

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MEMO

DATE: November 8, 1993
To: FOMC, Board and Bank Research Directors
FROM: Joe Coyne *JRC*
SUBJECT: FOMC meeting

The attached article by market news service runs clearly counter to the discussion at the July FOMC meeting about contacts with the press. An unidentified Federal Reserve source is quoted variously as saying that a near-term change in monetary policy is unlikely and if faster economic growth is sustainable the Fed is prepared to tighten. (See first and second paragraphs of attached story by Steven Beckner).

This article affected credit markets and bond prices after it appeared on teletype screens beginning at 11:03 a.m. on Friday, November 5. As discussed at the July meeting, it is totally inappropriate to speculate on the course of future monetary policy, which is the responsibility solely of the FOMC.

Please pass this memo on to your staffs as a reminder that Fed people should avoid comment on individual economic indicators and certainly should not speculate on future monetary policy.

Attachments

USER: SSZ PAGE: T1415 12:11:28 5Nov93

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11:03 11/05 **SOURCES: FED TO SNUG IF GROWTH KEEPS UP, ADM. MAY NOT OBJECT P
BY STEVEN K. BECKNER

~~- WASHINGTON (MKTNEWS) - THE OCTOBER EMPLOYMENT FIGURES CONFIRM THE
ECONOMY IS ON A MUCH HIGHER GROWTH TRAJECTORY IN THE SECOND HALF BUT
DOUBT REMAINS WHETHER THE IMPROVED GROWTH TREND WILL CONTINUE. SO A
NEAR-TERM CHANGE IN MONETARY POLICY IS UNLIKELY, A FEDERAL RESERVE SOURCE
INDICATED FRIDAY.~~

~~HOWEVER, IF AND WHEN IT BECOMES CLEAR THAT FASTER GROWTH IS
SUSTAINABLE, PROBABLY AFTER THE FIRST OF THE YEAR, THE FED IS PREPARED TO
TIGHTEN, SAID THE SOURCE.~~

~~FOR ITS PART, THE CLINTON ADMINISTRATION IS NOT ANXIOUS TO SEE THE
FED RAISE THE FEDERAL FUNDS RATE BUT, GIVEN THE RISE THAT HAS ALREADY
OCCURRED IN MARKET RATES, WOULD NOT BE TOTALLY AVERSE TO A QUARTER POINT
INCREASE IN THE RATE AT SOME POINT, ACCORDING TO ANOTHER KNOWLEDGEABLE
SOURCE.~~

SOME OF PRESIDENT CLINTON'S ADVISERS SEE AN INCREASE IN THE FUNDS
RATE AS INEVITABLE, GIVEN THE RESPONSE OF MARKET RATES TO RECENT STRONGER MC

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11/05 11:07 EST MARKET NEWS PAGE 1416

>> **SOURCES: FED TO SNUG IF GROWTH KEEPS UP, ADM. MAY NOT OBJECT PG 2
ECONOMIC DATA AND SUGGEST IT MIGHT EVEN HAVE A TONIC EFFECT ON
LONGER-TERM RATES.

THE LABOR DEPARTMENT REPORTED NON-FARM PAYROLL ROSE A
STRONGER-THAN-EXPECTED 177,000 IN OCTOBER, COUPLED WITH UPWARD REVISIONS
TO AUGUST AND SEPTEMBER PAYROLL LEVELS. MANUFACTURING EMPLOYMENT, FOR
ONE, WAS UP BY 12,000. STRENGTH WAS ALSO EVIDENT IN AVERAGE WEEKLY HOURS
(UP 0.1 OVERALL AND IN FACTORIES) AND IN FACTORY OVERTIME. THE
UNEMPLOYMENT RATE TICKED UP FROM 6.7% TO 6.8%, BUT THIS WAS BELIEVED TO
BE DUE TO A SEASONALLY FLAWED JUMP IN THE LABOR FORCE.

THE FED SOURCE SAID THE FIGURES SUGGEST FOURTH QUARTER GROWTH WILL
BE IN EXCESS OF 4%. "IT'S STRONG, NO QUESTION ABOUT THAT," HE SAID.
"IRRESPONSIBLY STRONG? PROBABLY NOT."

AS FOR THE POSSIBILITY OF A TIGHTENING OF MONETARY POLICY, THE FED
SOURCE COMMENTED, "THE FED DOESN'T LIKE TO SEE-SAW RATES." IF THE FEDERAL
OPEN MARKET COMMITTEE CONCLUDES FASTER GROWTH IS HERE TO STAY, IT WILL
VOTE TO TIGHTEN, BUT "IF WE BELIEVE IT'S TEMPORARY, THERE WON'T BE ANY MORE

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MARKET NEWS

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>> **SOURCES: FED TO SNUG IF GROWTH KEEPS UP, ADM. MAY NOT OBJECT PG 3
ACTION" ALTHOUGH THE FOMC MAY MOVE BACK TO AN ASYMMETRIC DIRECTION WITH A
TIGHTENING BIAS.

"YOU HAVE TO LOOK A LITTLE BEYOND CHRISTMAS TO FIND OUT IS IT
(FASTER GROWTH) GOING TO STICK," THE SOURCE CONTINUED. "IF THE RATE IS
HIGH THEN WE MIGHT DO IT (TIGHTEN)."

"IT WOULD BE NUTTY TO RAISE RATES BEFORE CHRISTMAS THEN FIND OUT THE
ECONOMY IS WEAKER THAN WE THOUGHT AND HAVE TO CUT RATES," THE FED SOURCE
WENT ON. "THAT LOOKS BAD, ESPECIALLY WITH (HOUSE BANKING COMMITTEE
CHAIRMAN HENRY) GONZALEZ ON YOUR TAIL."

FOR THE TIME BEING, THE SOURCE ADDED, INFLATION REMAINS QUIESCENT.
"YOU'RE NOT LIKELY TO SEE (A PICK-UP IN INFLATION) AT THIS RATE OF
GROWTH."

MEANWHILE, A SOURCE INVOLVED IN THE ADMINISTRATION'S ECONOMIC
ANALYSES AND DELIBERATIONS INDICATED THE ADMINISTRATION WOULD NOT
STRONGLY OBJECT TO A SNUGGING OF THE FUNDS RATE IF DATA CONTINUE TO PUSH
UP MARKET RATES. AFTER INITIALLY REMAINING FLAT, BOND PRICES WERE OFF

MORE

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>> **SOURCES: FED TO SNUG IF GROWTH KEEPS UP, ADM. MAY NOT OBJECT PG 4
19/32 BY 10 A.M. EDT, PUTTING THE LONG BOND YIELD AT 6.2% COMPARED TO A
RECENT LOW-POINT OF 5.77 OCT. 18, AFTER THE LABOR DEPARTMENT ANNOUNCED
THAT THE CONSUMER PRICE INDEX WAS UNCHANGED OVERALL AND UP 0.1% EXCLUDING
FOOD AND ENERGY IN SEPTEMBER.

THE SAME SOURCE AGREED THE JOBS DATA (ON TOP OF THE RECENT GDP AND
NAPM REPORTS) SHOW AN ECONOMY THAT APPEARS TO BE PICKING UP STEAM BUT
ALSO SAID IT IS POSSIBLE GROWTH COULD DIP NEXT YEAR. THE SOURCE SUGGESTED
THE ADMINISTRATION WOULD NOT BE SURPRISED OR DISMAYED IF THE FED PUSHES
THE FUNDS RATE UP 25 BASIS POINTS FROM THE EXISTING 3% TARGET ONCE IT
BECOMES CLEAR REAL GROWTH OF 3% IS SUSTAINABLE. THE SOURCE NOTED THAT THE
FUNDS RATE HAS BEEN AT 3% SINCE SEPTEMBER 1992 AND THAT MARKET RATES HAVE
BEEN ON THE RISE ACROSS THE MATURITY SPECTRUM.

FORMER FED GOVERNOR LYLE GRAMLEY, NOW ECONOMIC CONSULTANT TO THE
MORTGAGE BANKERS ASSOCIATION, SAID HE EXPECTS THE FED TO TIGHTEN BUT
SAID, "I DON'T THINK THEY'RE GOING TO START MOVING UNTIL EARLY NEXT
YEAR."

MORE

USER: AXD PAGE: T1419 12:08:35 5NOV

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MARKET NEWS

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>> **SOURCES: FED TO SNUG IF GROWTH KEEPS UP, ADM MAY NOT OBJECT PG 5

"ONCE THE FED BECOMES CONVINCED THAT THE ECONOMY IS ON A 3% GROWTH TRACK, THEY WILL WANT TO TAKE A CAUTIONARY MOVE TO BRING DOWN THE GROWTH OF M1 AND KEEP NOMINAL INTEREST RATES ABOVE THE RATE OF INFLATION," GRAMLEY SAID, BUT FOR NOW "THERE IS NOTHING THAT REQUIRES A SENSE OF URGENCY."

CHARLES LIEBERMAN, MANAGING DIRECTOR OF CHEMICAL SECURITIES INC., EXPRESSED THE VIEW THAT IT IS TIME, IF NOT PAST TIME, FOR THE FED TO TIGHTEN. "THE FUNDS RATE WAS REDUCED TO 3% WHEN THE ECONOMY WAS PERFORMING BADLY," HE SAID. "NOW, HERE WE ARE WELL OVER A YEAR LATER, THE ECONOMY IS DOING QUITE A BIT BETTER, BUT THE FUNDS RATE IS STILL AT 3%. THE LOGIC FOR FUNDS AT 3% DOESN'T EXIST."

HOWEVER, LIEBERMAN SAID THE FED WILL NEED "A SMOKING GUN" IN THE FORM OF ONE OR MORE BAD INFLATION NUMBERS, TO JUSTIFY A TIGHTENING TO CONGRESS, SOME OF WHOSE MEMBERS HAVE THREATENED TO CURTAIL THE CENTRAL BANK'S INDEPENDENCE.

DAVID RESLER, CHIEF ECONOMIST FOR NOMURA SECURITIES INTERNATIONAL

MORE

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MARKET NEWS

PAGE 1420

>> **SOURCES: FED TO SNUG IF GROWTH KEEPS UP, ADM. MAY NOT OBJECT PG 6
INC., SAID HE DOUBTS THE FED WILL TIGHTEN UNTIL "SIGNS OF STRENGTH IN
THE ECONOMY BEGIN TO SUGGEST AN INFLATION THREAT SURFACING, AND I DON'T
SEE THAT IN EVIDENCE YET."

RESLER SAID THE FED SHOULD READ THE RUN-UP IN GOVERNMENT SECURITIES
YIELDS WITH CAUTION. HE SAID THOSE HIGHER YIELDS "COULD BE A PRECURSOR TO
A POSSIBLE FED TIGHTENING" BUT THE FED SHOULD RECOGNIZE THAT "WHAT'S
HAPPENING IN THE BOND MARKET IS ONLY PARTLY RELATED TO THE ECONOMIC
DATA." RATHER THAN SHOWING A MARKET FEAR OF HIGHER INFLATION, HE SAID
FALLING BOND PRICES (AND RISING YIELDS) REFLECT MORE MARKET PARTICIPANTS'
DESIRE TO LOCK IN CAPITAL GAINS MADE ON THIS YEAR'S HISTORIC BOND RALLY.

"THE MARKET IS NOT AFRAID OF A NEW OUTBREAK OF INFLATION BECAUSE THAT IS
WHAT THE FED OUGHT TO BE CONCERNED ABOUT," RESLER SAID.

THE FED SOURCE DEMONSTRATED COGNIZANCE THAT A CHANGE IN PORTFOLIO
MANAGERS' STRATEGY HAS HAD A LOT TO DO WITH THE BOND MARKET'S RECENT
PRICE BEHAVIOR. THE MARKET IS "NOT REACTING QUITE AS MUCH TO THE DATA
AS TO TRADING DYNAMICS," HE SAID. BOND TRADERS REALIZE "IT'S BEEN A GOOD MORE

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MARKET NEWS

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>> **SOURCES: FED TO SNUG IF GROWTH KEEPS UP, ADM. MAY NOT OBJECT PG 7
YEAR, AND THEY ARE SELLING TO LOCK UP CAPITAL GAINS," THINKING "IT'S
TIME TO LOCK THEM UP NOW. WHAT DIFFERENCE WOULD A MONTH MAKE?"

END