

Meeting of the Federal Open Market Committee

January 31-February 1, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., starting on Tuesday, January 31, 1995, at 1:30 p.m. and continuing on Wednesday, February 1, 1995 at 9:00 a.m.

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

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

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

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

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

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors  
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors  
Mr. Simpson, Associate Director, Division of Research and Statistics, Board of Governors  
Mr. Winn, 1/ Assistant to the Board, Office of Board Members, Board of Governors  
Messrs. Hooper and Reinhart, Assistant Directors, Divisions of International Finance and Monetary Affairs, respectively, Board of Governors  
Mr. Rosine, 1/ Senior Economist, Division of Research and Statistics, Board of Governors  
Mr. English, 1/ Economist, Division of Monetary Affairs, Board of Governors  
Mr. Freeman, 1/ Section Chief, Division of International Finance, Board of Governors  
Ms. O'Day, 1/ Associate General Counsel, Legal Division, Board of Governors  
Mr. Baer, 1/ and Ms. Misback, 1/ Managing Senior Counsels, Legal Division, Board of Governors  
Mr. Ely, 1/ Senior Attorney, Legal Division, Board of Governors  
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Barron and Rasdall, First Vice Presidents, Federal Reserve Banks of San Francisco and Kansas City, respectively

Messrs. Beebe, Goodfriend, Lang, Rosenblum, Sniderman, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Richmond, Philadelphia, Dallas, Cleveland, and Atlanta, respectively  
Messrs. McNees and Miller, Vice Presidents, Federal Reserve Banks of Boston and Minneapolis, respectively  
Mr. Evans and Ms. Krieger, Assistant Vice Presidents, Federal Reserve Bank of Chicago and New York, respectively

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1. Attended portions of the meeting.

Transcript of Federal Open Market Committee Meeting  
January 31-February 1, 1995

January 31--Afternoon Session

CHAIRMAN GREENSPAN. Good afternoon, everyone. The first item on the agenda is the election of officers and I turn the chair over to Governor Blinder.

MR. BLINDER. For parliamentary reasons known not to me but to some people, I have the distinct honor and high privilege of opening the floor to nominations. I understand that I am not allowed to nominate anybody.

CHAIRMAN GREENSPAN. You are the Chairman.

MR. BLINDER. The floor is open for nominations for Chairman of the Federal Open Market Committee for 1995. Do we have any nominations? [Laughter]

CHAIRMAN GREENSPAN. This silence reminds me of last year!

MR. BLINDER. Nobody nominated!

MR. LINDSEY. I nominate Alan Greenspan as chair.

MR. BLINDER. Do we have a second?

MS. MINEHAN. Second.

MR. BLINDER. All in favor?

SEVERAL. Aye.

MR. BLINDER. Opposed? [Laughter] I now have the honor to open the floor to nominations for Vice Chairman of the Federal Open Market Committee for 1995.

MR. KELLEY. I nominate President McDonough.

MR. BLINDER. Is there a second?

MS. MINEHAN. Second.

MR. BLINDER. All in favor.

SEVERAL. Aye.

MR. BLINDER. Opposed? It is done. I believe my duties are completed now.

CHAIRMAN GREENSPAN. You did that with exemplary efficiency. I call upon our esteemed colleague to read the list of officers tentatively put before you for nomination and action.

MR. BERNARD. The list is as follows:  
Secretary and Economist, Donald Kohn;  
Deputy Secretary, Normand Bernard;

Assistant Secretaries, Joseph Coyne and Gary Gillum;  
General Counsel, Virgil Mattingly;  
Deputy General Counsel, Ernest Patrikis;  
Economists, Michael Prell and Edwin Truman;  
Associate Economists from the Board:

David Lindsey,  
Larry Promisel,  
Charles Siegman,  
Lawrence Slifman, and  
David Stockton;

Associate Economists from the Federal Reserve Banks:  
Lynn Browne, proposed by President Minehan;  
Thomas Davis, proposed by President Hoenig;  
William Dewald, proposed by President Melzer;  
Frederic Mishkin, proposed by President McDonough; and  
Carl Vander Wilt, proposed by President Moskow.

CHAIRMAN GREENSPAN. Would somebody like to move the slate?

SPEAKER(?). So move.

CHAIRMAN GREENSPAN. Is there a second?

MS. MINEHAN. Second.

CHAIRMAN GREENSPAN. Without objection. We now move on to the selection of a Federal Reserve Bank to execute transactions for the System Open Market Account. Is there a nomination?

MR. BLINDER. I will nominate the Federal Reserve Bank of New York.

CHAIRMAN GREENSPAN. Second? [Pause]

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. This is getting trickier and trickier.

MR. BLINDER. You almost lost that one, Bill!

VICE CHAIRMAN MCDONOUGH. I was worried about that pause.

MR. LINDSEY. This should have been staged better!

CHAIRMAN GREENSPAN. Are there any objections to the selection of Peter Fisher as Manager of the System Open Market Account? If not, I will assume he is appropriately appointed.

The next item is our traditional approval of the minutes, which I knew we would get to, of the December 20 meeting. Would somebody like to move their approval?

VICE CHAIRMAN MCDONOUGH. So move.

CHAIRMAN GREENSPAN. Without objection. The consideration of FOMC disclosure policy is now on the table, and I call upon the chairman of our subcommittee to handle that, Governor Blinder.

MR. BLINDER. Thank you, Mr. Chairman. The staff has circulated, or actually recirculated, to each of you a memo from the subcommittee that was prepared in August; it was accompanied by a lengthy and more recent memo from Virgil Mattingly on certain legal aspects. I am not going to summarize those memos; I just want to say a few words. What is before you today are proposals from the subcommittee calling essentially for the ratification, with some exceptions--I am going to come to the exceptions--of what has become the de facto status quo but has never actually been adopted as a policy of this Committee. The de facto status quo has evolved since the existence of the taping system was revealed in the fall of 1993 and the prompt announcements of policy actions were started in February 1994. It is true, however, that when we go from a de facto policy to a formally adopted policy, and we formalize and enunciate things, that is a time for clarifying and tying up the loose ends and in some sense committing to staying with such a policy--not forever but for some period of time. In that sense, our policy merits some discussion. There is only one thing that I think is an important new wrinkle in this document. That is the matter of concurring statements to the minutes, which I will say a few words about in due course.

The overall philosophy of this proposal is that the central bank's independence carries with it a corollary of accountability. Perhaps--I will put in the "perhaps" to make sure everybody agrees--the Federal Reserve has not quite acquitted itself of this responsibility of accountability, at least not as well as it might. In particular, the public has a right to know more about what the Federal Reserve is doing and why it is doing it.

There are three principal things in the proposal. The first has to do with announcements. This issue must be relatively noncontroversial because we have been doing it since February 1994. As far as I know, everybody seems to be relatively happy with the practice of announcing our decisions promptly. Furthermore, it is hard to imagine how we could avoid doing so as long as interest rates are the target. That seems to lead ineluctably to the conclusion that we should continue making prompt announcements of policy changes.

There is an issue here that has to do with the statements that we make about the policy being adopted rather than just saying what the policy is. I think there are two questions: How often will we make statements explaining ourselves, and how detailed will these statements be? Very briefly on the "how often:" The subcommittee reached a majority opinion on the recommendation that we ought to make a statement when we change policy--in this case that means changes in short-term interest rates--and not make a statement when we do not change policy. I must confess that I was more favorably inclined to making statements, period, but the majority of the subcommittee, three out of four of us, clearly favored statements only on interest rate changes. That is the committee's recommendation--the subcommittee's, excuse me. I may occasionally lapse into calling the subcommittee a committee.

A slightly more interesting question, perhaps, that merits some short discussion here but that cannot literally be resolved is how detailed these statements ought to be. The statement that accompanied our May action, and included a change in the discount rate, had what I would call one substantive sentence. I am not

counting the usual boilerplate--the Federal Reserve Board acted on recommendations of such and such Reserve Banks and the explanation of what a discount rate is. There was one sentence of substance that said something about the reasons for the actions. In the August announcement, there were three sentences of substance. If I remember --I hope Don will correct me if I am wrong--the November statement had none. It announced the decision; it had only the boilerplate. I am pretty sure that is right. Those are the last three announcements we made without enunciating any formal policy on announcements. The subcommittee discussed this issue to some extent. Not surprisingly, we could not reach a consensus for many reasons, including the fact that it is hard to define what a consensus is. I think the only useful thing would probably be for the Chairman, who will be the drafter of such statements, to hear the views of the members--to what extent do we want to say something and to what extent do we not want to say anything. I don't believe it will be possible to enunciate a clear and crisply defined policy on this issue.

The second issue has to do with tapes and transcripts. While I think many people believe that, in the abstract, it would be better if the taping system did not exist, it was the unanimous view of the subcommittee that we have the taping system now and we ought not to be turning it off. The issue here is whether there should be an "off the tape" portion of FOMC meetings. This would afford the opportunity to discuss nonmonetary policy matters with the tape turned off. There was a feeling that there probably was a case for that. A slight nuance mentioned in the report is whether we want to construe this as "the tape is almost always on and occasionally turned off" or "the tape is off except when monetary policy is being discussed." There is, of course, a third alternative and that is not to turn the tape off at all, which is in fact the status quo under which we are operating right now.

On transcripts, the subcommittee again recommended ratifying the status quo, which is to release them after five years, edited more or less exactly as they are now--no change from current policy. The one new wrinkle that bears mentioning is dealt with in some detail in the Mattingly/Baer memo that is in front of you. It has to do with the potential danger of a premature, let me call it, release of the tapes or the transcripts in response to a subpoena from a certain number of members of the Government Operations Committees in the House and the Senate. At the time the memo was written, the number was seven members in the House and five in the Senate; but it may be different now. The issue is that it is a finite number, not necessarily the majority, of the members of those committees. The conclusion of Virgil's memo was that in fact there was such a danger. The conclusion of the subcommittee was that that did not change our decision that we should maintain the taping system essentially as it is now, much as we would regret a successful subpoena that would actually get hold of these tapes prematurely.

The third issue is the minutes. We basically recommend continuing the minutes essentially as they are now. The operational content of that recommended action is that they would continue to be written without attribution of particular thoughts to particular people. We would add the option of concurring statements by individual members. I want to stress that it is an option; nobody is going to be asked to put in a concurring statement just to make the

minutes longer or because it seems like a nice thing to do. So, our recommendation is to leave concurring statements as an option for those members of the Committee who wish to avail themselves of it on an ad hoc, meeting-by-meeting, person-by-person basis. The virtues of this seem to me, and indeed to the subcommittee, to be three. The first is an increase in Federal Reserve accountability as it relates to the quantum of information about the Federal Reserve's policies that is received by the public. The second advantage is that these statements can potentially serve as a halfway house between agreement and dissent. That is, there may be times when a member of the Committee is basically willing to go along with the decision, but that member may not be entirely happy, for example, with the presumably very brief statement that the FOMC issues at the time--if indeed there is a statement--and may wish to put some sort of nuance on the assenting vote. A concurring statement makes it possible for a member to say something without dissenting, if that member wishes to. The third advantage, I think, is an operational advantage. Having these assenting statements will, I believe, make it much easier in practice to leave the drafting pencil for the Committee's official statement in the hands of the Chairman without having to worry about 19 people around the table deciding whether the verbs and adjectives suit them. The proposal is to let the Chairman write that statement exactly as he sees fit, and a person or persons who want to put a somewhat different light on their decision would have that as their option.

Those are the three things in the proposal. I should add one more that is not in the document. I have discussed this with the Chairman, though not recently. So this will come as a bit of a surprise; I thought of this again last night. It is the issue of the blackout period. We now have a symmetric blackout period of one week before and one week after a meeting. This made a certain amount of sense under the old policies. Most people think it makes very little sense under a policy of announcing the interest rate change immediately. The suggestion is for an asymmetric blackout period, including a more limited or no blackout period after a meeting; but we may not want to go that far. Certainly an asymmetric blackout period of some sort seems in order. Mr. Chairman, I think you suggested a one- or two-day blackout after each meeting when we talked about this.

CHAIRMAN GREENSPAN. No. Actually I am agnostic on the whole issue because I really have not given it enough attention. I would be very curious to hear what the members have to say.

MR. BLINDER. So, I would also like to put that on the table. There is no proposal from the subcommittee on that issue. I think I have now put everything out on the table.

CHAIRMAN GREENSPAN. Do you want to go piece by piece and see whether we have a consensus?

MR. BLINDER. Okay.

CHAIRMAN GREENSPAN. It will be useful, I think, if we just have individuals raise specific questions relevant to each of the issues that you outlined. Then, at the end of the discussion, we can see whether there are significant qualifications or dissents from the subcommittee majority.

MR. BLINDER. Do you want to go issue by issue or around the table person by person?

CHAIRMAN GREENSPAN. I think issue by issue.

MR. BLINDER. Okay. Why don't we take the question of announcements first. I reported our proposals in the inverse order of how much discussion I thought the Committee would want to give them. The first is the issue of announcements, where the proposal is to make prompt announcements of each interest rate change and not to make an announcement when the change in interest rates is zero. Then, as a subquestion, it would be helpful to get some guidance or some feeling from the Committee regarding how detailed these announcements ought to be. This piece of paper says that Bob Parry is first.

MR. PARRY. With regard to announcements, I think it is clear that we ought to continue the present procedure. What I would be a little concerned about would be too much detail in the explanation. I think we have been pretty well served by the practice of explaining the reasoning but keeping it quite short. I don't see much advantage in providing a detailed statement. There would be the issue of whether we would get a consensus on it as well.

MR. BLINDER. President Broaddus.

MR. BROADDUS. On the announcements, I certainly agree that we should continue to announce policy actions immediately. With respect to the statements that accompany these announcements, I have mixed feelings about the subcommittee's recommendations. Frankly, I have some reservations--not about announcing our actions--but about making accompanying statements because it is so easy for people to misinterpret them no matter how carefully we write them. As Tom Melzer points out in his letter that we all received, the rationale supporting an action is going to be released in a fairly short period of time anyway. If we do decide to continue to make such statements, I think we ought to think a little about how they get prepared. We know from experience with discount rate announcements that the statements or explanations that accompany these actions have a material effect on market reactions, mainly because they clarify what the action may signal with respect to what we are going to do in the future, whether it is the first of several actions or the last action of a series or whatever. The record on this is pretty clear. We have done a good bit of research on discount rate announcements at our Bank, and some other research has been done elsewhere. So, I think that point is well documented.

Consequently, and I certainly mean no disrespect to the Chairman, but given this market impact, I think the full Committee should be involved in preparing these statements. I am well aware of the problem of having 12 or 19 people around this table trying to write these statements in detail, but we might be able to cut through this by asking the staff, perhaps in the Bluebook, to include in its discussion of alternative policy actions perhaps a couple of alternative statements that might go along with each alternative that involves a policy change. The format that might be followed is that the alternative statements could give some sense of what the Committee's stance is going to be after the action is taken, whether



it is symmetrical or tilted in one direction or another. In any case, I think we ought to give that some consideration.

MR. BLINDER. President Melzer.

MR. MELZER. First of all, I favor making statements only when there is a change in policy, not when there is no change. Secondly, I am comfortable leaving it up to the Chairman's discretion. I could imagine, for example, a change in policy where the Chairman decides not to say much at all, and I can imagine other changes where more would be appropriate. But I think ultimately it has to be at his discretion. From time to time he may want to consult with the Committee, but I would not make the consultation obligatory.

The one concern I have about statements relates to the possibility that they may take some flexibility away from the Committee in the future. We have to be very careful about that. Otherwise, the language becomes subject to negotiation because it is predisposing what we may or may not be able to do in the future. The statements have to be very carefully drafted in my view so as not to take that flexibility away. I do not think that the opportunity for assenting statements really offsets that because once that public statement is made, an expectation has been set in motion in the marketplace. Assenting statements coming out six weeks later are not going to make any difference in altering those expectations or really give any solace to an FOMC member who feels that the Committee's flexibility has been compromised by the statement.

CHAIRMAN GREENSPAN. Tom, may I just ask you a quick question?

MR. MELZER. Yes.

CHAIRMAN GREENSPAN. You are raising a tricky problem. Al Broadus is saying that their research, and I suspect most other research, indicates that there is content with respect to future actions embodied in the statements. If you want to leave full flexibility for the Committee for the future, then by definition the announcement cannot have that content. The question essentially gets to the issue of whether you want the statement to have forward-projecting content. If you have that, then Al's point about the Committee having a voice in its drafting clearly is a matter of material importance. If it has no content or it leaves full discretion to the Committee, which I would guess is what you are suggesting and what a normal statement is supposed to do, it really should be backward-looking; it should not be forward-looking unless there is a specific policy that the Committee wants to convey. If there is no forward content to the statement, then it is a matter of indifference whether I write it or not. But I do think that this decision really comes down to the question of what the Committee wants in that statement, not who does it. Do we want any forward-looking content or do we want a retrospective statement that effectively captures the reasons that led up to the particular decision?

MR. MELZER. What I would want would be the latter, what you just described--a description of our rationale for taking the action.

CHAIRMAN GREENSPAN. If we are successful, the correlations in Al's studies should go to zero--theoretically.

MR. BLINDER. I doubt that we could do that. It would be hard. These things are read and parsed very carefully, and whatever we say to explain what we did by reference to the past, even if we don't mean it to, will be interpreted as having some implications for the future. If we now make an interest rate move and say not a single word, a thousand people around the world will start saying what that means for the future just from the size of the move, how it was related to previous moves, and a whole variety of other things. I think the reference to the future is always implicit. To what extent we make it explicit is a kind of art form.

CHAIRMAN GREENSPAN. It has been our usual practice to read the draft statement to the Committee. The purpose of that statement is to capture the essence of the Committee's reasoning. I think it is crucial to avoid the optional differences in phraseology that we all have, which I think is impossible to do with 19 people or 12 people. Unless somebody objects, I think the current practice seems to be working reasonably well. What I try to do when I write the statement is to anticipate who is going to object when I read it to all of you. In general, I have been forecasting reasonably well. What does have to happen, however, is that the statement that is made has to be vetted to the Committee before it becomes public so that if there are objections, it is important for them to be on the table and get addressed. But I would strongly recommend that the Committee as a whole not try to write the statement because the meeting will go on and on. It is like writing a communique at an international meeting where the communique can take four-fifths of the time of the meeting.

MR. BLINDER. I think what you just said is exactly what the subcommittee had in mind.

CHAIRMAN GREENSPAN. Would anybody object to this as a procedure?

MR. BROADDUS. It would be helpful if we had a chance to look at the statement in draft form and make whatever comment we deem important. Just very briefly, in the research on the discount rate announcements--it is not exactly analogous--some researchers have tried to distinguish between alignment announcements, which really do not have any policy content and talk about moving the discount rate back into alignment with the funds rate, and announcements that are clearly a policy signal. The latter announcements almost always have, because of the way they are worded--and people have studied this very carefully--some impact on policy. As I believe you said, Governor Blinder, it is hard to avoid some kind of impact. By putting the draft out on the table, somebody here might spot some problem that might escape the drafter.

MR. BLINDER. I have three more people on the list. Vice Chairman McDonough.

VICE CHAIRMAN MCDONOUGH. I am very strongly persuaded that we should announce policy decisions. As I have mentioned before, our previous practice would make it possible in today's very sophisticated financial markets, had we continued that procedure, to give an

advantage for only 10 seconds or half a minute to the more sophisticated market participants. We do, in fact, say when there is no policy action that the Committee has met and there is no further announcement. That is an announcement of sorts. Therefore, I think whether we do that or whether we say the Committee has met and there was no change in policy is--

CHAIRMAN GREENSPAN. There is a big difference.

VICE CHAIRMAN MCDONOUGH. It is the symmetric directive issue.

CHAIRMAN GREENSPAN. No. Somebody has argued--I have forgotten who it was; it may have been Don Kohn--that there is an important difference. Suppose we purposely delayed an interest rate change for 48 hours pending somebody's speech or some statistical release, and we said there was no change, and then 48 hours later we made a change; it would look awkward.

VICE CHAIRMAN MCDONOUGH. That is right; I had not heard that argument.

CHAIRMAN GREENSPAN. If we say the Committee has made no decision or something like that, we still have full flexibility to make a change later.

VICE CHAIRMAN MCDONOUGH. The point I want to emphasize is that we should continue to have Joe Coyne announce that the Committee meeting is over and that there is no further announcement.

CHAIRMAN GREENSPAN. Yes, I think that works.

VICE CHAIRMAN MCDONOUGH. I think the content of what we have had to say in our announcements of policy changes has been quite good. Personally, looking back to August 16, I wish that we had not said that these actions are expected to be sufficient at least for a time to meet the objective of sustained noninflationary growth. Since I was very supportive of the decision, I understand why we did it. I think, henceforth, we might want to be even more careful about making such a statement.

MR. KOHN. Mr. Chairman, I would like to put another point on the table. That is, the Committee made several policy changes last spring that involved only open market operations and not discount rates. In those cases, except for that first change, you simply announced the fact that the rate had changed without a full explanation at that time. Explanations came later when the Committee's actions were taken in conjunction with changes in the discount rate. This is really a question for the Committee. Does the Committee wish to put out discount rate type announcements when discount rates are not changed or would it prefer to try to maintain this tiny distinction between what Governor LaWare used to call "ringing the gong" with the discount rate and a less open policy change involving only the federal funds rate?

MR. BLINDER. The subcommittee's proposal was the former. A statement with an interest rate change was the subcommittee's

recommendation. The full Committee can reject it if there is no discount rate change.

MR. KOHN. So there would be no announcement unless the discount rate is changed?

MR. BLINDER. No. Either.

MR. KELLEY. Either.

MS. MINEHAN. Either or.

MR. BLINDER. An announcement would accompany an interest rate change, whichever kind of interest rate it was.

MR. KOHN. A statement would say more than just "we changed the interest rate" but would give at least some boilerplate explanation as to why we changed.

VICE CHAIRMAN MCDONOUGH. A very brief explanation.

MR. BLINDER. President Hoenig.

MR. HOENIG. First of all, I agree on immediate announcements, and I like the way we have done it. That is, when we take no action, we say there is no announcement. Regarding the statement, I think it should give no reason or be extremely brief. We started making announcements to make sure there is no advantage to anyone. Our procedure takes care of a lot of that and is one of the reasons I am pleased with it. Now, if we take it a step further--especially when we have a change only in the fed funds rate, and start explaining--we open ourselves up even more to misinterpretation, I think. Every word is taken a different way, and that causes more confusion than it settles. Except in very rare instances, and there are always instances one can think of, we should minimize any comments.

MR. BLINDER. President Minehan.

MS. MINEHAN. I also am in agreement with the announcement policy, but I would like to argue for a bit of flexibility on whether we do or do not announce "no change." There are instances where no change is not a change in policy. There are instances where the reverse is true. For example, if we decided not to do anything at this meeting, I think that would suggest something different in the way we now see things than is indicated in the minutes of previous meetings. I would think that where we have a situation where no change is in fact a change in policy, something ought to be said, but we should not hold our feet to the fire every time we have a meeting and do not make a change. We should keep our options open, but where there is something to be communicated, we should communicate it.

CHAIRMAN GREENSPAN. I think that is a good thought.

MS. MINEHAN. I would leave the statement wording to you, Mr. Chairman, because I don't think there is any way we can draft it as a Committee. I would like to hear the statement before it is released, but I would give you the flexibility. I also feel that

President Broadus' suggestion of having a staff draft to work from has some interest, but I would really hope that the statement would be very short and crafted to reflect the discussion that went on in the meeting, which can't always be anticipated before the meeting. I would go with the subcommittee on the suggestion that you draft the statement, Mr. Chairman, and if you want to tell us about it, fine.

CHAIRMAN GREENSPAN. The point at issue is that if it is more than boilerplate, Governor Blinder is absolutely right. There is no way to make any value-neutral statement in the English language. There is always some value element involved. We have always had time to have a statement written in advance, and I would suggest that short of an extraordinary situation or a surprising situation, that really ought to be part of the process. What that statement says, leaving the particular language aside, does have content that affects the market, and the Committee as a whole should have control over at least the basic substance. I can conceive that in an emergency we might have to bypass that, but I would say it would not be wise policy under normal circumstances.

MS. MINEHAN. Are we talking about the directive or the actual statement itself?

CHAIRMAN GREENSPAN. Just the statement.

MS. MINEHAN. We have not been writing the statement in advance, have we?

CHAIRMAN GREENSPAN. Yes. When we were doing the discount rate announcements, we always had a draft if there was a possibility of a change in the rate. We would have a tentative statement to be read in the event that the votes were there.

MR. BLINDER. Two-handed intervention!

VICE CHAIRMAN MCDONOUGH. I would like to raise a minor, or maybe not so minor, objection to that. Don Kohn, I believe, has been the drafter of the statement, but the fact that he has had it in pectore rather than on the table means that the debate is not inhibited by people looking at the statement and seeing what the party line may be.

CHAIRMAN GREENSPAN. No, the statement has always been discussed after the vote.

VICE CHAIRMAN MCDONOUGH. I thought you were suggesting that you were going to have it available for people while they were voting.

CHAIRMAN GREENSPAN. No, we vote and then decide what it is--

MR. BLINDER. What we voted on!

CHAIRMAN GREENSPAN. What we have been doing recently is to vote and then discuss what type of statement would be issued should the Board approve a discount rate change that would be part of the decision. That was never done to my recollection until after the FOMC had voted.

VICE CHAIRMAN MCDONOUGH. I understand how it has worked. I, at least, got confused by what you said just now.

MS. MINEHAN. Yes.

CHAIRMAN GREENSPAN. I am sorry. I would say that if we are going through a process involving an FOMC vote, and it is going to be either preceded or followed by a discount rate change, the statement that is to be used in the discount rate announcement should be indicated to the FOMC, at least in approximate form, after the FOMC vote. If there is a challenge as to whether or not the statement captures the substance of what the Committee decided, we have a chance to change it.

MR. BLINDER. President Boehne.

MR. BOEHNE. Just a couple of comments: I might state somewhat differently than did the Vice Chairman the rationale for why we are doing what we are doing. We are trying to make the best possible monetary policy decisions and that depends very crucially on the quality of the deliberative process. At the same time, we also want to be as open as possible. That balance of having a quality deliberative process and a degree of openness, I think, ought to be reexamined from time to time. What was the right balance in one period may be different in another period. I agree with the immediate change. I think that there are some rather strong reasons for only announcing changes and not getting into the habit of announcing "no change" decisions, even though I can conceive of situations where that might be best. In addition to the examples you gave, Mr. Chairman, where there may be a reason to delay the implementation for a couple of days and it therefore would be very awkward to issue a no-change statement, there is also the complication that we sometimes have conference calls between meetings. In my view we would not want to get into the habit of stating that policy was not changed at a meeting even though we might have considered the possibility of a change at an unscheduled meeting during the intermeeting period. Another complication is the delegation that the Committee makes to the Chairman. The Chairman has the flexibility to change policy between meetings. While it may be splitting hairs, conceivably the Chairman could think about making a change and decide against it. If we have a stated policy that we are going to announce both change and no change, it could get more complicated. It is much cleaner to do it the way that we have been doing it.

On the issuance of a statement, I think we ought to have a statement when we do make a change. It ought to be short. To me, the main reason is that somebody is going to explain our action, and I would rather our words be the basis for that explanation than somebody else's interpretation. So, I think it is worth a sentence or two, but I feel rather strongly that it has to be up to the Chairman. The Chairman can get all the advice he wants from the Committee, but it is his responsibility, and I think we ought to make that clear.

MR. BLINDER. President Jordan.

MR. JORDAN. I agree with announcing as we have done over the past year, including the indication as appropriate that the meeting has adjourned and there is no further announcement. As far as the

substance is concerned, though, I think your characterization, Mr. Chairman, of the message about the future is the important criterion. That depends critically on the regime that we are in. If we were in an era when people had absolutely no doubt about the ultimate objectives of the Committee--if we already had a totally credible commitment to future price level stability, or had announced something along the lines suggested in the Dave Lindsey memo regarding future objectives--and the only message was a matter of tactics in order to achieve those objectives, that is one thing. In that case, I would be willing to be more forthcoming about how our action is intended to achieve the objectives. However, the regime that we are in, as I perceive it, is one where there is some uncertainty about our objectives. The message could get confused in the minds of the public as to what it is we are trying to achieve versus how we are trying to achieve it. In that case, I would prefer the briefest possible statement to minimize that misinterpretation.

MR. BLINDER. Governor Phillips.

MS. PHILLIPS. I agree that it is appropriate to make announcements of policy changes, and when there are no changes to continue to indicate that meetings have ended. With respect to the statements, I think that, as a general matter, making them as short as possible is probably the best rule of thumb. We always have to leave open the ability to communicate what needs to be communicated, and I think that should be left to the Chairman's discretion. If he has a draft statement that he feels matches the gist of the discussion, I think it would be useful for that to be read. But I would hate to see that built in as a requirement because I do think that the Chairman needs to have some discretion in terms of wording the final statement.

MR. BLINDER. That is the end of the list. I would just like to add my own views. I would like to align myself very strongly with Cathy Minehan's views on the "no change." We would not want to be committed to making a statement every time we did nothing.

MS. MINEHAN. Right.

MR. BLINDER. Many of those times we have nothing to say. There have been times in history when not changing the interest rate was the news or changing the interest rate was the non-news. I would certainly like to see us have the flexibility to make an announcement and explain why we decided not to change interest rates, where that seems sensible. My personal preference would be for a policy that calls for a statement at every interest rate change and the option of a statement on a no-change, but by no means a requirement of a statement on a no-change. I would also like to go out on a limb--I am not hesitant to go out on limbs as you know--against what is obviously the tide toward briefer and terser. I believe, for the reasons Ed Boehne and others mentioned, that we now have a situation where the people that speak the least about the Fed's decisions are those at the Fed, and we are interpreted voluminously. There is nothing wrong with that. We will still be interpreted voluminously even if we say things. But our statement is a chance for us to say what we are up to and why. I don't have a specific number in mind, but a number of central banks around the world say a lot more about their policy than we do. We could expand from our current empirical norm of zero to

three sentences. Going up from that would still leave us with a fairly short statement. I am not talking about writing a book.

On the issue of the pen in the Chairman's hand, it seems to me that we have coalesced around a policy where the Chairman has a draft, he reads it, he listens to what people say, and then he has unilateral authority to do with that as he wishes. It sounds like almost everybody is there on that one. President Moskow wants to speak also.

MR. MOSKOW. I generally agree with the thrust of what has been said. Let me just preface it by saying, as a newcomer, that I think the announcement policy of the past year has been working quite well. Essentially, what we are doing is ratifying the current practice. Certainly, we should continue announcing our policy changes after each meeting. The announcements should be brief. I think the Chairman's suggestion that they continue to be read to the Committee for any comments is good and useful. Maybe this is just a nuance on the Minehan/Blinder suggestion, but I would phrase it a little differently though I think I am in complete agreement with what you are saying. As I understand the current practice, after the meeting Joe Coyne announces that the meeting is over and that there is no announcement. That is the announcement; there is essentially no announcement. Now it seems to me that we as a Committee can make an announcement at any time if we want to without changing interest rates. We always have the option of making a statement if we want to. We could do it after the meeting if we so desired. I just would not put it in the context of a "we are going to announce no-change." I think I would say that if we have an announcement to make when there is no change, we will make an announcement.

CHAIRMAN GREENSPAN. One way to resolve this issue of whether to make an announcement when there is no change in policy is to view it as a policy question that should be part of our debate. In other words, if we are in a situation where part of the response that we expect to get stems from our doing nothing, that is a major policy issue, not a disclosure question; so that is part of our discussion. On rare occasions--I think probably quite rare--it might be that what we want to do is to put aside our standard procedure, which we always have the option of doing anyway, and as part of a policy decision we could say that policy has not changed and make a statement. Or we could just say that we did not change our policy and make no statement. Both of those are policy-oriented matters. I gather the thrust or consensus here is that we should leave our announcement policy as it is. That is, if policy is not changed, Joe Coyne will say that we have ceased functioning, which may have more implications than--[Laughter]

MS. MINEHAN. He won't say that!

CHAIRMAN GREENSPAN. There would be no announcement unless there is something positive to be gained as a result of making one, in which case that would be part of what we would discuss and we would instruct Joe accordingly. I would guess that that may happen once a year, maybe less. I do think that leaving the issue open in the abstract and maybe as a practical matter does have some merit.



MR. MOSKOW. That is exactly what I had in mind, Mr. Chairman.

MR. BLINDER. I think we may have reached a consensus. It sounds like one.

CHAIRMAN GREENSPAN. Why don't you try to define it?

MR. BLINDER. I have been assigned to define the consensus. The consensus is that on interest rate changes, be they federal funds rate changes only or discount rate changes only or both, there will normally be a statement. I think there was a strong consensus that those statements should be terse. A draft of them should normally be read to the Committee by the Chairman who will ask for comments and then will have the authority to do with those comments as he wishes. In cases of no change in policy, there is an option of making a statement, if we see something to be gained. But there is no presumption that there will be a statement.

CHAIRMAN GREENSPAN. Tom.

MR. HOENIG. If I may, it seems to me that the last part of that should be stated the other way. There is a presumption that if there is no policy change, the meeting would end with no announcement. An exception would be made if there is a policy consideration to be served, which we would discuss at the meeting. Is that what I heard?

MR. BLINDER. Yes, I think so.

MS. MINEHAN. That is what it is.

CHAIRMAN GREENSPAN. Yes. An announcement when there is no policy change is an exception and must be agreed to during the discussion in the FOMC meeting.

MR. HOENIG. Thank you.

CHAIRMAN GREENSPAN. Any objection to that summary, which I thought was scholarly?

MR. BLINDER. A much higher grade than I would have given it. Thank you.

CHAIRMAN GREENSPAN. I am emotionally involved with CRA!  
[Laughter]

MR. BLINDER. The second issue relates to the tapes and transcripts. The subcommittee is basically recommending the status quo except for the issue of an occasional off-the-tape discussion that is not about monetary policy. It may be, for example, about some confidential personnel matter. Other people may have other examples, but monetary policy would not be included. I guess the floor is open. Governor Lindsey.

MR. LINDSEY. Unfortunately I am going to be dissenting on this. I realize I am in the minority. The discussion in your memo says there is a strong consensus that we would all be better off if the practice of taping FOMC meetings had never begun. That is true.

It is also true that this Committee never authorized the maintenance of tapes. As the memo points out later on, most of us were taken by surprise when we found out that the transcripts were maintained. So, I think that there is an issue of justice here and that we are ratifying an injustice by approving the recommendation, practical though it may be.

The second concern I have is a hypothetical one. At the moment we live in a very benign political environment in which the chances that the tapes will be used against the Committee are very slim. That is not necessarily the environment we should presume in considering whether or not it is wise to tape these proceedings. In fact, an abundance of caution would suggest that we should imagine a very non-benign situation. One might think of it as a witch hunt in which we are turning over to the prosecutors evidence that is really none of their business. It is possible for us to prevent taping under those circumstances by turning off the tape now. It will not be possible in that less benign political environment for us to turn off the tape when we feel we need to. So, I think we should show at least a little caution about the vagaries of the political process and protect not ourselves but some future Committee that may be in a more hostile political time than that in which we find ourselves and I'd turn off the tape now while we can do it.

MR. BLINDER. President Melzer.

MR. MELZER. A couple of comments: First, on this issue of turning the tape off for certain periods of time, I have had a concern that in doing that, even though it might be desirable in some respects, we could incur a fairly heavy political cost with respect to how the Federal Reserve is perceived. Apparently, the public perception is that the Fed is not as forthcoming as it ought to be, and turning off the tape for parts of our meetings would be perceived as a step in the direction of becoming more secretive. So, as I mentioned in the letter that I sent to Alan Blinder earlier, while it might be desirable in some sense, I think if I were going to incur that cost, I would be inclined to shut the tape off entirely.

Second, in thinking about these issues, I come at it the same way that Ed Boehne described before. We really have to think in terms of this tradeoff between the deliberative process and providing disclosure to the public. Our primary responsibility ought to be to make sure that we have an effective deliberative process and then provide as much information to the public as possible. In thinking about the issue of continuing to run the tapes, I feel much the same way as Governor Lindsey has stated here. In my view it is just a matter of time, given the various avenues through which we could be served a Congressional subpoena, that those tapes will be listened to on virtually a real time basis and could be used as a means of isolating members and basically killing the deliberative process. The only way to preserve that process at that point in time would be to say, now that the damage is apparent, we are going to turn the tape off. But that would be in the very sort of climate that that action would be considered as a major affront. Frankly, I have seen us back away from much less threatening situations because of the concern about the potential for legislation. In this particular issue with respect to the tapes, we have had a couple of opportunities along the way, in my opinion anyway, where we might have had an opening to

correct this. The first instance occurred when the Justice Department announced its new policies with respect to defending agencies on FOIA requests. We may have had another opportunity more recently this fall. In any event, I think that we could be leaving a future FOMC in a very difficult position. In effect, in approving what is recommended here, we have to be saying to ourselves, I am approving this recognizing that an important condition would be that, in the event of that sort of request, we would be prepared to take the action and turn the tape off to try to preserve the deliberative process and fight whatever battle needs to be fought at that time. But again, that is going to be one difficult battle. The real question is whether there will be a better opportunity in some other environment to straighten out our record-keeping practices. I think all of this is better stated in my letter that you all have than I have just stated it.

MR. PARRY. As a point of clarification, what did the subcommittee conclude with regard to this point?

MR. BLINDER. When the subcommittee met and drafted its report, we viewed the subpoena option as considerably less likely than we did subsequently--after Virgil's memo pointed to the route through the Government Operations Committee. But a subpoena was already a possibility. I believe our view was that we should resist a subpoena if and when it came.

MR. MELZER. There is a reference to that in our report at the bottom of page 2 and the top of page 3. It is an explicit statement of the conditions under which we would approve turning off the tape.

CHAIRMAN GREENSPAN. Where?

MR. BLINDER. It is the very last sentence on page 2 carrying over to page 3 in the subcommittee's report. President Forrestal.

MR. FORRESTAL. I must say that when it was revealed that we were taping these sessions, I wished that we had never started this practice. But having thought about this over the past year or so, I have begun to think that having the tape may not really be all that bad. It does provide evidence of the accountability of the Federal Reserve. I don't think that it has in any way interfered with the deliberative process. I did sense at the very beginning that some interference might have happened, but I now feel that the deliberative process has been preserved. We agreed to a five-year period before release of the transcripts, and I think that in itself helps to safeguard the deliberative process. I see the danger of a subpoena as fairly minimal. I don't believe it is going to happen, although it could, and if it does I think we have ways of resisting it. In the interests of accountability and openness about what happens in the central bank, keeping the tape on is the way to go, even leaving aside the political difficulty of turning it off at this point. It is a good idea to have the tape on as a matter of principle.

Having said that, I would agree that a very good argument can be made for turning the tape off on those occasions when we have to discuss very sensitive personnel matters or perhaps matters dealing with other central banks--the situation we are in at the moment--or

issues involving foreign governments. I think we can draw an analogy from the Freedom of Information Act. It is a statute that calls for accountability and openness in government, but there are exceptions and exemptions that are brought to bear. Those include personnel matters, deliberations pertaining to foreign central banks, and so on. Such exemptions can give us the justification for turning off the tape. I believe the way our policy should be stated is that the tape is on as a general rule but that it is turned off in those exceptional cases. To conclude, we would be in a very difficult position if we were to turn the tape off completely, and as I said, I don't think it is costing us very much to keep it going anyway.

MR. BLINDER. President Minehan.

MS. MINEHAN. I would like to align myself with most of what President Forrestal had to say. I do see the need for such a record for reasons of accountability, but I have a question. We have tapes and we have lightly edited transcripts. Do we have to keep both of these? Are both the full record, or do we get rid of the tapes upon the development of the lightly edited transcripts? Would a potential subpoena, assuming it did not cover a recently completed meeting for which we have a tape but not yet a lightly edited transcript, cover only the lightly edited transcript? Or do we have to keep the tapes, too?

MR. MATTINGLY. No. Once the edited transcript is approved by the participants, the tape can be dispensed with.

MR. KOHN. And so can the draft, lightly edited, that is sent to the members for review.

MS. MINEHAN. Okay.

MR. MATTINGLY. The approved record would be the edited transcripts.

MS. MINEHAN. So the lightly edited transcript is what we are talking about in terms of what might be subpoenaed. In this connection I would like to note that there has been some delay in terms of our getting the word-for-word transcript. I have not seen one in a little while; maybe I am just behind in my work. To the extent that that is pretty much up to speed--

CHAIRMAN GREENSPAN. The transcript for the December 20 meeting came out several days ago.

MS. MINEHAN. The lightly edited version?

MR. BERNARD. That transcript was sent out about the 12th of January.

MS. MINEHAN. Really?

MR. KOHN. The draft version for you to correct.

MS. MINEHAN. I saw the minutes for the December meeting. I have not seen that transcript. I don't know why.

MR. KOHN. One point of clarification, President Minehan: For earlier meetings before the Committee started to review the transcripts--that is, those before January of last year--we are not permitted to throw away the raw transcripts.

MS. MINEHAN. Right.

MR. KOHN. But for all the transcripts that the participants in the meeting have reviewed and made corrections to their statements where necessary, we can throw away both the tapes and the draft transcripts. That would cover everything from the start of 1994 on.

MS. MINEHAN. So, have you thrown away the tapes but still have the draft transcripts, or have you kept both?

MR. KOHN. So far, pending this discussion, we have kept everything.

MS. MINEHAN. Going forward then, we would--

MR. KOHN. Going forward, once the lightly edited transcript is finished, we would throw away the other transcript and the tape.

MS. MINEHAN. So within the ambit of the next meeting, you would have a lightly edited transcript and no draft transcript or tape?

MR. KOHN. I don't know what the timeframe will be. It might take a couple of months before we get all the corrections and are able to incorporate them into the lightly edited transcript. By the time we send the draft transcripts to you, you send them directly back to us, and we incorporate corrections, there may be a meeting that goes by.

MS. MINEHAN. Okay. I think it is important that most of what anybody would get with a subpoena would be the transcripts that we have reviewed for accuracy--the lightly edited transcripts with the confidential information redacted.

MR. KOHN. Yes.

MS. MINEHAN. Then I think that normally keeping the tape on is the right way to go. The tape is normally on, and it is explicitly turned off only for certain discussions of confidential matters other than monetary policy. I am convinced that we have less risk with this policy, given what Don has said about the lightly edited transcript.

MR. BLINDER. The Chairman has just requested that we speed up this conversation. With that, I call on President Parry.

MR. PARRY. I basically agree with what President Forrestal said. I would stress, though, that if we do have the tapes subpoenaed we fully intend to stop taping at that point.

MR. BLINDER. President Jordan.

MR. JORDAN. Thank you. If we did not already have the tapes, I am not sure that I would support initiating such a procedure,

but I don't see the possibility of terminating it at this time. We have transcripts for 1994. They will be released five years from now, or sooner if somebody makes us. That leaves us basically with two choices if we were even to contemplate turning the recorder off. Either we announce now that we are stopping, take the storm now, or wait until the year 2000 and then say that we turned the recorder off five years ago. Neither alternative is realistic. That to me is just not something we can consider. I would oppose turning the tape off even for non-monetary-policy parts of our meetings. The principle that we have established of taping entire meetings, as we have done in the past year, is really the one we have to support. One of the defenses we have against earlier release, whether we end up with four years or three years or one year or whatever, is that we do discuss sensitive matters. We do discuss foreign governments and foreign central banks and individuals. And leaving that sort of information on the tape is the reason that we can give as to why we have to have a five-year delay.

CHAIRMAN GREENSPAN. That is a very good point.

MR. BLINDER. President Hoenig.

MR. HOENIG. I would say the current situation is such that as much as I would like to turn the tape off, I don't think we can. Having said that, I must tell you that I think Governor Lindsey is right. First of all, I believe the tape has had some chilling effect on our discussions. I see a lot more people reading their statements. I think it is harder to be as candid as some of us might otherwise be. But more importantly, I think if we do start seeing the threat of a subpoena or inquiries, that will have a clear chilling effect, and it could happen at the most critical of times for monetary policymaking. We are in a sense confined to this outcome of leaving the tape on for now. I hate to see this enunciated as a formal policy. I would like to see our options preserved for the time when we can seize the opportunity to turn the tape off.

MR. BLINDER. Governor LaWare.

MR. LAWARE. I must say that I have never seen any reason why we should not keep the tape on. I agree with some of the representations made here that might serve us well in protecting the tape. The lightly edited transcript, I think, is very useful from a historic point of view. If we can delete or remove or edit the confidential material, I don't see the problem. What puzzles me here is why we feel it necessary to enunciate this policy change. Why do we have to tell anybody what we are doing? Do we have to make it public? This does not involve any change in monetary policy. I was baffled when I came across the issue of how we should enunciate this on our agenda. Is somebody out there waiting for us to enunciate a policy?

CHAIRMAN GREENSPAN. Yes.

MR. LAWARE. Let them wait then. [Laughter] They will forget about it after a while. I just don't see the need to do that. It will just reopen the whole issue and stoke the fire under it.

CHAIRMAN GREENSPAN. Let me respond to that because it is a quite legitimate question. It is my impression that House Banking Committee Chairman Leach has been holding off on any legislative initiatives in this area on the grounds that we are going to do it ourselves. The impression I have--I don't know how firmly based it is--is that if we don't set our own policy, there will be real interest in that committee in trying to do something. Whether or not the issue would go to the full House is a question, but my suspicion is that there is more support for FOMC openness, on both sides of the aisle, than I think we have realized up to now. Larry Lindsey is obviously correct. The degree of Congressional friendliness is much more evident when, say, Jim Leach is in the chair instead of Henry Gonzalez. But I don't think that their views on the issue of the openness of the Fed, on disclosure and that sort of thing, are significantly different. Let me just ask Don Winn to make sure that I am not misreading. Do you have an impression, Don, as to the answer to that?

MR. WINN. I agree with your impression, Mr. Chairman. My understanding from talking with the committee staff is that there was interest on the part of the new chairman of the committee on including something on this subject in legislation. Indeed, the bill that was introduced on the first day of the session concerning the Reserve Bank presidents probably would have included a provision dealing with transcript-type issues--maintenance of the transcript, release of the transcript, and the time period for the release. Such a provision was left out because there was an understanding on their part that we would be addressing this issue. So, the interest in the transcripts subject cannot be thought of as simply a matter that the other side of the aisle was focused on and interested in. It is a subject that continues to be of interest in the Congress. It is also a subject in which the new chairman of the committee through his staff has expressed an interest to us. The expectation on their part is that we would make some kind of policy decision.

CHAIRMAN GREENSPAN. Chairman Leach effectively is leaving it to us to make the judgment, but he has made it very clear that he wants us to make a judgment.

MR. LAWARE. Okay.

MR. BLINDER. Are you finished, Mr. Chairman? Did you want to say more?

CHAIRMAN GREENSPAN. I don't want to say more.

MR. BLINDER. President Moskow.

MR. MOSKOW. I am very concerned about making a long-term decision on this today that is going to bind future Open Market Committees for many years to come. Since I am very new to this, I am begging indulgence if I ask some very basic questions. First of all, you mentioned that Virgil Mattingly's memo came out after the subcommittee had written its report. Did the subcommittee consider that legal memo in later deliberations and still agree to go forward with its recommendation?

MR. BLINDER. Yes. Subsequent to that memo we had a conference call devoted almost exclusively to the memo and we left the recommendation intact.

MR. MOSKOW. I divide this into two questions. One is, would we want to have these tapes today if we were voting today to set up a system of taping and follow the procedure we are going to have? Would we do that today? My sense just from reading this report and from the comments here is that we would not initiate this.

CHAIRMAN GREENSPAN. You could stipulate that. [Laughter]

MR. MOSKOW. Okay. If that is the case, then the second question I have is whether we have explored both within the Committee and with those in the Congress who are so interested in this area other ways that we could be more open. I agree that we should have a policy of openness unless it is going to interfere with our deliberative process. Have we explored other options?

CHAIRMAN GREENSPAN. Let me address that. I think the answer to that is definitely yes. We have explored it on the Hill and tried to get a sense of where everyone was. We obviously can't do this in any detail, but I am not sure that any of the options we tried to surface had any support. The only real option that exists for us now is to turn off the tapes. That is an option for which I believe there was some strong support within this Committee a year or so ago, mainly on the grounds that we thought the taping inhibited the deliberative process, not that we were concerned about the subpoena issue, which is a somewhat different question. I think the conclusion, with perhaps a qualification from Tom Hoenig, is that there is very little evidence that the quality of our discussions has been reduced. Indeed, some of our most fervent discussions have occurred in the period since we all knew the tape was on. On that issue, I think the question has pretty much become moot. What is an issue, and I think it is a real one, is the subpoena question. It is an issue that could freeze our discussions at some point. If we really wanted to get paranoid on this whole thing, we basically could say that, if we had no transcripts, we would all get subpoenaed to testify in some open forum. My own judgment is that the chance of getting subpoenaed clearly is very negligible in the short run, certainly the next two years. If we get into an environment in which the subpoena issue becomes a big question, my guess is that it will not be our most important problem.

MR. BLINDER. Mike, were you finished?

MR. MOSKOW. Yes.

MR. BLINDER. President Broadus.

MR. BROADDUS. I want to support Jerry Jordan's point--if we are going to leave the tape on most of the time, I think he made a compelling argument for leaving it on all of the time.

CHAIRMAN GREENSPAN. Then the lightly edited transcript would be released after five years in redacted form. We have redaction capabilities. So, it is really a redaction issue.



MR. BROADDUS. Yes, it would not preclude that. I think we would still have the lightly edited transcript as the principal written record, but I also think that there might be something to be gained by keeping the draft transcripts somewhere in our archives so that any questions that might come up about the integrity of the editing process could be answered. I do not think we would lose anything by that.

CHAIRMAN GREENSPAN. Isn't there a legal question on the redacting? That is, within 30 years don't we have to send the unredacted transcript to the National Archives? We can't redact the transcript and throw the unredacted version away.

MR. BLINDER. I am confused. Could you clarify? I thought we had to keep an unredacted transcript for archival purposes, but I also thought I heard you say before that we do not have to do that and that we can just destroy that transcript once we have done the redactions.

MR. KOHN. What we would destroy is the draft transcript that does not incorporate your edits. We would then have a complete lightly edited transcript--

CHAIRMAN GREENSPAN. Including the materials that would later be redacted before publication.

MR. KOHN. Yes, before release to the public. The unredacted transcript would be turned over to the National Archives after 30 years.

MR. BLINDER. Okay. Governor Lindsey.

MR. LINDSEY. I have a point of information that I think gets to the heart of President Boehne's comment and our willingness to redact certain materials. Mr. Chairman, is it your intention to turn off the tape during the discussion of Mexico we are about to have later this afternoon?

CHAIRMAN GREENSPAN. It is one of the questions that I was going to raise with the Committee after we discussed the grounds for redacting central bank issues. However, I must say my own inclination would be to forget this issue of turning off the tape from time to time on a discretionary basis because that leaves open the question of how to do that. It may be more of a problem than it is worth.

MR. LINDSEY. No quarrel from me; I think it makes the point that we were making earlier.

MR. KELLEY. On the last point that you made, Mr. Chairman, about when to turn off the tape, there is a way to accomplish that and that is by doing it in a negative way instead of in an affirmative way. In other words, what is at issue here, I believe, is an appropriate record, whatever that may be, of monetary policy discussions. I would argue that it would be unfortunate if this Committee left itself in a position where it was unable to talk freely about whatever it might want to talk about other than monetary policy. I do not know what those issues may turn out to be, but I certainly would like to have available to us the opportunity to discuss off the

tape anything that we might want to discuss. Our monetary policy discussions, properly defined, do have to be appropriately recorded for posterity. Beyond that, if we want to go the route of maintaining the ability to discuss whatever--Mexico, personnel matters, you name it--off the tape, all we have to do is to adopt a policy that says we will tape monetary policy discussions, period.

CHAIRMAN GREENSPAN. I forgot this issue. Some of the things that I had in mind for turning off the tape were organizational discussions and issues relating to how we as a Committee comport ourselves. The reason I would raise that issue, and I retract what I just said about leaving the tape on all the time, goes back to what I thought was a frankly outrageous request for the tape of our discussion in October a year ago. It covered a discussion of how we would comport ourselves at a House Banking Committee hearing. That is the sort of discussion that we should leave ourselves flexibility to have with the tape off.

MR. KELLEY. Precisely.

CHAIRMAN GREENSPAN. I would not turn the tape off on central bank discussions on the grounds that they may involve important issues. But I would think that personnel matters and discussions about how we relate to the world at large and how we organize ourselves as a Committee could be done without the tape running.

MR. MCTEER. For example, this conversation we are having now would not be taped?

MR. KELLEY. Exactly.

CHAIRMAN GREENSPAN. This conversation, yes.

MR. KELLEY. I take it your point is, of course, that what is taped ought to be broadened to include perhaps central bank considerations as opposed to somewhat more tightly defined monetary policy considerations?

CHAIRMAN GREENSPAN. Yes.

MR. BLINDER. Let me tell you what I think I heard as a consensus, though I am not sure. Correct me if you think I am wrong. It seems to me that we need a vote to determine this. I think I heard a consensus, though not unanimity, that we should continue taping and that we should enunciate a policy on this issue. It is possible not to say anything. Is that correct? I think so. I am leaving aside the issue of when the tape should be off where I did not hear any consensus--maybe someone else heard a consensus. Maybe we should just have a vote on whether there should be an "off the tape" portion. Do you agree?

CHAIRMAN GREENSPAN. I agree. It is not clear where the Committee is on that. I think we ought to take a vote of all 19 of us because this is a policy in which we will all be involved, not just the current members of the FOMC.

MR. MCTEER. I have some questions. First, what is the definition of "enunciate?" Could enunciate be a private communication to the chairman of the House Banking Committee?

MR. BLINDER. Do you want to answer that, Mr. Chairman?

MR. MCTEER. Is it the same thing as an announcement to the public or could it be different?

MR. BLINDER. I used the phrase enunciate a policy and the question is does that mean--

CHAIRMAN GREENSPAN. When the tape would be turned off, is that what you mean?

MR. MCTEER. No, the question is do we enunciate a policy on taping, and I do not really know what enunciate means in this context.

SPEAKER(?). You mean make public do you not?

CHAIRMAN GREENSPAN. Oh, yes.

MR. BLINDER. That is what I meant.

MR. KELLEY. Make a public announcement.

CHAIRMAN GREENSPAN. The answer is "yes." We would make a public announcement and mention our decision in the minutes. But the announcement would not go into details. It would just list the various items; it would be a very short statement.

MR. MCTEER. You could not just have it in the minutes and then convey that to the chairman of the House Banking Committee?

CHAIRMAN GREENSPAN. If it is in the minutes, it is public.

MR. BLINDER. The minutes will be published in about six weeks.

MR. MCTEER. Oh, you mean those minutes?

CHAIRMAN GREENSPAN. Yes.

MR. MCTEER. Okay.

MR. BLINDER. I think we have a few more people who want to speak.

MR. BOEHNE. I just have a question and this has to do with whether we allow the tapes to go off for certain subjects. It is a question to Virgil: What could we argue reasonably convincingly about redaction? For example, if we keep the tape on all the time, what is it that we could hold back for 30 years? What would be a legitimate kind of argument? Would the example the Chairman uses about how we comport ourselves with the rest of the world be a legitimate redaction?

MR. MATTINGLY. That is legitimate. We could keep from the public information that we get from another central bank or foreign government on the grounds that if we disclosed it after five years, we would no longer be able to get that information. That source of information would dry up and that is legitimate grounds to redact the material.

MR. BOEHNE. What about how we organize ourselves for the rest of the world?

MR. MATTINGLY. We would have to make that discussion public. Our organization rules are public. Now, if the Committee is talking about the appointment of a person to a particular position, the debate about that could be redacted. There would be a possible invasion of personal privacy.

MR. WINN. I would note with respect to dealings with foreign central banks that Congress, back in the late 1970s and the early 1980s when they were considering legislation dealing with the maintenance of transcripts, did contemplate an exemption dealing with foreign central banks that would have allowed us to withhold that information for 30 years.

MR. BOEHNE. Returning to your example, Mr. Chairman, I would agree that it was outrageous to request the tape for that telephone meeting we had in October 1993. In hindsight, however, it probably served us well that we had that tape because it was very useful in showing that there was no conspiracy, that there was no evil activity going on. I think it cleared the air rather nicely even though we thought that it really was not a legitimate request.

CHAIRMAN GREENSPAN. I think it did clear the air, but the issue is that if we had known our discussion was going to be transcribed and made public, would we have been inhibited in that discussion--as indeed I think we were in other discussions later. There is a very special type of discussion that any committee, independently of the individuals who happen to be members of it, should be able to hold in private. That is the committee's internal organization. An example is the content of that particular meeting--who would say what to whom, and how we would decide who followed whom, and who would be responsible for indicating such and such. As it turned out, as soon as we brought all those Congressional committee staff members here to listen to the tape, the issue was gone. No one uttered a new word. But the fact that the tape for that discussion was available to be scrutinized is what I found inappropriate. We will be accused of all sorts of conspiracies whether we have tapes, whether we do not have tapes, or whether we publish them at any time because there is always the question: what are we not telling them? It is an unanswerable question. Maybe I was overly sensitive to that particular episode, but I thought that it was a real violation of the Committee's rights. For example, there are certain types of conversations we can't have with each other about how we are going to organize if we are subject to making those publicly available. There can't be any informal discussions.

SPEAKER(?). That's exactly right.

MR. WINN. Mr. Chairman, when we are dealing with monetary policy, it is a lot easier to defend preserving the confidentiality of a document. I think there really is a lot of respect for the independence of the Fed in the Congress. When anyone is trying to get information and we can say it relates to monetary policy, we are going to be more successful in defending documents of that nature. Where it is not monetary policy--and that was the kind of tape we were dealing with--it is very hard to raise our best arguments in protecting our information. I guess that argues for limiting what is taped to monetary-policy types of information. It is hard to defend non-monetary-policy types of information from a Congressional request or demand.

MR. BLINDER. Tom, did you want say something again?

MR. MELZER. Not on substance. I was just going to suggest that it might be helpful for the Chairman to take a straw vote--a show of hands--on that issue first, just to get a sense of where people are without a formal vote.

CHAIRMAN GREENSPAN. I am not going to record these votes because we do not have to. There is no legal requirement. But we do have to find out where everyone stands.

MS. PHILLIPS. Before we do that, may I ask a question? A lot of times we have briefings where one of us or a member of the staff presents information and we ask questions. Is this the kind of thing that you would contemplate not taping?

CHAIRMAN GREENSPAN. No, the tape would be on for that.

MS. PHILLIPS. I was thinking about legislative matters such as what is happening on the Hill, those kinds of discussions?

MR. PARRY. That is not done during the meeting.

MR. KOHN. It is done when the meeting is over.

CHAIRMAN GREENSPAN. We usually do that at lunch because it is not part of the FOMC deliberations.

MR. KOHN. And the tape is not on.

MS. PHILLIPS. Okay.

VICE CHAIRMAN MCDONOUGH. I think, Mr. Chairman, we could distinguish between organizational matters that would not be taped and monetary and central banking matters that would be taped.

CHAIRMAN GREENSPAN. Yes.

MR. BLINDER. I would have suggested something like "confidential matters not pertaining to monetary policy" as the rubric for not taping. That is just a suggestion.

CHAIRMAN GREENSPAN. You know what the problem with that is? It is the word "confidential."

MR. KELLEY. Strike "confidential." Just say "matters."

CHAIRMAN GREENSPAN. "Confidential" is precisely what we do not want. It has to be based on the nature or the substance of the discussion. I thought that the Vice Chairman's formulation seemed reasonable. What I want to do is ask for that and also ask whether or not it should be the choice of the chair to make the decision on when the tape goes off.

MR. BOEHNE. Could you repeat what Bill McDonough just said?

CHAIRMAN GREENSPAN. Bill, why don't you repeat it.

VICE CHAIRMAN MCDONOUGH. I suggested that organizational matters, which we discussed as examples, would not be taped. Other matters would be taped and those would be monetary policy and central banking matters. I do not know of anything else we talk about.

CHAIRMAN GREENSPAN. Let me give you a case in point--today's meeting. We would not have taped the very beginning of the meeting where we discussed the Committee's organization. We would publish, obviously, the list of everyone who got elected; that is part of the normal record. I suspect we would not be taping this particular discussion.

MR. MCTEER. That's right.

CHAIRMAN GREENSPAN. This is an organizational discussion.

MR. MCTEER. What about Mexico?

CHAIRMAN GREENSPAN. Mexico I think we tape because that is a central bank matter.

MR. BOEHNE. And redact?

CHAIRMAN GREENSPAN. Yes.

MR. BLINDER. This is one of the reasons that I have a somewhat negative reaction to the phrase "central bank matters." It is not obvious that what we just discussed is not a "central bank matter."

VICE CHAIRMAN MCDONOUGH. You could leave it as monetary policy because to me, monetary policy is a very broad, broad church.

MR. BLINDER. Yes.

VICE CHAIRMAN MCDONOUGH. It certainly would include a discussion of anything we may do vis-a-vis Mexico.

MR. BLINDER. I think most people would say this is not about monetary policy.

CHAIRMAN GREENSPAN. Can we just say that organizational issues will not be taped, all others will be?

MS. MINEHAN. That is the formulation I would favor for keeping the tape on.

CHAIRMAN GREENSPAN. Can we add that?

VICE CHAIRMAN MCDONOUGH. Yes.

CHAIRMAN GREENSPAN. Okay, the proposal is that all organizational matters will not be taped but, as relevant, the substance will be included in the minutes. All other issues will be taped. A lightly edited transcript will be made available, redacted as may be necessary. The unredacted versions go to the National Archives after 30 years. Okay? All those in favor of that particular proposition, please raise your hand. All those opposed. The "Ayes" have it. Shall we do the next item?

MR. BLINDER. Yes, since this one was so easy, let's go to the novel aspect of the subcommittee proposal, which is to allow individual members at their option to add concurring statements to the minutes. I would like to say in starting this off that there was a Mullins subcommittee before this subcommittee, as a lot of you will remember. I inherited this proposal from the Mullins subcommittee and heartily endorse it, although it wasn't my idea by any means. I wanted to mention that. The floor is now open.

MR. FORRESTAL. I think there is a lot to be said for concurring statements and, Alan, you articulated the arguments very well. I would just like to throw in one reservation. If we have the possibility of concurring statements, we are going to invite more than we might like. If we start with one concurring or two concurring statements, we are going to have five or six in the next set of minutes. If that were to happen, the quality of the minutes would diminish because the concurring statements would detract from the essential elements of the minutes. Over the years, and maybe Virgil could confirm this, I have read many Supreme Court and Court of Appeals decisions that have concurring statements. My judgment has always been that if there are more than a few concurring statements, it really takes away from the essence of the decision of the court. That is what I have in mind when I raise this possibility. I think this will be an invitation for people to get their names in the record. I'm saying that as delicately as I can. [Laughter] Perhaps this discussion today is an example of that--

CHAIRMAN GREENSPAN. Bob, you were not very successful!

MR. FORRESTAL. There are advantages, but I think we need to take that potential drawback into account. If we do agree that we are going to allow concurring statements, I would urge the members of the Committee to be very judicious in the use of those statements.

CHAIRMAN GREENSPAN. Let me ask a question relevant to that because I think Bob Forrestal is raising a very crucial question. Did the subcommittee consider any sort of halfway alternative where there would be a significant--

MR. BLINDER. Could I interrupt you for one minute?

CHAIRMAN GREENSPAN. Yes.

MR. BLINDER. Governor Lindsey suggested that we just decided to--

MR. LINDSEY. To turn off the tape; let's turn it off.

MR. BLINDER. I am neither endorsing nor opposing this. Governor Lindsey suggested we just agreed on a procedure for turning the tape off.

CHAIRMAN GREENSPAN. I think that is a valid request but we are almost through with this. [Laughter]

MR. LINDSEY. Pardon me!

MR. KELLEY. You would make a good terrorist! [Laughter]

MR. LINDSEY. What do you think they do on weekends?

MR. FORRESTAL. That is on the tape!

MS. MINEHAN. Some may view him as a terrorist already.

CHAIRMAN GREENSPAN. Did the subcommittee discuss anything similar to what Bob Forrestal just said, namely, that only under extraordinary circumstances would it be appropriate to have assenting statements rather than as a general rule? Did you discuss that question at all?

MR. BLINDER. I do not believe we did. We discussed restrictions. The whole subcommittee is here. I don't remember discussing that.

MR. BOEHNE. I think, Alan, the general feeling of the subcommittee was that the concurring statements ought to be an available option, but there was a general feeling that such statements would not be used often. Now, there is no real way to enforce that. We count on the good judgment of every individual member of the Committee, but we count on the good judgment of every member of the Committee for a whole lot of things.

MR. BLINDER. I do not think we ever discussed this issue, but I would guess, like Ed Boehne, that this option would not in fact be heavily used.

CHAIRMAN GREENSPAN. Can we make the issue basically that what is on the table is "assenting statements, to be used only with great judiciousness" or something like that?

VICE CHAIRMAN MCDONOUGH. This is a different human nature than I am familiar with. I think I am closer to Bob Forrestal's view of it as a privilege rather than a right.

MR. BLINDER. President Hoenig--I am going down the list.

MR. HOENIG. As the Chairman has defined the proposal now, I could live with it. But as a concept, let me just say, number one, I think that we are a consensus-building body and our success has been very much built around that. I also think that nuances and



differences are reported and defined in the minutes so that the outside world can see them. I believe it would be a mistake to begin having concurring statements unless they are extremely limited. I would define that as almost never if not never. Otherwise, we invite into the process, as Bob Forrestal said, a feeling of obligation to state a view because one's view is not quite the same as the view expressed by another member or a member wants to get his or her name on the record. But more importantly, if there are differences, I think concurring statements invite a proliferation of statements. That then opens up even more the issue of releasing the minutes sooner. This could take us down a very rocky road.

CHAIRMAN GREENSPAN. I must say I have considerable sympathy for that analysis and the view that there is a problem here. Do you mind if I ask Don Winn a question? Don, I know that there has been very little discussion of this issue on the Hill. Have you heard of any? Do you have any sense of where the committees might be on this?

MR. WINN. I really do not have the sense that this is a point of great significance to the Hill people. I don't think we need to base our determination in terms of input that we have gotten on that. I just cannot report anything significant on either side of the aisle.

CHAIRMAN GREENSPAN. We originally brought this notion forward, as I recall, when we were looking for ways to be more open. I am wondering whether in fact we have overreached.

MR. WINN. I think you recall correctly, Mr. Chairman, that we came up with it as an alternative to some of the proposals that we were getting from the Hill. It is not a Hill proposal.

CHAIRMAN GREENSPAN. Just to say my piece, I had been in favor of this proposal, but I have been having second thoughts recently. I am willing to go along with whatever the majority wants, but I must say that my enthusiasm for this is fading. The type of argument that Tom Hoenig and others have made is really difficult to get around.

MR. BOEHNE. I think this came up originally when we were thinking of ways to expand the minutes. But subsequent to that, I believe, we discovered that the meetings were being recorded and we decided to release the transcripts. Also, we made the decision to release our actions promptly to the public.

CHAIRMAN GREENSPAN. You mean it may be moot at this point?

MS. MINEHAN. Yes.

MR. BOEHNE. Yes, it may be moot at this point. This had a life that preceded our making those decisions. I think the arguments that have just been made are very good, particularly in light of the fact that we really are being rather forthcoming. When it was still the Mullins subcommittee, I think I was in favor of this. But enough has changed since then that it seems to me it is not really a terribly important issue anymore.

MR. KELLEY. As a member of the subcommittee, I want to associate myself with what Ed just said.

MR. BLINDER. I would like to disassociate myself. I felt strongly that this was a way to provide more information to the public. I feel even more strongly about it now, given the decision that we just made to keep our press statements extremely terse, which is the majority view. This is in some sense a substitute for that. But having said that, I won't belabor it. President Jordan.

MR. JORDAN. I'm opposed to concurring statements because it seems to me the only way they can be used is to express reservations or reluctance to go along with the majority. I think that is inappropriate for people to do. If they feel strongly enough about a decision, they should dissent. Otherwise, they should go along and keep quiet about it. It is very divisive to publicize, even with a 45-day lag or so, degrees to which people are or are not on board with the majority. I think it plays into the hands of people on the Hill and elsewhere in a very negative way. In principle I just think that concurring statements are wrong.

MR. BLINDER. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. I think it is an unfortunate bit of history that people who dissent make a statement explaining the dissent. It is fine to dissent if one thinks he or she ought to, but I think the dissenting vote is enough. So, it is very easy to understand why I think that consenting opinions are truly a terrible idea. I believe the function of this Committee is to make decisions on monetary policy. That is best done when the Committee reaches its decisions after an open and frank debate. The notion that, well, I supported the majority but here is why I think my view is a little different from what is stated in the minutes opens us up to factionalism. I think Bob Forrestal is right. First there would be one statement, and then there would be two, and then there would be heaven knows how many. The press and the Street would have a field day deciding who is in one camp and who is in the other camp. I think it would be a terrible disservice to the great reputation and the enormous responsibility of this Committee.

MR. BLINDER. President Parry.

MR. PARRY. I used to be very supportive of such statements, but in light of all the changes that we have made that are clearly in the direction of openness, I do not see a necessity for it any longer.

MR. BLINDER. Governor LaWare.

MR. LAWARE. I don't think the opportunity to make a concurring statement is urgently needed by anybody around this table. Secondly, I think a policy decision is significantly weakened if, within that consensus, we have a half dozen nuances of opinion. I would be strongly opposed to it.

MR. BLINDER. President Minehan.

MS. MINEHAN. Initially, I came at this wondering whether it was really possible for us to prevent anyone from writing a concurring

statement if that member absolutely wanted to do so in the context of our having dissenting statements. I am not sure what the answer is to that question, but I am much more in the camp of those who think that such statements are not a good idea and are divisive in terms of the minutes of the meeting and the statement of the consensus as a whole. Can the Committee administratively preclude someone from writing a concurring statement?

MR. MATTINGLY. A person can write a concurring statement.

MS. MINEHAN. But we just would not include it?

MR. MATTINGLY. It is not included in the official record of the FOMC.

MS. MINEHAN. Okay. [Laughter] There is no inalienable right or anything like that?

MR. MATTINGLY. No.

MS. MINEHAN. Okay.

MR. BLINDER. That is in fact the status quo--dissenting opinions and no assenting opinions.

MS. MINEHAN. Right, but I didn't know if that was by rule.

MR. BLINDER. The question is, is it by rule?

MR. MATTINGLY. Dissenting statements?

MS. MINEHAN. No, assenting statements. Is there a rule?

MR. MATTINGLY. My position would be that the Committee can establish its own rules. If the Committee votes not to allow a concurring statement, it would seem to be within the Committee's right.

MR. BLINDER. President Melzer.

MR. MELZER. At the risk of jeopardizing the direction in which this conversation is headed, which I favor, I will point out that I was the minority view on the subcommittee against assenting statements. [Laughter]

CHAIRMAN GREENSPAN. That is a dangerous position to take.

MR. BLINDER. I think you have moved into the majority! There is a strong consensus on this. We do not require a vote.

CHAIRMAN GREENSPAN. I don't think so. Well, let me just be sure. Does anybody object to not moving toward assenting statements but leaving the minutes essentially as they are, with only dissenting statements allowed?

MR. LINDSEY. Just a point of information--I always thought dissenting statements were required. They are not?

CHAIRMAN GREENSPAN. Required by whom?

MR. LINDSEY. I have always been asked for one whenever I have dissented. I didn't want to bother writing one. [Laughter] If you are going to tell me that in the future that I have less work to do when I dissent, I will be delighted. [Laughter] So, I take it that there is no requirement to issue a dissenting statement?

CHAIRMAN GREENSPAN. There is no requirement.

MR. LINDSEY. Thank you for the point of information.

CHAIRMAN GREENSPAN. You have saved a few hours a year!

MR. LINDSEY. Yes, I hope not to dissent very much, but--  
[Laughter]

MR. BLINDER. The last issue is the currently symmetric blackout period--moving from a symmetric blackout period around the meeting date to an asymmetric period. There actually is no proposal on the table. Would you like to make a proposal, Mr. Chairman?

CHAIRMAN GREENSPAN. No, I have been agnostic on this. I do not have any strong views.

MR. BLINDER. I do not have firm views on this either. I was thinking of a blackout period covering a week before and a day or two after a meeting.

MR. PARRY. Would you explain what the blackout period is?

MR. BLINDER. We now have a blackout period in which none of us is supposed to talk publicly about monetary policy a week before the FOMC meeting and a week after.

MR. PARRY. Monetary policy?

MR. BLINDER. Monetary policy. I think that is right, but correct me if I am wrong.

CHAIRMAN GREENSPAN. It is rather unfortunate that it has become such an elastic concept that I am not certain what that means. People around here comment on data when they come out, and that is very clearly related to one's position on monetary policy. I think it would be useful if we had a definition of what this is all about.

MR. BLINDER. President Melzer.

MR. MELZER. I do not see any reason to change any of our rules with respect to how we communicate with the public. I think the blackout period is appropriate. It is consistent with the discussion we just had. Our monetary policy decision should come across as a decision of the group. To the extent there is a statement issued, that is the statement explaining our action. Frankly, I have taken the view that I am not going to talk about any monetary policy decision until the minutes of that meeting are out, and even then I might not talk about it. The record of the meeting is then public but I have not, for example, taken the view that after one week I am at

liberty to talk about what the Committee decided and why. I think that is a very important rule.

CHAIRMAN GREENSPAN. As I remember what this issue was about, there was a view in the old days that we should not discuss anything related to monetary policy, which in fact includes virtually everything that everyone around this table talks about when they speak to the press. This so-called blackout is very difficult to define. I am not sure what it is and I was wondering if Joe Coyne would just take a second to give us a history of this.

MR. COYNE. This goes back, I would say, 15 years when there was a lot of discussion in the press stemming from comments made by various members of the Committee both before and after an FOMC meeting. Some of the papers liked to do a summary story immediately before the meeting. They would do a round-robin, calling all 19 people. They would compare answers and try to figure out what was going to happen. We were asked to put together some informal guidelines. These are not "rules" of the Committee. They are simply guidelines that I have propagated to the Committee. The purpose was to help the Committee deal with the press in sensitive periods. One of the things we came up with, that the then-Chairman agreed with, was this blackout period. People were not to talk to the press a week before and a week after a Committee meeting. The purpose was to try to prevent all the speculation in the press and subsequently in the market about what the Committee would do. Now, we still get that speculation, but we get it from commentators. We do not get it from members of the Committee anymore. It has worked to an extent. It has not worked 100 percent. But a lot of members of the Committee use the blackout period to avoid talking to the press during these sensitive periods.

MS. MINEHAN. Yes.

CHAIRMAN GREENSPAN. Joe, are you suggesting that it actually has been useful?

MR. COYNE. It has been very useful in my view. If you are going to make the blackout period asymmetrical, I would say make it asymmetrical to the Friday following the meeting rather than for just two days. If it is only two days, then everybody will jump on it after 48 hours, and we are still going to get a lot of different comments. One of the problems is, if someone comments one way, as Mr. Forrestal just said, somebody else is going to try to jump the other way. Then we are going to get more and more people commenting.

CHAIRMAN GREENSPAN. So, in a sense, the thrust of the announced decision of the Committee then gets diluted in the same way that consenting statements would do that.

MR. COYNE. That is right.

MR. FORRESTAL. May I just raise a question? Is there any compelling reason to change the blackout period?

MR. COYNE. Someone asked whether it just covered monetary policy. It was supposed to cover monetary policy and the economy--

things that the Committee discusses when it is formulating monetary policy.

CHAIRMAN GREENSPAN. My impression is that if a reasonably good reporter gets one of us to sit and discuss what is going on in the economy, it is a farce for us to say, "I won't discuss monetary policy but let me tell you what is going on in the economy." It is a farce because, while it may be that in the old days reporters were not very knowledgeable, many of the current breed have MAs and PhDs in economics.

MR. BLINDER. I was taught the blackout policy by Joe Coyne when I arrived here, and it was that one does not talk about the economy the week before and the week after.

MR. KELLEY. Me, too.

MS. YELLEN. Exactly.

MR. BLINDER. I think the answer to Bob Forrestal's question is that a change is not compelling if the Committee does not think it is compelling. The current blackout is a leftover from a time when we did not announce the decision when we made it. There was still some secrecy and there was a lot of speculation as to what the FOMC had done. Now there isn't and the post meeting blackout now seems like an anachronism. But there certainly is no urgency if nobody wants--

MR. FORRESTAL. I would like to follow up my question by expressing my belief that the blackout period as it now is constructed serves a very useful purpose. I think the change to an immediate announcement does not really affect that. I think we ought to keep it the way it is.

CHAIRMAN GREENSPAN. For the same reason that the assenting statements are not desirable?

MR. FORRESTAL. Yes, exactly.

MR. BOEHNE. There is another reason and that is that these FOMC meetings are now hyped-up more by the press--before and after--and I don't think we ought to contribute to that hype. Even though our practice is not perfect and it is only a guideline, I personally have found it to be very useful just to say, look, there are two weeks that I am not going to talk to you people. If you want to talk about some banking condition or something like that, that is a different story. But as a general proposition, I just do not talk to the press for the two weeks around the Committee meeting. As I said, I have found it to be personally very useful, and I think it collectively keeps us from this hyping up of Committee meetings.

CHAIRMAN GREENSPAN. Any objections to what Ed is proposing?

MR. LINDSEY. I think, first of all, that the blackout was defined so that we never, never, never talk about what goes on at an FOMC meeting, period--whether that is one week before, two weeks before, eight weeks before, or seventeen weeks after. It is not an issue of talking about the FOMC because we never should. I have no right to tell someone what any of you said; that is your business.

CHAIRMAN GREENSPAN. To my knowledge, as long as I have been here there has never been a breach of that confidence.

MR. LINDSEY. That is correct and I think that is important. We should separate out the FOMC from the blackout issue. I think not talking to the press about economics or monetary policy is very useful the week before because of the issue of how we are going to vote. If we do, reporters are going to write it all up in the Sunday supplements. It probably was useful to have the blackout after the meeting while there was some ambiguity about how we voted, but in practice I think that, given the obligations we have to the public to explain our views, allowing us to talk about the economy and give economic speeches the week after is not unreasonable. Otherwise, we are in a situation where we are in blackout literally one-third of the time. I can respect the people who like that situation, but it is very, very difficult. If we are going to have the kind of strict blackout that Joe discussed where we do not talk about monetary policy or the economy, then I suggest we limit it to one week per meeting.

MR. BLINDER. President Melzer is on the list.

MR. MELZER. I just wanted to clarify what you were saying, Alan. I think you are right in terms of individuals never being identified. We did have that very difficult period where the leaks to The Wall Street Journal and others covered Committee deliberations and positions. To make sure I understand it correctly, what I want to confirm is that we really should never be talking about what went on in an FOMC meeting in terms of who said what.

MR. KELLEY. Ever.

CHAIRMAN GREENSPAN. I had forgotten about that incident.

MR. MELZER. Okay.

MR. BLINDER. That is not what this proposal is about.

SPEAKER(?). It is a good defense mechanism.

MR. BLINDER. This proposal is only about talking to the press about things that under normal circumstances we can talk to the press about. That excludes the FOMC discussion.

MR. PARRY. Isn't there another element to the blackout in February and July?

MR. BLINDER. Because of Humphrey-Hawkins.

MR. PARRY. Yes, the blackout covers the period between the meeting and the Humphrey-Hawkins testimony.

MR. BLINDER. Yes, okay. Mike.

MR. MOSKOW. First of all, I think any of us can set a blackout period if we want to. We can just say, my policy is not to speak to the press for a week before, a week after, or whatever the time period is, and the press will respect that if we set it. Any of us has that ability. I can see a blackout the week before. I think

it makes good sense that we not talk about the economy or monetary policy before the meeting. After the meeting, I view us as having made a consensus decision; we are going to go out and try to explain it to people. I think that helps in the education of people and the better understanding of monetary policy. I could see some limited blackout time after a meeting--perhaps 48 hours or as Joe suggests through Friday. I would go with a more limited period after meetings than one week. I wouldn't tie everyone's hands for a full week afterward because I think it can be a great benefit to the Committee and to what we are trying to explain.

VICE CHAIRMAN MCDONOUGH. I have always looked at Joe's very good guidelines as a reminder to all of us to be prudent. That can be between the meeting and the Humphrey-Hawkins testimony because we do not want to preempt what the Chairman is likely to say. That is easy because usually we do not know! [Laughter] But now that we announce the decision, we could all look rather foolish if somebody were to say, "Well, you raised interest rates on such-and-such a date, didn't you?" We don't want to say, "Sorry, I can't say anything about that." So I think the blackout is a reminder to be prudent. I think it is very, very important for us to be quiet during the week before the meeting so that we do not provide the entertainment in the Sunday supplement. After the meeting, it would seem to me that one has to be careful not to reveal positions for just the reasons that we do not want concurring opinions.

CHAIRMAN GREENSPAN. Maybe Joe's suggestion is a good compromise on this. In other words, a blackout through the end of the week rather than a full week probably captures most of what everyone would be concerned about. Does anybody object to that as a solution to this dilemma? If not, Joe, why don't we just change it to be through--are we always meeting on a Tuesday?

MR. BLINDER. No, tomorrow is a Wednesday.

VICE CHAIRMAN MCDONOUGH. This year we have one Wednesday meeting in November because of the BIS conflict.

MR. KELLEY. We can say the balance of the week of the meeting.

CHAIRMAN GREENSPAN. Why don't we just leave it at the balance of the week? Okay?

MR. COYNE. Fine.

MR. BLINDER. We have exhausted this issue.

MR. KELLEY. We certainly have.

MS. MINEHAN. This issue and ourselves!

CHAIRMAN GREENSPAN. Now, let us get to the easy issue of inflation targeting! It has been suggested, and I think it's a good idea, that we have pro and con statements on inflation targeting. I have asked President Broaddus and Governor Yellen to take the pro and the con. Al, why don't you get started?



MR. BROADDUS. Thank you, Mr. Chairman. I appreciate the opportunity to make a few comments about inflation targeting. Actually, I am going to use the term "inflation objectives," if I may, because I think that describes and reflects more accurately what I have in mind. To my mind, this is an idea whose time has definitely come. Let me cover just three things. I will try to do this as briefly and compactly as I can and still get the main points across. First, I will summarize as clearly as I can the analytical case for some kind of explicit inflation objective. Then, I want to comment on just one of the most frequently heard objections. Finally, I would like to say a little about what specific kinds of objectives we might want to introduce and how we might proceed if the Committee decides, and I hope it will, that this is a good idea and wants to move in this direction. In doing this, I will build on Dave Lindsey's memorandum that I think did a very nice job of laying out the main issues and considerations in a balanced way.

Very briefly, the basic argument, as I see it, for implementing an operationally meaningful explicit inflation objective is that it would allow us over time to foster a better economic performance. This would occur, in brief, because we would be moving away from the almost purely discretionary approach to policy we have followed historically, with its focus on reacting to emerging short-term economic developments, toward an approach where the central focus would be on precommitment to a permanent low inflation objective that would be clear and feasible. Of course, on the face of it, the assertion I just made that changing our approach to policy in this way is going to improve economic performance is just that; it is an assertion. But I think it is fair to say that it is supported by much, if not most, of the important research done in monetary economics over the course of the last twenty years. Dave Lindsey alludes to this when he refers to such issues as how the public and the market form expectations about future inflation and how these expectations and the way they are formed relate to monetary policy and its effect upon the economy--the so-called time-inconsistency problem and all of that. Beyond these theoretical considerations, however, experience over the years under our current approach to policy, with accelerations and then decelerations and then re-accelerations of inflation, suggests that periodic inflation scares in the financial markets and the damage inflation has done to the economy naturally make a lot of people think there has got to be a better way.

Against that broad background, let me quickly list some of the most important advantages that I see for a credible inflation objective. Many of these are also noted by Dave in his memorandum. First, by signalling the disinflation in advance, a credible inflation objective very likely would reduce the real cost of transitioning to a permanently lower inflation rate. Moreover, related to this, the credible objective would allow the Committee to pursue a more activist policy more freely in the short run without worrying about losing credibility. The situation we face today is a good example of this. Since we probably have not yet seen the full effect on the economy of our tightening actions last year, and we are already beginning to see at least a few signs of moderation in aggregate demand, one could make a case for caution in approaching any further tightening in policy today. However, under our current approach to policy, there obviously is a big risk. If we exercise such caution, it could be misunderstood, reduce our credibility, conceivably produce an

inflation scare in financial markets, and destabilize the economy. That is one point.

Next, an explicit inflation objective would be an efficient way to break out of our current Humphrey-Hawkins reporting conundrum. The problems with targeting monetary aggregates are well known to everybody including Congressmen. Consequently, in the Humphrey-Hawkins process, I would argue that if we continue to focus a sizable amount of our attention on the aggregates, we will look a little silly. On the other hand, if we don't provide some substitute, we risk having our agenda set for us with the focus on whatever short-term problems seem to be most pressing at the time as distinct from a coherent, consistent longer-term strategy that befits a central bank of our standing and stature.

Finally, it is worth noting that a number of other industrial countries, as I am sure all of you are aware, have established explicit longer-term inflation objectives in one form or another. Most of these have been put into place over the course of the last three or four years. I think the motive in most cases has been to try to lock in currently low inflation rates. Obviously, we have only limited experience with these new procedures, but if they are reasonably successful over time, and I think they very likely will be, I am not sure we want to be one of the few industrial countries not moving in this direction. It is true, as Dave mentioned in his memorandum, that the Bundesbank does not have explicit inflation objectives, but it does have a strong legal mandate for price stability, and of course, it has very broad public support rooted in long and bitter historical experience. These are the main positive arguments for an explicit inflation objective as I see them.

Just quickly on the main objection to such an approach: As Dave points out, the main objection is that a short-term trade-off is said to exist between real activity and inflation. Critics of inflation objectives consequently argue that we can maximize our contribution to public welfare and to economic welfare by exploiting that trade-off. Hence, they argue that anything that prevents us from doing that, like tying our hands with an explicit inflation target of some sort, would be undesirable. As Dave indicates, this argument would seem to be most compelling in the case of supply shocks, like the oil shocks back in the 1970s. But as I see it, this argument really does not have a whole lot of punch except in the limiting case of a very rigid, inflexible numerical inflation objective. In general, as I see it at least, there is nothing incompatible between a credible long-term inflation objective on the one hand and having the flexibility to cushion the economy against supply shocks as long as the public understands and is confident that the longer-term commitment remains in place while we are dealing with the short-term problem. Indeed, far from reducing our flexibility, it seems to me that a credible long-term objective arguably would increase our flexibility in dealing with such shocks because we would not be worried about losing credibility in that situation.

Let me move to the final issue I want to address: that is, exactly how we should go about establishing a credible commitment-- exactly what kind of objective should we set and what should we tell the Congress? I want to recommend that we need something more concrete to back it up. An important point here is that the inflation

objective should not be used in the way that we used the old money supply targets, that is, as a mechanism for guiding short-term, tactical monetary policy actions. I apologize for the repetition: The purpose of an inflation objective is to commit ourselves credibly to maintaining the purchasing power of our currency, like the Bundesbank's legal mandate does in Germany. I have to confess I had to think about this a lot, and my staff had to get me in a room and persuade me of this. With these things in mind, I would argue that we should not adopt a numerical target even in the form of a range because I think that would set us up for failure. Instead, I would recommend that the Committee commit itself firmly and publicly to the objectives contained in the Neal amendment with respect both to the language of the amendment in the way that it defines price stability and also importantly with respect to the 5-year time horizon. As for communicating this, the Chairman could state in his upcoming Humphrey-Hawkins testimony that the Committee is considering taking this step, perhaps in the summer, given the increasingly obvious problems with focusing on the money supply targets in the Humphrey-Hawkins process. The Chairman could also urge the Congress to pass the Neal amendment. I recognize that the amendment has not gotten significant support to date, but the election has clearly changed the makeup of Congress a good bit, and again the technical problems with using the money supply as a nominal anchor are increasingly apparent to all. I think we can explain it against that backdrop.

Finally, as I see it, there are some very strong advantages to proceeding in the way that I just suggested. For one thing, we are already on record in favor of the Neal amendment. Doing this would not be a radical departure from the position the Committee has taken earlier. Also--this is very important--doing what I have suggested would not prevent the Fed from taking the kinds of policy actions that we take today to stabilize employment and output. What it would do, and this probably is the most important thing I am saying today, is to discipline us to justify our short-term actions designed to stabilize output and employment against our commitment to protect the purchasing power of our currency.

In this respect, and this is also an important part of what I would propose, I would recommend that we begin publishing some sort of inflation report, perhaps semi-annually, in conjunction with the Humphrey-Hawkins process along the lines of the report that is currently put out by the Bank of England. That would help guide us in making our short-term policy decisions, and it would also publicly underscore our longer-term commitment. My view is that if we agree to do this, the report should be prepared by the Committee's staff, drawing on any System resources the staff wants to draw on. If we do this, it seems reasonable to me to presume that progress toward achieving our inflation objective would naturally supplant the money supply targets, especially the short-run money supply targets, as a principal focus of the Bluebook and other staff presentations. For example, the short-term policy alternatives that we always have in the Bluebook could be discussed at least in part from the perspective of their consistency with our long-term inflation objectives, the rate of progress toward that objective, and any risk that a particular alternative would present with regard to missing the objective and related matters.

Let me end by saying that I realize that an explicit inflation objective is not a magic wand: it is not going to solve all our problems; it is not going to solve all the world's problems; it is not going to grow any hair on my head. But I do think the kind of objective that I suggested is a practical one and I believe it is a feasible one. Over time, I am convinced that it could help improve and increase our contribution to the nation's economic welfare. I rest my case.

GOVERNOR YELLEN. I am strongly opposed to the adoption of formal multi-year inflation targets. I thought I would begin by outlining the case against them. This proposal has two distinct features. The first has to do with the number of goals we should be pursuing, a single goal or multiple goals. I am taking this proposal to be essentially the strong one that Dave Lindsey suggested in his memo, namely, that the inflation rate should be the sole objective of policy for current and future years with no weight being placed on achieving competing, ultimate goals for real variables. I am going to speak against that proposal, and I note that it is a somewhat stronger proposal than I heard Al just support. The second aspect of the proposal has to do with numerical as opposed to qualitative targets. Since I am particularly opposed to the single goal, that is what most of my remarks are going to focus on rather than the numerical character of it.

I began by asking myself the question, what is it that the public cares about? The answer seems straightforward to me. It is not just high and variable inflation; that is not the only aspect of economic performance people care about. The public also cares about real outcomes. Households and businesses very much dislike fluctuations in output and employment, for good reasons. Quite naturally, they prefer higher average output and lower average unemployment. I consider these goals eminently sensible, not foolish nor irrational.

Then I ask myself, what is it that the Fed can accomplish? I conclude that the actions of this Committee affect not just the level and variability of inflation but also at a minimum the variability of output and employment. I know that some people would argue against our trying to reduce the variability of output on the grounds that economic forecasting is so uncertain and that there are long and variable lags in monetary policy, so maybe all we would do is to destabilize the economy rather than stabilize it. But when I look at the record, I just do not agree. It seems to me the record shows that within limits, tuning works even if it is not "fine." The proof of the pudding is in the eating. I would give the Greenspan Fed a grade of close to A for its performance. I see this Committee as having been leaning against the wind and, by so doing, significantly mitigating fluctuations in output and raising social welfare in the process.

The moral I draw is simply that the Fed should pursue multiple goals. It follows almost automatically that when the American people have sensible multiple goals and the Federal Reserve affects multiple dimensions of economic performance, that the Federal Reserve Act should enshrine all of those goals and we should do our best to honor them. I simply can't see how we could support legislation that in the extreme case, not quite what Al just

supported, would in essence direct us to abrogate our responsibility for stabilization policy. I think it would be dangerous at a time when fiscal policy has been disabled for use in stabilization. I understand that the mandate of the Federal Reserve Act to pursue multiple goals is pretty vague. There really is no guidance in the Act as to how to call the tough trade-offs. But I see the objectives as fundamentally sound, and I think this Fed, in pursuing those goals, has enhanced social welfare.

Fortunately, the goals of price stability and output stability are often in harmony, but when the goals conflict and it comes to calling for tough trade-offs, to me, a wise and humane policy is occasionally to let inflation rise even when inflation is running above target. Supply shocks, of course, like those in the '70s are the most obvious case. To have avoided any uptick in inflation would have required such a dramatic tightening of monetary policy that there would have been a downturn of even more major proportions. With the benefit of hindsight, it seems to me that maybe the Fed should have accepted more unemployment and less inflation. There has been a valuable lesson there for all of us. But the extreme proposal--that we need to counter shocks with a pure inflation target--is to me draconian. More recently in 1990-91, this Committee was sensibly loosening monetary policy before price stability was achieved and, to my mind, producing better economic results as a consequence.

I do not want to belabor this point; we could discuss it in great detail. However, I want at least to mention that if this Committee were to decide that it really wanted a quantitative monetary policy rule incorporating a numerical inflation target--for example, because it was thought to be important to have a nominal anchor for monetary policy--we should not go with the type of rule embodied in the Neal amendment, which is a pure inflation targeting scheme. Why? Because there clearly are better rules. We could talk about those at length but a simple approach, not necessarily the best, that dominates inflation targeting would be a hybrid rule that would adjust monetary policy--and this could be a mechanical rule if it were so desired--on the basis of two gaps, not one. These would be the gap between actual and target inflation and also the gap between actual and potential output.

The next question is, what do central banks really do? When I look at the behavior of the FOMC and other central banks, I simply can't find a lot of cases in which monetary policy has ever been driven by an exclusive focus on inflation performance. Consider, for example, the policy of the Bundesbank--whose price stability commitment, it seems to me, is not seriously in question. How do they behave? They deliberately tightened monetary policy in 1991, but by how much? Not by enough to keep inflation from rising even though they knew inflation would rise. They deliberately chose to tighten by less than what was called for to keep that from occurring. Now, if you take the case of the FOMC, it seems to me that a reaction function in which the real funds rate changes by roughly equal amounts in response to deviations of inflation from a target of 2 percent and to deviations of actual from potential output describes tolerably well what this Committee has done since 1986. This policy, which fits the behavior of this Committee, is an example of the type of hybrid rule that would be preferable in my view, if we wanted a rule. I think the

Greenspan Fed has done very well by following such a rule, and I think that is what sensible central banks do.

Let me turn to the issue of credibility. A key argument in favor of inflation targeting--Al made this point--is that it would raise the FOMC's credibility and result in a lower sacrifice ratio. Clearly, if we could achieve this, it would be a very worthwhile benefit. The problem in my view is that it is not achievable. First, when I look at the experience of countries that have adopted and carried through inflation targeting programs, I consider the results discouraging. Then, I think about the Bundesbank and ask myself why it is, if credibility really lowers the sacrifice ratio, that the Bundesbank bore such high costs, or rather Germany bore such high costs, first in 1980-83 and then from 1992 through the present in its efforts to reduce inflation. Then, I look at empirical estimates that suggest that the German sacrifice ratio actually exceeds ours, whereas I think there is little doubt that their credibility probably exceeds ours.

The second point concerning credibility is that I do not think inflation targets would raise credibility for the simple reason that they would not be credible. Who would be prepared to believe that the FOMC is single-mindedly going to pursue an inflation target regardless of real economic performance, if not even the Bundesbank is prepared to go that far? So, that means that the targets are going to be perceived as a hoax. They are not going to be any more believable than I would be if I told my child that I was going to cut off his hand if he put it in the candy drawer. To me, an inflation targeting strategy could easily undermine the Fed's credibility and reputation because the policy itself just is not credible.

Let me conclude. We could talk a little about dynamic inconsistency, but for the sake of time I think I will pass that up unless someone wants to come back to it. Let me just make a final point. My final concern in connection with FOMC support of inflation targeting legislation like the Neal amendment, or some new version of that, relates to what we will do if we go to Congress to testify for it. My concern here is that we will most likely end up understating the cost. My guess is that we will argue that price stability is a goal of overriding importance, that it is so important and so beneficial that it should be pursued at all costs. In truth, I think we have excellent evidence that the one-time cost of lowering inflation is high. Each percentage point reduction in inflation costs on the order of 4.4 percent of gross domestic product, which is about \$300 billion, and entails about 2.2 percentage-point-years of unemployment in excess of the natural rate.

If we testify, it seems to me that we should point out that the benefits of price stability are elusive and that the costs of additional output instability with such a plan could easily outweigh the benefits of greater inflation stability. Why? Because uncertainty about sales impedes business planning and could harm capital formation just as much as uncertainty about inflation can create uncertainty about relative prices and harm business planning. I noticed that the Neal resolution contained a preamble, and it read in part, "whereas zero inflation promotes the highest possible sustainable level of employment, the maximum sustainable rate of economic growth, and the highest possible rate of savings and

investment..." I found it interesting to contrast this with the conclusion of the Federal Reserve System's price stability and economic performance project in 1989 that read, "We have investigated both direct and indirect evidence surrounding the hypothesis that inflation adversely affects the performance of the real economy. The bottom line of these efforts probably will not be surprising. It remains exceptionally difficult to uncover clear-cut evidence that moderate rates of inflation reduce perceptibly the growth or level of measured GDP."

My final point is that, from a political standpoint, if we support an inflation targeting amendment, and we do so without appropriately emphasizing its costs in order to obtain a mandate to achieve price stability at all costs, I believe there will be consequences for us. We will end up being blamed when the realities falsify the belief that this is close to a free lunch. On this point, I would like to conclude by quoting a remark made by former FOMC Vice Chairman Corrigan, which I gleaned from the transcripts of the December 1989 FOMC meeting where this was discussed. He said the FOMC should be "excruciatingly careful about what we claim." He said, "I do worry a bit that in our collective zeal, we've got to be careful not to oversell what can be done and at what cost. Because if we do leave the impression of a cost and it turns out to be a lowball estimate, we are going to get fried. There is just no question about that whatsoever."

CHAIRMAN GREENSPAN. You would never have known who was speaking!

MR. JORDAN. I think Al laid out very well the arguments as to why setting inflation objectives would be desirable and helpful for the Committee to do in accomplishing our mandate. I took Janet Yellen's response as being a combination of implementation problems versus desirability issues, and those I think we need to discuss separately. If we had Al's magic wand, what would we want to do? What we would want to do is wave it and have businesses and households in the country make their decisions in the expectation that any increases in inflation--and in associated nominal interest rates--are temporary and will be reversed. I would argue that we want to return to a period like the one we had in the 1950s and early 1960s when people looked at the shocks that happened along the way as transitory. That is because they were confident that the central bank would conduct its affairs in such a way that inflation rates would move in the direction of zero and associated nominal interest rates to low levels. I believe that the Bundesbank is in that position today.

Janet is right when she says that the public does not care just about high and variable inflation; what they care about is standards of living. She is raising a different type of issue--whether or not that mindset on the part of the American public would in fact achieve the kind of rising standards that they want. They want to be as rich as possible over time. If we believe that stabilizing the purchasing power of money achieves that condition of making people the richest possible over time, then that is what we want to do. When I address the question of the appropriateness of monetary policy such as at this meeting today and tomorrow, I cannot do it thinking only about what is going to happen to the CPI or any other measure of the purchasing power of money in 1995. We all know

about long and variable lags. I also cannot do it based on anybody's forecast or unfolding events as they occur with regard to output and employment. I can only do it with regard to what is going to happen to the future rate of inflation, at the soonest in the second year and much more likely in the third and fourth years. Ultimately, I come to a conclusion about what monetary policy is appropriate by asking myself what is going to happen to inflation in 1996 and 1997. If it is going back down, and if people have confidence that that is what we are going to produce and they make their decisions based on that, then I think that monetary policy is appropriate. If not, then I say monetary policy is not appropriate. I would think that the American public would want to have confidence in assessing our monetary policy objectives, as distinct from monetary policy actions, by asking whether we are going to produce a lower inflation rate sometime out in the future. That is what an inflation objective does.

PRESIDENT MINEHAN. I think there are two issues here and they tend to get mixed up. One is whether or not we should be explicit about our objectives over a reasonably long period of time. The second is whether or not we should focus solely on price stability or inflation measures as a target of monetary policy. Looking at the latter issue first, I would be very much in agreement with Governor Yellen that monetary policy should not focus on only one target. We need to recognize the short-term trade-offs between inflation and economic growth, and we should not beholden ourselves to a single measure in judging our effectiveness as a central bank. Getting away from focusing on a single target for monetary policy, is there a case for being more explicit about what we are doing over a longer time period? In thinking about that, I ask myself what problem are we dealing with here? I do not think the problem is that we have not demonstrated a commitment to inflation fighting. We have committed ourselves to inflation fighting. We went through a period of high inflation and high interest rates in the early 1980s--when I tried to get a mortgage and the terms were 19-3/4 percent and 5 points--and we weathered that period, but we paid a big price for it. I think we have been fighting inflation very effectively since then while recognizing the short-term tradeoffs with economic growth.

The problem we really have here is that we have a communications vehicle that we are required by law to use. It involves the monetary aggregates, and there are not many people who believe that they are an effective communications vehicle anymore. We need to think about communications vehicles that are appropriate in terms of explaining to Congress what we are doing over a period of time. I do not think that Congress harbors any suspicion that we are not fighting inflation. I think they have the suspicion that we are too willing to fight it, that we are too willing to sacrifice economic growth and employment in pursuit of inflation targets. In my view, we should either leave well enough alone or we should adopt a series of multi-faceted targets that might be better communications vehicles to Congress than the monetary aggregates. Janet described using two ranges or two kinds of gaps. We also could use nominal GDP, if we wanted, as a target or range or something like that. So that is how I come out on this. Frankly, I don't know if we can really decide this issue. This is a big issue. We received a good paper, and I would be in favor of trying to refine our thinking, however we come out, and get something explicit on the table before we take a vote on this.



CHAIRMAN GREENSPAN. Let me just say what I think the purpose of this discussion is. To go to inflation targeting without a Congressional statute is probably unwise. We do not have a Neal bill, but there clearly is going to be a Connie Mack bill that will be very close to the Neal bill, and we are going to be asked to comment on it. The basic purpose of this discussion is to get our first cut as to where this Committee stands for purposes of testifying on that legislation. My own judgment is that if we do not announce any specific inflation targets, our policy can actually be similar to what Al Broadus was suggesting. If we do announce explicit inflation targets, they become in effect a statutory obligation for this Committee to adhere to; and I am not sure by any reading of the Humphrey-Hawkins statute that inflation targeting is consistent with it. But as I said, there is a real legislative issue coming up on which we are going to have a very significant effect, depending on how we testify. I think it is a real issue. It is very important for those of us who are going to testify on that bill to know where the Committee members are since we will be speaking for them. President Melzer.

PRESIDENT MELZER. Alan, in general, I would associate myself with what Presidents Broadus and Jordan had to say. I have my own two questions, a la Cathy. My first is whether we agree that the primary focus of monetary policy should be on achieving price stability. Secondly, do we agree that we are more likely to achieve price stability and be credible if we set specific targets for inflation?

With respect to the first question, I take a very simple-minded approach. My view is that monetary policy only affects prices in the long run. I have a hard time justifying setting objectives with respect to things that we can't influence in the long run. So, I would very much like to set objectives that are consistent and that we can influence in the long run. I might add--this is something to which Al has already alluded--that I don't think we have the expertise to fine-tune the economy on the real side in any timeframe because of the vagaries of forecasting and because of the uncertain effects of the policy actions that we take. Frankly, even though the record of the FOMC has been pretty good over the last ten or fifteen years, my view is that one could conclude that perhaps our actions to stabilize actually have been destabilizing from time to time. We made some progress in bringing inflation down, but we are still a long distance away from what I would consider to be price stability even though we give lip service to that concept. The point that Al touched on, which I think is very important, is that in the regime that we are in right now, trying to serve two masters, we are incurring transition costs all the time in both directions. As perceptions change concerning what we have in mind as an acceptable rate of inflation, there are necessary adjustments on the real side. One can talk about the transition costs to zero inflation, but at least they are incurred only once and once we have zero inflation, that is it. We are in a mode right now where the economy is incurring transition costs all the time in both directions, and I do not find that very satisfactory.

With respect to the second question--whether we agree that we are more likely to achieve credible price stability if we set specific targets for inflation--I think Al's answer to that is right. I do not want to get bogged down in technical details. I have thought about

the issue of targets, and I would be inclined to set them. I think that if we do set quantitative targets--and we could do this with respect to a trend rate of inflation so we would not be making a point estimate for a given year or a relatively short period of time but would be looking at a moving average over time--we could set targets that we would be able to achieve over a reasonable timeframe.

CHAIRMAN GREENSPAN. Excuse me, are you talking about inflation as distinct from the price level?

MR. MELZER. I think that is another issue. There are pros and cons for both of them. I don't think it is productive to get into that today, but if we could continue this discussion later, that is clearly one of the issues we ought to have the staff look at and we should discuss further. With respect to this point, clearly just announcing that we have set targets would not do much for our credibility. What really determines credibility in the long run is how we perform. I guess I am saying that making ourselves accountable for something that is quantifiable is much more likely to get us to price stability than the regime we have been in. We have been talking about price stability for years, but we are still a long distance away as far as I am concerned even though I think the record of the FOMC has been quite good.

The third point I would make relates to something you said a minute ago, Mr. Chairman. That is, there will be legislative proposals on this and hearings will be held. I think it is incumbent on us to get ourselves in a position where we can state a meaningful view as a Committee and try to influence the outcome. It is quite possible that, regardless of what we think about inflation targeting, we will get legislation. If we are confused about what we want, we could well get legislation that we do not like. The other thing I would say is that it is not clear to me, and this again is not the time to discuss it, that the present legislation under which we operate would absolutely preclude some sort of inflation targeting regime. I think there would be some advantage to go along the course that Al described where as soon as we can reach some sort of consensus, assuming that there is some consensus in this direction, we could move ahead to take some actions on our own. We could have the staff look at various issues and announce that we are considering this matter. We might indicate that we would consider this issue and report on it in connection with the Humphrey-Hawkins testimony at midyear and that we would be thinking in terms of setting some sort of provisional targets down the road. Obviously, various questions would have to be evaluated before those would be finalized. My point is that if we acted in a sense independently of the legislative process, the failure to get legislation would not necessarily preclude us from proceeding with something that I think makes sense in any case and possibly could be reconcilable with some of the other objectives in the existing legislation. That is all I have.

CHAIRMAN GREENSPAN. May I suggest that we take a break now for a short while. We have coffee out there and we will continue on with President Boehne.

[Recess]

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I come out somewhere between President Broadus and Governor Yellen. Over time, the primary goal for a central bank ought to be price stability, but we do not get there in a straight line. Whether we like it or not, in the real world we have to deal with short-term issues like liquidity problems, weakness in demand, recession, that sort of thing. The important thing is that when we deal with these short-run issues, we try to do it as best we can in the context of pursuing our longer-term objectives.

The second point is that--while I appreciate the theoretical arguments that if we make a commitment, the sacrifice ratio is less-- in the real world what matters is not what people say, it is what they do. We got off track in the late '60s and '70s not with what we said but with what we did. We got back on track in the '80s and early '90s. We did this, I think, not so much by worrying about whether inflation went up a tenth or two over the business cycle; we did it in a secular context. From cycle to cycle inflation rose in the '60s and '70s, and from cycle to cycle inflation went down in the '80s and '90s. I do not think there is enough political support for the pursuit of a single inflation goal without regard to short-run considerations. If we got 50 people in the Congress to vote for that, I would be surprised. In the real world, we have to deal with short-run issues.

My own view is that we ought to continue largely as we have for the last fifteen or so years. I think you best expressed that view, Mr. Chairman, in one of your very recent testimonies, but I don't remember the quote exactly. It went something like this: That we ought to aim to extend and hopefully improve upon the low inflation record. I think we have to do it in the context of knowing that when we have short-run issues, we can't ignore them. We are going to have to deal with them. Just as we have worked inflation down from double digit rates, I think we can get closer to price stability over time.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I think that the recommendations outlined by Al would be very useful. It would be useful, I think, for us to communicate to the public as a goal some idea of a predictable average level of inflation. I also believe we could deal with short-run cyclical issues even within the context that Al suggested. I would also say that as one looks at what is in the Greenbook and the Bluebook, it is clear that we have a rather difficult period ahead of us, and that suggests to me that it would be nice to have some consensus about these issues within the Committee, regardless of whether we go to the public. Quite frankly, I am not sure how we would approach these issues that are covered in the Greenbook and the Bluebook over the longer term without some operating consensus.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, as all issues go, I think both arguments have merit. I believe a couple of things: one, for us to change our emphasis, there needs to be some kind of legislation, and that is partly what this is about. Among the alternative approaches that have been discussed, I am inclined toward something like the Neal amendment because I think that price stability is a necessary condition for long-term growth. At the same time, I would not be

strongly inclined toward a numerical target, because I think there is a measurement problem with that. So, I prefer the language in the Neal amendment regarding the objective of price stability. I think that having that would not negate our need to maintain balance, but it would give us an emphasis toward price stability that is necessary for long-term growth. It also would give us the important discretion to handle shocks or to allow for events to take place which monetary policy can address within a clear mandate toward price stability in the long term that in turn will give us a better opportunity for long-term growth. That is how I would approach it.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. My instinct is similar to that of many others in that I feel it would be a step in the right direction for us to adopt some sort of inflation objective. As others have already observed, inflation is something that the profession and the Committee believe we can be held responsible for in the long run. It is related to monetary policy, and controlling it may be the most important contribution we can make to economic performance in the long run.

Having said that, I would be very careful about overselling this at this point on a number of grounds. One that already has been referred to is that, without Congressional support, I don't know that our unilaterally doing this would buy us very much credibility. Secondly, I come down on the side that ultimately we would need some sort of numerical objectives. Otherwise, it is not clear to me how the proposal differs very much from what we already are doing. Many of us already have spoken over the years in favor of some kind of price stability objective, recognizing that in the short run we may pursue other objectives. Thirdly, I don't think this is an objective that we can adopt or pursue independently of fiscal policy. Do we really believe that if fiscal policy were in some sense exploding, we simply would try to pursue price stability? I have real reservations about that. Another issue is, do we need a penalty? If we fail to gain credibility, if we fail to achieve the objective, does there have to be some sort of penalty, as in New Zealand? I am not suggesting that particular penalty! [Laughter] Without that, what do we gain?

I would say the real sleeper issue--I touched on this earlier and Janet raised it implicitly--is that when push comes to shove, I'm not sure that we have very good evidence that going in this direction really makes a lot of sense from the point of view of economic welfare as opposed to, for example, stabilizing inflation at the current rate, if that is a feasible alternative. We talk as if we do and we hope that we do, but the analysis that I see on that subject does not lead me to be very confident. I think we have to hold ourselves to the highest standard on that issue because if the question is put to us in Congressional testimony concerning what benefits we can expect in terms of economic performance from taking inflation down from 3 to 2-1/2 percent or whatever over the next x years, we have to be prepared to address that question in a serious way. It is a tough question.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, it seems to me there are two potential ways to go here: one is primarily quantitative and the other

primarily qualitative. I guess there are some hybrids. I would be very leery about a predominantly or entirely quantitative approach because I think it might very well imply performance that we would not be able to deliver or might not even want to deliver under some circumstances. Either of those developments would be intensely counterproductive over time. In the case of qualitative-type goals, it is hard for me to see how the Fed is going to do itself much good or to cause much good by unilaterally stating such a goal. I just do not see that as being very helpful to our credibility. For one thing, every one of us has repeatedly put forward publicly our commitment to price level stability. There should not be any question in anybody's mind as to where every person at this table stands on that issue. If we did announce quantitative goals and there subsequently was a shortfall, it would be extremely counterproductive even if the shortfall was for a very good reason. It would impair our credibility tremendously.

Now, if we are going to have to testify on a specific proposal in the Congress--it used to be a Neal proposal and now perhaps it will be a Mack proposal--I think we are going to have to look at it quite specifically. If it is too soft, it will be somewhere between useless and worse. If it is too rigid, that would probably be a mistake also because there has to be some allowance over time for shocks, external events of all different sorts. Gary just mentioned the relationship between fiscal policy and monetary policy. We all agree that it is terribly difficult to fine-tune, perhaps impossible. I think we would have to look at the specific proposal to see if there is adequate flexibility in it, appropriate timeframes, appropriate social welfare goals, and so forth and then delve into the details. We are just going to have to see what is proposed rather than try to make a broad general statement today or sometime in the future.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I think the Yellen-Broadus debate was very useful in setting up the merits of both sides of this issue. I think inflation targeting has a lot of appeal. The main way that it appeals to me is that it would help us to focus our policy over the long term and give us a longer-term focus than I believe we have had until now. Our focus has been far too shortsighted, and inflation targeting would help us in that respect. On the other hand, I don't think that we have a mandate for inflation targeting. Now, it was not clear to me when I read the materials whether we were talking about an inflation target that would be set unilaterally by the Committee or through legislation. I would have very, very serious questions about our ability legally to set an inflation target given the Humphrey-Hawkins mandate. On the other hand, if we are talking about proposed legislation and whether to support it, I still would raise the question about whether there is a social mandate in the country. Any inflation target to be credible has to be accompanied by widespread agreement that it is indeed our mandate.

Gary Stern hit on another aspect of this--the question of mild inflation. I think everyone in the country agrees that if we had inflation of 10, 12, 14 percent, something would need to be done about it. But is 3 percent inflation so harmful to the economy that it needs to be reduced? Just announcing or adopting an inflation target

does not do anything for our credibility. We had the same experience with the aggregates when they were working. Most of the time, we were lowering those aggregates, and I don't think that necessarily bought us a lot of credibility. The Bundesbank has been mentioned a couple of times. It seems to me that the situation in Germany is quite different because there is a very clear mandate on the part of the German people to have low inflation. As Janet Yellen mentioned, an inflation target can backfire if we do not use it judiciously. The bottom line for me is that I do not believe that the only goal for a central bank is price stability or low inflation. I believe that it is the primary objective of a central bank but that we have other goals as well. As Governor Kelley indicated, much depends on the structure of the legislation that might come through; we would have to have escape clauses and all the rest. But if we are talking about an explicit target, I would be very, very leery of that. If I were asked today to decide this issue, I would say I would be against an inflation target and I would associate myself entirely with the views of Governor Yellen. But I do think that it is an issue that needs to be explored further. We need to give additional thought to this, particularly in light of the legislative language that might develop.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. As usual, let me defend the status quo. We have a dual objective in the Federal Reserve Act now. I think it works very well. I think the case that it is broken and needs fixing is extremely thin. Some of you may remember that I defended the Federal Reserve Act at Jackson Hole, thereby provoking a great deal of controversy. I have not changed my views on that one iota. Many of the reasons were enunciated by Janet Yellen. But the fact of the matter is: there is a short-run trade-off, and it does matter to people. There is no existing evidence--and I can't say this too strongly--that having such targets leads to a superior trade-off. None at all. It is not one of those cases in which the evidence is equivocal. There is nothing that can be cited. We know that the employment costs of inflation reduction are very substantial. There is even a reasonable consensus about how to measure them. The benefits of moving, as Gary Stern said, from 3 to 2-1/2 percent or lower inflation are very hard to measure. We would be hard pressed to come up with anything convincing that led to a large number. The case for inflation-only targeting comes from the view that the central bank needs more discipline. This view, by the way, comes out of academia with a lot of baggage, some of which I think is pretty silly, having been in that world a very long time. The view is that you have to control these central bankers because they do not know what they are doing, and you can't trust them to be true to the mandate to fight inflation! I do not see the behavior of the Federal Reserve over time as fitting that charge.

Next--this is very important to me, but it is not something I ever thought about before I was on this Committee--is the issue of honesty. Many central banks claim to have only a price stability mandate or objective; none of them acts that way. I would not like the Federal Reserve to be in that position. The Bundesbank was mentioned, but the Bundesbank does not act that way. If it did, you could ask yourself why it lowered interest rates for two years while inflation was still 3 to 4 percent. They were not at price stability; they said they were not happy with the inflation rate at that time;

and yet they were lowering interest rates. You do not fight inflation by lowering interest rates--not the last time I checked! Like Janet Yellen, I do not think being fundamentally dishonest in this way breeds credibility. The alternative is to be fundamentally honest and really do what our legislative mandate says.

We do not have a Mack proposal, so I think I have to agree with Mike Kelley that we can't be against it until we see it. I read a short colloquy between our Chairman and Senator Mack in the Congressional Record in which the senator clearly says his objective is to take away from the Fed any concern with short-run employment. That is what he wants to do. If we had such a directive from Congress, we could either refuse to do what Congress told us, which I do not think is a very good idea, or we could in fact ignore the employment objective, which I am guessing will be the intent of Senator Mack's proposal, if there is indeed a proposal. That is not a choice I would like to have. If the proposal is going to be anything like what we think it is going to be, I would certainly urge that the Federal Reserve oppose it in testimony.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. I think we have just proved the anti-economist adage that, if we lay all the economists in the world end to end, we will not reach a conclusion. I will at least try to touch both ends. At the last meeting I was looking for a bridge to both sides of the river; I will continue that analogy. I thank you for raising the Mack measure because I think it focuses our discussion.

The first point I would make is that if it comes down to a choice between Humphrey-Hawkins and a Senator Mack proposal, I think the right way to do the Mack proposal is to see it as a way to change Humphrey-Hawkins. Governor Blinder probably incorrectly characterized Humphrey-Hawkins as giving us a dual objective; it does not. It gives us seventeen, eighteen--heaven knows how many; there is a paragraph of objectives. That is not a good directive for the Federal Reserve. I think I can say that few of us would select Humphrey-Hawkins if we were drafting this kind of legislation. The gain here is that we are opening a door that we should use as a vehicle for change.

Second, I view as very well taken Janet Yellen's point that we should not oversell and should not underestimate the costs of a Mack proposal. We need to be honest, and I do not think there is any disagreement on that at this table. The Mack legislation would be costly. Third, I think if we look at the loss function, or the other side of the loss function which is a gain function, we find that politicians are well aware of the gain function. The reason we have fourteen-year terms is the recognition that politicians are well aware of the gain function and want to exploit it. They exploited it as recently as the late 1970s, and we had a very painful disinflation to pay for it. If there was an advantage to changing the law toward focusing on price stability, it would not necessarily be to change our behavior but as a recognition of this political disequilibrium. I think that is a real plus in passing something like that.

Fourth, one of the things we all taught in economics was that, if we have one instrument, we can only work with one target. I don't think it necessarily follows that the target should be price

inflation. I think it should be nominal GDP, and I believe that is somewhat in line with what Governor Yellen said. But once we pick nominal GDP as our objective function, it begs a second question that has to be answered. It is that a nominal GDP target probably has to be consistent with some desired level of inflation. So, having this process and having Congress tell us some desired level of inflation, I think is probably good. But our target should not be the desired level of inflation; our target should be nominal GDP. You disagree? Well, not wildly! [Laughter]

The final part of whatever Congressional testimony we have on this subject is that the real focus of Congressional action should not be to tell us what the inflation rate should be, although that would be useful. It should be on the policy actions they control that affect the nonaccelerating rate of inflation. I do not think it is given to us by God; I do not think it is etched in stone; I think it is given to us by the Congress. I think that higher real minimum wages raise the NAIRU and lower real minimum wages lower the NAIRU. We can go through a whole list of other things. So the right way to improve the loss function or gain function is not in this room; it is up there on Capitol Hill. Maybe part of our objective should be to remind them of that.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Although the Humphrey-Hawkins Act is in fact full of goals I reduce them, as I think Governor Blinder did, to two that I describe as sustained economic growth and price stability. But I find that to be really a single goal, since I am absolutely convinced that the best way to achieve sustained economic growth is through price stability. I prefer to state the objective of price stability in words rather than as a numerical goal. I believe that in achieving our goal of price stability, we should seek a downward secular path in inflation from business cycle to business cycle. That goal means somewhat more disinflation because I do believe that the present level of inflation at, say, 2-1/2 to 3 percent is higher than one wishes to have for either economic or social reasons.

I question the whole idea of credibility. Nobody has been able to prove that credibility has bought the Bundesbank or any other central bank the benefit of a lower cost to reduce inflation. In fact, Stanley Fischer presented a very good paper at the 300th anniversary of the Bank of England proving rather the contrary. There is no particular benefit in the so-called credibility, and I think credibility mainly makes central bankers feel better about themselves. It seems to me that the record of this Committee over recent years has been as good, if not better, than any central bank I can think of, including specifically the Bundesbank. I think it would be very unconvincing as a public policy goal for us to position ourselves as driving toward some number for inflation, which presumably if one could figure out how to measure it accurately would be zero, where we know the costs of achieving it would be very high and we are very, very uncertain of the benefits.

CHAIRMAN GREENSPAN. Governor Phillips.



MS. PHILLIPS. We all come at this in slightly different ways. I do think it is important for any government entity or quasi-government entity, however we are classified, to communicate its long-term goals--which are not unlike a mission statement that any kind of entity would have. Inflation is probably the area where we have the most control in the long run. I do not think that we have as much control in the area of employment in the long run, given fiscal policy and other effects. It seems important to me for us to state clearly that our long-run goal is to control inflation. Now, I certainly recognize, and I think Ed Boehne stated very clearly, that we operate in the real world and we have to take into account certain short-run issues, be they business cycle issues or liquidity issues, whatever. But it seems to me that if we make monetary policy decisions in the context of a long-term goal that we are then still being true to our mission.

If I look back at the period when we were easing, one of the things that I looked at, and I think a lot of people around the table looked at, was the kind of progress we were making on inflation. Even while we were easing, we were still looking at the fundamentals of price movements to see whether or not we would be doing some kind of damage to our ultimate objective of price stability. I come down on the importance of expressing clearly that control of inflation is our major goal. It is clear that we do not have it as a mandate now. So, what do we do in the interim? Even in the existing Humphrey-Hawkins reports, I think we could start to be more explicit about looking at perhaps a range of inflation measures. We could look at it as a monitoring goal somewhat like the way we look at the monetary aggregates. Obviously, the Congress ultimately is going to have something to say about it, but it seems to me that if we take the initiative to start working in this area, we would be more in the driver's seat than simply reacting to a piece of legislation that comes forward. Unless we have a specific proposal before us, it certainly is difficult to say, yes, I would be for this or against that. But as a general matter, I think that it would be important for us to communicate that we want to control inflation, with price stability as our long-term goal.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, the proposal for a balanced budget amendment implies to me an abject admission of total lack of self discipline on the part of the Congress. I do not think we need to make that kind of admission about our pursuit of the goal of stable prices. If we set a target, we do not get any credit for hitting it from three feet away; we have to hit it from a hundred yards away. It seems to me that not being able to achieve the goal that we set up then makes us subject to an enormous amount of criticism that is quite justified because we said we can do this but then fail to do so. I do not see how we can commit to that kind of objective as long as fiscal policy over which we have no control is out there and can be the loose cannon on the deck or the wild card in the inflation wager. I recognize that Humphrey-Hawkins makes the monetary policy mission of the Federal Reserve a little more difficult because it is a three-legged stool on which it is not very easy to keep the seating. But I do not think it is inconsistent with pursuit of a policy of stable prices. That is demonstrated by the progress that has been made in reducing the level of inflation over time. I am much more in sympathy

with Governor Yellen's analysis and conclusions than the rigidity that is implied by what Al has proposed.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Mr. Chairman, I am from the "if it ain't broke, don't fix it" school. It is not that the Humphrey-Hawkins bill is the ideal piece of legislation, which it clearly is not, but I think as Governor LaWare said, this FOMC has implemented it extremely well. Our record is good, and I think that opening it up now and trying to make changes in it may raise other problems that we do not want to get into. If we are to have any type of targeting or numbers or even ranges, that should require legislation. The reason I say that is that for targeting to be successful it clearly would require the efforts of the legislative branch, the executive branch, and of course our own efforts. Looking at the experience of other countries that was reported in the staff paper, for those that had targets, I could see that in every case the central bank was doing it jointly with the finance ministry. Therefore, the executive branch was clearly tied into it; it was not the central bank doing it alone. In most of those countries, the central bank is independent. I think it clearly has to be a government-wide effort to do this; it just can't be the central bank alone for reasons that others have mentioned here.

On a numerical target, I would be concerned if we announced a numerical target for inflation that we just would not gain that much and also it would limit our flexibility. When thinking about this in talking to our staff, I came to the same conclusion that Larry Lindsey came to, namely, that we should choose nominal GDP as the target to give us more flexibility. But there are some problems with nominal GDP, too. I think we would still have the escape hatch issue, although it may not be as severe as just choosing an inflation target. If we have a nominal GDP target, we still have to have a long-term inflation target within the nominal GDP. Even then, there could be some cases where we probably would go beyond the nominal GDP target and we would have to lay those out in advance. If we lay them out in advance, that affects our credibility. Would people really believe this? Clearly, nominal GDP would be much better than a long-term inflation target alone, if we are going to go that route. I also thought the paper was interesting in noting that in the New Zealand case, when they started to bump up against the inflation target, they suggested redefining measured inflation to exclude some things that affect prices.

I guess my conclusion is that we should not make any changes unless they are necessary. If we have to respond to some legislation that is on the table, then I think we should at least seek some alternatives. We should have this fleshed out a little more by the staff, and look at some options and alternative ways to respond specifically to that legislative proposal.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. On the narrow question of how to respond or testify on a Connie Mack bill, we need to be in a position to support the idea that price stability is our primary long-term goal. I would hate to see us in a position of having them offering it and us rejecting it. I agree with Ed Boehne that it is highly unlikely that

Congress will actually go through with it and give it to us. I do think that we have a pretty good thing going right now. Our story is that price stability is our long-term primary goal but not our only goal. It contributes to the other goal, which is high output and employment. Humphrey-Hawkins is written with multiple goals. There is a paragraph full of them. However, in the public mind and I think in Congress' mind, there really are only two goals: price stability and employment growth. We pretty well have finessed that issue, as we have it right now. Ed mentioned that in the 1970s, inflation ratcheted up with each cycle and that in the 1980s and early 1990s it has ratcheted down in each cycle. It seems to me that we are now just one cycle away from price stability under current arrangements.

CHAIRMAN GREENSPAN. Listening to this is really quite interesting. We now understand why this Committee has had difficulty confronting this issue. It is because we are as split down the middle as we could possibly get. I wonder, however, how much of the difference is real and how much is imagined. The reason I put it that way is that I ask myself periodically what range of actions do we have available to us, and how does that compare to an earlier period? What strikes me about where we are is that even though the Federal Reserve is an independent institution in the legal sense, meaning that our decisions are not subject to further evaluation by other authorities, we are in fact very dependent on the culture and the philosophy of the society in which we function. It is a subliminal issue and one needs only to have been exposed to it for a long time to realize what the differences are.

When I first got into government in 1974, inflation was just beginning to take hold as a big issue. For the first time--I think it may have been at the Rambouillet Summit or the 1977 Summit--it was generally agreed among the G-7 that inflation was the cause of unemployment. Now, this was an extraordinarily unusual thought that was not present in earlier years. One could see the changes that were beginning to emerge. I remember Arthur Burns, with whom I used to visit quite often and whom I had known since graduate school, would speak against inflation like none of us here is used to hearing. If one looks at what the Federal Reserve did in that period, that anti-inflation attitude is scarcely to be seen in the policy or in the numbers or in anything. Then I ask myself, how is that possible? Here was a stalwart inflation hawk and look at the record. The answer is that he had to deal with an environment in which the philosophy was still partially held over from the fifties and the sixties when, for a while, there was a notion held very broadly that a modest amount of inflation was good, not bad. The issue of price stability was never an issue that was presumed to have the importance that it subsequently has acquired in our era. There is no one today among the 535 members of the Congress who would say that inflation is a good thing. Thirty years ago that number would have been a minority, but I would submit to you that it would not have been zero.

There has been a fundamental change, and I think it is the result of the extraordinarily negative experience we all had in the late 1970s. That is, the culture changed very dramatically in the 1980s, and what we have now is a basic view that inflation matters. In the debates that we have on the Hill--Humphrey-Hawkins and the like--there is never a question of whether we should accept a little inflation for some decrease in unemployment; that usually was the

relevant discussion twenty years ago. The discussion now centers around the assertion that there is no inflation and that monetary policy is too tight.

This really raises some very interesting questions as to where we are. My own impression is that even if we now locked into law a fixed inflation rate--say, 2 percent or 1 percent--and the Congress voted for it with a large majority, in the first recession everyone would be arguing to go in a different direction. I am not certain that there is enough knowledge in the Congress about what the true trade-offs are to get useful, informed opinions because we are dealing with people who generally are not economists and have not been involved in some of the monetarist or other policy subtleties with which we deal. I would not even take as a given, if the Congress gave us authority to have an explicit goal, that we really would be able to adhere to it and say the reason that we are raising rates now when the unemployment rate is going up 2 points a month is that we are worried that we won't meet our inflation goals. I will tell you that if we could get 80 percent of the Congress to vote for that goal, 95 percent would take a different position when the world changes.

My own view is that a general long-term view of price stability of the Neal form is a very useful conceptual anchor for us to do basically what we have been doing. This is essentially, as Bob McTeer mentioned just a moment ago, that we are sort of one cycle away from being there. But the problem is that we do not go in a straight line, to the extent that we are even focusing on it. You may recall that a couple of years ago, we all basically said we were going to have to move early on the up side or we would not achieve anything resembling price stability. Now, I submit to you that is exactly what we did. We did follow a price stability objective in a cyclical sense, that is, one where the inflation rate is going to be lower at each progressive cyclical peak and lower at each progressive cyclical low. But that objective is not being implemented in a straight line because we have recognized, and I think correctly, that the Congress would not give us a mandate to do that.

If we got legislation in the form of, say, something like the Neal bill or a considerably watered down version of the earlier Mack proposal, it probably would be useful for us because it would give us a particular goal. But if we tried to implement it in an explicit form independently of where we were in the business cycle, my suspicion is that we would find that all that support would just evaporate. I would not say the current policy is the best we can do. I hope that this Committee would subscribe, as I believe it does subscribe, to the ultimate goal that low inflation/price stability is where we would like to be, other things equal. What we would not state as a goal is that we would like the unemployment rate to be 5 percent, independent of everything else that is going on. I think we ought to have an inflation goal that is qualitative, as Al Broadus says, one that is defined in operational terms, not in terms of numerical targets. We would always be moving in the direction of price stability, recognizing that we would not do so in a straight line because I do not think we have the philosophical, cultural, or political support in this society for that. There still is a short-term Phillips curve. People respond to it; they are aware of these trade-offs, and to deny them, I think, is a misunderstanding of how our political system works. If we do have to testify on a Mack bill,

which I think we will, we have to support or should support the view that low inflation or price stability is very valuable to have as a long-term goal. Until we see the actual bill circulated among the members and they are polled individually, I am not sure, just recording what everybody said, that we would find a way of breaking what looks to me like a "on the one hand or on the other hand" situation; basically, what we have is two-handed FOMC members.

That is all I have to say. Does anybody else want to raise any questions? I may have ended up being last. Why don't we wait to see what type of legislation we can get? I think it will be a very important piece of legislation for us. Rather than try to develop a position in advance, I would suggest that we wait and see what the actual legislation is and try to get a consensus for our response if we can find one in this group.

The last item for today is a report by Ted Truman on developments in Mexico in the last 48 hours or so.

MR. TRUMAN. Thank you, Mr. Chairman. I am sure you have heard more than you would like about Mexico's situation in the last few days and weeks. Nevertheless, I thought it would be useful to summarize the state of play with regard to the Mexican situation as of this afternoon. I will touch on five topics: first, the now apparently dead legislation in the U.S. Congress; second, the total U.S. plan to deal with the Mexican crisis that would be aided by certain FOMC actions; third, the IMF program; fourth, efforts to mobilize other forms of multilateral support; and finally, the Bank of Mexico's request to make a further drawing on the existing Federal Reserve/ESF swap lines. We need a sense of whether the Committee is inclined to approve the increase in the swap line.

First, I can be very brief on the now apparently dead legislation that would have provided up to \$40 billion in U.S. government guarantees of Mexican government securities. The prospects for passage of that legislation have gone steadily downhill since it was announced almost three weeks ago. Decisions were made last night and this morning by the President and the bipartisan leadership to stop pushing for the legislation. I think it is fair to say that the future of the legislation is nonexistent, but I won't belabor the point.

Turning to where we are now, before I say anything more, I would note that I am acutely aware of the strongly held view on this Committee that the central bank should not be expected to underwrite foreign or other debt issues, in large part because covering such debt obligations would involve the inappropriate use of central bank funds. That being said, the U.S. authorities faced two broad alternatives as it became clear that the legislation would not pass. We could conclude that we had tried and failed in what the Chairman has called the "least worse" approach, which was to leave Mexico to fend for itself. Alternatively, we could try to help by using an approach that is feasible but worse.

MR. LINDSEY. Ted, I'm sorry, we are having trouble hearing.

MS. MINEHAN. Please speak up a little.

MR. TRUMAN. In the end, the second alternative was chosen. The materials that were distributed to you contain several items. The first page is a statement by the President and the Congressional leadership. Despite the note on top, which is barely legible but says that the new financing package is on hold and has not yet been cleared, the package has now been cleared. Attached to that is a summary of the currently proposed program, and behind that you will find President Clinton's speech this morning to the National Governors Association in which he announced this change of strategy. The last item is the announcement by the Managing Director of the IMF this morning regarding the Mexican situation and the proposed IMF package.

The new approach would basically involve the heavy use of ESF lending to Mexico in the form of short-term swaps, medium-term swaps, and possibly loans and guarantees of Mexican government securities. The latter two types of operations apparently are legal for the ESF but apparently also would set a precedent. The total could be up to \$20 billion. To provide the ESF with the necessary dollar liquidity to undertake these operations, the Federal Reserve would be asked to agree to warehouse foreign currencies now held in the ESF, at present \$19-1/2 billion in holdings of DM and yen. The reason is that the liquid dollar assets on the ESF's balance sheet are only about \$5 billion. In addition, the Federal Reserve has been asked to participate directly as well. The form, consistent with precedent and with what I said earlier about the role of a central bank in such circumstances, would be for the Committee to agree to increase its swap line somewhat as part of this operation. However, there would be a "take-out" in the form of a commitment from the Treasury that the ESF would take over any System obligation that was outstanding for more than 12 months. We are not going to make a formal recommendation to the Committee for action on a specific proposal today. However, an increase in our Mexican swap line to \$6 billion would, in my opinion, be reasonable as long as we get the take-out. I also think the limit on the warehousing of foreign currencies for the ESF should be raised to \$20 billion with the understanding that the special increase is linked to the Mexican situation. I should also say that a further understanding could be that we have a situation that could last for as long as ten years. The Committee may want to discuss these suggestions today and vote on them tomorrow.

The third topic is the IMF program. Last Thursday, the Mexican authorities announced agreement with IMF management on an economic program in support of Mexico's stabilization efforts. The program is scheduled to be considered by the IMF Executive Board on Wednesday with the first disbursement by Friday, assuming the program is approved. The program as first proposed was unprecedented in its size, both absolutely and relative to Mexico's quota at the IMF. It was three times Mexico's quota, or about \$7.7 billion, of which \$3.9 billion was to be released on approval of the program. The economic content of the program is tighter than that proposed by the Mexican authorities on January 3rd in terms of its fiscal policy parameters and especially its monetary policy parameters. On the surface the program is designed to achieve the same macroeconomic objectives: In terms of growth, as you will recall, the Mexican program called for growth of 1-1/2 percent year over year; inflation in the Mexican program was set at 19 percent December over December; the exchange rate was to get back to 4.5 pesos per dollar; and the current account balance was to be cut to a deficit of \$14 billion this year. However,

implicit in the program is the notion that some, and probably all, of these objectives will have to be revised and that the terms or contingency arrangements of the program will need to be further tightened as well.

Following the collapse of the U.S. legislative proposal, the Managing Director of the IMF decided this morning to make two changes to his recommendations tomorrow with respect to the program. The first is to increase the size of the program by \$10 billion, which he hopes to finance from non-BIS-member central banks. There is some question about that point, and if the funding is not obtained from those central banks and governments, then it would come from the IMF's own resources. Second, he would have the IMF disburse the full amount of the original program immediately.

On my fourth topic, other multilateral efforts, the extraordinary size of the IMF's original program can be explained by two factors. The first is a recognition by IMF management of the serious threat to the international financial system posed by the Mexican situation. The second is a recognition of the need, especially as perceived by the United States Congress, for greater international "burden-sharing," as they call it, in efforts to stabilize Mexican financial markets.

With respect to burden-sharing, we and the Treasury have been discussing certain proposals with our central bank colleagues. The first is to enlarge from \$5 billion to \$10 billion the BIS facility in favor of Mexico that was agreed upon in principle on December 30th. The second is to make the financing from the BIS readily available to meet current short-term financing needs. On the first point, the BIS agreed that the increase, in principle, could be announced as part of the package that was unveiled this morning, although you will note that some of the language of the subsequent announcements suggests more agreement than actually exists, as is almost always the case. We are less optimistic about agreement on the second point.

The Treasury, with our technical support, also has approached three groups of other countries to ask them to assist Mexico. You probably have heard that a group of Latin American countries-- Argentina, Brazil, Chile, and Colombia--generally has responded favorably, although the modalities for the assistance are not yet agreed upon. In addition, the Treasury has approached a group of countries in the Far East and another group of countries in the Middle East for participation. I suspect these efforts will now be rolled into the IMF endeavor to raise an additional \$10 billion to finance the Mexican program through the Fund.

Last, as you know, the Bank of Mexico so far has drawn \$1 billion on the \$10 billion Canadian and joint Fed/ESF swap facility. Those drawings have been made available to the Bank of Mexico rather than being locked up at the Federal Reserve Bank of New York. We understand that as of the end of the day, Mexican reserves will be between \$2.4 and \$2.9 billion including those drawings. There is some uncertainty about how much they lost today, whether it was \$1 billion or \$650 million. And then Mexico intends to announce the level of its reserves tomorrow. Governor Mancera has made an urgent request that we allow a further drawing to enable him to pad his reserves somewhat. After consultation with the Treasury, the Chairman has suggested that

we allow the Bank of Mexico to draw an additional \$2 billion, \$1 billion on each swap line, with the understanding that this entire amount would be locked up at the Federal Reserve Bank of New York and not immediately available for use by the Bank of Mexico. On that somber note I will stop and would be pleased to answer any questions.

MR. MELZER. Ted, what is the status of the collateral arrangements that you discussed on the conference call we had some time ago?

MR. TRUMAN. The security arrangements with respect to the existing enlarged swap arrangement are all in place. Under this new proposal, they would remain in place behind the ESF's operations because the ESF would be committed to taking us out first. So this arrangement would be behind ours as well--any money would go to us first. Those are essentially the same arrangements as those that have been widely talked about in connection with the guarantees arrangement. "Collateral" is the word that I fight against a lot, Mr. Chairman. I have had too much feuding with the lawyers on this point.

MR. MELZER. What are the security arrangements?

MR. TRUMAN. They are an "assured means of repayment." The way they work is that the non-Mexican customers receive irrevocable instructions from the Mexican government as of a specified date, a date which would be after a payment was due on the guaranteed bonds or whatever debt instrument we are talking about, to make their oil payments to a bank in the United States, an account of Pemex in the bank in the United States. Those receipts would be immediately paid into the government account and from the government account into a Bank of Mexico account at the Federal Reserve Bank of New York. By prior agreement, though that is not required but useful, the Mexicans would then acknowledge that the Federal Reserve Bank of New York would have the right to set off funds in that account against claims of the United States government that had been assigned by the United States government to the Federal Reserve.

MR. MELZER. What would that support? In a one-month period of time, what would those receipts be?

MR. TRUMAN. I think it is about \$6 or \$7 billion a year, so it is about \$500 million a month. The Chairman has pointed out that this is a mechanism that would allow repayment. It is also fair to say that if there were circumstances where the repayment was difficult, it might be difficult to fully enforce the mechanism. But I think the most likely scenario would be that a subsequent agreement would be made. It may be good in this circumstance that the agreement would be between the Mexican government and our government; we would be the agent, but we would be left out of it. The subsequent agreement in effect would say: Because of other disasters that have happened with Mexico, rather than taking all your oil receipts we would take a more practical amount--not \$6 billion a year but \$2 billion a year. So, rather than paying off \$20 billion over 3+ years, they would pay it off over 10 years.

MR. MELZER. What ability do the Treasury or the ESF have to take us out of an obligation if funds are not appropriated by



Congress? Do they have the ability just to say, we committed to this and we are going to pay the Fed off?

MR. TRUMAN. Yes, they could.

MR. MELZER. But if they can do that, why can't they just advance it themselves?

MR. TRUMAN. They could, but I think they feel that it would be useful to their objectives to have a lot of people--

CHAIRMAN GREENSPAN. Can I just suggest where the funds come from? How about a credit against our payment to the Treasury?

MR. LINDSEY. Why do we come before other creditors to the Treasury--I guess that is another way of stating the question--with regard to any funds? In other words, why do we come in front of Social Security recipients?

MR. TRUMAN. We would come in front of the Exchange Stabilization Fund, not the Treasury.

CHAIRMAN GREENSPAN. It is the Exchange Stabilization Fund. The point, you know, is that this is not an either/or situation. For example, the Treasury can validly pay us off with a note. Treasury obligations are on our balance sheet right now. If they took us out with a special Treasury security, we would put it on our balance sheet.

MR. TRUMAN. There are two issues about whether we are dealing with the Treasury itself or with the ESF.

CHAIRMAN GREENSPAN. Let me put it this way: If the ESF loses its whole balance sheet, we have more problems than we know!

MR. LINDSEY. But 80 percent of their balance sheet is going to be pesos!

MR. TRUMAN. The Treasury is very conscious of the fact that if they make this arrangement--that is the reason for the warehousing of up to \$20 billion--they would need to allow for the fact that we had advanced \$4, \$5, or \$6 billion. Therefore, we would have to have a contingent claim on them for that \$6 billion--if that's the amount--12 months down the line. They would have to be able to take that claim over, if necessary, either by advancing their own swap or by an arrangement with the Mexicans under this program whereby the Mexicans would use their proceeds to pay us off.

CHAIRMAN GREENSPAN. Could I just formally respond to Governor Lindsey? There is a question here of whether or not the amount the United States Treasury gives us has to be appropriated funds, which I think is really where our examination of the issue has to be. In examining the take-out, we ought to make certain that we talk to them with respect to the question of what happens if they do not get the appropriated funds.

MR. TRUMAN. Mr. Chairman, the Exchange Stabilization Fund does not have appropriated funds.

CHAIRMAN GREENSPAN. Are we going to be getting a take-out from the Exchange Stabilization Fund?

MR. TRUMAN. I think that is what is in the program.

CHAIRMAN GREENSPAN. Okay.

SPEAKER(?). That is not the same as the Treasury.

MR. TRUMAN. Even if we didn't, the precedent in the 1960s--I think there was a question then about whether the Treasury could engage in foreign exchange operations outside of the ESF--was the use of Roosa bonds in the 1960s. The Treasury floated Roosa bonds to obtain foreign currencies and used some of those currencies to take us out. That did not involve appropriated funds. That was treated as a debt-management operation. The Roosa bonds were issued under their debt-management portfolio.

CHAIRMAN GREENSPAN. Since we have double collateral, if you will excuse the word, the interesting question is: If there is a default, do we go first to the oil proceeds or to the Treasury?

MR. TRUMAN. I would suggest, though maybe it's not the right thing to suggest, that we would go first to the Treasury. If the Treasury went to the oil collateral, if I may use that word, that source of repayment would go first to us.

MR. HOENIG. When you say "go first to the Treasury," the Treasury then is providing the backing, not the ESF?

MR. TRUMAN. I said the "Treasury;" I meant the ESF.

MR. HOENIG. Okay.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I will forego my question.

MR. BROADDUS. If I may, Mr. Chairman, I just want to make sure I have the numbers straight. We now have a \$3 billion swap line.

SEVERAL. \$4-1/2 billion.

MR. BROADDUS. Right, \$4-1/2 billion. I want to make sure I understand. Is the \$20 billion package on top of the \$18 billion total package we have now?

MR. TRUMAN. No.

MR. BROADDUS. Then it is the same thing?

MR. TRUMAN. It subsumes the \$9 billion that we have now. The \$18 billion is comprised of \$9 billion from the United States, \$1 billion from the Canadians, \$5 billion from the BIS, and \$3 billion from the commercial banks.

MR. BROADDUS. Let me just cut through and ask what our exposure would be including the amount of warehousing we would be contemplating in the total package?

MR. TRUMAN. I don't consider warehousing to be exposure, but--.

MR. BROADDUS. Okay.

MR. TRUMAN. The figures would be what the Mexicans draw from us and our warehousing with the Treasury.

VICE CHAIRMAN MCDONOUGH. It's \$6 billion for the Mexicans with a take-out from the Treasury.

MR. TRUMAN. Yes, with a take-out from the Treasury. Essentially it's \$26 billion with the Exchange Stabilization Fund.

MR. LINDSEY. \$26 billion?

MR. TRUMAN. The \$6 billion would be part of the \$20 billion, so it would be--

MR. BLINDER. It's twenty minus six, is it not?

MR. TRUMAN. Six billion dollars would be dedicated to taking us out. The twenty includes both what we advance in the short run and what the ESF advances. The maximum exposure to Mexico of the ESF and us that is now contemplated, matches, so to speak, the \$20 billion of the warehousing.

MR. FORRESTAL. Is the new amount from the IMF in addition to the stand-by arrangement they have already--the \$7-3/4 billion?

MR. TRUMAN. They haven't approved that stand-by arrangement for Mexico yet; they will consider that tomorrow.

MR. FORRESTAL. If they do, is it in lieu of that \$7-3/4 billion or in addition to it?

MR. TRUMAN. The two are added together. So it will now be \$17-3/4 billion rather than \$7-3/4 billion.

MR. HOENIG. Let me just ask: How big is the ESF right now in terms of its assets?

MR. TRUMAN. Roughly \$25 billion in liquid assets, of which \$5 billion is in dollars and \$20 billion is in foreign currencies. It also has about \$9 billion of SDRs, but most of that is matched on the liability side of the balance sheet by liabilities to the Federal Reserve.

MR. MCTEER. How have the markets reacted to this announcement today?

CHAIRMAN GREENSPAN. Ted, how did the markets close?

MR. TRUMAN. Quite positively. The last time I looked the peso was about 5.70, having weakened earlier to a new low of 6.55.

CHAIRMAN GREENSPAN. When I spoke to Governor Mancera he said it got as low as 6.70 to 6.80.

MR. FISHER. It closed today at around 5.70 to 5.80 and their stock market was up about 9 percent. It's very positive after yesterday. I caution that the peso level is only at Friday's close.

CHAIRMAN GREENSPAN. What happened in Brazil and Argentina?

MR. FISHER. I don't have the closing levels in front of me. The stock market in Brazil was up strongly.

SPEAKER(?). What about the U.S. market?

MR. FISHER. In the U.S. the Dow was up about 14 and the dollar was up about 2 pfennigs.

CHAIRMAN GREENSPAN. The bond market was up 25/32.

MR. FISHER. The long bond closed at 7.69 percent.

CHAIRMAN GREENSPAN. Any further questions for Ted? I'm sorry; go ahead, Cathy.

MS. MINEHAN. The amount of funding that was initially suggested for commercial banks and investment banks was a small amount of the original \$18 billion, \$3 billion or so. My understanding of that from banks in our own District was that it was being made contingent on the \$40 billion. Now that the \$40 billion is gone, is there any part of this package that is coming from any of our investment banking organizations?

MR. TRUMAN. I don't think it was ever contingent on the \$40 billion because it was put into the market before the \$40 billion in guarantees was announced. But it was contingent on the BIS facility that existed. It was to be paid out pari passu with the BIS part of the package. The truth of the matter is, speaking frankly, the banks have not been particularly supportive of this operation.

MS. MINEHAN. Right.

MR. TRUMAN. My guess is that once this situation stabilizes, there will be some effort to suggest that the banks could be a little more supportive. One of the dominant themes on Capitol Hill has been the question of who peddled this paper, and although a lot of it is not on the balance sheets of the banks, they did a lot of peddling.

MS. MINEHAN. Is the way to add up these numbers 20 plus 15 plus 10 plus 1?

MR. TRUMAN. Twenty plus--

MS. MINEHAN. If the IMF is preparing an expanded support package totaling \$15 billion, should that be \$17 billion?

MR. TRUMAN. \$17 billion!

MS. MINEHAN. Twenty, 17, 10, and 1?

MR. TRUMAN. Yes. Well, 2 would be the last number.

MS. MINEHAN. Oh yes, I forgot that. Okay, a total of \$49 billion.

MR. BLINDER. Someone will throw in another billion.

SPEAKER(?). A billion here, a billion there.

MR. BLINDER. We usually manage to double count one of these things.

SPEAKER(?). Yes.

MS. MINEHAN. The amount now contemplated, whether it is \$49 billion or \$50 billion, is now some \$10 billion over the \$40 billion that was in the proposed legislation, which seemed like a big number to begin with.

MR. TRUMAN. On the other hand, the number before was the \$40 billion plus the \$7 billion plus the \$5 billion. So, the two totals are broadly commensurate.

MS. MINEHAN. Okay.

MR. LINDSEY. Ted, credibility has been a problem all along. I want to ask two questions. First, you said that Governor Mancera wants \$2 billion so he can pad his balance sheet before it is released tomorrow. Now, one of the things that would be most useful in the long term would be for the Bank of Mexico to provide an honest description of its balance sheet not only to us, which would be useful, but to the public at large.

MR. TRUMAN. Absolutely!

MR. LINDSEY. After we pad his balance sheet tomorrow is this going to stop?

MR. TRUMAN. Governor Mancera is very conscious now that he has a commitment to announce his reserves after the end of every month. My understanding from the people I have talked to is that his intention would be to say, as he did the last time the Bank announced its reserves--and this is a small but significant step forward--that his reserves are X and that those include drawings on the North American swap lines of Y.

MR. LINDSEY. But they are not releasing the Bank of Mexico's balance sheets?

MR. TRUMAN. Not yet, but I think that will be part of the Treasury--

CHAIRMAN GREENSPAN. I think we will find, after Governor Mancera reported all his money supply and reserve numbers in the Wall

Street Journal today, that it is going be difficult for them to say the drawings do not exist.

MR. LINDSEY. That is right.

MR. TRUMAN. They existed--and that was the problem!

VICE CHAIRMAN MCDONOUGH. Could I clarify something? What Governor Mancera said just a couple of hours ago was that, if before the end of the day today he is informed that we the United States are willing to make these \$2 billion available, he would envision when he announces his reserve figures to say that they have X, say \$2.4 to \$2.8 billion, and in addition, because I don't think we can get value to them today, that he had agreement from the Federal Reserve and the Exchange Stabilization Fund for an additional \$2 billion, value tomorrow presumably. So he will lay it out accurately, I think.

MR. TRUMAN. I think the major concern--and that is only partly addressed by this since we tentatively plan, at the moment anyhow, to lock up funds--is that announcing he has \$2.4 billion in reserves, given the kind of problems he is up against, does make him look rather naked.

MR. LINDSEY. My second question has to do with our credibility. I don't know what questions to ask, and I hope you will help me out in that regard. I have this document in front of me, which includes a page entitled "What is the Exchange Stabilization Fund?" The document came from Treasury International Affairs. I gather it was written by them. I have written enough of these to know what you do, and that is to tell your point of view. Paragraph 3, not to mention the dots indicating an omission in paragraph 2, got me a little nervous. Paragraph 3 says these holdings in the ESF are used to enter into swap arrangements with foreign governments, to finance exchange market intervention, to provide short-term bridge finance, etc., and all these things are great. So, basically paragraph 3 is establishing that this is not unprecedented. My question would be: Do we do all these nice things if it's not in support of the dollar? Is this unprecedented with regard to the fact that we are supporting another currency?

MR. TRUMAN. The language before the dots is--

MR. LINDSEY. I am talking about the third paragraph. I will go to the second paragraph in a second. I'm sorry. I am running a little out of order. It is saying the ESF has done all these things.

MR. TRUMAN. The legislation governing the objectives of the ESF was changed, I think for the most part in the mid- to late-1970s. The changes included the language that the government of the United States and the International Monetary Fund have the obligation to promote orderly exchange rate arrangements leading to a stable system of exchange rates. That was interpreted to include making loans to Bolivia in helping it maintain a system of stable exchange rates.

MR. LINDSEY. So that has happened before?

MR. TRUMAN. Yes. They have made loans to or financial arrangements with at least 37 countries around the world over the last 50 years.

MR. LINDSEY. I think we all will be asked questions about this. Can you read this paper and tell me that there is not something missing that I should know about, meaning that this is not only the truth but the whole truth?

MR. TRUMAN. I can only say that Treasury lawyers have looked into the question of whether these operations are legal under this broad authorization of what they can do and what the purpose is--

MR. MATTINGLY. If I can help out?

MR. LINDSEY. Yes.

MR. MATTINGLY. It's pretty clear that these ESF operations are authorized. I don't think there is a legal problem in terms of the authority. The statute is very broadly worded in terms of words like "credit"--it has covered things like the gold swaps--and it confers broad authority. Counsel at the White House called the Treasury's General Counsel today and asked "Are you sure?" And the Treasury's General Counsel said "I am sure." Everyone is satisfied that a legal issue is not involved, if that helps.

MR. LINDSEY. Is there anything missing on this page?

MR. MATTINGLY. No, there is not. If you look at the last paragraph, for example, that is part of the statute.

MR. LINDSEY. About notifying Congress in writing in advance?

MR. MATTINGLY. The statute says that with the permission of the President they can make loans.

MR. MELZER. In the penultimate paragraph, what is the identified source of repayment?

VICE CHAIRMAN MCDONOUGH. The Mexicans historically have been very sensitive about that. Now the whole world is informed that there are oil payments as an assured method of repayment. The Mexicans, for reasons with which you would be very familiar given Mexican history, have been rather sensitive about that being quite so open as it is now.

MR. MELZER. Does this legislation contemplate taking 100 percent of a country's oil payments for four years to insure repayment?

MR. TRUMAN. Not the legislation--but operations for three years.

MR. STERN. But you indicated that in fact that might not be the way it falls out.

MR. TRUMAN. I was trying to live up to Governor Lindsey's entreaty that I suggest the questions one could ask as well as the answers.

MR. MELZER. You said this might be outstanding to the ESF for what--10 or 20 years?

MR. TRUMAN. We have used these arrangements five times since 1982.

SPEAKER(?). The oil?

MR. TRUMAN. The provision for payment from oil export proceeds. We never have had to have recourse to them.

MR. MELZER. I don't mean that. Has the ESF ever been used to provide financing, as I think you said earlier was a possibility, that was outstanding for as long as 10 or 20 years?

MR. TRUMAN. Ten.

MR. MELZER. Ten years. Is there any precedent for that? The law seems to contemplate short-term bridge financing.

MR. TRUMAN. The earlier ESF balances agreement also ran for multiple years. Whether it ran as long as 10 years I can't remember, but it is unusual to go that long. There is a difference between whether it is legal and whether there are precedents for having done it. It is unprecedented in that the loans are expected to be outstanding that long. So they got involved in offering us a repayment guarantee.

MR. MCTEER. May I ask a question about the \$40 billion that was in the proposed legislation? I believe that legislation did not contemplate giving the Mexicans any money but was offering loan guarantees that in effect would have substituted the credit of the U.S. government for the credit of the Mexican government. Presumably, they would have had to roll over short-term debt at very, very high interest rates because of the default risk. Was the point of the \$40 billion guarantee to eliminate that default risk and to lower their interest rate structure?

MR. TRUMAN. And to allow them to stretch out the debt--to replace short-term debt at high rates with long-term debt.

MR. MCTEER. Okay. Now we have stopped talking about the \$40 billion; now we are talking about a certain number of billions but the whole nature of it has changed. Have they said what they are going to use this money for? I think it's different from what they were going to do if we had given them the loan guarantee. Is this just strictly for use to intervene in the foreign exchange markets to drive up the peso?

MR. TRUMAN. I think the Treasury's intention is to secure a financial plan from the Mexicans about what they will do with that financing--that is, their whole debt-management strategy. This, of course, would have to be worked out by agreement between the Treasury and the Mexicans and we would participate in terms of our own part in that. As would have been provided for in the legislation, the plan



would have to be in place before a substantial amount could be drawn free and clear.

MR. MCTEER. This does not address their credit risk problem, though. Anybody who invests in their paper still has that to overcome.

MR. TRUMAN. The Mexicans would in effect be substituting credit from the U.S. government or the Exchange Stabilization Fund rather than from the private market as under the previous guarantee program.

MR. MCTEER. So, instead of taking our money and using it in their operations in their financial markets, they will be taking our money and offering it as a promise of repayment. Is that what you are saying? It just seems that the whole nature of the thing has changed, and we have not gotten rid of the credit risk problem.

MR. TRUMAN. In one case they would have borrowed the money with the full faith and credit of the United States in the private market--in the guarantee mechanism.

MR. MCTEER. Right.

MR. TRUMAN. In the second case they either do that, which is one possibility, or they would borrow the dollars from the United States Treasury which would borrow in some sense from the ESF. The ESF does not have dollars but it has Treasury bills that it could sell, and the proceeds would be invested in Mexican obligations.

MR. BOEHNE. But we have moved from loan guarantees to direct lending.

MS. MINEHAN. Yes, to direct lending; we are in more of a credit risk position than we were before.

MR. HOENIG. Ted, why is the Federal Reserve involved in this? Is it because of a liquidity problem for the ESF?

MR. TRUMAN. We are involved for two reasons. One, the ESF does not have the liquidity, so that involves us in the warehousing. The other relates to our participation--this would be short-term participation--through the existing swap line, the enlarged swap line, and the suggested super enlarged swap line.

MR. HOENIG. The latter would have us involved for how long? For the ten years that was mentioned earlier?

MR. TRUMAN. No, I think for one year. That is one of the reasons why I did not put a specific proposal to you today. What I had been thinking, but I wanted to do it tomorrow morning when I had a clearer head, is that you might want to set something up so that they could draw up to \$6 billion. But once they had drawn \$6 billion and the drawing had been outstanding for 12 months it would have to be repaid, and they could not redraw on the enlarged portion of the swap line. The Committee would decide over what period--or maybe it could be for two periods--the Mexicans would be allowed to draw on the enlarged swap line. And after that point they might be allowed to

roll the drawing over up to three times and then be required to repay any unpaid balances. As the drawings were repaid, the enlarged swap facility would be extinguished and they could not redraw on it. The swap line would drop back to our normal swap line agreement and any further drawings would require Committee clearance.

MR. HOENIG. Okay.

MR. FORRESTAL. Could I ask a question? Ted, this is a slightly different issue. A couple of days ago there were rumors in the market that the reserves of the Mexican government had dropped from post devaluation levels of about \$6 billion to \$2 billion. The Bank of Mexico immediately denied that those levels had gone down so much. Now, tomorrow they are going to announce that they have roughly \$2 billion in reserves plus an agreement to get \$2-1/2 billion from us. That is still considerably below the \$6 billion which was already lower than their earlier reserves. What is going to happen?

MR. TRUMAN. They announced on the 9th of January that their reserves were \$5.6 billion.

MR. FORRESTAL. Yes, but they quickly denied that their reserves had slipped to the \$2 billion level.

MR. TRUMAN. As of yesterday their reserves were above \$2 billion.

MR. FORRESTAL. My question is: What is this announcement going to do to the market confidence?

MR. FISHER. I don't think anyone thought five days ago that their reserves were still at \$5 to \$6 billion. There is no credibility loss because they are down closer to \$3 billion. Yesterday, the market was saying that they were at \$2 billion; the Mexicans denied it and said that they were above \$3 billion. Now, one can split hairs but they were by all accounts, and in terms of their conversations with us, above \$3 billion.

CHAIRMAN GREENSPAN. They were at \$3.4 billion.

MR. FISHER. Yes, \$3.4 billion. We are getting down to small numbers, but no one thinks there will be a credibility loss because they were at \$6 billion earlier and tomorrow they will announce \$2 billion.

MR. FORRESTAL. In other words, you don't think that the announcement tomorrow will in any way offset what has been done by the President and our facility?

MR. FISHER. It's not going to offset it entirely. People will, as people in this room did, sort of take a little breath and say, well, that is a low number. But I think the President's package and all the things that have come out today should mitigate the effects of that to a great extent.

MR. MELZER. What are the implications of the Treasury just dusting out what they have in the ESF to provide liquidity to the ESF?

MR. TRUMAN. Do you mean sell those foreign currency assets in the market? In this case, it would be just like any other exchange market intervention, I think.

MR. MELZER. Are they liquid holdings?

MR. TRUMAN. Yes, Peter holds them for the ESF. They are reasonably liquid.

MR. FISHER. Yes, they are reasonably liquid instruments. I think the sum jumped up today. The dollar/mark today was--well, I think dollars had been a little oversold and people were covering back. But some of it was rumors that, in order to do anything, the United States might be selling all the marks and yen immediately. Now, that was mostly a skittish thing going into a rather anxious, jerky market. I don't put too much stock in that.

MR. MELZER. Although that might explain some of the behavior of the dollar today.

MR. FISHER. Yes.

MR. TRUMAN. It is fair to say that as a policy measure, one of the reasons why the Treasury chose to go with the loan guarantee originally rather than using the ESF was that by going to the ESF, even with our cooperation, they felt there might be some sense that their ability to defend the dollar with existing foreign exchange balances was being impaired. And, therefore, if forced to sell out to the market, their ability to defend the dollar subsequently would be difficult without foreign exchange reserves, even aside from what one may think about the effectiveness of intervention. The Treasury is not particularly "gung ho" on intervention, but they are "gung ho" on having some powder in the magazine.

CHAIRMAN GREENSPAN. Okay. Shall we call it an evening?

MR. TRUMAN. We need some sense of the Committee's view on the "drawing" or whatever word you want to use.

CHAIRMAN GREENSPAN. Yes. As Ted indicated, we think it would be useful in this context to agree to our billion dollar lockup of reserves to Mexico. The reason for the lockup, frankly, is that until we know that everything is in place, I would not feel comfortable exposing ourselves even with the collateral. But if we get a take-out and everything is moving along, then all the risk elements to the Federal Reserve will be gone. I think we'll probably get fairly good confirmation of that soon--by tomorrow, do you think?

MR. TRUMAN. It may take us a little while to work out the take-out.

CHAIRMAN GREENSPAN. Is there any objection to our authorizing a \$1 billion drawing from the \$4-1/2 billion swap line to be locked up for the Bank of Mexico?

VICE CHAIRMAN MCDONOUGH. As president of the Bank where the money will be kept, I can assure you that we will keep a very close eye on it!

MR. MELZER. Is this a matter that needs Committee approval or are you just consulting?

CHAIRMAN GREENSPAN. No, actually it does not need approval, but I would feel uncomfortable if there were a significant negative response even though you have already given me the authority. This situation is changing and has changed sufficiently that I want to make certain that there are no significant changes of views on the overall position.

MR. MELZER. I am very concerned about the overall proposal and how it would involve the Federal Reserve. To the extent that a further drawing would involve us further in this arrangement, I do have concerns. At the same time I recognize that you have the authority to do it and that you are being prudent in terms of how that money would be secured. It is hard to object to that in isolation. In fact, I don't have the right to, really! But it does concern me in terms of being another step in the direction of a toe in the water, then the foot, the leg--that is what I am concerned about. I know we are going to be discussing other aspects of this issue tomorrow, but I feel that if I did not express that concern now, I would not be totally forthcoming.

CHAIRMAN GREENSPAN. We are going to get to the other issues first thing tomorrow morning. Yes, Tom.

MR. HOENIG. I have to ask you, when you say "lock up"--Are we committing to this now? Is this something that, if we have a change of heart after our discussions later, we can not take back because we are in this now?

CHAIRMAN GREENSPAN. I don't think so.

MR. TRUMAN. As President Melzer said, previously--the action was taken on December 30th--you approved a special increase in the Mexican swap line for a short period of time. Now, in fact the drawings by Mexico are still within the \$3 billion swap line that existed before it was expanded with the special arrangement on the 30th of December. So, you are operating under what was previously agreed upon.

MR. HOENIG. I understand and I hear what Tom Melzer said. What the Chairman is saying is that things are changing quickly. Yes, we have approved it, but what are we buying into? That's what I just do not know.

MR. TRUMAN. The answer, I suppose, is that participation in this current phase requires action on the warehousing limit for one. Secondly it involves acting on the proposal with respect to raising the \$4-1/2 billion swap line to some number, or not raising it, and articulating how long the enlarged amount would be outstanding before it reverted to the \$3 billion normal size of the swap line. So, if the Committee does that, I am done.

CHAIRMAN GREENSPAN. Jerry.

MR. JORDAN. I am not voting this year but if I were, I would oppose the package because of the warehousing. Once this Committee is in on the warehousing, we are in and we are going to be in--

CHAIRMAN GREENSPAN. The only thing I object to is that that is a subject for tomorrow.

MR. JORDAN. Okay.

CHAIRMAN GREENSPAN. You can be the first one on the floor tomorrow! I am just saying the clock is ticking. Let's get out of here.

[Meeting recessed]

February 1, 1995--Morning Session

CHAIRMAN GREENSPAN. Since the Mexican discussion may be open-ended, I thought it would be desirable to put it at the end of the agenda and start this morning's session with Peter Fisher on both foreign currency and domestic open market operations. Peter.

MR. FISHER. Thank you, Mr. Chairman. I will be referring eventually to the three colored charts on the single sheet of paper distributed this morning. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Peter, we have seen the current account deficit of the United States rise continuously in recent years. Projections now suggest yearly deficits of around \$200 billion in the next couple of years, and there is no evidence of any retreat. It has always been the conventional wisdom that, because of the prominence of the dollar in world portfolios, the U.S. dollar was driven largely by portfolio shifts and that the net flow of claims against the United States, which are virtually all in dollars, really was not a major force because of the huge size of the stock. But when we are getting deficits of \$200 billion, that strikes me as no longer de minimis, and I am curious to know how you evaluate the presumably depressing effect on the dollar from the cumulating current account deficits. How would you evaluate the general effect of the deficits on both the level and the trend? In other words, are they fully discounted in the market so that there is only a level issue? Or are they not fully discounted, implying that there is further potential erosion stemming from the fact that we are going to borrow, net, \$400 billion over the next two years?

MR. FISHER. There are two aspects I would focus on. One is the trend, as you point out. What is disturbing, or important, to the foreign exchange market is the sense of rising current account deficits; the foreign exchange market sees the trend in the current account as being against the dollar. If there were to be forecasts of stable \$200 billion current account deficits for 5 or 10 years, that might be something to which the foreign exchange market eventually would adjust. So, I think a big component is the fact that the deficit seems to be ratcheting up, and people in the market do not see where the process might stop. Obviously, the level is also important; and in the past year, as you have all read and have heard at this table, the combination of the current account deficit and the outflow of U.S. savings in search of portfolio diversification abroad was seen as having a piling-on effect by the foreign exchange market. Market participants did not see where the demand for dollars was going to come from.

I certainly err in the direction of being interested in some of the micro mechanics of markets, so you will have to forgive me. But I think it also is important to keep in mind that, increasingly, all sorts of managers of funds and portfolios abroad who are interested in holding dollar assets view the foreign exchange exposure component of that as something that has to be managed completely differently. These foreign holders set aside their dollar assets subject to exchange rate exposure and give them to someone to manage. And so, even if foreign investors view holding U.S. Treasuries as a very good investment, they probably have passed off to some other manager X billions of their dollar exposure to be managed on a perhaps

slightly more aggressive basis in the foreign exchange market. And so stable flows--stable for the foreign exchange market--may be a thing of the past for the portfolio manager.

CHAIRMAN GREENSPAN. Any other questions for Peter?

MR. BLINDER. I have one. It has two parts, the first of which is probably unanswerable, but if you want to give it a shot, go ahead. The question is: What would you imagine the implications are, for the peso and the Canadian dollar, of another 50 basis points on the federal funds rate?

MR. FISHER. With regard to Canada, I would expect the Canadians to add 50 basis points themselves. The Bank of Canada has leaned very strongly against the wind in the last few weeks and in doing that has impressed their markets. That is, the Bank of Canada raised its rates, and when market rates started to come back down, the Bank kept taking action to make sure the rates stayed up. After that was done two or three times, the yield on 30-year bonds fell 30 basis points. If the Bank of Canada adjusted basis-point-for-basis-point with us, I think the Canadian dollar would be relatively stable against the U.S. dollar. I don't mean to jump too much into the fun the Committee will have this morning, but I think the important question is compared to what?

MR. BLINDER. Yes, compared to zero.

MR. FISHER. If it is a 50 basis point increase in the federal funds rate compared to zero, I think zero would be quite bad for the Canadian dollar. I also think our own markets would be rather disturbed by zero and that it would be worse for the peso than 50 basis points. If one looks at where the market would like to price Mexican assets, 50 basis points added to the cost-of-carry just is not worth anything. So that is not the issue. The issue is stability of the interest rate environment.

CHAIRMAN GREENSPAN. Further questions? Yes, Tom.

MR. MELZER. I had understood Ted Truman to say yesterday that \$1 billion had been drawn down on our swap arrangement, and you just said \$1-1/2 billion, Peter.

MR. TRUMAN. Combined. The Mexicans drew \$1 billion earlier, divided equally between the Federal Reserve and the Treasury. Last night they drew an additional \$2 billion, of which \$1 billion is from the System.

MR. FISHER. Yes. I was referring to their total drawings for the month on the Federal Reserve. That is, we did \$500 million earlier in the month and last night we accepted their request and locked up an additional \$1 billion.

MR. MELZER. So the total outstanding on our portion of that facility is \$1-1/2 billion?

MR. FISHER. That is right.

MR. TRUMAN. I was talking about the combined amount for the United States and Peter was talking about the Federal Reserve portion.

MR. MELZER. Okay.

CHAIRMAN GREENSPAN. Further questions? If not, would somebody like to move to ratify the transactions of the domestic open market Desk?

VICE CHAIRMAN MCDONOUGH. So move.

CHAIRMAN GREENSPAN. Is there a second?

MS. MINEHAN AND OTHERS. Second.

CHAIRMAN GREENSPAN. Without objection. Let's move on now to the staff report with Messrs. Prell and Hooper.

MR. PRELL. Thank you, Mr. Chairman. [Statement--see Appendix.]

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

CHAIRMAN GREENSPAN. How high is the unemployment estimate that the CEA is currently using?

MR. PRELL. It looks like 6 percent is the fourth-quarter level that they are working with at this point.

CHAIRMAN GREENSPAN. They cannot publish that in the CEA report. Going up to the Hill and saying "our program will raise the unemployment rate by more than 1/2 point" will hardly get ringing endorsements.

MR. PRELL. Given that their projected output growth will be pretty much in line with their estimates of the trend of potential output, it will look somewhat anomalous on that basis. But when they were developing these numbers earlier, they were working from a much higher base. It is hard to tell but they could say in the Economic Report that the news is good, the numbers now look better, and so we have adjusted the figures that appeared earlier in the budget.

CHAIRMAN GREENSPAN. Questions?

MR. JORDAN. Mike, in both the Greenbook and in your oral presentation you remarked that you had reexamined the economic model that you use, the approach that you use, in bringing these forecasts together, and you concluded that your model tracks well enough. It is within the confidence intervals for 1994. And as best you can tell, there is not enough evidence yet to say that the NAIRU is different from 6 percent. Accepting that, I went back a year to see what the forecast was. I am assuming that looking at things ex post is still the best way; the model itself of necessity had to be built judging this ex ante--hindsight does not help here. A year ago the projected unemployment rate for the end of 1994 was 6.8 percent, and for 1995 it was 6.8 percent. We are now at 5.4 percent. I look at your current projection for the unemployment rate for this year and your projection for 1996, which we did not have a year ago, and I also look at the



CPI, which came in below the estimate for 1994 but is now projected to be .3 percent higher for 1995 than you had it a year ago. So, if the model is still working, that means the lags are a lot longer than you estimated earlier and the projected outcome is someplace further out in the future, or it would cost 1.7 million jobs to reduce the inflation rate by .3 percent just to make the model consistent with a year ago.

MR. PRELL. I think we went through this last time, and I won't repeat the four-part harmony answer on the 1994 error. In a sense, we were thrown off by some movements in the numbers in 1993 that caused us to hesitate to follow the model religiously. Looking back over the past year--as you noted and we noted in the Greenbook--the behavior of prices is not out of line with the model forecast over the past couple of years on the assumption of a NAIRU in the 6 percent area. The behavior of compensation, including the latest reading, might on balance be a bit more favorable--too high in 1993 relative to the model and on the low side in 1994--and that perhaps raises some question, but it is still within the confidence interval. At this juncture, as we go forward in this forecast, I think the predictions are well in line with conventional short-run Phillips curve analyses. We run many different models and we get different answers, and I think this is a reasonable ballpark estimate of what the history embodied in these models would suggest is likely to happen in 1995 on the assumption that we get this kind of employment data.

MR. JORDAN. I'm still missing something. If the difference between .8 percent above the NAIRU on last year's projection and .6 percent below it is only .3 percentage point in the CPI, how wide is your confidence interval around the NAIRU?

MR. PRELL. I would say usually 1/2 percentage point.

MR. JORDAN. So the NAIRU is 6 percent plus or minus 1/2 percentage point?

MR. PRELL. I think that is a reasonable range. We might narrow it a bit but we would be pressing science pretty hard.

MR. JORDAN. Okay.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mike, the estimated equilibrium real interest rate is mentioned in the Bluebook in the section where there is a discussion of the simulations of the FTS model. A very interesting result is that, if the greater fiscal restraint were put into effect, the equilibrium real interest rate would decline by 1-1/2 percentage points. I found that very interesting, and I assume it was a result of some simulations of alternative scenarios. Could you describe the process by which you get this estimate? I would really be interested in what your estimate of the level would be if there were no fiscal restraint.

MR. PRELL. Basically, we have an estimate of about 1-1/2 percentage points for what the elimination of the structural deficit would do.

MR. PARRY. That is exogenous?

MR. PRELL. No.

MR. KOHN. It is a 1-1/2 percentage point decline in the equilibrium real rate that came out of the model simulations. I think to get a sense of the level you might look at the chart in the Bluebook that follows page 11. The end point there for the funds rate is 6-1/2 percent without fiscal contraction and 5 percent with the contraction. That is your 1-1/2 percentage point decline in the real rate. The inflation rate is about 3-1/2 percent, so I would say that without fiscal restraint the equilibrium real funds rate--this is cutting things much too fine--is approximately 3 percent.

MR. PRELL. This is obviously an "iffy" proposition and to some extent one might view this as schematic as opposed to very precise.

MR. PARRY. I understand.

MR. PRELL. It is our belief that real rates have been elevated by the structural deficits of the 1980s and elimination of the deficit would yield a lower real rate. One of the things we have to speculate about in this forecasting process is the anticipatory effects that might result. Estimating those effects is very difficult. One has to think beyond the financial markets to other kinds of responses--to expectations about cuts in taxes and federal spending.

MR. PARRY. Well, as I said, the fairly significant decline in the equilibrium real interest rate is a very interesting result.

MR. STOCKTON. Mr. Chairman, I would like to come back for just a moment to try to provide a footnote to Mike's response to President Jordan. One thing to remember is that a year ago when we were dealing with the changeover in the Current Population Survey, we were expecting that revision to add in excess of 1/2 percentage point to the unemployment rate. We now think the addition is more like .2 percent. So, that is part of the explanation for the difference last year, and the revision also is leading us to change the projected unemployment rate in comparison with what we were indicating earlier.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Just a clarification question to you, Peter. You talked a little about, and the Greenbook also referred to, some backing off in the growth of foreign demand for U.S. exports. But this morning you are still talking about continued robust growth. Am I understanding you correctly? Is there still some backoff in your projection?

MR. HOOPER. The decline in foreign demand is related to the Mexican situation. Excluding Mexico, we do not expect a significant change.

MR. HOENIG. You are not looking for a change in Europe or elsewhere?

MR. HOOPER. There is a little drop in Canada's rate of expansion because of their monetary policy tightening--

MR. HOENIG. But otherwise the outlook is still pretty strong?

MR. HOOPER. Yes.

CHAIRMAN GREENSPAN. If there are no further questions for the staff, obviously the rest of us have all the answers. Who would like to start? President Parry.

MR. PARRY. Mr. Chairman, growth in the Twelfth District economy is gathering momentum. Employment growth has picked up and the unemployment rate has continued to fall, in large part due to improvement in California. Within the state, economic conditions have improved in both northern and southern California. Recovery in our District should stay on track, although several recent developments will likely damp overall growth and have more pronounced effects on some regions. In California, for example, floods are affecting some communities quite a bit, but without having much effect on the state economy overall. In Orange County, the losses in the county's investment pool have been marked down to about \$1.7 billion. Also, spreads between rates on California State debt and other tax-free debt have narrowed some.

The earthquake in Japan also is reverberating in California, holding down shipments between the damaged port of Kobe and major West Coast ports such as Oakland, which counts on Kobe for about 9 percent of its business. High-valued shipments between Oakland and Japan reportedly are going through ports other than Kobe, but the increased transport costs are limiting shipments of lower-valued products such as animal feed.

The devaluation of the peso could hit states like Arizona and California harder than most other states. But assuming that the currency situation stabilizes, we do not expect this to prevent further economic growth. Still, some businesses in southern California are greatly concerned about the situation in Mexico. An area of particular concern is San Diego where the unemployment rate has not improved as much as has been the case in Los Angeles and where retail sales recently have weakened as a result of the crisis in Mexico.

Turning to the national economy, it is clear that employment, output, and spending all exhibited surprisingly strong growth last year. As a result, the economy now has attained levels of labor and capacity utilization that are inconsistent with steady inflation, to say nothing of progress toward lower inflation. In our outlook, nothing suggests that the monetary tightening of last year will slow the pace of real economic activity sufficiently over the forecast horizon to produce any slack in the economy. This point is also amply demonstrated by the Greenbook forecast. With no further tightening, there likely will be a deterioration in the inflationary environment in 1995 and 1996 as well as beyond the forecast horizon. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. New England continues to recover from the recession at a moderate pace, with substantial variation in employment growth from state to state. Long-term structural issues continue to plague the region with defense downsizing, uncertainties in health care, and re-engineering downsizing or rightsizing--whatever you want to call it--affecting many of our large employers. On top of all of that, we do not have any snow! Tourism buoyed the District through the summer and the fall; it has been less of a factor this winter as mild temperatures and some rain have dimmed ski area prospects. Beyond employment and the weather, other indicators suggest that economic activity is continuing to expand. Specifically, help-wanted ads, consumer confidence, housing permits, and a lot of anecdotal data show some strength to the continued recovery. Manufacturing contacts are generally positive but retailers are more varied. We continue to hear reports of input price increases, especially paper, but selling prices have not yet ticked up generally. I might also note that while everybody is complaining about paper prices, producers of paper in Maine have a different attitude; they think that paper prices are about where they should be.

I noted at our last meeting that the District's bank loan growth trailed the rest of the country substantially, with annual growth rates in all categories about half or less than that of other Districts. We have done a little work with the Senior Officer Loan Survey to try to determine why that is the case. The First District has shown relatively stable loan demand and no relaxation of credit standards. This is quite different from the nation as a whole and undoubtedly reflects concerns by the banks in our District about asset quality after the recession. In addition, First District banks still have relatively larger securities holdings than banks in other areas. They have had sizable realized and unrealized portfolio losses this year, and their stock prices have suffered as a result. All in all, I think their appetite for risk in 1994 was not very great, though continued moderate growth in 1995 in the region and nationally may change that somewhat.

Turning to the Greenbook, I applaud the inclusion of a "no change" baseline to compare with a likely alternative path. It was very helpful to me in assessing what the various factors are in the Greenbook forecast. I was a little struck, though, by how little difference it seems to make whether or not we do anything. In the baseline forecast, inflation rises by .4 percent this year and only about .1 percent next year--if I have those numbers right--while unemployment stays well below the NAIRU in both years. In the alternative path, we make marginal inroads on inflation in 1996, again without the unemployment rate rising above the natural rate. It may be that things have changed in the labor markets along the lines suggested in the Greenbook, but I do not know that we have any evidence of this; I think that is close to what you were saying, Mike, when you were talking about the Greenbook analysis. As Part II of the Greenbook points out, there is no reason as yet to expect much compensation growth, given that the third-quarter unemployment rate was 6 percent. We have had only one quarter with the unemployment rate below the natural rate. We need to avoid the human tendency to indulge in some wishful thinking. Our own expectations are that inflation will be a bit more of an issue than the Greenbook suggests, especially in the baseline projection.

In sum, I think the Greenbook is really well done this time. I liked it a lot. I am putting in a vote for you to do it this way more often, Mike, even though it is more work for you.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Mr. Chairman, on balance the Seventh District economy is still growing at a moderate to vigorous pace, although there has been some easing recently in a few interest-sensitive sectors. As I said to the Committee last time, two U.S. auto manufacturers reported cuts in orders from dealers as early as mid-December but no reduction in consumer sales at that time. More recently, there has been a lot of discussion in the press about a possible slowdown in the auto industry. In addition to dealer orders being down, reports now indicate that for some models inventories have risen, production schedules have been trimmed, and new incentive programs are being offered. In addition, used car prices have been declining in our District. The challenge is sorting through all this information to determine to what extent demand has moderated. Our assessment is that while there has been some moderation in sales growth, most of the recently reported signs of slowing overstate the degree of moderation, in part because 1994 was such a strong year for auto manufacturers, suppliers, and dealers. We expect auto and light truck sales to increase about 2 percent in 1995. This is significantly slower than the 8-1/2 percent increase in 1994, but production would reach a strong level of about 15.4 million units in 1995.

One area where the signs of slowdown are becoming clearer is in the single-family housing sector. For example, builders and realtors in the Chicago area started seeing slower traffic and sales in the fourth quarter of last year, particularly in December despite quite favorable weather that month. Reports from District retailers are mixed. Sales gains remain heavily concentrated in hard goods, with apparel sales still slow. Some retailers express concern about high inventory levels, although it is interesting that the Loan Officers Survey indicates that banks are not concerned about loans for inventory financing. Competitive pressures are still reported to be intense, and increased promotional activity is widespread. The District's manufacturing sector ended 1994 on a very high note with many industries, especially in durable goods manufacturing, reporting a record or near-record year. While some industries expect to exceed those levels this year, the widespread expectation is that growth will moderate. Utilization rates are quite high and in many cases above the peaks reached in 1989.

As I reported earlier, raw materials price increases are pervasive. Although many firms are unable or unwilling to pass on such price increases to their customers, some firms are now expressing the belief that price advances are becoming more feasible. For example, rapidly rising sales and backlogs have led to two price increases within a month in the heavy paper industry. Obviously, we did not hear this from Cathy's Maine producers.

In agriculture, recent developments indicate the District's farm sector is holding up better than we had anticipated. A sharp unexpected decline in exports from China has significantly enhanced U.S. corn export prospects. However, the peso devaluation will

undermine some of the near-term agricultural trade benefits that had been expected to accrue from NAFTA. In particular for the Midwest, some of the recent gains in corn exports may be lost. In addition, the earthquake in Kobe may briefly disrupt our trade patterns with Japan, which is the largest foreign market for U.S. agricultural commodities.

On the employment front, labor markets remain quite tight. In many metropolitan areas, the reported unemployment rate is below 4 percent, including a rate of 3-1/2 percent in the metropolitan Detroit area. A few reports indicated outright shortages of clerical workers, and concerns were expressed about the inability to find sufficiently well qualified workers. Wages for clerical workers are reported to be up more than 10 percent from a year ago. Overall economic activity in the Seventh District is consistent with a national economy that has moved into a range where a pickup in inflation is considered likely.

Turning to the national picture, our outlook for real GDP growth in 1995 is similar to the Greenbook's alternative projection. Growth in real GDP should taper off significantly over 1995. The inflation outlook is one area where we are less optimistic than the Greenbook, even assuming further monetary policy tightening this year. While we tend to agree with the Board staff estimate of the NAIRU, we expect to see consumer prices responding more rapidly to the low rate of unemployment than is forecast in the Greenbook. As a result, we expect CPI inflation to rise perceptibly to ranges in the neighborhood of 3-1/2 percent by the second half of 1995.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. The Philadelphia region continues to expand, with some evidence that the pace of expansion is slowing. Wage and price increases generally remain subdued, but with labor markets tightening, there is some concern, more than I have heard before, about building inflationary pressures. Manufacturers report that industrial activity is still on an upward trend, but some slackening from the pace of the fourth quarter is occurring. Gains are more common in metals and equipment, while steady-to-declining activity is more characteristic of nondurables. Retailers in general were reasonably pleased about holiday sales. They did not do as well as they had hoped, but well enough not to be complaining. Sales in January were more subdued with lots of discounting, especially for apparel, which was the weakest area in December. Existing nonresidential structures are still selling at prices below replacement cost in the Philadelphia area, so there is little need for new construction. Residential construction is clearly feeling the impact of higher interest rates. Loan volume is growing moderately, with middle market companies prominent among new borrowers. There are still reports--I would say an increasing number of reports--that underwriting standards are slipping and complaints from bankers that loan pricing does not adequately compensate for risk. With rising loan demand, there is more competition for deposits. Labor markets in the District have tightened noticeably during the last couple of months. Some employers expect upward wage and price pressures down the road. Others believe that there is still much potential for further productivity gains and that such gains plus intense competition will continue to contain wage and price pressures.

My reading of the national economy is that we are likely to see moderating growth as the year progresses, largely from less robust personal consumption, less inventory investment, weaker residential construction, and perhaps not as strong export growth as we previously thought. Nonetheless, moderating growth is still a forecast with the usual amount of uncertainty surrounding the degree of moderation and the timing. On the inflation side, the weight of historical evidence points toward some cyclical rise in the inflation rate. It is probably true, however, that the economy is now less inflation prone than it was in the last decade or so. Whether it is a little less prone or a lot less remains to be seen. The answer is probably in between--not as optimistic as some would have us believe but better than our models suggest.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, the Southeast economy continues to expand, although we have seen some deceleration during the fall and early winter. Employment growth in the District outpaced the nation last year but our unemployment rate fell relatively less because of in-migration to the area. We are expecting an unemployment rate of 5.7 percent for December when the final numbers come in. Retail sales growth has been relatively strong, led by durables, although we have seen a noticeable decline in auto sales from very high levels. Dealers view the current pace as sustainable. Tourism is mixed at the moment. In the very large Florida market, the usual strong inflow of Canadian visitors has been restrained by weakness in the Canadian dollar and, to some degree, by the high cost of health care for Canadians when they travel outside Canada. Also, unseasonably warm weather in other parts of the country has hurt Florida resorts and cruise bookings.

Manufacturing activity grew moderately in December and early January and the outlook for capital expenditures improved. Production levels remained quite high in industrial chemicals, paper, pulp, and metals. Manufacturers report that the markets for building materials and home furnishings have softened recently. In the important defense contracting area, contractors remain under pressure but foreign military orders are bolstering activity at some plants. A broad range of industries in the region have posted significant gains in exports since the implementation of NAFTA, but there is now considerable concern that the sharp devaluation of the peso will cut into those exports; in fact, we are already beginning to see a little of that. Realtors in most of the District report that sales of single-family homes have slowed due to rising interest rates, but multifamily and commercial construction continues at a pretty good pace. Bank lending activity is mixed in the District. We are getting some anecdotal reports about a lessening of underwriting standards, but consumer default rates are continuing at a quite low level. We still hear reports of difficulty in getting skilled and unskilled workers; that is particularly true in Tennessee.

On the inflation side, we are seeing more pressures on prices but that is somewhat sporadic. The deceleration in housing has eased pressures on prices of materials and has alleviated shortages of semi-skilled labor in many areas. Retailers anticipate that vendors are going to raise prices on new merchandise, but they are concerned that they are going to be unable to pass these increases through to the

consumer level. Reports of rising prices of raw materials remain very widespread with the pressures most intense for chemicals, paper, and textiles.

Looking at the national economy, I too would like to applaud the staff for including an alternative forecast. I think it is very, very helpful. I would hope that this can be done on a more frequent basis. We revised our forecast upward when it became clear toward the end of the year that the deceleration we had anticipated was not going to take place. We do show some moderation in the future. Our baseline forecast is pretty much the same as that in the Greenbook, although we do show somewhat greater strength in real GDP than the Greenbook and somewhat higher inflation. I would like to believe that capacity utilization constraints are not going to be as important as they once were and that the shortage of labor is not going to pass through into wages, but that may be wishful thinking. At the end of 1996, we have a 3.6 percent rate of inflation. Again, I would like to hope and believe that that will be the cyclical peak for inflation and that it will come down from that, but that may be wishful thinking.

I think the really important question and the difficult issue that we have to face will be the need to stop adjusting our policies at a time when current data still appear strong. If we believe in policy lags, we need to start asking ourselves how we are going to know and what we will look at that will make us decide that we have done enough. It is the opposite to the question of inflation. When we see inflation, it is too late, and it may be too late for us to stop when we begin to see deceleration. That is a very tricky issue for us to face. Thank you.

CHAIRMAN GREENSPAN. President Broadus.

MR. BROADDUS. The reports we have received lately indicate that overall conditions in our District are still generally robust. Like a lot of other people, we have seen some signs of deceleration in parts of the District and in some industries, but really nothing of size. There are just too few signs to reach any definitive conclusions at this point. At their January meeting, our directors were uniformly bullish. They said their local economies were holding up surprisingly well in the face of recent interest rate increases. They also reported widespread optimism regarding the outlook for their local areas in the year ahead. One director at the meeting did express concern about the weakness in apparel sales over the holiday season, but even she said that in general things look pretty strong.

Some directors continue to report rising price pressures at earlier and intermediate stages of production. These people still expect at least some of these increases to be passed through to final prices in the near future. In fact, our monthly service-sector survey did show a pickup in retail prices from November to December. Our latest monthly survey of the manufacturing sector suggested a slight decline in the growth of manufacturing activity in our region, but the various indexes we use remain quite high in terms of levels. The North Carolina economy, as I have reported before, still is extremely robust--lots of manufacturing activity there. There are some signs in the middle part of the state, in areas like the research triangle of Raleigh-Durham and in the Charlotte area, of some labor shortages and at least a few signs of upward pressure on wages in some industries.



Another thing from the District that might be worth mentioning: One of my directors who is especially conscientious in gathering useful anecdotal information for us called me late last week. He told me that in the last week three general contractors, whom he normally surveys for each of our meetings, had called him of their own accord and told him that just in recent days they either had to revise or, in one case, actually withdraw a preliminary bid on a major construction project because they were getting bids from their subs that were much higher than anticipated. The main reason for this appears to have been increased pressures on prices of materials, but apparently labor costs also played a role.

As for the national economy, I would join Cathy Minehan and Bob Forrestal and others in complimenting the staff on their analysis. I thought it was very well done. I was especially interested in the impact that the changed assumption has on the outlook for major macroeconomic variables over the next couple of years. The assumption of a constant funds rate compared to the December projection does have a noticeable cumulative upward impact on GDP growth and employment by the end of 1996, with only a relatively small increase in the inflation rate--.3 percentage point by the fourth quarter of 1996 to be exact. In any case, it is fair to say that this new projection is calling for what reasonably could be described as a classic soft landing. I think a favorable outcome like that is certainly possible; that is basically what we are projecting. As a number of people have pointed out, we already have seen some initial signs that our tightening actions last year have begun to cause growth to moderate at least in some sectors. But again, as everyone knows, we recently have gotten a string of exceptionally strong economic reports that indicate clearly that whatever may be happening going forward, the economy has entered this year with a great deal of momentum. Even housing seems to be holding up pretty well in the face of higher interest rates. Back at the December meeting, I said that I thought the risks in the national outlook were more balanced than they had been earlier in the year. I still think they are more balanced than they were several months ago, but I think they are less "more balanced" than I thought back in December. In this regard, it is worth noting that the long bond rate, while it is still well below its high in mid-November, has stopped declining. It stopped declining in early December and has been basically in a holding pattern at around 7-7/8 percent since then. That suggests to me that people still think the expansion at least for now is continuing at an unsustainable pace. I think they are waiting to see what we are going to do about it.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. The Ninth District economy remains healthy. Unemployment rates are almost uniformly low throughout the District. Employment gains over the past year have been very substantial, and there are labor shortages in many parts of the District right now which over time certainly will slow the pace of expansion. Not unrelated to what has been going on, there are also housing shortages in many parts of the District. Apartment construction in some of those mid-size communities is very substantial, at least by their historical standards. Obviously, that will help to alleviate the housing problem over time, but right now, even if employers in those communities could attract more labor, they would not have any place to house them. Despite these circumstances, there is still no widespread

evidence of an acceleration of wages. There are perhaps a few more reports than there were a few months ago of some pickup in wage pressures, but they still are not widespread. That is not what I might have anticipated given the clear evidence of labor shortages.

Overall, the District economy continues to do quite well. Natural resource industries had a very good year: We already have talked a little about paper and forest products; mining of iron, copper, and so forth also has done well. The retail sales picture has not been much different than elsewhere in the country. We have had a bifurcated pattern where hard goods have been selling well and soft goods, especially apparel, have not. I don't pretend to have any insight into why that should be the case. The weather has been mild and the lack of snow has affected tourism, which had been running quite strongly for a good number of years. So, it has not been a good winter in many parts of the District as a consequence of the weather.

The other thing I might mention about the District economy is that it seems to be widely, though not universally, expected that 1995 will not be as strong a year as 1994. I suppose there is nothing remarkable about that in the sense that 1994 was quite a good year as was 1993, and people just naturally are cautious that this can't go on forever and there may be a sense that we are bouncing off the ceiling. These attitudes have been around for a while; there is nothing that has triggered them. It may be that people simply have been taking another look at consensus forecasts that things will slow, but that does seem to be the prevailing attitude.

With regard to the national economy, I must admit I am a bit uncomfortable about the inflation outlook. I am particularly uncomfortable if I adopt the Greenbook framework, which emphasizes capacity pressures and a NAIRU of around 6 percent. It seems to me that, in that environment, we will get an acceleration of inflation. Maybe it will be modest and only cyclical but, of course, the outcome probably is not wholly independent of what we choose to do. In my judgment, that is where the risk is.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Thanks, Alan. The U.S. economy continues to grow more rapidly than forecasters had expected and likely more rapidly than can be sustained, with a four-quarter growth rate through the end of last year of about 4 percent. The unemployment rate fell 1.3 percentage points in 1994 to 5.4 percent in December. In the Eighth District, unemployment is averaging 4.2 percent in the major states and stands at 3.9 percent in the St. Louis area, the lowest level in decades.

Nationally, employment gains have been robust, with the economy adding about 307,000 jobs per month from January through December 1994. This trend has been mirrored in the Eighth District over the last year: Arkansas and Kentucky registered payroll employment gains at an annual rate of nearly 6 percent during the fall. Some of our District states have picked up some momentum. During 1994, employment in our District actually was growing more slowly than in the nation as a whole. In fact, contacts throughout the Eighth District report that labor markets are the tightest they have seen in years, with wage pressures in evidence in some markets.

District retailers reported holiday sales up 6 to 7 percent over year-earlier levels, and post-holiday sales generally have met expectations, reducing retail inventories. In a recent survey of small businesses in the District, about 3/4 of the respondents said they expected the current boom to continue or gather strength over the next six months.

In general, the performance of the economy has made a mockery out of the slowdown scenario widely predicted last summer for the second half of 1994 on the basis of the inventory buildup in the first half of the year. Is it possible that the slowdown scenario now widely predicted for 1995 is also wrong? Our forecast envisions real output growing about 3 percent in 1995 with the CPI inflation rate increasing to about 3-1/2 percent. Unemployment in the fourth quarter is forecast to be about the same as its current level. Other forecasts--both from the private sector and the Greenbook, even in the case where no further tightening is assumed as in the Greenbook--look for a sharper slowdown in 1995 than we do. These forecasts of a weak economy appear to be based in large part on two observations: (1) the economy has a strong tendency to return to trend, and (2) the level of inventory investment has been abnormally high. While it is true that the economy does tend to return to trend, the pace at which such a return occurs is highly variable and still could be many quarters away. Though recent economic performance has been strong, it has not been nearly as strong as in some other expansions and above-trend growth might well be sustained through 1995 as the economy continues to work off the enormous amount of liquidity that was created in 1991 through 1993. A prospective downturn in inventory investment is another negative consideration, but I continue to think that most of the recent inventory accumulation has been planned, which I believe is consistent with what Mike said, as a means to meet expected demand. The inventory/sales ratio is holding at an historically low level.

In short, while a slowdown is bound to occur at some point, presently there is little hard evidence of it. In my view, the risk of misjudging the thrust of demand growth on inflation remains significant despite the widespread opinion that substantially slower growth is ahead. In that light, a disturbing feature of the current situation is that most private forecasters expect little improvement on inflation over the next two years or for that matter over even longer periods. That observation reflects poorly on the credibility of the FOMC's commitment to price stability. With respect to CPI inflation, the recent Blue Chip report predicts 3-1/2 percent inflation in the current quarter and little change to the fourth quarter of 1996 where the projection is 3.6 percent. Likewise, the current Administration assumption has inflation rising to 3.4 percent in the outyears of their budget projection horizon and basically staying there indefinitely. Recent long-term government bond yields of somewhat less than 8 percent suggest longer-term inflation expectations substantially above current inflation. We certainly have a way to go to establish the kind of inflation credibility that existed before we lost it in the 1970s.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Thank you, Mr. Chairman. The Tenth District economy remains strong, bolstered by healthy gains in its key industries across the states. Our directors from all parts of the

District report a robust pace of business activity. A director from our utilities industry reports strong growth in electricity sales to important industrial customers including manufacturers of steel, automobiles, and plastics. In the transportation industry, growing demand for shipments of coal, automobiles, and other products continues to strain capacity. A national manufacturer of home improvement products in our District reported exceptionally strong sales over the last year. His company has, for the first time in several years, successfully passed increases in prices to his customers. Director reports about shortages that I commented on previously are not coming in strong. Whether that is because some have stopped reporting because they already have done so several times or because conditions have changed is not certain.

Recent employment data confirm anecdotal reports of economic strength. Nonfarm jobs in the District were up nearly 3 percent December over December this past year, nearly matching the national average. Three of our states including New Mexico had job growth twice the national average. District manufacturing activity continues to strengthen, with most of the improvement in the durable goods industries. Our contacts in the automobile industry tell us that the District's assembly plants are operating at very high rates of capacity. Construction activity remains brisk but the industry's mix is shifting. Housing construction is slowing, while commercial and public works construction is strengthening. The energy industry remains weak due to crude oil and natural gas prices. The agricultural sector has strengthened on improvements in livestock prices. Bank credit continues to increase at most of our District banks, with strong loan growth more than offsetting runoffs in holdings of securities. Our bank directors remain very positive about economic conditions.

At the national level, I believe there is still considerable momentum in most sectors of the economy. I think this momentum will extend well into the second quarter of this year, at least. We are perhaps beginning to see some moderation, but it is a moderation from a very high growth rate and it leaves overall growth well above potential. I do remain concerned about inflation prospects. I am pleased that we have not yet seen an acceleration of inflation at the consumer level. Anecdotal evidence as well as our experience over the postwar period suggest it is a matter of time. More specifically, I agree with the Board staff's assessment that rates of unemployment and capacity utilization are currently at inflationary levels. Given the lag structures, I still would expect to see a gradual increase in inflation in final goods this year.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Thank you, Mr. Chairman. A pause has developed in New York City, which has slowed the economic expansion in the Second District despite sharp recorded drops in the December unemployment rate in both New York and New Jersey. The weakness, fortunately, is largely confined to the New York metropolitan area. In the remaining two-thirds of the District, recovery appears to be intact, led by moderate gains in New Jersey and more modest growth elsewhere in New York State. In December, New York State payroll employment was stagnant following four consecutive months of decline. The comparable New Jersey figures have not been

released, but employment growth has averaged 1.6 percent at an annual rate over the past five months. Probably because of reduced earnings and bonuses in the financial industry, personal income tax collections for New York State and City fell 7 percent below a year ago in December and were up just 2 to 3 percent for the year. In contrast, personal income tax collections were up nearly 20 percent in New Jersey in September, the latest reported month, while the year-to-September gain in the state was over 9 percent. Realtors reported that the sales rate of existing homes declined from the third to the fourth quarter and the median price fell between 5 and 10 percent, depending on the location in the District. The aggregate consumer price index for New York and northeastern New Jersey rose at a rate of just 2.1 percent in December and 2.4 percent for the year. In the finance sector, people continue to be very blue. Members of the securities industry reported sharp declines in fourth-quarter earnings, ranging from 50 to 80 percent. Numerous new layoffs were announced among banks and brokerage firms, including the very strongest.

Despite all that, there does seem to be something of an improvement in attitude in New York State. Even in the area between Albany and Buffalo, traditionally a strong manufacturing area and where the unemployment rate is not that high--ranging in about the 4 to 5-1/2 percent area--the attitude that I encountered up there six or seven months ago was generally very dismal and now it is improving quite a lot. Fortunately, it is not that people think the new governor is going to wave a magic wand and fix everything. It is rather that with the likelihood of a more pro-business state government, they are getting more of a notion of helping themselves. For example, in Syracuse where I was last week, a manufacturing company could not find enough workers and was planning to leave the area. The Chamber of Commerce managed to find enough skilled workers from among its member businesses to enable the company to stay in the town. That attitude of "let's do it for ourselves" is something that I have been encouraging in speeches up there. We do seem to be making some progress in spreading the notion that if the governor can do something good, that is terrific. But if business can help itself, that is even more so.

On the national level, we too have a general difference with the Greenbook in that under the current policy assumption, we have real GDP somewhat stronger, almost 1/2 percentage point higher. Unfortunately, we also have the CPI at 3.3 percent Q4-to-Q4. We have a very low unemployment rate at 5.1 or 5.2 percent. We have done some "what ifs." Even if the optimists are right and the NAIRU is 5-1/2 percent instead of 6 percent, it would appear that we have a rate of economic growth in the system that is going to create more inflation anyway. It is only if we have very low employment growth and relatively slow additions to the work force that in our forecast we would get up to the 5-1/2 percent unemployment rate. So, we do have considerable concerns about the likelihood of inflation picking up, and in fact our economic forecast under current policy assumptions shows a pickup.

I also applaud the new approach in the Greenbook. I think it has, among other things, helped us to talk about the economy and not talk about policy in this part of the meeting.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. There is not much I could say about the Fourth District to add to what we put in the Beigebook or especially to what Mike Moskow said about what is going on in the Seventh District. In most respects, developments in our two Districts are very similar.

We pay a lot of attention to manufacturing, both because it has been so strong in the Fourth District and because of its absolute share or relative size. Manufacturing employment in Ohio, for instance, is twice the national average and is very heavily concentrated in motor vehicle production and related capital goods. So, we pay a lot of attention to it. Our average workweek last year was about 2 hours longer than for the country as a whole. Our unemployment rate is much lower. The rate in Ohio as a whole is over a full percentage point lower; and in certain metropolitan areas in Kentucky and within Ohio and western Pennsylvania, unemployment rates are much lower than that. Nevertheless, we are not seeing an effect on manufacturing wages, which rose only 1.1 percent last year, less than the national average. We are not hearing stories from people in the industrial sector about wage pressures. We are hearing that they are planning to spend a lot more for a third year on expanding capacity or improving productivity. A lot of them have plans to reduce their current work force through productivity-enhancing investments. We have very recently heard some negative reports out of Cincinnati. The phone company there has announced a very large layoff and Federated moved an operation down to Bob Forrestal's District; so we will experience a loss of about 1,500 jobs in Cincinnati.

When I turn to the national economy, I do not know what to say about the Greenbook. I like having the alternative in there. It seems useful to have the staff draw up for us what they think an unchanged fed funds rate would imply and then an alternative. But the baseline for this Committee always ought to be to derive the policy that achieves our objectives. Unless the Committee has changed its objectives, the baseline should be producing a downward trend in inflation in the future, moving us toward price stability; an alternative forecast could be drawn from that. So, I would have flipped around the baseline and the alternative that the Committee would discuss. In trying to assess what I think about the two alternatives as they are presented, I have problems with such things as the assumptions about the fiscal policy. It has always mystified me why shrinking the federal government by having it spend less, borrow less, and maybe even tax less has a negative effect on the economy. I don't know what to make of the fiscal policy assumption. I do not find the inflation outlook satisfactory even under the alternative forecast. Either the model is wrong as to what it would take to get there or the objective should be viewed as unsatisfactory.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. The Eleventh District remains strong except for the border areas. The most optimistic word comes from Lubbock where we heard at our last board meeting that the biggest tightwad in west Texas had just bought a new pickup truck. [Laughter] Of course, the mood is just the opposite of that on the border in Brownsville, El Paso, Laredo, and McAllen--places like that. They were already weak because Mexico had been imposing a \$50 limit on what people coming

across the bridges could buy and take back into Mexico. Mexico has been doing that for more than a year, but this peso devaluation comes on top of it. A lot of merchants in those towns are being devastated right now. Also, one measure of U.S./Mexican trade is the length of the backup on both sides of the bridge in Laredo on I-35. That backup is not nearly as long as it was before the devaluation. The effect is not just on the border. All of Texas is going to be hit somewhat because Mexico is our number one foreign trading partner, and the share of our trade is much higher than it is for the country as a whole. But abstracting from that, the District economy is, overall, still very strong.

On the national economy, the only straw in the wind that I can offer is some anecdotal evidence that retail sales, while weak in December, have picked up in January. J.C. Penney indicates that their national sales in January were far ahead of expectations. Their weakest areas in January were California and Texas--California because of the rains, presumably, and Texas because of the peso.

My economists do not want me to say anything about the weak growth in the aggregates because they believe that it is well explained. But after many years of paying attention to them, it is hard not to be a little concerned that they seem so uniformly weak. But I won't bring that up. [Laughter]

CHAIRMAN GREENSPAN. Especially since they have recently gone up!

MR. MCTEER. The main other thought I want to convey is that I agree with Bob Forrestal in that I think the most crucial question for us now is what we should be watching to know when it is time to stop tightening monetary policy. How do we deal with the lag when policy is moving to restrain the growth of the economy?

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Thank you, Mr. Chairman. I want to join what sounds like virtually universal praise for the new approach in the Greenbook. I thought it was very, very helpful to have it stated this way.

I also want to agree with what Bob Forrestal and Bob McTeer were saying about the tendency to go too far. There are some caution signs out there. Even those rabid inflationists, the Shadow Open Market Committee, have suggested that we might want to consider saying, "enough is enough."

I am not sure exactly what a soft landing is all about, but I would like to pose a thought as to what it is. We tend to approach policy by looking at a way of restricting flows sufficiently to get the economic expansion down to a sustainable growth path. In practice, most major recessions including the 1991, 1982, 1980, and 1974 recessions involved wealth destruction. That was the main cause of the slowdown in the economy. I am toying with the notion of defining a soft landing as one where the slowdown is accomplished without wealth destruction. I hope we keep that in our minds when we think about how far we are going to go in raising interest rates. The Greenbook is about right in saying that we are going to have a

slowdown, but I think it is going to occur a little later than the Greenbook is indicating.

I am very concerned about the situation in the consumer sector where I think we are going to be seeing a cut in flows anyway. The consumer is simply overextended. Of the roughly \$250 billion increase in personal consumption expenditures from the fourth quarter of 1993 to the fourth quarter of 1994, 44 percent was put on installment credit, meaning credit cards or auto loans. People just can't finance 44 percent of their increased spending through higher debt and do that for very long. Mortgage data are a similar concern. If you look at increased mortgage payments over gross investment in housing in 1993, the ratio was 77 percent. The 80 percent figure is pretty standard for a first-time home buyer. If you figure that existing homeowners also are going to be taking out mortgages, however, that will take appreciation out of existing homes. If that calculation is made, increased mortgages exceeded net investment in housing by \$55 billion, meaning aside from our capital gains, people were taking money out of the housing sector as well as financing 44 percent of their increased spending on installment credit. That is just not going to go on for much longer. The question is: When is it going to stop?

I think the Greenbook has the fiscal policy slowdown just about right, but the fact is we just do not know, and we are going to have to see. Again, I think the risks as in the consumer sector are probably on the down side and not on the up side. The risks come because our Congress is not a smoothly functioning machine. The biggest cog that I can see, and it is a whopper, is the debt ceiling bill. Assuming Congress can pass a budget resolution in April, which is probable, the debt ceiling traditionally has been something on which every congressman can hang a bauble and try to get it through because the legislation has to pass or else the government shuts down. Since we have that coming up, I think that the risks in fiscal policy are big and their financial ramifications are also large.

Similarly, I think the risks in the net export sector are all on the down side. If one thinks about the uncertainties: When is Deng going to die in China, or is he already dead, and what will that mean? Russia seems to be in chaos; the Middle East seems bankrupt; Latin America will speak for itself. All of these problems suggest that we have a lot of downside risks to the economy.

There is a major upside risk that has not been mentioned and that I think will tend to delay the timing of the slowdown. That is the cut in FDIC premiums, down to 4 basis points, that was announced yesterday by the FDIC. That cut is in effect going to be pumping \$5 billion more into the capital of the banking sector. That \$5 billion would have been very, very valuable back in 1991 when bank capital was constrained. At present, given that banks are not capital-constrained but will want to put that capital to use, I look forward to such things as getting two credit card solicitations a day instead of the current one, and similar frivolous uses of bank credit. All of this, I think, is going to postpone the inevitable slowdown.

I am in agreement with the Greenbook that we are going to have a slowdown. It will be flow-based. But I think it is going to occur later than in the Greenbook projection. That raises the



question of whether we have gone too far, and I think it is a fair question. We also have to balance it with what I think is a very risky international situation. There I come back to being a two-handed economist, and I am not going to bore you with both hands. Instead, I am going to wait to hear what you are going to tell us, Mr. Chairman. [Laughter]

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, as a dedicated cynic when it comes to evaluating the good intentions of Congress, I am more than moderately skeptical about a balanced budget program. I have grave doubts about the wisdom of a balanced budget amendment. I do not expect the states to ratify the amendment even if it passes the Congress because of the realization that expense cuts at the federal level will undoubtedly shift costs to the states. For those reasons, I am unable to embrace the baseline forecast even though I expect some slowdown as a result of earlier policy moves.

Consumer confidence remains high. In spite of the additional debt load that Larry has referred to, credit lines have been increased automatically by many purveyors of revolving credit. That is a great temptation for consumers to continue to run up their debts. Eventually the debt load will catch up, but I think the easier credit standards will build in some more lead time. I am convinced also that we may still underestimate the export sector of the economy, even ex-Mexico. High capacity utilization creates conditions that I think are even more favorable for making price increases stick. I believe that upcoming labor negotiations may well result in a greater focus on basic wages rather than benefits and work rules. The stage now seems to me to be set for further upward pressure on inflation. The rest of my speech I have had to delete because of the prohibition against mentioning policy. [Laughter]

CHAIRMAN GREENSPAN. We have a real blackout this time!  
Governor Kelley.

MR. KELLEY. Mr. Chairman, looking at the possible courses for the economy, one end of the spectrum would be that the expansion is slowing now, or it soon will be slowing, and that the slowdown will be adequate. A real doomsayer would say that the economy already is locked into an excessive downturn. At the other end of the spectrum, one could make a case that the expansion is roaring along unimpeded at 4 percent plus and we are soon going to be into a true boom/bust cycle. We very seldom in this life get the extremes one way or the other.

There is, of course, a big broad gray area. It might be described as a bit of a slowdown now, or soon, but one that may not be enough to accomplish our policy objectives, and, looking ahead, the expansion is very likely to reaccelerate. Along that broad spectrum, history tells us that inflation will appear under those conditions. When will it occur and how strong will it be when it does? Are we getting that slowdown? Well, my guess is that we probably are to some degree. I won't take the Committee's time to go through all the different components; you all know what they are. We probably will get a little slowing, led maybe by autos and housing, less inventory accumulation, the Canadian and Mexican situations, and of course a

good bit of monetary policy tightening earlier that is still going to hit. But that slowdown may not turn out to be very deep, and it may not continue if policy were to remain unchanged.

We still have booming consumer confidence. As the Committee knows, I have been very concerned about the consumer for a long time. I thought consumers would get conservative a long time ago. They have not yet, and I am about ready to capitulate in the short run. I do not see that happening any time soon, given where we are with new job formations and so forth. Business investment will continue to be strong. We have a weak dollar and the foreign economies are beginning to come back, other than the two immediately adjacent to us. I have a hard time seeing real interest rates as being what one would call high. It seems to me that they are more on the high side of neutral at this point.

All in all, it seems to me that the risks are still tilted to the up side. What we are most liable to get in my view is a little slowing that is not adequate to realize our policy objectives and an expansion that is likely to reaccelerate later. Following Governor LaWare's lead of eschewing any comment on policy, I will stop right there.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Thank you. I think that the impressive national growth that we have been talking about around the table today is showing a few tentative signs of abating. I would cite spending that is off its highs. We talked about the inventory buildup in the fourth quarter and a flattened yield curve--inverted or humped at times. But even if growth does abate, I do not think it is likely to do so by much, at least not very soon. Business investment is continuing. Fourth-quarter profits are strong enough to finance continued investment. The returns on investments are still greater than the cost of capital. Business has a continued commitment to improve productivity in a competitive economic environment. Just as we are seeing some slowdown reported in the housing area, commercial construction is now recovering and helping to take up some of that slack from housing. But even housing is stronger than might have been expected. With employment at fairly lofty levels, it is likely we will continue to see consumer spending maintained, albeit possibly at a reduced but still quite respectable pace. The banking system is quite strong and can certainly support expansion. While the financial markets generally have moved sideways in 1994 and thus are not as supportive of direct financing, I think we are past at least some of the uncertainties in financial markets, and that is likely to be less of a risk. The uncertainties I am referring to are Orange County and Bankers Trust. Mexico certainly is still a factor, but so far that appears to be contained or focused on the foreign exchange markets. If Congress actually continues to concentrate on deficit reduction, that too should provide support for the markets. In my view all of these factors provide an environment for the continued momentum that we saw coming out of 1994.

It seems to me that there may be a different way of stating whether or not we are at the cyclical turning point. Since the economy is operating at or above capacity, we have to ask ourselves why we are not seeing increases in producer or CPI prices. How long

can the economy actually operate above capacity without price increases? There are a lot of explanations for why it seemingly is operating above capacity. Maybe we do not have the correct capacity measures. The 85 percent capacity that everybody cites may no longer be applicable in view of the re-engineering and the improved computer and information systems. In any case, firms are adding to capacity. There has been some discussion today about whether we have the NAIRU right at 6 percent or whether it is plus or minus 1/2 percentage point from that level, and whether or not the unemployment rate at 5.4 percent actually implies that workers are more willing to move. I think that there is some evidence to support the notion that there is more flexibility in the labor market than a 5.4 percent unemployment rate might imply. One can look at the number of involuntary part-time workers and the seemingly higher losses in permanent jobs. The ECI has shown little wage pressure, implying that people are concerned about their jobs. The discontent of the American electorate certainly is being well argued at the other end of Pennsylvania Avenue. Over the longer term, average real wages have fallen. There is continued uncertainty about downsizing. I do not think that any of these explanations is particularly satisfying, and all of us could mount a pretty good argument against any one of them. But we clearly seem to be at a stage of testing the confidence distributions around the estimates of capacity, both the NAIRU and the production capacity level of 85 percent. And while we are in the range of testing these capacity levels, we clearly are in the inflation danger zone.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. Thank you, Mr. Chairman. If you will pardon the metaphor, I would like to see your praise of the change in the Greenbook and raise it. I thought the change in the nature of this Greenbook raised its usefulness for thinking about policy from next to zero to a quite considerable level, which is more than a small increment. Not only that, but when I read the details, it changed my outlook somewhat and I want to talk about that.

I prepared my Humphrey-Hawkins projection, like all of you, before I had the Greenbook and before I had the staff do some further work that flowed from the Greenbook. I will talk about that in a moment. I winged it, just like most of us do; and I wrote down 2-1/2 percent as my growth forecast for 1995, which I now see puts me squarely in the middle of the members' projections. The Greenbook is at 2.2 percent for 1995, which sounds like splitting hairs, but that assumes no further increase in interest rates, which was not my guesstimate of what the FOMC would do. Therefore, I dutifully followed the instructions and embodied further rate increases in the forecast. So, the difference is a bit more than a split of a hair.

I must say that when I went over the details in the Greenbook line by line--consumer durables, producer durables, the government sector, the works--I found it difficult to find a piece of the GDP that I thought would grow faster than the Greenbook forecast. I found it extremely difficult to make an argument to convince myself that things look better than the Greenbook indicates on lines 1, 2, 3, 4. That then led me to the question of how I could make these numbers add up to growth of 2-1/2 percent. I think the reason that I was higher has to do with my belief in a forward momentum to the economy, which several people also mentioned, and I am sure that it colored my view.

Belief in momentum gets things right most of the time, which is why we believe in it. But it always misses at turns; it always underestimates turns. All of us fall victim to that, including me. I know that if I were doing my Humphrey-Hawkins projections again today with the benefit of the Greenbook, I would come in lower than I did about a week ago.

Choosing between the two scenarios in the Greenbook in terms of preferences I find an easy call--I will come back to that when we talk about policy--in that I would prefer the baseline scenario. Let me say what I mean. If I believed the Greenbook religiously, given the two choices, I would like the baseline outcome a lot better than the alternative, which I would characterize as following the financial markets. But let me leave that for later.

The difference between the two scenarios quantitatively, sticking to positive economics, is the staff estimate of the decrement to GDP growth from tighter money: some .3 percent in 1995 and 1.1 percent in 1996. I had various staff members produce seven other estimates of that same parameter--that totals eight. Mike knows all this; this is not behind his back. Those other seven estimates were clustered tightly around the 1995 number, averaging a decrement of .4 instead of .3 percent. For 1996, while the estimates were, of course, more spread out, the average was extremely close to the 1.1 percentage point difference that you see in the Greenbook. These are estimates from vector auto regressions and from other large macroeconomic models. That gave me a lot more confidence about the difference that policy would make than I had 10 minutes after opening the Greenbook. It convinced me that that was about the best estimate we could make of the decrement in GDP growth from tighter money. The best estimate that we can make is quite different from saying that it is the truth, of course.

The key question in front of us now--that almost everybody around the table has spoken to in their turn--is how much of a slowdown we can expect without further tightening, or indeed with further tightening. I think there is a strong consensus, which I share, that given our dual objectives we need a slowdown from the 4.0 percent growth rate in 1994 to something no bigger than 2-1/2 percent and quite arguably, but I would say correctly so, less than 2-1/2 percent. The question for me is whether that is in the cards and, if so, where it is coming from. I think it is coming from three places and I want to go over that.

First, it is coming from the swing in inventories. I find the Greenbook forecast for inventories very reasonable, leaving aside the timing; nobody has a clue about the timing, including Mike and me. Over the next four quarters, comparing the fourth quarter of 1994 to the projection for the fourth quarter of 1995, the Greenbook forecast has a swing in inventories that by itself will clip 1-1/2 points off the GDP growth rate, that is, comparing 1995 to 1994.

Secondly, we have monetary policy, as you might have guessed. I asked the staff to answer the following question for me, and I got eleven different answers. These eleven stem from using different techniques to answer the same question. This is the question: Imagine that, instead of easing monetary policy in 1991 and 1992 and then holding the federal funds rate low in 1993 and tightening policy

in the last year, the Open Market Committee had simply locked into a constant real federal funds rate. It simply would not have gone down and then come up. One could call that, although I guess we don't use that term anymore, a "neutral" monetary policy. The reason I got eleven different estimates is that neutrality can be defined at different levels; it is not obvious where one puts neutral. Also, there are different estimating techniques having to do with different macro models and vector auto regressions. So I got eleven different estimates. If you compute the effect of that difference in policy on growth in 1994 and growth in 1995, you can then subtract one from the other and get an answer to the following question: What is the difference in the monetary impulse, positive or negative, hitting the economy in 1995 versus 1994? As I said, I have eleven different estimates of this number. It won't surprise you that they differ quite dramatically. The highest number, which comes from the staff's large econometric model, is a subtraction from growth of 2-1/2 percentage points comparing 1995 to 1994. The lowest number came from the Meyer model, which is only 1/2 percentage point lower. These numbers were clustered so that, if I did what was done to produce the Humphrey-Hawkins table and threw out the outliers and looked at the central tendency, the estimates of the decrement to growth coming from monetary policy would be concentrated in the 1 to 1-1/2 percent range. I conclude from that that using a number like a 1 percent subtraction is a quite conservative, though not quite minimalist, estimate of the decrement to growth from all the monetary policy of recent years.

The third factor that I add to this list of negatives is Mexico; much in the way that Peter Hooper earlier discussed, that gives us a number in the range of 1/4 point. So, I add them all up: 1-1/2 percentage points from inventories, 1 point from monetary policy at the minimum, 1/4 point from Mexico. And that gives me, say, 2 percent and not 3 percent, because it is not correct to add them all up; there has to be some double-counting in there. So, it gives me a mental number in the ballpark of 2 percent, plus or minus, with plenty of error I want to emphasize, around that. Since we are starting at 4 percent, if we subtract something like 2 percent, that leads me to the conclusion that there is a very good chance that GDP growth in 1995 will come in below 2-1/2 percent and a reasonable chance that it will come in below 2 percent. I want to remind you that that is based on the Greenbook baseline of no further tightening, which was not my personal forecast. You might say that that is a very pessimistic attitude. Now, I come back to where I started. The outlook is tempered somewhat by the realization that the surprises to GDP growth that we have had in the last few quarters have been coming in positive. In my estimation, one ought not to ignore that, so I mentally tend to bump up that more pessimistic outlook. It leads me to the conclusion that the risks are about balanced around a forecast very much like the Greenbook forecast for 1995. They had the number at 2.2 percent. I wrote in my notes here between 2 and 2-1/2 percent for 1995 with quite symmetric risks around that. As I said, if I were redoing my Humphrey-Hawkins projection now, that is what I would put down.

CHAIRMAN GREENSPAN. You can still change it.

MR. BLINDER. I can?

MR. KELLEY. Yes.

MR. BLINDER. Okay, mark me down; thank you. I did not know that. I thought I was bound when I put it down. It actually got typed, so I thought that once it was typed, that was the end.

MR. LINDSEY. When is the deadline?

MR. PRELL. We were going to propose next Monday.

MR. BLINDER. Okay, mark me down. Thank you, Mr. Chairman. On inflation, if we have overshot the natural rate, as seems likely to me, we should get a slow upcreep in inflation, as in the Greenbook, and continuing out in further years, as in the Bluebook. The analysis in those two documents seemed pretty much on target to me. Apropos of yesterday's discussion, however, this will leave the cyclical peak of these forecasts for inflation well below what it reached in 1990, and I think that is the right measure of progress on inflation. I do not accept the proposition, though I have heard it from a few people around the table today, that the measure of our success is to keep inflation going down every single year without any exception. When I put all of that together, the outlook for growth and the outlook for inflation look pretty satisfactory to me. Thank you.

CHAIRMAN GREENSPAN. Governor Yellen.

MS. YELLEN. Governor Kelley mentioned that it is possible to spin out two rather different scenarios concerning the economic forecast at this point, and I agree with him. In one scenario, no significant slowdown is in sight and the inflation outlook is pretty worrisome. In the second, we do have a slowdown in progress. We have already seen the first signs of that and it could be larger than the Greenbook anticipates. Frankly, at the moment I am losing about the same amount of sleep worrying about each of these possibilities. I think the baseline Greenbook forecast resolves the various uncertainties in an extremely sensible way to come up with a point forecast. It is giving reasonable weight to the new data that point to a slowdown, but it also is maintaining some skepticism about its magnitude. I want to convey my compliments to the chef on the forecast and I want to add my thanks for having changed the presentation for which I am very grateful; it also helps me think about policy.

What I conclude, though, is that the risk in the forecast has increased a lot. My level of uncertainty about where things are headed is higher than at any previous time over the last six months. Now, it seems to me as I read the newspapers that the press is almost uncritically accepting the slowdown scenario, producing new anecdotes in support of that view almost every day. I think there are signs that the economy is slowing down. Governor Blinder has explained why we should be expecting to see a slowdown, based on the idea that we still have restraint in the pipeline, and it should be making a big difference between 1995 and 1994 as he explained. I am not going to review that reasoning, but I want to comment about some of the evidence.

We had a surprising and unanticipated slowdown in retail sales in November and December, resulting in consumption expenditures in the fourth quarter that were lower than the Greenbook anticipated and inventory accumulation that was higher. Governor Lindsey has been

pointing to the massive buildup in consumer debt, which arguably will soon lead to some significant retrenchment. I think we could end up with a larger inventory cycle than is anticipated in the Greenbook. Reinforcing the possibility of a slowdown, we have a decline in durable goods orders, once defense orders are excluded. It looks to me as though those numbers are somewhat consistent with capital spending growth at least cooling off. All the anecdotal evidence from the reports about home building suggests that we have an industry that is on the verge of decline. We had a Dodge report yesterday pointing to a significant slide in construction spending. We now see automobile companies offering rebates on popular models, lowering production plans, and shutting down assembly lines for some periods. Dealer orders for inventories appear to have declined, maybe because the cost of carrying them is higher now, but maybe also because traffic through showrooms has declined. On the international front, as Governor Blinder pointed out, we have risks of declines in our exports to two of our most important trading partners, Mexico and Canada, with the possibility that if the Mexican crisis harms other emerging markets, our exports can suffer there too. We now have passage of a balanced budget amendment in the House and talk of fiscal restraint, and I certainly do not know where that is headed. I do not disagree in any way with what the Greenbook has done to produce a point forecast, but I see some downside risk there, too.

I couple those negative demand side factors with the fact that inflation has been well contained--running lower in the fourth quarter than I think anyone expected, with the ECI numbers suggesting no significant evidence of wage pressures even in very tight labor markets including the Midwest. Now, I agree with the assessment of Phillips curve models. I do not think there is significant reason to change our estimate of the NAIRU at this stage. A couple of numbers seem to be off, but they are within the range of forecast errors, so I am not yet buying into the idea that the NAIRU is lower than 6 percent. But that possibility is alive in my mind; I do not have a closed mind to it, and I don't think any of us should. I consider that a live possibility but not one I am yet ready personally to endorse.

Then I come back to the issue that Bob Forrestal mentioned, and I think it is important especially given the lags in policy. I do not want to cross the barrier into policy, but we can ask just how high rates are at this point. Are they high or low by historical standards? I come out with an assessment that they are not low by historical standards. The real fed funds rate is not low even given where we are in the business cycle. A couple of years ago, John Taylor, a Stanford professor who was a member of the Council of Economic Advisers, devised a very simple monetary policy rule that I look at to provide a rough sense of whether or not the funds rate is at a reasonable level. One property of this so-called Taylor rule is that it is quite sensible in the sense that it takes his forward-looking econometric model and looks for rules that perform well. As I mentioned yesterday, the Taylor rule is a hybrid rule; it is a policy rule based on the output gap and on deviations of an inflation target from 2 percent. It performs well, but maybe even more importantly it provides an incredibly close approximation of the Fed's reaction function since 1986 with the sole exception that the Fed eased more in 1992 and 1993 and then tightened more since early February 1994 than the rule would have called for. With the inflation and output gaps at

present levels, this rule right now would be forecasting a funds rate of 5.1 percent. Other sensible rules, including nominal GDP targeting rules that we mentioned yesterday, would also be looking for a fed funds rate at this point in the 5 to 5.6 percent range, so we are not so far from target.

Having said all of that, it seems to me that one also could discount most of what I just said about the slowdown. We are all looking for evidence of a slowdown, and I am worried that saying we are there, as Cathy said, may be wishful thinking--two retail sales numbers do not make a trend. Consumer debt is up but so is income, and the debt service burdens of households are not rising. Consumer optimism is high. Order backlogs are growing even if durable goods orders have tapered off, and the levels remain high, and that hardly presages a downturn in investment spending. Yes, inventories have risen a bit, but inventory/sales ratios are not high, and the downside risk from this source is somewhat limited. In any case, the Greenbook is anticipating a decline in inventory investment. The inventory downturn would have to be still larger to create significant downside risk. Automobile manufacturers, of course, do not want sales to fall off, but we are counting on some slackening in demand for autos. With respect to housing, it may be strong because employment and personal income have been growing. One could argue that seeing will be believing; we really have not seen anything much happen yet in spite of the anecdotes.

If I had to assign probabilities to these two different scenarios at the moment, I would put a .7 on the strong scenario and a .3 on the weak one that I started with, coming out exactly where the Greenbook does on balance. But the conclusion I want to leave you with is that my level of uncertainty has increased enormously, and I think the potential forecast error at this point is extremely high. My policy conclusions follow from the idea that the risk at this point is extremely high.

CHAIRMAN GREENSPAN. Thank you. Shall we break for coffee? Is coffee there?

MR. BERNARD. Yes.

[Coffee break]

CHAIRMAN GREENSPAN. Anyone who wishes to revise his or her projections for the Humphrey-Hawkins report can contact Mike Prell through Monday. Close of business Monday, is that correct?

MR. PRELL. Sure.

CHAIRMAN GREENSPAN. Let's move to the longer-run ranges for the aggregates. I call on Don Kohn.

MR. KOHN. Thank you, Mr. Chairman. First, I want to point out that the Secretariat is distributing or will distribute a memo sent to me from David Small that contains some of the information that Governor Yellen talked about this morning, including Taylor's rule. It is for your information and gives everybody access to what she was looking at; she indicated that a number of people had asked her about this material. Secondly, for the sake of expediting matters a little,



I will spare you some of the pearls of wisdom that I was going to talk about in terms of long-run scenarios. They will probably still be good in July; I have saved them on my word processor. [Laughter] I did want to say a few words about the fiscal policy situation--we have one scenario on that--before getting into the long-term ranges. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Don? If not, let me just say what I think may be the consensus of the group that is implied in Don's recommendation. I think we successfully brought the ranges down to where they are finally consistent with price stability in the context of a restoration of the old relatively stable M2 velocities and somewhat similar M3 velocity relationships. To tamper with that at this stage with no particular purpose would give signals that I do not think we really have any intention of giving. While there is a technical question with respect to the possibility of M3 running above the upper end of the range and hence the possibility of going to alternative I-A, I think Don's suggestion is basically a sensible one. We can certainly make that adjustment in July if such M3 growth appears to be probable for this year. But having perhaps achieved price stability nirvana in terms of our target ranges, we have to have good reasons to change them. Does anyone else want to speak on this issue? Let me just ask in general, is there any dissent to the views that I have just expressed? If not--

MR. LINDSEY. We all care passionately!

MR. BLINDER. Is there a vote for "who cares"?

CHAIRMAN GREENSPAN. Do we need an official vote?

MR. BERNARD. Yes.

CHAIRMAN GREENSPAN. Why don't I just move Alternative I and ask the secretary to call the roll.

MR. BERNARD.	
Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
President Hoenig	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President Melzer	Yes
President Minehan	Yes
President Moskow	Yes
Governor Phillips	Yes
Governor Yellen	Yes

MR. BLINDER. You skipped me, but I will vote "yes" anyway. I lost my vote!

MS. PHILLIPS. He took your "who cares" seriously!

CHAIRMAN GREENSPAN. That's right. Maybe it is recorded.

MR. BLINDER. I may have been recorded as "who cares."

CHAIRMAN GREENSPAN. Let's now move to the current monetary policy and the directive. I will again call on Don.

MR. KOHN. I will be even briefer, Mr. Chairman. [Statement --see Appendix.]

CHAIRMAN GREENSPAN. Questions for Don? Yes, Jerry.

MR. JORDAN. Don, one of the alternatives you gave us in the top panel of Chart 4 of the Bluebook assumes the NAIRU is 5-1/2 percent. If I understand this, the line labeled "Tighter" is not tighter compared to where we are. It seems to me to be based on maintaining the fed funds rate where it is. The bottom two panels tell me what your assumption would imply for the CPI and the rate of unemployment.

MR. KOHN. I agree that that chart is not well labeled. The long-dash line is the tighter alternative from the two previous charts. The short-dash line answers the question: What would the funds rate have to be with a lower NAIRU to get the same inflation outcome as from the tighter alternative? It is not well labeled.

MR. JORDAN. Mike's response to me earlier was that if we knew the "true" NAIRU was 6 percent, that really means we can say with reasonable confidence that it is someplace between 5-1/2 and 6-1/2 percent. This tells me that if we knew it truly was 5-1/2 percent, then we are really saying it is someplace between 5 and 6 percent.

MR. KOHN. A reasonable supposition.

MR. JORDAN. I do not have a clue where it is, but I am just trying to understand what these charts say.

CHAIRMAN GREENSPAN. Further questions for Don? If not, I will start off as usual on the policy side. Coming out of the fourth quarter, if we had seen no signs of slowing or of kinks in the unbelievable set of one-sided data, I think we would be in serious trouble at this stage. Fortunately, there are now tentative signs, not necessarily persuasive but definitely beginning to appear, of slight cracks along the road. It is crucial that those cracks continue to develop or we will have a serious problem ahead.

I would view the economic outlook at this stage as largely a balancing of forces, with capital goods markets, inventories, and the so-called interest sensitive sectors--housing, motor vehicles, and so forth--being the crucial elements in the outlook. In the capital goods markets, the data are uniformly very strong. That is, the backlogs are continuing to rise as Governor Yellen mentioned. We are beginning to see backlogs in the equipment area where, even though actual orders are flattening out, they are still very significantly above the level of shipments and hence the forward commitments continue to stretch out. In the nonresidential building area, starts and permits clearly are turning up quite significantly. They are erratic but, smoothing through these data, it is very obvious that there has been a rather marked pickup in nonresidential building. One sees it also in evidence that prices of commercial real estate finally are coming off their market lows.

As far as capital goods in general are concerned, the cost of capital continues to be quite low, and this is consistent with fairly strong forward commitments. The profit figures remain quite extraordinary. Preliminary estimates for the fourth quarter being tabulated by Business Week and others show very strong year-over-year profit figures. And as was noted in Part II of the Greenbook, private analysts' surprises on the up side are twice as large as those on the down side. This is the type of environment for the capital goods markets that essentially says there is a long way to go before this economy tilts down, provided the financial system does not intervene and upend it in the type of context that Governor Lindsey was raising, namely, one where we get significant wealth destruction that immediately causes the whole system to readjust. One can say that while the stock market is not low, it clearly is not anywhere close to being as elevated as it was a year or so ago in relative terms. We have taken a lot of the bubble out of the market. Indeed, I would think one of the successes of our policy to date is that we have taken the degrees of instability that one can envisage in stock prices down to a much reduced level of concern. What that does is to feed back into the longer-term outlook for capital goods, which is very difficult to undermine in any meaningful way. Certainly, business confidence indexes look strong; all of them are on the upper side of the ranges in which they have fluctuated. The quality spreads within the financial markets also attest to the fact that the forward risk premiums implicit in capital investment are quite modest.

It is very difficult to find roots of a recession in business cycle annals where the capital goods markets did not join in. So, unless we are ready to argue that something is going to break in those markets, it is very difficult to draw the scenario of a recession coming any time soon. And with profit margins not yet turning down, the lead times that usually are associated with this type of market really remain quite extended into the future before any credible downturn can be presumed. I leave out of this the usual changes that will probably occur in the motor vehicles area. Class 8 trucks, the very heavy duty trucks, in general have been going flat out for so long that there is only one way they can go: One of these days they are going to tilt down and that is going to happen sometime this year I am pretty sure.

On the inventory side, we are looking at a very interesting set of data. There is no question, as a number of you have indicated, that the rate of accumulation is essentially unsustainable. The reason basically is that the accumulation is a much larger ratio to the stock of inventories than is typically the case, and one must assume that it will slow down. I leave the inventory/sales ratios out of that for reasons I will get to. The problem, however, in making the case for a very major contraction and an immediate impact on GDP is that a substantial part of the rise in inventories has reflected imported goods. The normal average proportion of inventory change accounted for by imports has been about 17 percent, say 15 to 20 percent. During the last three quarters the share of the total change in inventories coming from imports has been approximately 30 percent. So, if we are forecasting lower inventory demand, roughly a third of that can be presumed to involve imports that do not impact dollar-for-dollar on GDP. I do not think there is any question that inventory accumulation is going to slow, but I do not see any evidence to suggest that the slowdown started in January because C&I loans, which

have been a reasonably good estimator of book value changes, if anything look stronger since the end of the year. And there is no anecdotal evidence to suggest that inventories are backing up and that these loans are financing unintended accumulations. So, while there is the presumption that liquidation or slow growth in inventories is about to occur, it is still a forecast and it does not show up in any of the data with which we tend to work. More important is the fact that the level of inventories remains low. One can see this in a number of ways other than the obvious inventory/sales ratios. One way is to take the domestically produced inventories, leaving out the estimated imported inventories, as a ratio to domestic sales. That ratio is quite low and is actually still going down. These are the inventories that have a direct impact on domestic production and employment.

Secondly, and this is not an independent observation, the ratio of inventories to output, after trade markups are subtracted, is still very low and does not show any uptilt at all. We have discussed this previously: If you are looking for inventory overhang, the question is not the constant-dollar total value of inventories that is required for estimating the national income, but how many units of inventory are out there. It doesn't matter so far as domestic shoe production is concerned--to whatever extent we still manufacture shoes--whether the shoes in inventory are at the retail level or at the factory shipping point. At the retail level they are a much larger dollar figure in the inventory figures, but that markup does not matter. There is very little evidence at this stage that we have accumulated levels of inventory that have to be readjusted. I think that is going to occur at some point and it may very well be the trigger of the next downturn, but it is not here, at least not yet. What we see, as we would ordinarily expect, is that the lead times on deliveries of materials are still quite long. There is pressure on facilities as a consequence of that, and we are also seeing various types of shortages, all of which underscore the fact that inventories are low and that there is very little unintended inventory accumulation in the pipeline. I might say, however, that it is possible from a statistical point of view to get a very sharp reduction in the rate of inventory accumulation, and hence a significant decline in the rate of GDP growth, that does not get captured fully in the import data because there is too much noise in the data. So we may actually get a much lower GDP increase in one of the next several quarters than we currently expect, and certainly less than is projected in the Greenbook, but it may be more a statistical discrepancy question than any real economic phenomenon.

In the interest-sensitive areas, where housing starts are the biggest item, single-family starts are probably being held up by smoke and mirrors. The current level is hard to believe even with all the arguments with respect to income and the like. I think it is almost inevitably going to come down and will be the biggest item, I would say, in an aggregative sense that we will have in holding down the growth rate in final demand. Sales of existing homes also will be falling significantly. That in turn will tend to reduce the capital gains realized on the sale of homes and will contract spending in the retail areas because a substantial amount of the realized capital gains, which are essentially financed by increases in mortgage debt, goes into consumer markets. Part of Larry Lindsey's concern is that the household debt numbers are already quite large and hence a sort of

double-whammy effect will probably soften retail sales to some extent. I should say, however, that while it is mixed there is evidence that motor vehicle sales were down in January; I gather that we have to be very careful about the official January figures because there is a new method for reporting when the cutoff for monthly sales occurs. From what we can gather from the Johnson Redbook and the Mitsubishi general merchandise surveys, January soft good sales are actually quite strong. So, it is not by any means clear that the retail sales markets have carried forward their deterioration from the fourth quarter. I do think, however, that we should not expect--in fact we should not hope for--strong retail sales in the next couple of months because if we do get that, then the notion that the expansion is slowing becomes very seriously in doubt.

The other data that we have for the January period are all consistent with the view that the economy has not shown very much in the way of a slowdown. There is some evidence. I think motor vehicles and housing starts probably are the major areas where the slowdown will occur. But initial claims are still quite low. Insured unemployment looks to be quite low, really at the bottom of recent ranges. Certainly, when one looks at the credit data, it is very difficult to find any evidence that monetary tightening is constraining debt flows. Consumer credit restraint seemingly is going out of style. If Larry Lindsey is right, there will be more credit cards--did you say two offers per day are now coming in, Larry?

MR. LINDSEY. Moving up toward two per day, yes!

CHAIRMAN GREENSPAN. Thanks to Ricki! [Laughter] C&I loans are just extraordinary. Consumer loans extended by commercial banks, especially when securitization is added back in, are also remarkable. And apparently we are still getting some easing in credit terms, which seems to suggest that bankers have not been told about our monetary policy tightening! This is an unusual phenomenon this late in the business cycle. So, the presumption that monetary restraint is taking hold in any material way at this stage is not self-evident in this case. As both Janet Yellen and Cathy Minehan pointed out, when we have a policy of trying to achieve a soft landing, we have to be careful that wishful thinking does not overcome our better statistics, if I may put it that way. There is a possibility that the expansion could slow fairly quickly and if that were to happen, granted the very strong capital goods markets and especially if inventory investment fell quickly to a new adjusted level, the second half of this year could be stronger than the first. That obviously presupposes that the first half turns out to be weaker than expected. What I find very difficult to envisage is a smooth adjustment the way it is in the Greenbook. There is one very important reason. It has never happened that way. The Greenbook of necessity has to provide smooth forecasts. So, something different is going to happen this particular time. So long as capital goods markets hold and are not undercut, we probably will have reasonably solid growth; but because of the inventory situation, as Governor Blinder pointed out, we have a really good potential to bring the rate of growth down to moderate levels which for want of a better term pushes the economy toward a soft landing.

Having said all of that, an argument can be made to stay where we are at this particular time. That argument would have considerable force were it not for the fact that the markets expect a

50 basis point rise in the context of an exchange market for the dollar that has not been all that impressive. We know that to the extent we choose to go against market expectations, we create a degree of volatility; indeed, that is the purpose of going against the market. But there are times when doing so is probably unwise. And were we to hold still at this point, we would in my view be taking unnecessary and undue risks. The risk on the exchange rate side is that the dollar would undoubtedly fall. The problem is not so much a decline as how quickly and how far it would decline in the context of the way world markets have been behaving, where countries that are viewed as slightly suspicious find the foreign exchange vigilantes running at them. The United States is just barely investment grade, if I may put it that way. I don't think we have much leeway on the down side to take those risks.

So, in my judgment, raising both the funds rate and the discount rate by 50 basis points makes the most sense. I think the risks are relatively small, especially since such tightening is so heavily discounted. But we have to be a little careful. When something is so fully discounted as the 50 basis points that is presumed here, the normal assumption is that markets will not adjust. That is not true. There are a lot of people who play on both sides of this and there will almost invariably be some adjustments. Frankly, it is unclear to me where they are going to come from. I wish the bond market had not been so strong for the last two days because one possibility is that we will get a bond market selloff in line with the principle that you buy on the expectation and sell on the news. This type of rally suggests to me that if we move up 50 basis points it is not self-evident that bond markets are going to be firm because of their pattern over the last two days. What I think is reasonably certain is that if we do not move now, we will have the makings of a little nervousness in these markets, and that is something which in my view doesn't make any sense for us to foster at this point.

Let me end there and just note that having said all I said about tightening, granted how I see the economic outlook, I think we will be truly symmetric if we raise the federal funds rate to 6 percent. It is by no means evident that if this cracking that we have seen continues and mushrooms in one form or another, there will be another tightening of policy. I'm not saying that there will not be; but while we could see that we had a way to go when we moved back in November, I think the issue is much more murky at this stage. Accordingly, I would suggest thinking in terms of going to symmetry if we move 50 basis points. I have held forth a little longer than I intended. Who would like to speak next? President Melzer.

MR. MELZER. Alan, I am in full agreement with what you recommend. The only thing I would add is that I would accompany that increase in the funds rate with an increase in the discount rate.

CHAIRMAN GREENSPAN. I'm sorry, I thought I said that.

MR. MELZER. I'm sorry, I missed it. My reasons are much the same; let me just quickly tick them off. First of all, in my view we must continue to restrain the growth in the monetary aggregates to ensure that incipient inflationary pressures are contained and that progress is made toward price stability. Secondly, though the growth in the narrow aggregates has been very slow over the last year, their

behavior must be evaluated in light of the very rapid growth rates in 1991 through 1993. In addition, as the Bluebook notes, two factors are estimated to have depressed M1 growth by about 3 percentage points in 1994. Both of those I think argue for continued restraint. While an argument can always be made to wait for more information, our credibility in fixed income and foreign exchange markets is fragile in my judgment. That would be very consistent with what you said, Alan. An imminent action is widely expected. Failure to move now might result in adverse consequences for the economy, especially if subsequent information supported continued strong demand and rising prices as I think is likely. Finally, I would note that the current account deficit is rising and will approach \$200 billion in 1995 based on the Greenbook forecast. This makes it all the more important that we focus on maintaining the value of our currency by keeping inflation low. I don't think it happens very often that I can do this, but that may be a more gentle way of saying exactly what you said about maintaining investment grade, Alan.

CHAIRMAN GREENSPAN. President Minehan.

MS. MINEHAN. I also am in full agreement with your recommendation. I meet with people from a lot of the mutual fund and money management organizations prior to coming to Federal Open Market Committee meetings just to get a sense of where they think the markets are. This time they were very strongly tilted toward an expectation, as you all know, that we would move by something like 50 basis points. There would be a good deal of surprise if we did not. It is not that we necessarily want to have a policy that follows the markets, but I am in total agreement with your view that there is a volatility issue to be considered. President Forrestal hit on a key point and that is the issue of knowing when and how to stop the policy tightening process. I am a bit concerned about that. I think 50 basis points puts us on a trajectory that is roughly halfway between the baseline and the alternative scenario. It is well within what we in Boston were projecting in terms of our Humphrey-Hawkins targets. I agree that the risks would be balanced and I agree with symmetry, but I hope when we see things begin to slow down that we will be as forward-looking on the way down as we have been on the way up and sensitive to know when to stop tightening and perhaps even when to back off.

CHAIRMAN GREENSPAN. President Broadus.

MR. BROADDUS. I support your proposal fully, Mr. Chairman.

CHAIRMAN GREENSPAN. Let me just say that I agree with Cathy Minehan. I think the point she has made probably should be in the front of our minds at every meeting for the next few meetings because we made a big case of being up front on the tightening side. If we seriously believe that there is a long lead time, while we may say our broad approach should be asymmetric in the sense that we are phasing toward price stability, it still implies that we should move ahead of the curve where there is the necessity to do so. President Forrestal.

MR. FORRESTAL. I agree with your analysis and with your policy conclusion, Mr. Chairman. If one looks at the Greenbook's baseline forecast, and indeed at our Bank's baseline forecast, the result is not bad at all. It is fairly acceptable, although one could argue perhaps that the inflation rate looks a bit high. The problem

with that forecast is that we have seriously underestimated the strength of this economy for a long time, and the risk is that we will continue to do so. So, I think it is wise for us to take out an insurance policy, if I can put it that way, to make sure that we do get the deceleration that is required in this economy. I would support your funds rate recommendation and also your recommendation about symmetry.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I think there is urgency in the need to tighten policy for many of the reasons that have been mentioned here. Clearly, the analysis in the Greenbook and our analysis in San Francisco support the need to tighten policy. Therefore, I would favor a 50 basis point increase. Quite frankly, the work we do--and I think it is implicit in the Greenbook as well--suggests that additional tightening probably will be needed in the future. Consequently, I would prefer asymmetric language, but I certainly could live with symmetry.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. Mr. Chairman, you and I have discussed this at some length. As you know, I have become firmly convinced as a result of those discussions that this would be a great time to wait for a few weeks, and I want to explain why. The key question to me is implicit in what we were talking about before. If we stop here, at 5.5 percent on the funds rate, would we--by, say, the end of 1996 plus or minus--be back to a zero inflationary gap? I think we probably have overshoot and we need to get back. So that is the crucial question. It depends on three things: how fast we think the economy is likely to grow over the next two years; where we think the NAIRU is; and what we think the potential growth rate is. On the latter, I accept the staff's analysis. On the forecast, I am very close to the staff's analysis, and on the NAIRU I am pretty close also. I would shade the NAIRU a tad to the low side of their estimate, but that is not a major difference. As I weigh all those factors, plus the standard errors around them, which are substantial in many cases, the odds seem to me less than 50/50 that we will in fact eradicate the inflationary gap by the end of 1996--less than 50 percent but better than, say, 20-25 percent. So, you might ask, doesn't that mean I should advocate an increase in rates right now?

Three things tell me it would be better to wait. The first is what I would characterize as a glimmer, or a whiff, of an imminent slowdown. I want to emphasize both of those words. I don't think it is more than a whiff. I think there is a very good chance--as you do Mr. Chairman--that this is in fact a false negative; and when we have some more data, we will see if that was the case. But the other word I want to stress is that it is a whiff of an imminent slowdown; it is not a whiff of a slowdown a year from now. If in fact the whiff is accurate, it would be a mistake indeed to be still raising rates at this point. That is a minor part of the problem; I do not think that is the major possibility.

The reason I would like to wait, though I can see that that is not going to be the outcome of this meeting, is that in just two weeks we will have another employment report and inflation reports at



both the wholesale and consumer levels. Also, and most important to me at this juncture in time for exactly the reasons you said, Mr. Chairman, though not usually that important to me, is that we will have one more month of retail sales data. For me, that will convey a lot of information about whether the data for November and December were an aberration, a fluke in the data for the Christmas season, or an indication of something real going on in the economy of which we are just seeing the beginnings. That is the major factor.

Two other factors are international. One has to do with the situation in Mexico, which says to me: Why throw another match into the oil at this point? I felt that way much more firmly Monday than I do now since something has actually happened on the Mexican front. But I think it would be ludicrous to say, and nobody would, that the Mexican situation has now settled down. That is very far from the case. While it is true, as Peter said before, that 50 basis points is nothing between friends if the friends live on opposite sides of the Rio Grande, the direction is clear. It is not going to help. Similarly, if we go north of the border, we have the Canadians struggling to keep up with the Federal Reserve--and not very successfully for a while. My guess, by the way, would be that they will more than match our rate increase; but that increase certainly is going to exacerbate the problems of our northern neighbor.

If the domestic factors alone were making an overwhelming case to tighten now--that is, if I believed, for example, as Bob Parry said, that there is an urgent need to tighten now--I would just say, "I am sorry Canada; I am sorry Mexico; we work for the Americans, and that is just too bad." But I do not see the case as urgent. I see the case as rather more finely balanced. We have just experienced a good inflation surprise in the fourth quarter. Almost all the inflation surprise of 1994 came in the fourth quarter. That says to me, first of all, that things are more balanced and the inflationary risks are less than I might otherwise think. In an atmosphere like that, these international considerations push me further toward waiting. I want to emphasize that I am not talking about waiting until the next FOMC meeting necessarily. This is a case where in just two weeks, we will have a significant quantum of new data. If those data refute the hypothesis of an imminent slowdown--and I think the probability is better than 50/50 that they will--I would be fully ready to support an increase in interest rates. On the other hand if they do not, I would be pushing very strongly for us to put our pistols in our holsters for a while.

The only argument I can see for moving today, and you made it, Mr. Chairman, is that the markets are strongly expecting it. That is true; I do not dispute that. The markets are indeed expecting it. The only place I would differ is that I do not take that as an important consideration governing what we actually do. That would seem to me like being led around by the markets much too much. As you know--we started talking about this, I guess, on Friday--I have been wrestling a great deal over the question of whether this is an important enough difference to merit a dissent. I finally decided it is not. The basic outlook that you just outlined, and the sort of medium-term strategy you have in mind for the FOMC, is not very different from mine. This is a tactical difference. I do feel very strongly that it would be wiser, more prudent indeed, to wait a couple of weeks. But, first of all, you might be right and I could be wrong.

Nobody can be sure about that. Furthermore, as I said, I do think the odds are better than 50/50 that the outcome of the wait for two weeks will be just to do two weeks later what you are proposing to do today. So, I am willing to go along. I nonetheless would like to lay down the marker that I think the chances may be one out of three, or something like that, that we are now in the process of setting the thermostat too low out of impatience that the room did not cool down as fast as we wanted it to. It is going to take some considerable evidence to get me to support another interest rate increase again anytime soon. Thank you.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I support your proposals.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Mr. Chairman, the preponderance of evidence that we have reviewed confirms that the economy continues to grow faster than its potential. We expect this will contribute to a perceptible increase in inflation despite the unexpectedly low inflation rates observed toward the end of last year. Some moderation of real growth rates does appear likely by midyear as a result of our earlier actions. Nonetheless, the adoption of a somewhat contractionary monetary policy is warranted in order to prevent the anticipated inflationary pressures from generating a permanent increase in the inflation rate. With the real fed funds rate in the 2-1/2 to 3 percent range, consistent with a policy stance that is only mildly contractionary, this suggests that further action is appropriate. These considerations lead me to support your recommendation for a 50 basis point increase in the fed funds rate and also a symmetric directive.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, strictly on the basis of domestic considerations, I would associate myself with Governor Blinder for the reasons he stated and for another one. We are going to be finding out not only retail sales; we are going to have both the Administration's budget and Mr. Gingrich's budget unveiled in the next two weeks. I think the reactions to that will answer some of our questions about fiscal policy. I do not know about the quality of the answers, but at least that will light a match in an otherwise completely dark room. I think your observations on the international side are well-taken. The case against waiting--I am going to flip the nuances of the way Governor Blinder said it--is that if we had a compelling reason to go one way or the other domestically, we should do it. If, however, we wait and we have a crack in the dollar in the next two weeks, the amount of tightening we would have to do in order to counteract that crack would be a lot more than 50 basis points. So, given that there is some uncertainty about the domestic scene, I view a 50 basis point increase as probably buying us some insurance that we will not have to tighten further. And so, I can very much support your proposal.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I think this decision really comes down to assessing the risks and one's comfort level in dealing with those

risks. Your analysis of the risks, Mr. Chairman, on the domestic economy is about as good an assessment as one can get. The risks still do favor, I think, the continuation of too much strength and, given where we are in the cycle, greater risk on the inflation side. Given that, I think we would be doing the right thing and my comfort level would be increased by following your recommendation of going up 1/2 percentage point. I would like to join others, however, and say that I think the way monetary policy has been conducted over the past year is one of the high points in this Committee's history, at least the part that I have been associated with. It has been that way because we have been forward-looking, but we also have been willing to be decisive when we needed to be. We need to continue to be forward-looking in this part of the cycle. While I am sympathetic to the notion that there are more data coming, that is always going to be the case. More often than not we get into trouble by waiting for one more piece of data. We tend to make the right decision when we take the information that we have in hand, make the best judgment we can, and then go for it.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I support your recommendations for a 1/2 percentage point increase and a symmetrical directive. I would like to say that whether or not we move now is based on whether we think it is prudent on the basis of the evidence. The preponderance of the evidence I heard today and your arguments suggest to me that moving now is appropriate. I am sensitive, too, to whether we are forward-looking or not, but there is one nuance in terms of what Governor Blinder said that is important as well. That is, if we wait because we have this whiff of a slowdown and if we are reasonably convinced that there is increasing inflation in train, we will come perhaps to the point where we get just another whiff with a little increase in inflation and find ourselves asking what we should do now. It will be harder to make the move then because we will have both rising inflation and this whiff of a slowdown at the same time. So, I think now is the prudent time to move. A move will help staunch inflation going forward. I think buying the insurance now and heading off further inflation and a larger move later, as Governor Lindsey said, is the right thing to do. I support you.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I support the recommendations.

CHAIRMAN GREENSPAN. Governor Yellen.

MS. YELLEN. I would like to associate myself fully with Governor Blinder's analysis and also with the conclusions that he drew from it. As I indicated, I think the forecast risk is very high at the moment, and I also agree that more data would be helpful in deciding. On the other hand, if I absolutely had to decide today, I would favor a further 50 basis point increase in the funds rate. If we knew that we needed that increase in the funds rate, I do agree that sooner is better than later. On the other hand, a short delay imposes only a very minimal cost. I do not think we should feel compelled to raise the funds rate today, and I do see definite benefits from waiting a little longer to decide. I fear that if we act today, our move may turn out to be one we will regret. I realize,

of course, that if we wait another few weeks as Governor Blinder suggested, we will see further data that I would definitely like to see: an additional retail sales reading, another employment report, and some further CPI and PPI numbers. I would like to see another housing starts number and some auto sales numbers as well. In my mind, this would reduce my uncertainty about which of the scenarios is the right one. That is why I favor waiting, not at all until the next meeting but just for a few weeks, to look at those data.

I understand that there is an expectation on the part of the market that we are going to move 50 basis points today, but I don't think that should force us to move today. The market's expectation, which I read as a further 150 basis points increase before we stop tightening policy, does not coincide with my own. On the basis of current information, I am envisioning only this 50 basis point increase. Given what I know about the economy and the uncertainty that I have about the natural rate, it would take a lot of new information for me to contemplate going up 150 basis points. That is part of the reason why I mentioned the Taylor rule, to give us a sense of where we think the funds rate should be. I find that many people I talk to reason as follows: As long as actual growth exceeds growth in potential output--that is, as long as the economy is growing faster than, say, 2.5 percent--the funds rate should be raised. Sometimes I find myself falling into that pattern of thinking, too--that the economy is growing too quickly and that means we should tighten some more. But this is a crazy way of thinking, and it definitely runs the risk of ending up with too much tightening. We can move 25 basis points or 50 or 75 basis points each time, and that is the way we end up with overkill. That is why I think we have to have a sensible notion of the right level toward which we should be heading. And we may have to stop before we see the slowdown under way. The Greenbook has one way of coming at what that level should be--7 percent. I do not disagree with the Greenbook strategy. But the Taylor rule and the other rules that were distributed to you call for a rate in the 5 percent range, which is where we already are. Therefore, I am not imagining another 150 basis points.

In spite of having said that my choice would be to wait, I intend to vote for your proposal. The reason is that I think the differences that we have largely concern tactics and not strategy. My guess is that, while I would prefer to wait, the probability is high that in three weeks I would want to go along, that I too would prefer a 50 basis point increase. I also grant that my views on tactics could be wrong and, therefore, I do not intend to dissent.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Thank you, Mr. Chairman. I very much agree with your conclusion, but I would like to state just briefly some of the reasons. Every possible conjuncture that we have been able to put together on the economy indicates that we need to increase official rates by 50 basis points--possibly by more than that, but certainly by 50 basis points. Therefore, just on the economics, I think the time to raise those rates is today, and I do not have to justify the increases in my own mind by the fact that financial markets clearly are looking for a 50 basis point increase. I do think that market expectations are a substantiating reason but perhaps from a slightly different perspective. It is reasonably

likely in my view that this will be the last interest rate increase. It is important that we do it decisively and that we not gratuitously create a problem in financial markets, especially at a time when I think the dollar is extremely vulnerable and likely to fall. There are going to be two times, possibly this year and maybe even probably this year, when we will disappoint financial markets. The first will be at the meeting at which they expect us to increase interest rates and we do not, especially if we accompany the decision, going back to our discussion at yesterday's meeting, with a statement that we have decided not to increase interest rates. The financial markets won't be ready for that. We will disappoint them even more when we decide that it is appropriate to reduce interest rates at a time when unemployment probably will be below anybody's notion of the NAIRU and when we could be having some uptick in inflation. That forward-looking move, which I think will take at least as much courage as any of the moves that we made last year or contemplate for today, will induce much confusion in financial markets. I would much rather confine the confusion to those two important times and not cause it this time for, I think, no earthly benefit for us.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. If we currently enjoyed a situation where there was no uncertainty on the outside about our intent to deliver a lower inflation rate in the years ahead, regardless of what happens in 1995, and to move toward ultimate price stability, then I would not move today. Because we do not have that kind of credibility, because there is uncertainty about our policy objectives, because our staff and private forecasters have inflation going up--the last OECD forecast that I saw had the United States with the highest inflation in the G-7 --and because of the dollar situation, I think that we are forced to err on the side of tightness whether this is to be the last tightening move or not. Without those things, I would not even do this today. But with those things I think we are forced to continue marching in a way that may turn out to be too much tightening.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. I support your recommendation, Mr. Chairman.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I also support the recommendation. I think matters would actually be worse if we delayed in anticipation of a resolution of Mexico's problems. In spite of the recent announcements, that situation is likely to be uncertain for quite a while. It is quite conceivable that this tightening move may be all that is needed. But in view of the strength of the economy, it seems to me that the risk of overshooting is minimal.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. I support your recommendation.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. I have already spoken. I support your recommendation.

VICE CHAIRMAN MCDONOUGH. We have heard from everybody.

CHAIRMAN GREENSPAN. Shall we vote? Would you read the directive?

MR. BERNARD. I am reading from page 26 in the Bluebook: "In the implementation of policy for the immediate future, the Committee seeks to increase somewhat the existing degree of pressure on reserve positions, taking account of a possible increase in the discount rate. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

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

CHAIRMAN GREENSPAN. May I request a short recess while the members of the Board of Governors go into the other room?

[Meeting recessed]

CHAIRMAN GREENSPAN. Before we go to lunch, I want to read, in line with our discussion yesterday, the proposed press release on the discount rate increase; the vote was 7 to zip. After the usual listing of the Banks that already have proposed 50 basis point increases, the operative language in this announcement would read as follows: "Despite tentative signs of some moderation in growth, economic activity has continued to advance at a substantial pace, while resource utilization has risen further. In these circumstances, the Federal Reserve views these actions as necessary to keep inflation contained and thereby foster sustainable economic growth." Unless there are any objections to that, we will continue the meeting but have lunch and turn the agenda over to Ted Truman to continue our discussion of the Mexican situation.

[Meeting recessed]

CHAIRMAN GREENSPAN. With regard to our disclosure policies, I believe I said yesterday, but I may not have, that we probably would issue a short press release tomorrow or Friday. Did I say that--does anybody remember?

MR. COYNE. No, you did not.

CHAIRMAN GREENSPAN. Does anybody have any objection to doing that? The alternative would be to wait until the minutes are released in about eight weeks.

MR. LAWARE. I just object to doing it at all!

CHAIRMAN GREENSPAN. Your view is appropriately registered! Ted Truman, whenever you are ready.

MR. TRUMAN. Mr. Chairman, I am very conscious of the fact that the members have not had their lunch yet! Obviously, if any of you have further questions about what we discussed yesterday afternoon, I will be glad to try to answer them. Let me preface that by saying that there probably will be some questions for which my answers will have to be less than perfect. But I would like to try to answer any that you have and either stop there, Mr. Chairman, or move on to the two proposals that I mentioned yesterday. I am at your disposal, including whether you want me to cover the proposals individually or together.

CHAIRMAN GREENSPAN. Governor Lindsey is first.

MR. LINDSEY. I have two questions. The first has to do with the responsibility that we might have to monitor the agreement. It is widely believed on Capitol Hill that the reason to vote for this is that the Federal Reserve will be monitoring Mexican monetary policy. In addition, the IMF released a statement yesterday saying that the Federal Reserve along with the IMF will monitor developments closely during the next six months. Would you tell us what our responsibilities are to monitor an agreement that has not been reached yet and whose terms we don't know?

MR. TRUMAN. I will do the best that I can! On the first part of your question, the legislation that was going to be proposed but which is now dead made reference to the Federal Reserve in several respects. I skipped over that yesterday afternoon because those provisions were no longer relevant, having been overtaken by events. They related basically to Mexico's monetary policy and the widespread view on Capitol Hill that it is the source of Mexico's problem. Some would say it is the exclusive source of Mexico's problem. We were mentioned in the legislation in terms of a requirement that the Bank of Mexico provide us with data and information on their policies. We also were mentioned in connection with the preparation of various quarterly or semi-annual reports regarding the progress of the program that the Secretary of the Treasury, in consultation with us and other relevant government agencies, was to submit to Congress. Since there is no longer any legislation, that in some sense is not relevant, though I would imagine that we will have to provide some reports to Congress, if not by formal mandate at least in connection with oversight hearings.

As for the statement in the IMF Managing Director's press release yesterday, I confess that it was somewhat of a surprise to me since Bill McDonough and I had been consulted and we thought it had been removed. When I got back to my office yesterday evening and saw it in the materials that I had handed out to you, it was a surprise to

me. I checked on this and apparently the reason it was in there is not unrelated to the first question--

MR. LINDSEY. Right.

MR. TRUMAN. Our good friends at the Treasury apparently felt that the statement was needed for two reasons. Now, I am interpreting their motives or putting forth hypotheses about their motives because I don't know for sure. The first was to add to the credibility, if that's the right word, of this revised proposal on Capitol Hill by continuing to assure certain members of Congress that we would be involved in the process. Secondly, they felt that the process would be somewhat less formal than would have been the case under the legislative approach, and therefore they apparently wanted to signal in the IMF's press release that we--we the United States and we the Federal Reserve in particular--would be involved in the normal monitoring, if I can put it that way, and that the IMF would do the managing.

MR. LINDSEY. Do we know what other commitments they have made for us?

MR. TRUMAN. I'm not sure what level of commitment this is, but I am reasonably confident that there are no big surprises.

MR. LINDSEY. You are confident there are not a lot of big surprises?

MR. TRUMAN. One of the reasons why I held forth quite as much as I did yesterday was to try to convey to the Committee in five pages as much information about this process and the substance as I could without going into every eddy and turn that this matter has taken over the last four weeks. I tried to outline the thrust of the policy issues and procedures as I understood them.



MR. LINDSEY. There was supposed to be a letter to Senator Dole, I believe today, outlining the conditions that we were going to place on Mexican economic policy. Do you have any idea what those conditions are at this point?

MR. TRUMAN. The conditions essentially are: You will have a tight fiscal policy; you will have a tight monetary policy; you will avoid exchange restrictions and those type of "thou shalt not" restrictions. There will be nothing quantitative in the conditions, which is one of the frustrations, as the Chairman testified yesterday. There is a desire on the part of some to say, for example, that the objective of this policy is to drive the peso exchange rate back to 3.5 per dollar. There are a number of members of Congress, as you probably are very much aware, who say that that should be the sole objective of the policy. First of all, I don't think that is what the United States Treasury has in mind. Although some people on this Committee may think that, I do not believe that is a majority view more generally. So, the lack of quantitative parameters in these restrictions is one of the reasons why certain members of Congress are concerned.

MR. LINDSEY.

MR. TRUMAN. With great difficulty!

MR. LINDSEY. Okay. But, believe me, in the minds of the members of Congress we are locked in; we are the ones who are to uphold this agreement even though we have not agreed to it.

MR. TRUMAN. I would argue that we are locked in anyhow. Even if we are not formally locked in, we would be in effect because, for a variety of reasons we have been very much involved--especially over the last couple of years and certainly in recent months--in the particulars of monetary policy and the financial market operations of the Bank of Mexico. It is not just the Federal Reserve Board and the Federal Reserve Bank of New York; it is also the Federal Reserve Bank of Dallas, for example, which has developed very detailed policy analyses and pronouncements relating to policy. We are involved and we cannot say that this is "they" and this is "we." And we do have an agenda. Bill McDonough will tell you that one of the agenda items--if I may put it that way, Bill--is to get the Mexican authorities to relax their restrictions on the functioning of financial markets so they will have a functioning foreign exchange market. A particular element of that, I think partly at Bill McDonough's insistence, was written into the letter of intent, which specifies that they would relax those restrictions. That is something we have an interest in because it is the judgment of the experts that, until they have more normal features in their foreign exchange market and as long as they do not have an absolutely pegged exchange rate, they will have sizable gyrations in their exchange rate. Such gyrations are not good for them and not good for us. If the rate moves 5 percent a day, there is

just no way for anybody to hedge or cover themselves. That is one example. We are already involved in that. We are trying to help them, through what might be called technical assistance, execute a floating exchange rate policy.

MR. LINDSEY. There is a difference between technical assistance and the word "monitor."

MR. TRUMAN. Right. I can only tell you what I know.

MR. BLINDER. As a short follow-up question: Does this letter to Senator Dole or to whomever say anything about tightening?

MR. TRUMAN. I have not seen the letter.

MR. BLINDER. Do we think it says anything about the value of the peso or the Mexican current account?

MR. TRUMAN. With regard to the peso, I think at most it says that one of the objectives of the program would be some strengthening of the peso. That was the language that was in the legislation that was set aside yesterday. It would not have tied them down to 3.5 or 4.5 or 5.0 to the dollar. But I have to say that I have not seen the letter.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Ted, it may be because it was the end of the day when you explained them, but I am still trying to understand the proposed series of transactions and the counterparties to the transactions. At the present time we have a \$4-1/2 billion swap line directly with Mexico?

MR. TRUMAN. With the Bank of Mexico, right.

MR. LAWARE. And we are being asked to increase that direct participation to \$6 billion--that is what it says here. Those transactions will all be directly with the Bank of Mexico. Are they included in the guarantee or the assurance of repayment from the Treasury? It is not actually from the Treasury but from the ESF?

MR. TRUMAN. Yes, from the ESF.

MR. LAWARE. Okay. Is the ESF backed by the full faith and credit of the U.S. government?

MR. TRUMAN. I can't give you a legal opinion. The ESF is an entity of the United States government. If it made a commitment to us that in some sense it could not cover out of its own funds, I do not know whether it would have an automatic draw on other United States government funds. What I can tell you is the following, and this may be helpful: The ESF will have \$20 billion in the sense that it is expected we will give it to them when or if we do the warehousing. So that \$20 billion program includes \$6 billion covering our swaps and \$14 billion of their other funds.

MR. LAWARE. You are jumping ahead of me now. I am just trying to understand the series of transactions here and who is behind

what. One statement that was made yesterday was that if the ESF did not have the cash or other exchange facilities to take us out of these arrangements, they might give us a note. Would a note of the ESF be a legal investment for the Federal Reserve?

MR. TRUMAN. I don't think that is what is contemplated.

MR. LAWARE. I'm sure it is not contemplated; nobody contemplates going broke, either.

MR. TRUMAN. But I don't think that's a realistic possibility because the Treasury knows that it has to have \$6 billion set aside to take us out 12 months later.

MR. LAWARE. I am stress testing the system, a good risk management technique! [Laughter] The second part of this transaction is a warehousing arrangement that I think was characterized last evening as technically a swap. We would take marks and yen out of the ESF in return for dollars. The ESF would then use the dollars to provide liquidity to the Mexicans. Is that correct? Does this reassurance of payment include taking us out of whatever warehousing we do for the ESF? And what is the time limit on that?

CHAIRMAN GREENSPAN. It is a swap with a fixed forward rate so that there is no market risk.

MR. LAWARE. I understand that, but what I am trying to ask is whether this same take-out applies to the warehousing arrangement as it does to our swaps with Mexico?

MR. TRUMAN. Warehousing is a mechanism that removes the foreign exchange from the ESF's balance sheet. As the ESF needs the foreign exchange or as they acquire dollars or otherwise have dollars, they would unwind the warehousing in the same manner they unwound the \$9 billion of foreign exchange that they warehoused with us in the late '80s and early '90s.

MR. LAWARE. Then, if the length of this agreement could go out 10 years, does that mean that this warehousing arrangement could go 10 years?

MR. TRUMAN. In principle, yes.

MR. LAWARE. Thank you.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. In the material that was given to us last night there are statements about--I don't know if they apply to the \$20 billion--the issuance of guarantees. What are they?

MR. TRUMAN. An operation the ESF may engage in would be one that the proposed legislation had contemplated authorizing. The ESF may issue a guarantee to the Government of Mexico allowing it to float securities backed by the U.S. government in the international capital markets.

MR. HOENIG. Would that be constrained by the total of \$20 billion?

MR. TRUMAN. Yes.

MR. HOENIG. So the ESF could only advance or guarantee that amount?

MR. TRUMAN. Or \$14 billion as I said in my answer to Governor LaWare. The \$20 billion includes \$6 billion to take us out; \$14 billion is for them to do these other things.

MR. HOENIG. A follow-up to that: Is it anticipated that we would not have to advance the full amount--our \$6 billion or the total of \$20 billion--but that that amount is the maximum we would make available? In other words, are we announcing this amount so that the markets will feel more comfortable and will come in, and hopefully that will keep us from having to go in with the maximum of \$20 billion? Or is it assumed that we are going in for the full \$20 billion?

MR. TRUMAN. Certainly, it is not assumed that we will go in for the whole \$20 billion. My personal judgment is that one also should not assume that we would stop substantially shy of that. I would be misleading the Committee, at least in terms of my own thought processes, if I left the impression that the amount would be only a couple more billion dollars beyond where we and the Treasury are today, collectively.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. A couple of questions, Ted. On the first page on the swap arrangement, item number 5 says the Treasury would provide assurance of repayment. That really should read the ESF if I understood you correctly?

MR. TRUMAN. Well, Treasury is the ultimate--

MR. MELZER. From a credit point of view it is not. But you mean the ESF?

MR. TRUMAN. Yes, but I think in fact what the Committee wants--this has not been written because I didn't want to put it in writing until after we had heard the Committee's discussion--is a commitment from the Secretary of the Treasury to do whatever is necessary in order to repay the Federal Reserve. I don't want to try to prejudge or anticipate the way in which that could be done. The ESF can get funds elsewhere. For example, one way the Treasury paid us off in the 1960s--took us out of exactly this type of arrangement--was that the general fund of the Treasury drew deutschemarks on the International Monetary Fund. It then advanced those deutschemarks to the ESF which the ESF used in turn to pay us off. So, I do not want to preclude the possibility that the Secretary of the Treasury in exercising his responsibilities would include other ways of paying us than just out of the \$20 billion. This is notwithstanding my answer to Governor LaWare's question that their current thinking is that their budget of \$20 billion includes \$6 billion that is needed to take us out.

CHAIRMAN GREENSPAN. Who's the chief executive officer, if there is one, of the ESF?

MR. TRUMAN. The Secretary of the Treasury--well, really the President of the United States.

CHAIRMAN GREENSPAN. The President of the United States is the Chief Executive.

MR. TRUMAN. My reading of the statute is that the funds of the ESF are to be used by the Secretary of the Treasury with the approval of the President. The ESF is under the exclusive control of the Secretary of the Treasury.

CHAIRMAN GREENSPAN. It is relevant to your question as to where the legal authorities lie.

MR. MELZER. I endorse what you are saying. We should get as much as we can in terms of assuring our sources of repayment. I would think in a narrow legal sense the credit we are looking at probably is the ESF and not the Treasury. Otherwise, we get into questions, if it is a guaranteed obligation, about our extending credit to the Treasury.

MR. TRUMAN. I agree, but either way, whether narrowly or broadly construed, the commitment would come from the Secretary of the Treasury because he has the authority, subject to the approval of the President, to do this.

MR. MELZER. There is no mention in here of the oil payments that you described yesterday.

MR. TRUMAN. My way of thinking about this, but that again is something one could debate, is that in some sense our backstop is the Treasury. How they backstop themselves is their business.

MR. MELZER. So, if this oil payments backup got set up, that is not really an issue for us?

MR. TRUMAN. Right. The Treasury has said they will ask for oil to back up their loans to Mexico, which would include the operations that they may take over from us.

MR. MELZER. But under this arrangement that becomes their business and not ours, and the swap is in effect an unsecured swap with a put to the Treasury or a put to the ESF?

MR. TRUMAN. You could do it either way, but I think it is probably cleaner to do it as I explained. If they take over our obligation to the Bank of Mexico, the funds from the oil facility would first come to them.

MR. FISHER. As fiscal agent it will be my problem to deal with their oil accounts and all that, but that is changing our participation entirely to that of just being the Treasury's agent. The New York Fed will still be used, but it is not the System's exposure.

MR. TRUMAN. The oil proceeds would flow from that account.

MR. MELZER. Under that arrangement, what is locked up at the New York Fed now in effect gets released? So, for us that is not an issue?

MR. TRUMAN. Let me be clear. Nothing can be locked up in the New York Fed. The only point at which something can be taken from the New York Fed is--. Oh, do you mean locked up in the sense we were discussing last night?

MR. MELZER. Yes.

SPEAKER(?). I think Tom meant locked up oil money.

MR. TRUMAN. Yes.

MR. MELZER. Okay. Let me ask a couple of quick questions about the warehousing.

MR. TRUMAN. There are a couple of points I did want to make going through this.

MR. MELZER. Are we still on the first item? I'm sorry. I was out of the room when you started.

VICE CHAIRMAN MCDONOUGH. He was on background from last night.

MR. TRUMAN. Yes, on general questions and now we are going to go to the specifics. Mr. Chairman, do you want me to say something about the specifics for both or for each separately?

CHAIRMAN GREENSPAN. Go ahead on both.

MR. TRUMAN. I just want to amplify a few points on the swap arrangement first. Basically, the first point on the piece of paper I handed out says that we would have essentially two swap arrangements: One would be the regular \$3 billion swap arrangement; the other would be a special swap arrangement. The Bank of Mexico would be able to draw on those arrangements for 12 months as of yesterday. Each drawing could be outstanding for 12 months. The next point says that the absolute outside time limit for final repayment either from the Mexicans or the Treasury would be January 31, 1997. As the Bank of Mexico did repay, however, the size of the special line would be reduced permanently. If after rising above \$3 billion the drawings got down below the \$3 billion mark, they would go back into the regular swap line, which would require a separate decision to be activated.

We talked about the Treasury take-out. There are a number of ways in which that could be done. One thing I did not mention--it's something we would have to work out--is the question of how, going forward, the drawings would be shared between the Federal Reserve and the Treasury. Currently, we are operating under the December 30th framework where everything is done 50/50. I would assume that going forward the sharing would be approximately two to one. Again, however, I think one needs to be realistic. If the ESF were to get

involved, for example, in making a \$5 billion loan guarantee, which would take some time to set up, there might be some adjustments as we went along. But ultimately as the amount got toward the maximum level we would be moving to that two-to-one proportion.

The warehousing proposal is probably somewhat clearer. The proposal is to raise the amount from the existing \$5 billion to \$20 billion. This is clearly a rather exceptional operation, and the rationale is to facilitate this program. The third point is that this excludes the warehousing of pesos. That, it seems to me, is required in terms of the overall logic of this arrangement. I would argue that that is a matter we probably ought to keep internal rather than put in the minutes at this stage. Finally, although I would say that this arrangement should be subject to annual review, I think in answer to Governor LaWare's question and someone else's is that in principle some of this warehousing might be outstanding, in the limit, for 10 years.

MR. PARRY. What is the size of the ESF?

MR. TRUMAN. The usable funds in the ESF today, counting the foreign exchange as usable, amount to roughly \$25 billion.

MR. PARRY. Can you say how it is broken down?

MR. TRUMAN. About \$5 billion is invested in Treasury securities and the balance is roughly equally divided between marks and yen. I think they have slightly more yen than marks.

MR. PARRY. Thank you.

MR. BOEHNE. Is any of it obligated in any way beyond what we are talking about with Mexico?

MR. TRUMAN. It is obligated only in the sense that they have one other swap arrangement with the Bundesbank. So, in some sense if they wanted to advance dollars to the Bundesbank they would use some of the dollars for that. But nothing is obligated in a current commitment. One of the Treasury's concerns is that this operation does severely limit what the ESF could do over a fairly extended period of time. It preserves the ability of the ESF to use its foreign exchange holdings for exchange operations, but that is probably about all it does.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Ted, I have two questions. One has a preamble. Since we are an independent central bank dealing with the Executive Branch and because we are a bank, the analogy would be that we are a bank dealing with an affiliated company--something that we take very seriously as regards the way it is done by the banks we supervise. Is it safe to assume that we will have very, very clear documentation of both the warehousing facility and the take-out of the swap line?

MR. TRUMAN. Certainly. We intend to have a letter from the Secretary of the Treasury to the Chairman of the Federal Reserve on that matter.

VICE CHAIRMAN MCDONOUGH. The second question: If a bank says to a customer, we are making a line of credit available to you but as soon as you repay any of it, it goes away, that discourages the customer from repaying until the last minute. So I am not sure that that particular piece described on the first page, paragraph 4, is really in our interest, and you might want to rethink that.

MR. TRUMAN. There are two sides to that. Peter and I discussed it this morning. I decided that between the two choices the Committee would be happier saying that once the drawings got repaid the total would get subtracted and a separate decision would have to be made about putting the funds out again. If I may piggyback a bit on the question Governor Lindsey asked earlier and the fact that these swap drawings roll over every three months, if one found Mexico's reserves growing rapidly we would have the scope to encourage them to repay. We could not require them to repay but we could use moral suasion in the effort to secure early repayment. That might deal partly with your problem.

SPEAKER(?). But in fact we have always structured each rollover as subject to mutual consent.

MR. TRUMAN. We are committing ourselves in advance to provide that consent.

SPEAKER(?). But to whom are we committing? Are we committing to the Treasury or we are committing to the Mexicans? I think the whole thing does hang on the difference there. We can agree with the Treasury and within the Committee as to what the rules are, but vis-a-vis our relations with the Mexicans and how we rewrite the swap agreements, etc.--

MR. TRUMAN. The rewrite probably would say the maturity is three months with renewal--

SPEAKER(?). Three months and we have to agree to renew. So, that may be the discipline which squares the circle.

MR. TRUMAN. However, I doubt that we'd want to get to the situation where we use it. What we would end up doing is using moral suasion at the end of three months rather than whatever the alternative is--

SPEAKER(?). "Immoral" suasion!

MR. TRUMAN. --actually calling the loan.

MS. MINEHAN. May I just ask a question on mechanics? They have the right to draw for a period of up to 12 months. So let's say they draw on January 30th of 1996; that drawing could be outstanding three months and could be rolled over three times. Is the agreement with the Treasury that no matter how new the drawing is we get taken out a year from now or is the agreement with the Treasury that we get taken out of any drawing that is 12 months or older?

MR. TRUMAN. The latter.



MS. MINEHAN. Then in this hypothetical case we would not be repaid until January 31, 1997?

MR. TRUMAN. By 1997, yes.

VICE CHAIRMAN MCDONOUGH. Two years from now.

MS. MINEHAN. Okay. Second question: On the monitoring side, going back to March of last year--I think it was March when we first expanded the swap line under the NAFTA-related agreement--at that time Mexico had something like \$25 billion in reserves and everybody was pretty satisfied that repayment was not an issue. From March to December most of those reserves were lost. What different kinds of things will go on, going forward, to prevent that from happening again?

MR. TRUMAN. That is the other side of the monitoring question.

MS. MINEHAN. Yes.

MR. TRUMAN.

MS. MINEHAN. Would we have a firmer handle on this than the Treasury or the IMF?

MR. TRUMAN. We would have a responsibility, and the Treasury certainly feels it has a responsibility, because the Treasury will have a lot vested in the success of this. That is what I meant when I said in answer to Governor Lindsey's question that I think we have no choice but to be involved in the monitoring--whether our role is put up in neon lights by the International Monetary Fund or not. If I may make a personal statement on this matter, having lived through the devaluations of 1976 and 1982 and now this one, I have a personal stake in insuring that this does not happen this way again. That is all I can say as far as I am concerned; that is a personal remark rather than an institutional remark.

MS. MINEHAN. And one final question on the \$40 billion in guarantees: I think I understood how those would be used--essentially to lower the interest rate on new tesobono securities by replacing the Mexican guarantee with that of the U.S. government.

MR. TRUMAN. It would not have been linked. Basically what would have happened under the previous arrangement is that the Bank of Mexico would have gone out with the U.S. government guarantee and raised, for example, \$5 billion in the international capital markets. They would have used those funds to meet the pressure on the exchange rate that would be associated with the holders of tesobonos, which are paid off in pesos, not wanting to roll them over but rather wanting to take the pesos and buy dollars.

MS. MINEHAN. Right. Are these drawings basically going to be used in the same way except that the international capital markets do not get involved? They just use the cash?

MR. TRUMAN. As long as they do not use the guarantee with it. What would be necessary for the Treasury, and I would assume we'd be somewhat involved in an advisory role, would be to require the Mexicans, as under the contemplated legislation, to come up with a financial plan. That financial plan presumably would say: These are the sources of funds we are going to have over the coming short period of time; for some longer period of time, this is going to be our strategy, which includes what we do with monetary policy. I don't know what Peter thinks, but I personally thought it was a mistake yesterday for them essentially to cancel the tesobono auction because

the rates were so high and they had just been bailed out by President Clinton. I may be wrong about that.

MR. FISHER. I can add something that at least supports what Ted is saying, and I am being quite candid about some of the problems that Mexico has going forward, which you are both talking about. Mexico has an independent central bank. But, going back to the issue Ted raised about Bill's views and mine on the need to get their markets functioning, they do not have much of a secondary market. The signaling mechanism is through the control of the auction process by the Treasury, and that is the bigger problem. In the long run, the Bank of Mexico is controlling the monetary base. In any one week it is the Hacienda that is controlling the signaling process. And that was what happened in November; that is what happened yesterday; and that is a real problem going forward. That is partly why I feel so strongly that if they are going the route of the float, then they have to take steps to liquify and get better intermediation in their secondary market. It is one of the reasons.

MR. TRUMAN.

MS. MINEHAN. You mentioned the financial plan. I think you tied it into the legislation. Is that going to be tied into this agreement, too?

MR. TRUMAN. Yes. The Treasury will insist that in order to implement this program, an agreement or a series of agreements will have to be worked out with the Mexicans about what they are going to do. And I am using the term "financial plan" to refer to that. The Treasury needs to think about these things before it dribbles \$14 billion out the door.

CHAIRMAN GREENSPAN. Can I ask for a short recess? I have to consult with our utility hitter.

MR. TRUMAN. On another aspect of this problem!

CHAIRMAN GREENSPAN. This will take just a couple of minutes.

[Meeting recessed]

CHAIRMAN GREENSPAN. Mr. Truman.

MR. TRUMAN. My expectation is that we will get a commitment from the Secretary of the Treasury to do what is required to take this loan off our books after 12 months. Exactly how we are going to specify that, I do not know. It is my personal view that having a 52-page legal document between the Federal Reserve and the Treasury on these types of matters is not in our interest.

MR. JORDAN. I'm not sure how many pages are appropriate. Tom Melzer used the term "put," but is the Treasury committing to a legal obligation to take us out of this? You used the word "take-out" and I know what a take-out is. Is this a take-out or is it not a take-out?

CHAIRMAN GREENSPAN. Yes, it is a take-out. The issue of precisely how it will be constructed is something which our General Counsel and their General Counsel will work on. The principle of the agreement is that it is a take-out. Basically, the agreement is that the Federal Reserve has zero credit risk and zero market risk; that is the principle. How that is formulated and what documents are exchanged to implement that is up to the lawyers, but it won't be smoke and mirrors. I have no idea what they are going to do, and I suspect that they may in fact run into the same questions that have been raised with Ted about the ESF's legal authority for this, or who owns that, or what happens here. As Tom Melzer says, we can't make a direct loan to the Treasury; it is illegal. All of that will, I assume, be resolved. What I will say to you is that the nature of the handshake, if I can put it that way, is that we have zero credit risk and zero market risk. It is a take-out; that is unambiguous.

MR. TRUMAN. I would like to make one other point on this. President Melzer asked a question earlier about the oil mechanism. Even I, with a reputation for exuberance, if that's the right word, would not go so far as to give up the current arrangement that lies behind our \$4-1/2 billion swap line before being satisfied that we have appropriate arrangements in place to convert all this into some other form. Even I would not be so imprudent.

CHAIRMAN GREENSPAN. President Moskow.

MR. MOSKOW. Ted, I would like to ask you to sort of step back from this for a second. We have talked a lot about the details, and the Chairman has just said that the principle involved is for the Federal Reserve to have zero credit risk and zero market risk. What are the risks to the Federal Reserve here? What kind of scenario could you envision that could cause significant problems for us?

MR. TRUMAN. My answer to that question would be that the problems we are likely to have with this are least likely to be financial. It seems to me that there are essentially two risks. One lies with what might go on in Mexico if the overall program does not work. If the Mexican situation spirals out of control and we are involved--we already are involved with the existing swap line but our involvement could increase--we would get caught up in that situation economically. It seems to me that the other principal risk, which may or may not be related, is that this set of arrangements could come under intense political scrutiny in this country regardless of what goes on in Mexico. And I can well imagine that that kind of scrutiny is something that many people within the Federal Reserve would prefer to do without. I can say from my own experience that there are a number of people on Capitol Hill who are involved in oversight on these arrangements and are reassured by the fact that we are involved in the process.

CHAIRMAN GREENSPAN. Ted, can I go a little further than that? The response to your question might be that, as best we can judge, the risks from this new agreement to the Federal Reserve from a financial point of view are reduced because of the take-out issue. The real risks relate to the issue that Larry Lindsey is raising and implicitly what Ted is raising. The problem is the fact that we have managed to build up a high degree of credibility. The difficulty is that the Federal Reserve has now become the honest broker. I have just been invited to speak, for example, before the Democratic Senate Caucus, not on Mexico but more or less on the world at large. The Federal Reserve is presumed to be an honest nonpartisan broker, which therefore means that suddenly everyone wants to drag us into the middle of big problems. This is not the last time this is going to happen. We could very easily eliminate that by following a misguided monetary policy and making us all very controversial! But, as crucial players in the American government, I frankly don't know how to get around accepting this responsibility when we are being asked by the Congress and the Administration to somehow oversee this operation, which is a very fuzzy deal. I was out of the room when Larry was asking his questions, but I could figure out exactly where he was going. When he finished, I probably could have continued asking similar types of questions. This is where we have a problem. We do not have a choice, as I see it, of saying we are not going to be involved in this, but we do have a choice in terms of figuring out how we are going to get involved. At the moment, I have not been approached officially on any of this. The only call I have received was from Mr. Camdessus this morning. I could not return his call yesterday. He wanted to ask me whether his remark in his release published yesterday was acceptable to us. I assumed that it had been cleared. I thought it had been cleared by you, Bill, because he said he did speak to you.

VICE CHAIRMAN MCDONOUGH. That was earlier; yesterday he spoke with Ted.

CHAIRMAN GREENSPAN. So I heard what was involved, but I was asked only after the fact--as if it could be pulled back after a public release. That is the sole official request that I have gotten from anybody. I have heard a lot of rumors about all of this. Ted tells me about the different initiatives that are going on and what pieces of paper are being circulated. But nobody has approached us

and asked us to get involved in this. It is a very vague thing; it is like asking me to umpire the new game of zipswitch, and I would say, what? [Laughter] I don't know what the rules are. I don't know who the players are. I don't know what is going on, but am I to be the umpire? And they say, sure, why not? [Laughter]

MR. LINDSEY. Even though you have not been asked, it has been reported that you have agreed!

CHAIRMAN GREENSPAN. Agreed to what?

MR. LINDSEY. To umpire zipswitch. [Laughter]

CHAIRMAN GREENSPAN. Terrific! In answer to your question, Ted is exactly right. The risk is not a financial risk that we have here, but we do have a risk. The risk is essentially political--not in the sense that we are subjected to political pressures. It is in the fact that people are trying to get us to do things that I suspect cannot possibly be done effectively, efficiently, or otherwise. That is a problem that we are going to have to confront. I am not sure exactly how we are going to come out of this, or how we will handle it. But there is where I think our problem is. Anyone who has some great ideas is welcome to throw them in, especially if he or she can explain to me what the game of zipswitch is all about!

MR. MOSKOW. If I could just follow up on this for a second. I do not know the game of zipswitch. I think there clearly is a very significant risk. The other risk that Ted mentioned first is that the overall program in Mexico will not work.

CHAIRMAN GREENSPAN. If it does not work, that is a major economic problem.

MR. MOSKOW. Of course.

CHAIRMAN GREENSPAN. But it does not create more credit risk for us.

MR. MOSKOW. No, but it has the potential for drawing us in further down the road.

CHAIRMAN GREENSPAN. It could conceivably. That would be related to how we position ourselves with respect to this monitoring issue. The crucial thing that we have to do, no matter how we get involved in this, is to review Mexico's forthcoming plan. We were fully aware when this began that we were dealing with a serious problem. We knew that if we did not get involved, there were going to be some very serious negative responses and I am not sure how this whole thing would ultimately have come out. But we also knew that there is a slippery slope here. The question is, did we realistically have the option of saying, "this is a slippery-slope issue and we would prefer not to be involved." The answer is that it would have been irresponsible for us not to get involved. The reason I went up to the Hill at one point to speak on this issue to two-thirds of the Senate and about one-third of the House, all in one room, is that if I did not do it, it would not get done. That's because no one there had any knowledge of this except people in Treasury who are not--

SPEAKER(?). Have no standing or are from a different political party.

CHAIRMAN GREENSPAN. It is not a question of their standing or even being in a different political party;

As a consequence of that, what happened was that the Congressional leadership and the Secretary of the Treasury told me I had to go up to the Hill and talk about this. Was I going to say that I had to remain Simon-pure and not be involved with this? That would have been utterly irresponsible because in a certain respect we are the only institution in town that can credibly be involved in this sort of thing. We were not certain where it was all heading, but we knew that once we took the first step, there would be a lot of other steps down the road. How we could orchestrate that was not terribly clear, as indeed it is not clear now. I think we are going to have some very tricky moments before this gets resolved. If the Mexicans work this out, if the crisis gets resolved and everything simmers down, all these conversations are moot. The issue will just go away, the loans will be paid off, the funding facilities will be shut down, and we will go back to square one.

But there is a good probability that this financing assistance will not work, which means that at some point it will be cut off. I think the probability that Mexico will go through everyone's money and then default is zero. It is not going to happen that way. The really tricky problems are going to be how to work our way out of this if the program clearly is not working. We can't discuss that because, if we did, then we can be sure that the program would not work and we would have very serious problems. So, we have all of these issues which are quite risky for this central bank. Because of the take-out, the aspect I am least concerned about is the financial risk. We are okay there. That was not the case earlier when, as you all know, I was very much concerned about the amount of collateral that was available from Mexican oil proceeds or--I am sorry, Ted, about the choice of words--the "assured means of repayment" that we had. After a certain point, I think the oil guarantee is not a credible, or an assured, means of payment. But now that issue is moot because we have a Treasury take-out. What we now face is a very different set of problems that are going to be fairly difficult to deal with.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, I think you have described the situation very accurately. The credit risk to the Federal Reserve, as I view it, has been removed. Certainly, Virgil and our other legal colleagues can draft the documentation to be sure that it is removed and stays removed. I believe very firmly that you had no choice but to get involved. Since you got involved, the Federal Reserve got involved, appropriately in my view, even though it is uncomfortable for you and all the rest of us. Essentially, we are in a situation where our involvement has to be maintained and where we have to do the best we can to ensure that the terms for our involvement are done in the best possible way. This means some very tough conditionality, but as for the two items for which we need approval, I think we may have reached the point where a motion would be appropriate for both of them.

CHAIRMAN GREENSPAN. Before we get there, I think Tom Melzer still has a few questions.

MR. MELZER. Let me just ask a couple of quick questions on the financial side because I think it could be helpful as you work out these arrangements to be sure we all understand. As I understand it, of the \$20 billion in the warehouse facility, the most that would be advanced to the Mexicans would be \$14 billion. Then \$6 billion--

MR. TRUMAN. That is one way of thinking about it.

MR. MELZER. And \$6 billion would be retained in the ESF. When it is time to take our swap out, we in effect warehouse that remaining \$6 billion and pay ourselves off.

MR. TRUMAN. That would be one scenario.

MR. MELZER. It seems to me that we have to have some requirement that the ESF retains good collateral of \$6 billion so that transaction can get effected and we can get taken out. I am sure you will take care of that. I don't know whether it makes any sense to establish any expectations. I know we have annual reviews by this Committee of the warehousing facility. Does it do any good to establish any expectations up front that we would not expect this warehousing to be outstanding longer than 10 years, for example? And what sort of expectations should we set with respect to the possibility of doing additional warehousing operations, say, unrelated to Mexico? I think you said it before, but from my point of view this pretty much exhausts whatever flexibility the ESF has, or perhaps whatever we perceive we might warehouse for them. Never say never, but the expectation ought to be that there is not another \$20 billion behind this one if they want to intervene in exchange markets.

MR. TRUMAN. That is one of the reasons why we are bringing it up.

CHAIRMAN GREENSPAN. Can I just say something quickly? If they want to do that, they have to get authorization for new appropriated funds from the Congress. That has nothing to do with us.

MR. MELZER. I was talking about expectations with respect to our willingness to warehouse anything beyond this \$20 billion.

CHAIRMAN GREENSPAN. You mean in the future?

MR. MELZER. I see what you are saying; the ESF will have used up its assets.

CHAIRMAN GREENSPAN. Yes, there would be nothing left.

MR. TRUMAN. Well, following up on yesterday's discussion, I want to add two separate thoughts. One, as far as warehousing pesos, we have said no. I think that is important to the consistency of this operation. As a technical matter, the ESF will still have some limited capacity to acquire foreign exchange, more yen or DM, in the market. This is not a problem that I would worry about right now, but conceivably they might do that at some point. They might say we have bought another \$5 billion worth of yen and want to warehouse those



with the Federal Reserve, too. Whether the ESF can do that would require a separate decision by the Federal Open Market Committee. One of the reasons that I, at least, would favor putting in place the big number, which is matched with other big numbers in terms of the program itself and with their existing holdings of foreign exchange, is that it would make what we are doing much clearer. The slippery slope of doing things a billion here and a billion there is to some extent avoided.

On the question of review, I would think it depends on the appetite of the Committee. Peter will be regularly reviewing foreign exchange market developments with the Committee, and Mexico for better or for worse is inevitably going to be part of that for some months and perhaps a couple of years. So, I think there will be a lot of opportunity for the Committee to exercise its oversight of this. To the extent that disbursements mount up quickly, there will be a chance in March to find out what has been going on. The staff will make an effort--as we have tried to do in the past though maybe not always successfully--to keep the Committee as informed as we can about ongoing events and to minimize the number of surprises. There probably won't be any surprises because we have a perfect crystal ball!

MR. MELZER. One last question and then I have just a couple of comments that I would like to make. This has to do with the excess collateral in terms of backing U.S. currency. I recall that when we warehoused a lot of foreign currencies for the ESF before, we got into a problem with fairly narrow excess collateral. If we do this \$20 billion, we will then in effect substitute these foreign currency holdings for domestic securities. And when we have to sell domestic securities, we will have less of what is viewed as acceptable collateral to back the currency. If we exceed those limits, we have to announce to Congress that we are backing our Federal reserve notes with other types of assets. What is the likelihood of having to make that sort of announcement?

MR. KOHN. I do not know what the current situation is. My guess is--and it is a wild guess--that if the warehousing got up to \$20 billion, we could be in that situation.

MR. TRUMAN. I don't think we have an obligation to announce to Congress. We have an obligation in the sense that Governor Partee once said to Congress that we would use our foreign exchange holdings last to collateralize our Federal Reserve notes.

CHAIRMAN GREENSPAN. If we get to that point, we can always do an off-market swap with the Japanese or the Germans.

MR. MELZER. I am just trying to understand all the implications of this.

CHAIRMAN GREENSPAN. There are balance sheets implications. The last time it happened was five years ago, as I recall.

MR. MELZER. Yes, it was a seasonal thing, but there was a time of the year when we got very close to exhausting our regular note collateral--I think when we had \$9 billion of warehousing on our balance sheet.

MR. TRUMAN. What we do not know is whether the scale of things has increased enough since then combined with the fact that reserve requirements have come down so that we would have the room.

MR. KOHN. Brian Madigan said he thought the projection of free collateral was \$8 to \$10 billion over some indefinite period.

MR. MELZER. In terms of my own feelings about this, Alan, while I respect your point of view on this, I really have not heard anyone make a case that what we are facing here is some sort of financial crisis in the United States that has systemic implications. I think what we are really talking about--when I say we, I am saying that broadly--is providing long-term financing to

another country that has mismanaged its financial affairs. If the Treasury wants to do that, that is their prerogative. But it is not appropriate for a central bank to participate directly or indirectly in such arrangements, and I think we are setting a very bad precedent. Now, I know that technically the way this appears on the surface is that the Treasury is doing it and we are facilitating it. But I think the perception is going to be that we are very much a full partner in this.

The other thing that concerns me is the use of warehousing arrangements. As we all know, we have been criticized in the past when warehousing arrangements were used to facilitate "normal" transactions whose purpose was to stabilize dollar exchange markets. What we are talking about here is a totally different type of facilitation, much larger-sized. This gets back to the second risk that came out in response to Michael Moskow's question. I suspect that may subject us to even more criticism inasmuch as Congress and the American people apparently strongly oppose extending credit to Mexico. In effect, one could argue that we would be participating in an effort to subvert that will of the public, if you will. I do not want to be too dramatic in stating that. This could cause a re-evaluation of the institutional structure of the Fed in a very fundamental and broad way.

CHAIRMAN GREENSPAN. I seriously doubt that, Tom. I am really sensitive to the political system in this society. The dangers politically at this stage and for the foreseeable future are not to the Federal Reserve but to the Treasury. The Treasury, for political reasons, is caught up in a lot of different things. Republicans up on the Hill look at the Federal Reserve as the good guy. I think this issue of a majority on the Hill looking at us in another way is missing the problem, which is exactly the opposite of what you are saying. They look on us as the good guy and they are willing to be supportive of the President and the Administration only if we are involved. That is where our problem lies. It is like the 800 pound gorilla who loves you and grabs you. Thanks a lot! [Laughter] I seriously doubt that the problem you are discussing is where our vulnerability lies. I see that Larry Lindsey is shaking his head as I am talking. I must say that I disagree with both of you.

MR. MELZER. I am not surprised to hear you say that because obviously you would not have gotten involved if--

CHAIRMAN GREENSPAN. I would not have gotten involved, exactly.

MR. MELZER. I understand that and I think people can disagree on these issues. I just felt it was important to say that.

CHAIRMAN GREENSPAN. I was just trying to say that, if I can possibly talk you out of this concern, it is one that I think frankly is really de minimis. If you want something to worry about, I have lots of things that I would like you to worry about. This is not one of them. President Hoenig.

MR. HOENIG. Mr. Chairman, I think my questions have been answered. I have a general understanding of what is proposed here. There are two aspects to this: One is to contain the immediate crisis and the other is to assure that it does not recur in two years or whenever. I am very unclear on the process to assure that it does not recur, as you said that you are.

CHAIRMAN GREENSPAN. You bet!

MR. HOENIG. In another sense, I think it is unprecedented for us to come into this process with so much uncertainty. I will defer to your judgment. This is important and must go forward. But I have a lot of sympathy for what Tom is saying. I am uneasy about it. If it weren't for the magnitude of this crisis and your involvement, I would have grave reservations about doing this. I defer to your judgment.

CHAIRMAN GREENSPAN. I am going to be the last to deny that there are problems here. Let me say this, however. Those who believed that the Mexican situation was containable, short of something of this nature, did not have their fingers on the structure of things as they were falling apart. One can argue quite credibly that the fault is theirs. The problem is, to use another analogy, that they are the house next door. If somebody there smokes, the house catches on fire, and cinders going in our direction threaten to burn our house down, can we say we are not going to help them put out the fire? The answer is that we have no other choice. This crisis is not of our making. I am fully convinced that if we had tried to stay completely out of this and said that we would not get involved in any way, this situation could not have been staunched; I am not sure that it has been. From the point of view of the country as a whole, it would have been irresponsible on our part not to be involved. When your neighbor is lying in the street, screaming, you can just walk over him and keep walking and not get involved, I grant you that. I do not think we have that choice. Governor Blinder.

MR. BLINDER. I would like to endorse almost everything the Chairman said and then ask two questions, one of which I think you can't answer. And when you say you can't answer it, I am going to have a very specific request, because I do agree with the Chairman. First of all, I do not have any problem with what is on these two pieces of paper. I don't think we should have any problem for many of the reasons that were just stated. There is a third piece of paper that is not here that says the Federal Reserve will monitor...and now fill in the rest of the sentence. You can't answer right now what is in that part of the sentence. My request is to get an answer to that as soon as it is humanly possible.

CHAIRMAN GREENSPAN. We are going to do that.

MR. BLINDER. This is not a hostile question. I can imagine your coming back with a list that I would be perfectly happy with and not have the slightest bit of a problem. I can also imagine a list that I would not be happy with.

CHAIRMAN GREENSPAN. We can have a situation where we are required to oversee and enforce and where there is no way for us to know what it is.

MR. BLINDER. Exactly. I would like to attach some urgency to that request. Several of us were buzzing informally about that around here. The longer it reverberates in the press--that the Federal Reserve will do this or will do that--the worse it gets, if we do not want to do it. If we do want to do it, that is all perfectly fine.

CHAIRMAN GREENSPAN. Let's find out what this is.

MR. TRUMAN. Let me give you a two-part answer.

MR. BLINDER. As a sidebar to the question, I would like to know, and hopefully this could be known soon, when it says, "the Federal Reserve will monitor" whether that means the Board of Governors of the Federal Reserve, the Chairman of the Board of Governors of the Federal Reserve, the Federal Open Market Committee, or maybe some other choice. I can't imagine any other choice.

CHAIRMAN GREENSPAN. I think there are a lot of things we are going to have to decide today or very quickly.

MR. BLINDER. I really would like to know the answer to that.

CHAIRMAN GREENSPAN. The first thing I am planning to do after this meeting is to address that question by talking to the Treasury and others involved in the process.

MR. BLINDER. The second question--I guess this really is a question--is just for information since we are at least peripherally involved as an agent. Do we have any understanding of what the putative strategy is? Presumably, when someone goes into a deal like this, there is some notion of a strategy. Of the \$20 billion, \$6 billion is our share and that is presumably usable by the Bank of Mexico for exchange stabilization, if it so sees fit. Then there is the \$14 billion that could take the form of loan guarantees; it also could also be used for exchange stabilization; it could be used for long-term lending. Maybe I left something out, but those are the three things on the Treasury sheet. The legislative plan was \$40 billion and that was for loan guarantees.

MR. TRUMAN. On the legislative plan, there was still the question of what the Mexicans were going to do with the money. I think this is a question similar to the one that President Minehan was asking earlier: How are they going to use the money, whether the funds are short-term or longer-term funds? That is where it seems to me the financial plan that I referred to earlier comes in. And it is related to the question about our involvement in the monitoring of the economic policy side. Indeed, the major rationale for our being involved in the monitoring of the economic policy side is that without

that involvement, we could advance them the money--whether it's for the short term, medium term, or long term, and the money could easily be frittered away. The two interact.

MR. BLINDER. That only bothers us directly if we pledge to monitor something so that something does not happen. But the Treasury is lending money, and for political reasons we are not. We have no responsibility for monitoring; I don't think we have any business with it. I can name eighty-seven things in U.S. trade policies that I think are horrible, but those are political decisions that have nothing to do with the Federal Reserve.

MR. TRUMAN. Well, I can name eighty-seven, too.

MR. BLINDER. You can name more than eighty-seven!

MR. TRUMAN. Still, even if those trade policies go wrong, when they do go wrong, their impact on the Federal Reserve or the financial system is relatively minor. If Mexico has economic and financial policies that go wrong for the next millenium, or more immediately for the next two or three years, I think that will have a major impact on the Federal Reserve, whether it is wearing its bank-supervisory hat or its financial-system-stability hat, or its macroeconomic-policy hat. I think the Federal Reserve has to be concerned about how the Mexican Treasury spends the money, one way or the other. I would prefer that our concern not be put in neon lights, but I think we have to be concerned.

CHAIRMAN GREENSPAN.

MR. TRUMAN. I agree on your first question that I do not have a answer. I will tell you one small element of this, however--or give you my position. With respect to the International Monetary Fund, we are in a somewhat similar position, though on a slightly different scale, as we are relative to the Congress. The International Monetary Fund got itself into this situation essentially in December. They realized that they knew less about what was going on in Mexico than we did. We knew a great deal less than we wished we had known, even though we had devoted a considerable amount of resources to this on a daily basis for at least the last year. What the IMF does know is that Peter Fisher and his colleagues as well as people here at the Board have much better contacts and information about the day-to-day operations in Mexico than the Fund has. That is for two reasons: First of all, the Fund, for better or worse, does not have a culture that is designed to follow day-to-day developments in the individual economies of member nations. Secondly, on the other side, the Mexicans are world champions in terms of obfuscating about economic information while simultaneously providing a lot of other information. Transparency of the way economic policy is conducted in Mexico, including monetary policy, is a very serious problem, and it is one that relates to the comment earlier about the functioning of financial markets as well as comments--what Governor Lindsey was asking about yesterday--concerning the balance sheet of the Bank of Mexico from top to bottom.

To extend Chairman Greenspan's analogy a step further--maybe I am taking it a step back--once we have put the house fire out, we want to build a more fire-proof house and we want to try to encourage the resident of the house to stop smoking or at least to stop smoking in bed. I think we have an interest in getting it done, not that we are going to create a mistake-proof economic environment in Mexico any more than we can create a mistake-proof economic environment in the United States. We can hope that with some effort and a considerable expenditure of Federal Reserve resources--I mean human resources and budgetary resources in one sense--to fix things so that at least we will not have these problems coming back.

Let me come back to another point on resources. I share, for all the reasons Governor Blinder has stated, the concerns about what we will monitor and how we will monitor because this will have, among other things, resource implications for the Federal Reserve System. I want to know whether I am going to have to budget one man year or forty-two man years to get this job done right. We need to know at the minimum what we are going to be asked to do, and see whether it is feasible to do it both in terms of resources and, as Governor Lindsey and the Chairman have said, in terms of the intellectual feasibility.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I had two points: the big "P" political point and the small "p" political point. First, I find myself uncomfortable disagreeing with you. Pat Buchanan had a good quote in The Wall Street Journal the other day. He was talking about the collapse of the Mexican bailout bill. He said that this was the first complete rout of the governing elite since the League of Nations went down to defeat. Now, I was for the Mexican bailout. If I had been here in 1919, I probably would have been for the League of Nations. So, I am on the side of the governing elite.

CHAIRMAN GREENSPAN. Pat Buchanan is with the governing elite, too. What is he doing?

MR. LINDSEY. Well, he is running against us. Our political risk is not going to come from the chairmen and the senior members of the current majority. Our political risk comes because people in the country are damn mad. A bill that they opposed was defeated, and now the governing elite, to use Pat Buchanan's phrase, has said in effect: We are going to win anyway because we are going to go around all the normal processes and pull money out of this little pot people never knew even existed and use that money. Well, maybe everyone will forget about it, but I don't think so. I think that is where--

CHAIRMAN GREENSPAN. They will if it works and they won't if it does not work.

MR. LINDSEY. If it does not work we--and I cannot imagine a greater governing elite group than this institution--and all governing elites are going to be under a microscope. I very much agree with the point made earlier that because we are so obviously an elite, if the elites come under question, then our functions are going to be revised by Congress. Our political risk in this is enormous.

The second point I would make is that, frankly, given examples such as the Camdessus memo, we have been treated--to borrow a phrase--a lot like mushrooms. The only thing we can do about that, I think, is to maximize what little bargaining power we have when we have it. We happen to have the maximum bargaining power right now. Once we approve these two documents, which I have no problem with in themselves, we have no bargaining power left. So, I would modify the pace at which Governor Blinder said we should do things and request that we get answers to those questions before we ratify this. Now, we could even make the motion that we approve these subject to getting the "third page," to use your phrase. But once we approve these, we have no more bargaining power, and the people who are committing us without our consent have unlimited capacity to commit us to more things.

CHAIRMAN GREENSPAN. I disagree with that. I think our bargaining power has not changed. I think our bargaining power is essentially our ability to say that we will not engage in, we will not accept, the monitoring of x, y, or z. We have a veto on what it is. These documents are basically facilitating the United States Treasury and the United States government. Our doing that in no way either enhances or reduces our bargaining power. I think our bargaining power is based solely on our ability to say no. If we say no or say we will not do such and such, our ultimate leverage against the Treasury is that there is nothing they can do about that, because starting with the original hypothesis, the reason we are involved is because of our credibility. But I really don't think we get any bargaining power from this because, from the point of view of the Treasury, they are giving something to us in this deal, not the other way around. They are removing the modest degree of credit risk that we have under the existing arrangement. The only thing that they have seen in this agreement is that they are acquiescing in removing all financial risk from the central bank for this deal. But if they think by doing that we are going to acquiesce in all the individual items, I would just commit to everyone here that I will say "no." And I don't see what they could do about it. I would not hold the approval of these proposals up; I am willing to go along; I agree. These two documents are in our favor, not the other way around. I would be a little concerned about holding these documents up because I do not like the fact that we are sitting out there with a half billion dollar exposure with alleged "collateral." Let us get that behind us. President Broadus.

MR. BROADDUS. Mr. Chairman, just very briefly, I certainly respect your point of view, and I think I understand fully the very difficult position that you and the System have been put in. I take that in consideration. But I still just have to make a brief comment in general support of Tom Melzer's position and Larry Lindsey's position. I am just very uncomfortable with this. I am sure that, as a formal matter, what we are proposing to do is legal. But as I see it, this action--the whole package--is by any reasonable definition in substance a fiscal action, not a monetary policy action. It is therefore the province of the Congress. The Congress did not have the will to take what I think we all agree was the appropriate action, so we are being left holding the bag. I guess I just see it as a raid on our independence, and I regret it. I agree with you that the risk to us, while I think it is substantial, is probably remote, although I'm not sure I think it is as remote as you do.

CHAIRMAN GREENSPAN. I'm not sure I think it is as remote as I think it is either! [Laughter] Governor Phillips.

MS. PHILLIPS. My question is not meant to reflect on these two propositions because I actually agree with them. But what would happen if the Fed did not go along either with the increase to \$6 billion or the warehousing? Is the Treasury contemplating covering it and going elsewhere for their warehousing? What would be the mechanics?

MR. TRUMAN. As a technical matter, if we declined to do the warehousing or pulled out of the existing swap agreement, leaving aside for the moment just hypothetically that we are already involved for \$4.5 billion, the Treasury presumably would do it all alone! Our collateral would be improved by this arrangement, but let's suppose we were starting from square one, and square one probably has us going back to about 1967, and we had never had any dealings with Mexico. They are all going to be done via the State Department and the Treasury Department. Then the Treasury would take \$20 billion and do it all directly without having us as a temporary junior partner on the swap side of it. On the warehousing side of it, in principle, the Treasury could find other means to move that \$20 billion in foreign exchange off their balance sheet. It would be obvious that they did that and that we had said "no." But in principle they could do it. As the Chairman suggested, perhaps they could do it by warehousing with the Bank of Japan and the Bundesbank. I'm not quite sure how they would do that, but in principle they could do it. In principle, they could warehouse it with the BIS, and the BIS could warehouse it with the Street. All those options are, from some standpoint, maybe preferable as far as we are concerned. I would even argue that they illustrate the fact that this is a fairly straightforward set of financial transactions. The very fact that it could be done in the private sector suggests that it is perhaps more normal, or less abnormal, than some people think it is. But in principle if we walk away from both sides of that, the Treasury would go ahead and do it anyhow. That's my thought.

CHAIRMAN GREENSPAN. Okay, Jerry Jordan, go ahead.

MR. JORDAN. Last March when we entered into the agreement on the swaps, part of that agreement was that there would be a three-country consultation process quarterly and so on. I certainly do not feel that I have had either the quantity or the quality of information as feedback from whatever consultation was taking place to alert us to the situation. So, as long as this is outstanding, I would hope we get a lot better information. It does not have to come at the Committee table, but whatever is being generated by the New York Bank or the Board staff should be sent to us so that we are better informed. Part of the reason I say that is because I live on the south shore of Lake Erie. Maybe if I had Bob McTeer's southern border, I would think differently about it. But from where I sit, I worry about the political and economic situation to the north of Lake Erie very much. If we are not getting good feedback on developments up there,



MR. TRUMAN. I'm sorry you have not had sufficient information. I think this upsets everybody; everybody feels that way. We have made a very serious effort at the staff level to improve the reports. You may not read the weekly reports from the Federal Reserve Bank of New York but since shortly after last April, when this consultation process was formalized, some 60 percent of Peter's words in that report have dealt with his consultations with Canada and Mexico. So we have put in extra resources to provide the Committee with additional information on the current financial situation of both Canada and Mexico. It may not be enough, but we have stepped up our efforts.

The point about these consultations is absolutely true and I regret that personally. I called the Treasury and asked about it and recommended that we call a meeting of the North American Financial Group in early September to discuss Mexico's exchange rate policy and their strategy. They said "no." The next time, I would try to enlist the Chairman of the Federal Reserve in doing that, which might be my normal inclination anyhow. I just resisted it this time. I think we should have used that mechanism beforehand because that in fact was one of the reasons that we insisted it be set up. Having agreed to go up to a \$3 billion swap line from the previous \$700 million swap line, that was to be part of the quid pro quo. So if we were going to be more tightly bound because of the financing arrangements, we would have a mechanism that we could be more comfortable about. You are perfectly justified in feeling snookered. We all were snookered. I apologize to the extent that we could have minimized that, but we will try harder.

CHAIRMAN GREENSPAN. Okay, may I request the Vice Chairman to make individual motions. We need two votes.

VICE CHAIRMAN. Mr. Chairman, I move that we approve the increase in the Federal Reserve swap arrangement with the Bank of Mexico as detailed in the document that Mr. Truman presented to the Committee.

CHAIRMAN GREENSPAN. Is there a second?

MR. KELLEY. Second.

CHAIRMAN GREENSPAN. We need a recorded vote.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Blinder	Yes
President Hoenig	Yes
Governor Kelley	Yes
Governor LaWare	May I ask a question?

MR. LAWARE. Why are we voting? Aren't we already committed to this program? This document says that we are committed to this program, and Mr. Camdessus says we are committed to this program and that we are going to do certain things. The vote is a kind of formality, isn't it?

CHAIRMAN GREENSPAN. No, it's a legal requirement.

MR. TRUMAN. If the Committee decides to keep the swap line at \$4-1/2 billion, the Treasury understands that. The Chairman made it very clear in his conversation at the Treasury that we might stay at \$4-1/2 billion. If the \$4-1/2 billion is where the Committee wants to draw the line, that is where it can draw the line.

CHAIRMAN GREENSPAN. Let me just say that when the issue was raised with me, I said that I did not have an FOMC vote and that I did not know how the FOMC was going to come out. I indicated that one possibility was that the FOMC would keep the swap line at \$4-1/2 billion. I said I would request an increase, because I thought that was the right thing to do. But I in no way suggested that I knew how the vote was going to come out.

GOVERNOR LAWARE. I will vote "yes," but only because we improve our credit position as a result of doing so.

CHAIRMAN GREENSPAN. That is the reason why I said I would make the recommendation.

MR. BERNARD.

Governor Lindsey	I feel committed; I'm going to vote No.
President Melzer	No
President Minehan	Yes
President Moskow	Yes
Governor Phillips	Yes
Governor Yellen	Yes

CHAIRMAN GREENSPAN. Can we get a second motion?

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, I further move that the Committee approve the expansion of the warehousing agreement to \$20 billion as established and set forth on the second page of Mr. Truman's submission to the Committee.

CHAIRMAN GREENSPAN. Do we have a second?

MR. KELLEY. Second.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Blinder	Yes
President Hoenig	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	No
President Melzer	No
President Minehan	Yes
President Moskow	Yes
Governor Phillips	Yes
Governor Yellen	Yes

CHAIRMAN GREENSPAN. When is our next meeting?

MR. BERNARD. March 28.

CHAIRMAN GREENSPAN. Since the next meeting is such a long time from now, I think it would be worthwhile to have periodic

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telephone conferences on Mexico to keep everybody up to date as best we can. See you all next time.

END OF MEETING