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STRICTLY CONFIDENTIAL (FR)
CLASS II - FOMC

TO: Federal Open Market Committee DATE: September 21, 1994

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Enclosed are the Greenbook and information prepared at the Federal Reserve Bank of Boston.

Enclosures

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9/19/94

First District - Boston

Special District Report

Academic Level

Professor Samuelson was available for comment this month. He supported the 50-basis-point tightening in August. In fact, he believes that the data released since the last FOMC meeting reinforced the need for a tightening. The evidence suggests that inflation could begin to increase in the second half of this year. Although wage costs have not shown much sign of accelerating, Samuelson believes that increases in inflation are not always seen first in increases in wages. The recovery in the rest of the world seems to be progressing, which will put added pressure on prices directly and indirectly, through possible downward pressure on the dollar. As a result, he supports the monetary policy actions taken so far this year. As a caveat to the recent Fed action, however, he thinks it sends the wrong message to the markets to imply that each move may be the last.

Professor Samuelson does not believe that further tightening is indicated at this time, based on available evidence about the third quarter. Samuelson notes that the recent Blue Chip forecast is weaker than previous ones, and that many forecasters are predicting a slowdown sooner rather than later. If future growth comes in weaker than the modal estimate in the Blue Chip, it still may not be slow enough to prevent an increase in the inflation rate in the near term, since the inflation process is filled with inertia, but it might be weak enough to produce slack in the economy. Under these circumstances, Samuelson believes monetary policy should be prepared to turn around if the economy begins to weaken even though inflation may still appear to be a problem.

Currently Professor Samuelson sees the risks to the economy as roughly balanced. He supports the previous tightening and would support further tightening if the economy fails to slowdown. But he cautions that the Fed should be prepared to reverse itself if the economy proves weaker than currently expected. If growth significantly abates over the next three quarters, particularly if inventories rise simultaneously, then the Fed should be ready to undo the last tightening.