of a significant inventory correction. Industrial production is dropping, there may be a capital overhang, and business and consumer confidence is off. In each country the forecast is pretty much the same: Excess inventories will be worked off, the capital overhang will be worked off, and growth will resume. But what if that doesn't happen? What if some countries cannot quite achieve the growth toehold and then drag others down? And this story refers only to the healthy economies. The outlook, as you've heard, is much more problematic for countries like Japan, Argentina, Turkey, and the high-tech exporters of Southeast Asia. Again, the message is not necessarily one of overwhelming weakness, but rather one of fragility and significant downside risks.

On the other side of the ledger, since the start of the year the FOMC has already lowered the funds rate by 200 basis points. Isn't that enough? Not necessarily; that depends on where the funds rate was when we began lowering it. It is easy to fall into the trap of thinking about policy in terms of changes and not levels. In that connection, I'd like to join several others in referring to the Bluebook analysis showing the real funds rate in comparison to a number of alternative measures. As compared to the long-term historical average, the real funds rate right now is just barely below this benchmark. As compared to a forward-looking tax-adjusted measure of expected future funds rates, the margin is greater. The same is true in comparison with a number of indicators designed to measure the full employment funds rate derived from model simulations. The basic message I take from that is that even though we have lowered the funds rate a lot, in real terms monetary policy is not yet leaning against a recessionary wind by all that much. In view of the risks mentioned above, a further downward adjustment could certainly be justified.

One arrives at the same conclusion from the Greenbook model simulations. The baseline case assumes a reduced funds rate at this meeting and still has unemployment rising to 5.1 percent at the end of this year and to 5-1/2 percent at the end of next year. These unemployment rates are well above the rates necessary to control inflation, in my view. The simulation using the federal funds futures path arrives at essentially the same results. Those simulations have built into them a reasonably strong response of spending to interest rate changes, contrary to many arguments we're hearing that question that response. The lesson I would take from these simulations as well is that there is still a strong case for monetary policy easing.

On the inflation side, as everybody is well aware, the news has not been very good. Energy prices have risen sharply and various measures of core inflation have risen slightly, perhaps reflecting difficulties in measuring and filtering out the energy prices from the overall price index. Productivity is down and unit labor costs are rising more rapidly, again perhaps reflecting nothing more than the drop in capital spending. The TIPS nominal/real spread has risen rather sharply. But I would still argue that long-term inflation risks are basically well contained. Commodity prices are stable to down. Inflation expectations in the Michigan and Philadelphia surveys are stable. The Blue Chip forecasters are anticipating a slight dip in inflation, as is the Greenbook. Inflation measures in other countries are stable, well within the target zones for inflation in Canada and the United Kingdom, and for core inflation at least in the euro zone. There is still deflation in Japan. One can never be sure, but on the whole I would say that the inflation pattern we are observing is a series of blips largely related to energy prices and not a damaging trend.

My bottom line is that I am aware that we can't forever keep on easing monetary policy in large steps. I'm aware that if we get the real funds rate too low we will have to raise it again at some point. I'm aware that measured core inflation has crept up. But it also seems to me that the economy, both domestically and internationally, is currently in a very tenuous state, with still significant downside risks. Both from a short-term and a longer-term perspective, I think we can safely lean harder against these recessionary winds.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Thank you, Mr. Chairman. Are we beyond the crisis stage of our deep slowdown and are we now entering a firming and turning period? Much of the market's recent action and sentiment indicates that that is likely the case. And certainly if increasing difficulty in arriving at a firm conviction about monetary policy is symptomatic of a sea change, then I, along with Bob McTeer, probably am an indicator that we are there. I hope and cautiously believe that that is the case and that the economy is bottoming out. Recent incoming data suggest that it is. Last week initial claims fell. April retail sales were robust. Consumer sentiment showed an improvement. Both headline and core CPI are moving upward ominously, possibly suggesting renewing strength in the economy. The inventory correction seems well advanced. Our high-tech problems look to me more and more like another episode of sectoral rolling recession that we have often seen before in industries such as energy, construction, defense, agriculture, autos, and others. They seldom drag down the entire economy by themselves.

So, things are starting to look better. But a closer inspection reveals that much of this news is quite tenuous. Initial claims are a helpful but volatile series, and we have only one favorable week to go on. Obviously, we'll need much more to know if the rising pattern is

reversing. And with unemployment likely to go higher, that seems questionable. April's strong retail sales were accompanied by downward revisions to previous months. Stronger consumer sentiment needs a lot of confirmation. While the CPI is rising, the PCE and other price series are not. And while a great deal of inventory reduction is taking place, inventory-sales ratios are still very high in many sectors.

As for the rolling recession in the high-tech sector, it could prove to be more troublesome than most of its predecessors. It is occurring simultaneously with a number of other problems and imbalances in the economy including--in addition to the concerns already mentioned above--record household debt burdens, over-investment by business firms and over-spending by consumers, higher energy prices, a bear market for stocks, and a worldwide slowdown. Can all this be handled at the same time that our most dynamic sector of recent years is going through its own rolling recession? It is a concern. Possibly fiscal and certainly monetary policy could help provide the needed extra boost to pull us through to renewed growth.

To sum up, Mr. Chairman, I believe we are winning, but the fat lady has not yet sung. I suggest we would be well advised to keep the easing pressure on now, hope this is the last time it is necessary to do so aggressively, and then we will be free to focus more clearly on price level stability in future periods.

CHAIRMAN GREENSPAN. Governor Meyer.

MR. MEYER. Thank you, Mr. Chairman. My views of the outlook are very consistent with both the qualitative story and the general details of the Greenbook forecast. Relative to that forecast, the risks in my view have become more balanced. I also share the view that several others have expressed today--that given that forecast, we're approaching the point where it would be appropriate to become much more cautious about further easing.

In the near term, the negative wealth effect and the retrenchment in high-tech investment appear almost certain to be significant drags on the economy. As a result, growth looks likely to remain very weak in the second and third quarters and then to gradually, and only gradually, move back toward trend. The prospects for a gradual improvement reflect in part the stimulus expected, but not yet evident, from the aggressive easing moves over the first part of this year. Clearly, there are still downside risks.

We have approached the point where we also have to pay more attention to the upside risks. That may seem odd given that so much of the rise in the unemployment rate in this episode may still lie ahead of us. But the decision to move aggressively toward stimulus in 50 basis point increments, and including two intermeeting moves, means that we may also need to end the easing sooner. Indeed, we may get to the point where we have put in place an appropriate degree of stimulus even before much of the effect of that stimulus becomes evident.

The modest rise in core inflation and the upward adjustment to the staff's inflation forecast support this assessment. These developments confirm, in my view, that inflation risks were indeed building before the economy slowed so sharply. In addition, these developments point to what might lie on the other side of recovery. After recessions, the buildup in slack often allows a period of disinflation during the early cyclical rebound and, at the very least, a considerable period before concerns about rising inflation surface. The slowdown in this case began in my view with output above potential and growth in demand above the rate of growth of potential supply. In the Greenbook forecast the slowdown under way results in output falling below potential, but not very far below, by the time growth returns to its potential rate sometime in 2002. Indeed, in the Greenbook forecast, the unemployment rate rises to about the level of the staff's estimate of the long-run NAIRU in 2002, with the staff's estimate of the short-run NAIRU

lagging behind, but not very far behind, and still converging with the long-run NAIRU. At any rate, more so than in most cyclical downturns, there is potential for overshooting.

Let me conclude with a few comments on the role of the productivity assumptions in the Greenbook forecast. We have new data. The staff revised the estimates for 2000 going forward, and the projections now suggest that structural productivity growth stabilized in 2000 after ratcheting higher over each of the preceding eight or so years. The continuing rise in structural productivity growth in earlier years renewed each year the temporary bonuses associated with rising structural productivity growth--specifically, the stimulus to aggregate demand and the restraint on inflation. The apparent stabilization in structural productivity growth in 2000 may, therefore, have contributed at the margin to both a weakening in aggregate demand and to the upward pressure on inflation.

The second feature of the productivity story is the decline in structural productivity growth that the staff now projects for this year and next year. Just as the staff was quick to revise upward its estimate of structural productivity growth in response to revised data and prospects for capital deepening, they've been quick to revise it lower. Assuming the staff has that right, the decline in structural productivity growth could also reinforce both the downdraft on aggregate demand and contribute to upward pressure on inflation.

CHAIRMAN GREENSPAN. Thank you. Don Kohn.

MR. KOHN. Thank you, Mr. Chairman. By some measures, the Committee's cumulative easing of 200 basis points this year has already made monetary policy accommodative. The Bluebook highlighted one way to calibrate that judgment--the level of the real federal funds rate relative to an estimate of its equilibrium value. The real funds rate is as low as it has been since mid-1994, and it is at the lower end of a range of plausible estimates of its equilibrium level. But it has only very recently dipped into or toward that accommodative zone. The funds rate was restrictive late last year, and a portion of its subsequent decline was needed to keep up with

decreases in the equilibrium rate owing to lower productivity growth and higher equity premiums.

The easing of policy is showing up in other ways in financial markets. Although nominal yields on longer-term Treasury notes and bonds have risen a bit this year, longer-term borrowing costs for many private borrowers have dropped appreciably as credit spreads have narrowed; and these costs have fallen sharply in real terms if inflation expectations have increased by anything like the amount suggested by the widening spread between nominal and real yields in the Treasury market. Favorable conditions in bond markets have stimulated a large volume of issuance, providing alternative sources of funds for those businesses facing constraints on the availability of credit in the commercial paper market and, more broadly, facilitating a strengthening of corporate balance sheets. And the shift toward policy accommodation has been associated with a considerable buildup in liquidity on household balance sheets, judging from the sustained surge in the growth of M2.

But these financial conditions do embed expectations of a further easing of policy. Moreover, the movements of some asset prices, in particular the decline in equity prices of 6 percent this year and the rise in the dollar of around 4 percent, have offset a portion of the effects of monetary easing, reducing the amount of financial stimulus in the pipeline. And, the Greenbook and Dave's briefing identified a number of forces that are quite likely to be damping the expansion of aggregate demand relative to the growth of the economy's potential, working against the natural tendency for the economy to respond to relatively easy monetary policy.

If the Committee, like the staff, sees a high probability that these adverse forces will not be dissipating very quickly, then a somewhat more accommodative policy might well be called for to bolster demand several quarters out--the time frame in which policy can have an effect. Against this background, the question for the Committee today would seem to be how much further policy needs to adjust to take account of declines in the equilibrium real rate and to become accommodative enough relative to that rate to foster satisfactory economic performance over time.

Several factors might be seen as arguing for implementing a more cautious approach to further easing at this meeting, by lowering the funds rate 25 basis points. If productivity growth and equilibrium real rates remain fairly high, policy is already to the accommodative side. In that environment, the impulse from previous declines in interest rates, along with the support to income and profits from continuing technical change, should bolster the rate of expansion of consumption and investment over time. Moreover, the recent upticks in a number of measures of core inflation may tend to support the hypothesis that an unemployment rate around 4 percent

was perhaps too low to be sustained once productivity growth leveled out. Judging from market measures of inflation compensation, investors do not see the higher unemployment rates that have come about this year as likely to produce any decrease in price pressures. In these circumstances it would be important that the economy not snap back so strongly that labor and product markets begin to tighten again; indeed, they may need to slacken further, as in the staff forecast, to avoid a persisting intensification of price pressures.

That markets have built in considerable odds of a further 50 basis points of easing today and some chance of another 25 basis point decline in the funds rate by year-end may be more a comment on perceptions of your policy strategy than on what participants see as desirable to achieve satisfactory economic outcomes. Markets also have built in a percentage point of policy tightening in 2002, apparently reflecting optimism about the resiliency of the economy. Indeed, judging by the rise in equity prices and bond yields all around the industrial world over the intermeeting period, the pessimism that has been restraining spending plans may be starting to dissipate, which would give a further boost to demand. A 25 basis point easing at this meeting likely would change expectations about policy in the near term and would raise interest rates along the yield curve somewhat. But in addition, by altering perceptions of the trajectory of your easing, it could help to damp market reactions to incoming data and reduce the risk that markets will build in more ease than you would find appropriate. Even if you suspect that ultimately you will need to ease by a full 50 points but are far from certain, the smaller action would enable you to accumulate more evidence about the strength of demand and the response to earlier easings.

If, however, you believe that the forces holding down demand could well be strong enough to require a more definitively accommodative policy for a while, you might go ahead with a 50 basis point reduction in the funds rate at this meeting. The staff forecast would seem to support such an action as it sees the unemployment rate rising another percentage point even after a 50 basis point easing today. In that forecast, a relatively easy monetary policy is needed to counter the effects of an adjustment of household and business spending to the downshift in wealth, income growth, and the perceived profitability of capital investment--and that adjustment is expected to be exerting noticeable restraint over some time. Moreover, if the Committee harbored suspicions that the unemployment rate did not need to rise so high to contain inflation, 50 basis points would seem justified even if you see aggregate demand not quite as weak as in the staff forecast.

The Committee may be especially inclined to 50 basis points of ease if it believes that the new-found optimism in markets and the uptick in consumer confidence could be fragile. With weakness in employment

hitting households, and with the full dimensions of the softness in the demand for certain high-tech equipment still being incorporated into attitudes and spending plans, the Committee may prefer the potential stimulus of a small further rally in markets in response to a 50 basis point reduction to the possible restraint of a backup in interest rates owing to disappointment with a 25 basis point action. Preferences in this regard would seem to be consistent with a view that, even after a 50 basis point easing move, the risks still would be weighted toward economic weakness. Although the 50 basis point action would put policy more definitely into the accommodative zone, there is little concrete evidence that demand is yet responding appreciably to previous easings. With sluggish growth likely to be reducing pressures in labor and product markets in the period just ahead, inflation should be damped and economic growth below the growth rate of potential could still be seen as the main risk to satisfactory economic performance. Judging from the path of expected funds rates built into markets--encompassing only a moderate further ease and substantial tightening next year--your aggressive policy actions seem mostly to have affected very short-term expectations and they have not short-circuited the potential for financial markets to stabilize the economy as they react to incoming information. Hence, if you think 50 basis points of ease is quite likely to be required, there might be little gain to adjusting the tilt of your actions to a more gradual slope just to affect financial market expectations.

Policy action at this meeting, particularly if you reduce the funds rate 50 basis points, implies that you will have put in place a very accommodative policy stance relatively quickly, raising the risk of policy overshooting. You have, in effect, engaged in somewhat forward-looking policymaking. Although you waited for definitive signs of weakness before you began to ease, you have responded to those signs quite strongly, relying more on forecasts that the forces at work will persist than on actual output and inflation data to key the cumulative size of your moves. And, you have continued to ease before seeing how the economy was responding to your previous actions. Front-loading actions--either tightening or easing--should help to stabilize the economy, provided the shifts in demand or supply occur as you anticipate, or at least policy reacts "promptly and forcefully" when circumstances change. It will be especially important to continue to be forward-looking as policy becomes more accommodative. You may well need to stop easing even as the economy continues to demonstrate signs of softness, and you may need to tighten promptly once growth shows more definite indications of picking up. This would be a different pattern than policy has often followed in the past, but it would be consistent with your actions to date and with the arguments you have made for a less gradual policy strategy. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Questions for Don? If not, let me get started.

As best we can judge, the decline in industrial production--modest though it was in April--occurred in the context of a significant rate of inventory liquidation in the non-high-tech area of the economy. Indeed, rough estimates suggest that the rate of liquidation in that area continued much as it had proceeded since earlier in the year. An exception obviously is motor vehicles, specifically light trucks, where there has been some recent backup in inventories after earlier reductions. Unlike the experience in what we might call the traditional parts of the economy, inventory liquidation in the high-tech area probably did not start until very recently, and it has a long way to go because high-tech sales clearly are still falling. Obviously, the extent of further inventory liquidation will be significantly attenuated if growth in final demand starts to move up. That, more than inventory liquidation, is the effective tool for bringing inventory-sales ratios down to where they have to be, which means returning them to a path consistent with their earlier downtrend. Although the ratios actually have risen only modestly above that trend, they now have a long way to come down. The liquidation in the non-high-tech area likely will continue for a number of months, but that in the high-tech area will require a more protracted period. Fortunately, inventories in the high-tech area are not that large a part of total inventories and hence further inventory correction will not constitute a significant drag if business firms can get the non-high-tech inventory liquidation out of the way.

The inventory correction process is the basic stabilizing force in this type of economy. If demand holds, then clearly, as Dave Stockton said, production must start to rise at some point because there is a limit to how low inventories can get. Indeed, in a period when inventories are running off at a very significant pace, firms tend not to anticipate when a sudden need to scramble

to fill some orders will materialize. That process I would say has not started, but that's what we have to look forward to as the major force of recovery in business activity.

The key question is whether this recovery will start prior to any further, cumulative weakening in the profits and capital investment area. Profit expectations continue to erode, although the data in the last couple of weeks show a lesser decline than in the previous period. Nonetheless, it's very difficult to know whether we are over-analyzing a series such as this. Remember, what is involved is a thousand analysts reporting their profit expectations company by company to either IBES or First Call, and their reports are invariably a reflection of what they hear from corporate management and not a reflection of any great insights on their part. So, at this stage we don't know whether the slowing in the rate of decline in profits is an indication of some stabilization, but it is a precondition for that stabilization. If profit expectations do not stabilize, then it is very likely that the ongoing capital goods retrenchment will be far greater than in the Greenbook or in other forecasts.

Despite all the negative things we hear about capital investment--which is devastating in the dot-com area and almost as bad in the telecoms--the actual level of capital expenditures is still quite high. This means that the downside possibilities are not small. If we are thinking solely in terms of the way business cycles have behaved in the post World War II period, then our presumption is that the potential extent of downside adjustments will be relatively limited. That is, we have not had a really severe correction in this economy in the post World War II period, even in 1982. But when we begin to look over a longer historical period, the potential corrections look rather scary. Now, such a prospect involves a relatively low probability forecast, but if we are looking at loss functions in our determination of policy, its weight is really a lot more in my judgment than I think we have put on the table. One of the reasons is that, by

any relevant measure, stock market prices are still probably higher than what our models say would be consistent with their fundamental determinants. The trouble that we have with a stock market decline is that it never stops where the models say it should; it continues lower. Implicit in all stabilization forecasts, and indeed that is my forecast, is that stock market prices will hold at higher levels than the models would expect, largely because long-term rates of return and productivity increases are only very modestly diminished. If we believe that, we also have to say that price-earnings ratios will tend to remain higher than average. I believe that, but I'm fully aware of the fact that it is a forecast. I hope it will occur, but it is still a forecast.

The data in May so far are not giving us any really new insights into the future course of the economy. Sales of autos and light trucks for May are running modestly below where they were in April. The weakness is entirely at domestic producers, the Big Three. Imports are selling exceptionally well this month, as they did last month, and are continuing to take market share. That's not very helpful for American production, but it does indicate that consumer demand is still reasonably good. And indeed the chain store sales data are not bad so far this month. The data released this week suggest that sales are running better than last month--not a great deal, but they are not going down, which is very important.

My guess is that industrial production is running a shade lower. The reason is that high-tech output is doubtless putting downward pressure on overall production because the rate of inventory liquidation in that sector must assuredly be rising. The unemployment rate is clearly on the way up, and with demand weak or on the soft side, it's really a question of a tradeoff of rising or accelerating productivity and rising unemployment or the reverse. Rising productivity and rising unemployment imply a favorable long-term profit outlook that I think has

very important implications, but obviously it means shrinking consumer incomes and consumer confidence.

The confidence issue in this outlook is really quite crucial. The Michigan survey actually showed a degree of strengthening, and I suspect there's an element of reality in it. I don't think it's a phony statistic, but clearly the Conference Board numbers, which will come out shortly, will either confirm or dispute that there has been some stabilization. I think the ABC weekly index is a little questionable; it has been exceptionally weak, but I'm not sure what degree of confidence I would put in it.

The problem that bothers me particularly is that the risks are really different from any I've ever seen, and they are of concern largely because they are international. We do know that the extent of the interaction of the United States and the rest of the world is greater than we can define very accurately. In other words, the correlation between, say, growth in Europe and that in the United States is a good deal higher than we can explain in the trade flows or in exchange and interest rates. In fact, the implication, as Karen Johnson likes to say, is that global portfolio adjustments probably are involved and are serving to integrate the total system to a greater degree than we can specify. And it's fairly apparent that any negative interaction is necessarily self-reinforcing. This type of environment is something we haven't seen for a very long period of time. It doesn't mean that the economy is going to implode. It does mean, however, that the risk is there. And I think it would be a mistake not to keep a close eye in our evaluations on this particular process.

The crucial arguments in support of forecasts that economic activity will accelerate and indeed pick up toward a 3 percent or more growth rate next year largely rest on the notion that profits will stabilize and that the stabilization will in turn stabilize capital investment and

allow the termination of inventory liquidation to trigger a recovery. I do think, as does the Greenbook, that that is the best point estimate. My concern is that the risk distribution is not symmetric. Indeed, it has a fairly worrisome tail at the wrong end. A goodly part of this outlook rests in my view on the very substantial size of the worldwide wealth effect, which currently is taking a large chunk of demand out of the world economic system. Here I think we depend to a very significant extent on the prospect that the stock market will stabilize and perhaps even rise and that gradually the negative wealth effect, which has not yet created any serious evidence of consumer weakness in our economy, will begin to reverse. I don't think we know yet how this will come out. I do believe that we should probably be waiting. The wealth effect coming out of housing, which is still very solid and still quite strong, is greater dollar-for-dollar than the negative wealth effect that is coming from stock prices or equity values generally. But again this is not an issue that we know very much about because we haven't dealt with this type of economy previously.

The concern here is that even if we do get a turnaround, the presumption that we can somehow get a "V" type of economic performance involving some significant acceleration over the nearer term I find very much to be an outside probability. In my view, the economy has to absorb a very large amount of negative wealth effect that has to work its way through. So, the outlook is for a soft recovery in the sense that a very quick recovery seems to be extraordinarily unlikely at this stage, given the existing wealth effect.

The issue that has been raised quite properly around the table about inflation, which we tend to disregard when we're in a period like this, is quite important. I personally am not terribly concerned about the outlook for inflation for a number of reasons. One is that the contractionary effects in the economy are really quite substantial at this stage and are suppressing the ability of

the business community to pass through what unquestionably are rising costs. Energy costs have gone up significantly. Business firms have been able to pass through very little of those costs, which is one of the reasons for declining profit margins. The virtual stall in productivity growth in the context of generally rising average hourly earnings or average compensation is clearly increasing labor costs that now have to be spread across a smaller number of units of output. Here again I think that the pricing power of business firms is very limited at this point, judging from the widespread anecdotal reports that the capacity to raise prices in an environment such as this is extraordinarily restricted.

How do we relate that very strong and widespread consideration to the fact that our price indexes seem to be accelerating? I believe there are several explanations. First, I would discard the consumer price index. I think it is a flawed statistic. But we are seeing rising core inflation in the personal consumption expenditures deflator and other measures. As I have discussed many times in the past, part of the problem with the reconciliation is that service price inflation is exaggerated in our indexes. If indeed service prices were rising as much as the data suggest, we would in fact be getting a decline in productivity in the health services area, in legal services, and in business services. I don't mean a decline in the rate of growth in productivity; I mean an absolute decline, which is just not credible. When we do specific evaluations in health pricing, we invariably find that every single statistic goes down and that one cannot explain the rise in overall health inflation except by a flawed procedure. The latter involves measuring inputs as though they were outputs. There is an endeavor to move away from that procedure.

What I conclude from all this is that the Greenbook forecast is the most likely outcome. My concern, however, is that there is a very significant asymmetry to the downside in the risks to that forecast. Accordingly, the appropriate policy position for this meeting in my view is a

further 50 basis point reduction in the federal funds rate and a balance of risks statement biased toward economic weakness. I would hope that a 4 percent funds rate is as low as we will have to go. If stabilizing forces begin to emerge, which will happen if the Greenbook forecast is correct, we should be able to hold at 4 percent in June and either then or thereafter remove the bias. In line with the fact that the economy's adjustment processes are accelerating, I think we should not hesitate to start moving in the other direction if and when the indications require that.

In my judgment, it is premature at this point to start discussing in the statement we will issue today the steepening yield curve and its possible roots of growing inflation expectations. It's not that I think that it is incorrect or false. It's just that I believe it would be sufficient at this point to remove any market expectations of another intermeeting move. But as we approach the next meeting, assuming that stability is emerging, we should begin in speeches or interviews to address the possibility that 250 basis points of ease, assuming we move today, may be enough and at least raise the notion that inflation may not be dead. I will, for example, be making a speech at the Economic Club of New York on the 24th of this month, and I will be raising some of these issues. But I would hesitate to argue at this stage, given the fragility of confidence and the fragility of the outlook, that we are at a point when we might begin to change our policy position, even though I believe this policy issue will be resolved within two or three months. I do think we probably can stop our easing moves here, assuming we move the funds rate 50 basis points lower at this meeting. But I do not think we ought to show our hand because I think the potential consequences in terms of market reactions could be significant and of no help to us. So I would put that on the table. Vice Chair.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, I endorse fully the entire package, including your idea that sometime between now and the next meeting we probably

should begin to shape the record. And I would suggest, since you already plan to do that on the 24th of this month, that we all remain very silent until then.

CHAIRMAN GREENSPAN. President Broadus.

MR. BROADDUS. Mr. Chairman, I agree with your recommendation generally. If I may, let me make a few additional comments to indicate the way I've been thinking about this. As I said earlier when I made my economic statement, I believe it's important to put what we do in a context. And the context that I'm thinking of is the amount of overall leeway we have on the real federal funds rate. It seems to me, given the outlook today, that we certainly should not move the real funds rate below zero. I realize that there are some differences of opinion about inflation expectations, but the Michigan survey, for example, is saying that one-year-ahead inflation expectations are about 3 percent. If that's the case, with the nominal funds rate currently at 4-1/2 percent, the real funds rate is something like 1-1/2 percent. I know one can argue about that but if that's about right, we don't have a lot of downside leeway left.

In reflecting on what we ought to do today, I found it helpful to look at the economic situation the last time the real funds rate was at zero--which was roughly between September '92 and September '93--and to compare it with the current situation. In that earlier period, inflation was 3 percent and drifting down, long rates were coming down, and we were running up against financial headwinds. The unemployment rate was at 7 percent, higher than it is today. And trend productivity growth was still weak; this was before we got into the late 1990s. The Government deficit--remember those?--was still a problem then and there was talk about a tax increase to deal with it.

Today we have a very different situation. Inflation is about 3 percent and has been drifting up, and long rates have been rising. Lending institutions now are well capitalized, so

we're not looking at the financial headwinds we were experiencing then. The unemployment rate is drifting up, but at 4-1/2 percent it is still at a relatively low level. We may have the advantage of a couple additional points on trend productivity but we have a budget surplus and people are talking about tax reduction. The zero real funds rate policy that we had in the earlier period worked well, I think. In my view it helped to lay a solid financial and monetary foundation for the fine economic performance that we had in the late 1990s. But my comparison of the two periods suggests to me that if the overall economy were at a bottom now, a zero real funds rate might be too low in the context of the leeway target I mentioned earlier. I think that's important.

In any case, this led me to think about our decision this morning in the following way. Though I guess no one has thought very seriously about the 75 basis point alternative that was in the Bluebook, clearly, against the background that I've tried to lay out, that would be too much. It could push the real rate lower than we would want it to be once the economy hit bottom and began to turn up. On the other side of the argument, I believe a case could be made for a reduction of only 25 basis points today. And there's a big part of me that thinks I ought to be making that case! But obviously that would disappoint expectations. It would risk prolonging the time before the economy gets to a bottom and might make the bottom deeper than we need it to be. So by process of elimination I come out where you are, with 50 basis points as the right move today.

For me a really key point is that if we reduce the funds rate by that amount, we're going to reduce that leeway--based on the way I'm looking at it--significantly further. And this might be where I differ with you a bit. Having reduced that leeway, I think we ought to be very careful with respect to the expectations we foster about where we're going from here. In my view, it would be helpful to signal the markets now that there's a limit to this process and that we

may be closing in on it. We could go to a symmetric or balanced risk statement; I think a case could be made for that. But if we drop the rate 50 basis points and keep the asymmetric risk statement--which is, of course, expected--at a minimum I would hope that the press release language would suggest that we may be closing in on the limit of this easing process. I believe we should begin to get that idea built in, within the context of where we are going in the long run. Thank you.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. I agree with both of your recommendations, Mr. Chairman. But I would like to associate myself very closely with everything that President Broadus just said. I could have supported a move of 50 basis points with a balanced risk statement; I could have supported 25 basis points with a statement that the risks continue to be weighted toward economic weakness. I could have supported and argued for--although Al did a much better job than I would have--either one of those positions.

I think it is critical, though, if we are going to send a signal, that we send it in a message from the Committee and not in various speeches. I am not in any way denigrating your efforts in that regard, Mr. Chairman, but if we want to send a message from the Committee I believe it is important that we in fact send it from the Committee. So I would reiterate --

CHAIRMAN GREENSPAN. I was actually suggesting that we send it in June.

MS. MINEHAN. Instead of now?

CHAIRMAN GREENSPAN. Yes.

MS. MINEHAN. Well, I think Al Broadus has a point, and it may be worthwhile in the statement we put out today to say something about the limits on how far we can go in one direction.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I believe that it would be prudent to cut the rate further and I support your proposed reduction of 50 basis points. For this meeting I also prefer to retain a balance of risks statement weighted toward economic weakness. However, I think we are getting close to the point where we should seriously re-examine that stance. Thank you.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Thank you, Mr. Chairman. I support your recommendation for a 50 basis point cut and an asymmetric directive toward economic weakness. I do think it's important that we start getting the word out, as suggested in the comments by Al Broaddus and Cathy Minehan. Let me make several points. One is that we should start indicating that 250 basis points of ease may be enough--that it will take some time for these cuts to have some impact on the economy. We should make it clear that we may decide not to ease further during that time--but we will be waiting and watching and monitoring carefully--and also that inflation is a concern longer term. We could put this in the statement today. Or, your recommendation to start talking about it in your speech on May 24th and then put it in our statement in June is fine with me. I think that's a reasonable way to proceed going forward.

CHAIRMAN GREENSPAN. President Santomero.

MR. SANTOMERO. I concur with your recommendation, Mr. Chairman. However, given my view of the economic outlook, I think it would be useful for us to try to telegraph some message that indicates we're getting close to the end of this process. If I had my druthers, I'd probably go 25 basis points today with the tilt toward economic weakness and indicate that we would be prepared to respond to further indications of weakness. If we go 50 at this point, I

believe it's still necessary to leave the tilt. Nonetheless, in my view it would be useful at least to include some wording in our press release that indicates we have indeed eased a lot.

CHAIRMAN GREENSPAN. President Poole.

MR. POOLE. Mr. Chairman, I support your recommendation. I'd like to amplify a couple aspects of my position. With regard to the April 18th rate cut, about which I expressed reservations, I haven't changed my view on that. But that rate cut is a fact. To me that Committee action indicated several things. First of all, it suggested a great sense of urgency. The press statement released at the time of that action indicated a great deal of concern over weak investment. In my view it was practically an announcement of another 50 basis point cut at this meeting. That's the way the market interpreted it; the fed funds market quickly bid in a high probability of another 50 basis points at this meeting. Since April 18th, we have seen a very weak employment report, industrial production is down, and we've heard lots of news about weak investment and layoffs. I think we have to do 50 basis points today because it reflects what we said we were going to do and it would make no sense to surprise the markets in one direction on April 18th and surprise them in the other direction on May 15th. So in my view it's critical that we do 50 basis points today. When the time comes to move the funds rate up, it's not going to make any difference whether we start from a rate of 4 percent or 4-1/4 percent; we're going to face essentially the same kinds of issues. But to be consistent I think we do need to cut the rate 50 basis points today, and I feel very strongly about that.

In terms of the future, I would say a couple of things. First of all, when we developed the balance of risk language, we tried to make it a statement about the outlook for the economy and not about the outlook for policy. We might want to remind people of that. And we might want to remind them that, given the lags in policy, we might still see some economic weakness

ahead but they should not necessarily interpret that to mean that it would call for additional policy easing. Secondly, I would like to put the outlook for rates in the coming months this way. I don't know for sure whether further rate cuts are required. I think the probabilities are more or less even that the next rate change is going to be up as down. We're in a very uncertain situation, and I believe it would be a mistake to say that we know for sure that our easing process has come to an end. After all, we gave lots of reasons why the outlook could be weaker than what is now our best guess. So I don't think we should say that the easing process is necessarily at an end. In my view we should say that we now believe there is more or less an equal probability that the next rate change will be up as down because we don't know how the future is going to develop. That would be my take on the sense that we should try to impart to the marketplace because something could come along very quickly and wipe away any suggestion that this process is at an end.

Things could happen abroad or wherever. Thank you.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. I share many of the general sentiments that Presidents Broaddus and Minehan expressed. In fact, I think I could go a bit further and make a reasonable case for why we ought to pause today. But given the tide, I won't belabor that issue. Nevertheless, a key issue for me is the lag question. It's certainly well acknowledged that there is a lag between our actions and their effects on the economy. At some point we're going to have to remind market participants, probably in a relatively forceful way, of those lags. And at some point we're going to have to take that pause, probably well before there is altogether convincing evidence that the economy is stabilizing and improving. I think that day is, if not here, not all that far away. As a consequence, I believe we need to be quite cautious at this stage.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Thank you, Mr. Chairman. I support your recommendation. I would add that I am concerned that too overt a comment today about the possible ending of this easing process might well be a bit premature for two reasons. First, it would be premature if some of these downside probabilities that we're concerned about materialize; if they do, it could be a problem to have said that. Second, if this release will have an asymmetric tilt--as I think it should because it's the only honest thing that we can say now--then that coupled with too strong a statement about ending this process could send the market a very confusing message and have a counterproductive impact.

CHAIRMAN GREENSPAN. Governor Meyer.

MR. MEYER. Thank you, Mr. Chairman. I can support your recommendation for a 50 basis point easing today and a statement that the risks remain unbalanced toward economic weakness. On the other hand, I could also have joined Presidents Minehan and Broadus in supporting a case for slowing the pace of easing today and moving only 25 basis points. That might have been a very effective way of signaling the sentiment that we now need to move toward a more cautious monetary policy and that we may not be far from ending the easing cycle.

But more importantly, Mr. Chairman, I agree with you on what I believe is the really important issue, and that is the prospect that we may be near the point--and perhaps after this move at the point--where we have to be very cautious about any further easing.

CHAIRMAN GREENSPAN. Governor Ferguson.

MR. FERGUSON. Thank you, Mr. Chairman. I agree with your recommendation. I'm fortunate in my speaking order because I can agree with some of what the four people who spoke prior to me had to say. First, I think President Poole is absolutely right to remind us that the language on the balance of risks has to do with the economy and that we clearly tried to get

away from predicting what we might do in terms of policy. I happen to think that as of today the balance of risks is more toward the down side and, therefore, that the current language should be retained. I agree with President Stern that there is always some risk of overshooting. And in that sense I will also join Governor Meyer in that I, too, don't know what the future is going to be, so I don't think we should try to signal one way or the other. Because there is great uncertainty, I agree with what Governor Kelley had to say, which is that we shouldn't try to send a message about the future in our press statement because the future is unknown. Contrary to the fact that we use the words "foreseeable future" in our statement, it actually is not foreseeable. [Laughter] I don't know who suggested that we should use those words! But very seriously, I don't think we should try to signal too much in this statement. And finally, there is a point on which I honestly have to disagree with you, Mr. Chairman. While you should certainly feel free to present your views in an upcoming speech, I would be very concerned if there emerges a perception that through speeches we are trying to do anything just yet. There is a desire, I suspect, to make clear that inflation is a concern. We don't want markets to think that we aren't concerned about it. But given the prevailing degree of uncertainty, I'd prefer that the press statement speak for itself and then when we get back together have another statement that speaks for itself.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. As Mark Anthony said when he burst into Cleopatra's bedroom, I'm not here to make a speech. So I agree with both of your recommendations.

CHAIRMAN GREENSPAN. Careful, sir! Governor Gramlich.

MR. GRAMLICH. Bob, that's a tough act to follow! [Laughter] I was planning to make a speech.

MR. MCTEER. You're not going to let my comment discourage you, though!

MR. GRAMLICH. First, I support both of your recommendations, Mr. Chairman. At the same time, I agree with many others around the table that we can't continue to ease monetary policy in such large steps. I see the wall looming out there. I don't see it quite yet, as I said earlier, but it's out there and we should be aware of it. There are lags and we should be mindful of that.

As for the press statement, I think my views are closest to Mike Kelley's. It's too soon to go to a balanced risk statement. In my view--if this makes any sense--we should have a relatively unobtrusive statement today.

The last comment I want to make is that a lot of us found the Bluebook exercise with the real funds rate computed in various ways very useful, and I would like to propose to Don and others that they continue to provide that analysis. In my view it's a good way to think about monetary policy. If we keep looking at it, we'll get used to it and we'll get a sense of when we ought to be wandering out of the gray band and when we should not be wandering out of the gray band. So, I would propose that the staff keep that exercise.

CHAIRMAN GREENSPAN. President Guynn.

MR. GUYNN. Mr. Chairman, I'm most comfortable with the comments of Al, Cathy, Tony, and Gary. I actually would prefer to come out of today's meeting with some clear signal that we have slowed the pace of easing--not that we've stopped easing but that we've slowed the pace. I did not read the announcement of our intermeeting action a month ago as signaling that we clearly were going to move another 50 basis points today. I, too, thought about how we could give a signal coming out of today's meeting and concluded that we could not change to a balanced risk statement. But it seems to me that a 25 basis point easing would be a cleaner, preferable action. It would call for fewer words in our press statement and cause less confusion

than the other approaches that have been suggested. I'm not sure how we go from five 50 basis point easing moves to cold turkey withdrawal from the easing process. So, I was of the view that a 25 basis point easing today would be a clean way to get on a different trajectory for the reasons discussed around the table that we may need to do that. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I think we should pull back on the throttle today. Over the past four and one-half months we've moved policy in a very aggressive way to an easier position. In my view an additional 50 basis point cut will move us to an overly accommodative position. We've added significant liquidity to the market. Now we should let it work through and we should be far more cautious about further moves. I think we have an opportunity with a 25 basis point move and an asymmetric risk statement today to give the signal that you're suggesting. So I'm of the view that a 25 basis point cut, with retention of the statement that the risk is weighted to weakness in output, is what we should do now. I certainly agree that the risk of weaker growth continues to dominate over the risk of inflation for now. But a lot of easing is in train. An additional 25 basis points would only continue the easing; it wouldn't stop the easing process. And policy, as we all know, works with a lag. Thus the relative risks have shifted since our last meeting--though not to the point where the predominant risk is inflation, which is why I think it is appropriate to reduce rates. My preferred approach would take us on a less aggressive trajectory down and prepare the market for our acting in either direction.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Thank you. Not only do I not think that disappointing the market--not doing what is already built into the market--is a bad thing, I think it's inevitable. We stopped easing in 1998 when market participants were saying we would move the funds rate down to 3

percent. We didn't. We stopped tightening last spring when they said we were going to raise the rate to 7-1/2 or 8 percent. We didn't. And I think there's going to be another time when we will disappoint the market's expectations. I'm afraid the message here will be seen is the same old message: another 50 basis points, another balance of risks statement toward economic weakness, and the FOMC will come back and do the same thing again in June. So I'd be happier with no change or a 1/4 point reduction today. But if we're not going to do that, then I think Bob McTeer's idea that the Board should consider taking the discount rate down only 1/4 point might at least send a different message out of this meeting rather than just relying on speeches to change that expectation.

CHAIRMAN GREENSPAN. Okay. The seeming majority is for a cut of 50 basis points and a statement that the risks are asymmetric toward economic weakness. Could you read the appropriate statement?

MR. GILLUM. Yes, Mr. Chairman. I will be reading from page 14 of the Bluebook. The directive wording is: "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with reducing the federal funds rate to an average of around 4 percent." The balance of risks sentence for the press statement is: "Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes that the risks continue to be weighted mainly toward conditions that may generate economic weakness in the foreseeable future."

CHAIRMAN GREENSPAN. Call the roll, please.

MR. GILLUM.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Ferguson	Yes
Governor Gramlich	Yes
President Hoenig	No
Governor Kelley	Yes
Governor Meyer	Yes
President Minehan	Yes
President Moskow	Yes
President Poole	Yes

CHAIRMAN GREENSPAN. I now suggest that the Federal Reserve Board retire to my office, while we recess this meeting temporarily, and vote on the requests from the various Banks.

[Meeting recessed]

CHAIRMAN GREENSPAN. The Board voted unanimously to approve the requests from several Reserve Banks for a reduction of 1/2 percentage point in the discount rate to 3-1/2 percent.

We now have a draft statement in front of us and I would appreciate everyone reading it and giving your reactions after you've had a chance to review it. It is essentially the same as the last statement, with all the references to further action deleted.

MR. BROADDUS. I think this statement as drafted is very likely to build into the yield curve another 50 basis point move at our next meeting. Our statement doesn't have to say anything about our being at the end of the easing process. If it simply indicated that with this additional move we have put a significant amount of stimulus into the economy to try to deal with the downside risks--which get so much emphasis in the draft--it would be at least a weak signal that this process can't go on forever. Repeating what I said earlier, I would love to see some wording that would give some sense of that, because I think it might serve us well going forward. That would be my thoughts on this.

MR. GUYNN. I'll echo that.

CHAIRMAN GREENSPAN. May I have comments from everybody, please?

Governor Meyer.

MR. MEYER. Actually, I think that would be a good idea. I also would like to see two parts of the statement adjusted. I'd suggest that the very last part of the second paragraph, which reads "threatens to keep the pace of economic activity unacceptably weak," be toned down a bit. It could say these factors "continue to weigh on the economy" or something like that. The proposed wording seems a little too sharp. And perhaps we could add a reference--maybe after the sentence that says the reduction in excess inventories seems well advanced--to the fact that consumption and housing expenditures have held up reasonably well. We might also note that the considerable easing over the last half year should begin to support economic growth.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, considering how the European Central Bank managed to completely confuse the market and hurt its own credibility very recently, I think trying to say things that are essentially contradictory--or that can easily be interpreted that way--has to be avoided. If we wish to give a signal that the easing moves are likely over, then the balance of risks statement becomes questionable--even though we all know that the balance of risks statement has to do with future economic activity. The market would clearly believe we were trying to have it both ways--trying to say that on the one hand we might ease because the economy might be weak, but on the other hand we might have finished our easing. If we wish to destroy our credibility, that kind of wording is what I highly recommend to you, and I assume that is not what we are seeking to achieve.

There will be a very large signal received from this statement, which is that we've removed any notion of an intermeeting move. And that is going to sound a big gong. It will say that the easing moves may slow or may be over. At a minimum the Committee has slowed the pace and is fairly close to where it wants to be. In my view that is how this statement will be interpreted. But it will be interpreted because we allow the market to read it. That is preferable to trying to give two signals--one that says yes and the other that says no--and winding up with a statement that says maybe. I think that would be very destructive to our ability to carry out our responsibilities. Also, given the view that some of us have--particularly you, Mr. Chairman, and I, too, I guess--about the downside risks, the last thing we want is to have a central bank that looks confused. If we want downside risks, a confused central bank will surely bring them.

CHAIRMAN GREENSPAN. President Santomero.

MR. SANTOMERO. First, to pick up on a point that President McDonough made, I think another signal will be the fact that the list of Reserve Banks requesting a discount rate decrease is an incomplete one; that will be interpreted as the feeling within the Committee. In my earlier comments I suggested that we should not indicate to the market that we weren't going to move again, which I think for all the reasons just stated is counterproductive, but rather that we have moved 250 basis points. That is a more neutral statement that conveys a fact. And it can be interpreted as an indication that we feel we have taken substantial steps. That's the only way I think we could constructively amend this statement, but that's your call.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. I have two suggestions. First, take the second and the third paragraphs out and go from the statement of action to the statement of risks. Second, add a

sentence to that last paragraph which says, "In that regard, the Committee recognizes that 250 basis points of easing is now in the pipeline." Period.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. My suggestions are along the lines of President Minehan's. I would shorten the statement.

MS. MINEHAN. Considerably!

CHAIRMAN GREENSPAN. Governor Ferguson.

MR. FERGUSON. I guess I come in on the other side, in that this seems to me an accurate statement of fact. I think the markets will understand what we saw that led us to make a move. I also agree with the Vice Chairman that we shouldn't try to send too many signals. I believe this statement is a fairly accurate description of our discussion and I would keep it very much as it is.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I'd like to support Governor Meyer, particularly on softening the statement at the very end of the second paragraph. I believe "threatens to keep the pace of economic activity unacceptably weak" is a bit stronger wording than we need to use. I think the language he suggested, "continues to weigh on the economy" is both accurate and adequate.

CHAIRMAN GREENSPAN. Yes, the language in this draft was from our previous statement, as you know.

MR. MEYER. Well, I think it would be good to have a different statement. That's a good reason to change it.

CHAIRMAN GREENSPAN. Any other comments at this stage? Governor Gramlich.

MR. GRAMLICH. I basically support the statement. I might note that there are actually three changes from the previous statement, as I remember it. First, we dropped the “alert” sentence. Secondly, as Tony mentioned, fewer Banks are listed as having put in for the discount rate reduction. And third, unlike the last statement, this one at least mentions the word inflation, and that is a significant change as well. I like that sentence. So I’m essentially happy with the draft. Perhaps we could make some changes in the adjectives on that last sentence in the second paragraph. But, as I said before, I’d like to keep this statement fairly unobtrusive and generally in the pattern of our recent statements. We have changed it in a few important ways already.

CHAIRMAN GREENSPAN. Let me suggest the following. Frankly, I think Governor Meyer’s suggestion is an improvement and unless there’s an objection, we’ll just make that change and put in his wording. Let’s then have a Committee decision on two possibilities: One is to go with this statement with that correction; the other is to craft a statement that basically tries to capture what Al Broaddus said earlier about being close to the limit of the easing process. We have various versions of this draft statement. So, Don, why don’t you read the relevant one?

MR. KOHN. I happen to have something handy, just in case! This one modifies the end of that sentence at the bottom of page 1. It says: “Although measured productivity growth stalled in the first quarter, the impressive underlying rate of increase that developed in recent years appears to be largely intact, which together with the effects of lower interest rates this year should support economic growth over time.”

VICE CHAIRMAN MCDONOUGH. And we offer that in the month of June?

CHAIRMAN GREENSPAN. That's the key question, whether in fact we move to a statement in line with Al Broaddus's proposal today or in June. I think it would be helpful to get members' preferences--I assume everyone is in agreement that we ought to do it--for May or June. Let's quickly call the roll and see what we get.

MR. GILLUM. What is their expression of opinion?

MR. KOHN. May or June.

CHAIRMAN GREENSPAN. Yes, just say May or June on including this sentence.

MR. GILLUM. Okay. Chairman Greenspan

CHAIRMAN GREENSPAN. May. I beg your pardon--June. [Laughter]

MR. GRAMLICH. Maybe you'd like a punch card ballot! [Laughter]

CHAIRMAN GREENSPAN. That's better than a butterfly! Sorry about that.

VICE CHAIRMAN MCDONOUGH. The Chairman voted June?

CHAIRMAN GREENSPAN. I voted June.

MR. GILLUM.

Vice Chairman McDonough	June
Governor Ferguson	June
Governor Gramlich	June
President Hoenig	May
Governor Kelley	June
Governor Meyer	June

MR. MEYER. Is that including the change I suggested in that paragraph?

VICE CHAIRMAN MCDONOUGH. We've got your change in.

MR. GILLUM.

President Minehan	May
President Moskow	May
President Poole	May

PRESIDENT MOSKOW. I'd just remind people that we said essentially the same thing at the end of January, so it's not new.

VICE CHAIRMAN MCDONOUGH. Six-four, close.

MR. GILLUM. The vote was six to four in favor of June.

CHAIRMAN GREENSPAN. So be it. Yes, President Minehan.

MS. MINEHAN. Could I just add a comment? I'm getting increasingly nervous about these statements. They are getting longer and longer and we have a total of five minutes to look at them yet they end up making a big difference in how our policy action is received. We spent it seemed to me months working on a statement of risks, which now gets totally lost in the wordage that is being added to the statement. And as a Committee we don't really get a chance to talk about that enough. I'm very concerned about that.

CHAIRMAN GREENSPAN. Yes, I think that's a valid point. What we probably ought to do is cut these statements all the way back. We can't do it now because we've already voted. But your point, which I think is a relevant one, is not that this should be short. You're saying that to the extent we are using the statement as an indication of our views--which we are, and frankly appropriately so in my view--that we should either circulate it before the meeting or cut it down.

MS. MINEHAN. Right.

CHAIRMAN GREENSPAN. I think we have to do one of those two things. And sending out statements around here would just be awful!

MS. MINEHAN. I think it would be very hard.

CHAIRMAN GREENSPAN. I believe we ought to consider cutting the statement back very substantially. Okay, the next meeting is June 26th and 27th. Remember, we are invited to the British Embassy on the evening of the 26th.

END OF MEETING