Federal Open Market Committee
Conference Call

September 21, 1998

A consultation of the Federal Open Market Committee was held by telephone on Tuesday, September 21, 1998, at 11:30 a.m. Locations of participants other than those at the Board of Governors in Washington are indicated in parentheses.

PRESENT:
Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman (London)
Mr. Ferguson
Mr. Gramlich
Mr. Hoenig (Denver)
Mr. Kelley
Ms. Minehan (Boston)
Mr. Poole (St. Louis)
Ms. Rivlin

Messrs. Boehne (Philadelphia), McTeer (Dallas), and Stern (Minneapolis), Alternate Members of the Federal Open Market Committee

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

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

Ms. Browne (Boston), Messrs. Cecchetti (San Francisco), Dewald (St. Louis), Simpson, and Stockton, Associate Economists

Mr. Fisher (New York), Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors

Ms. J. Johnson, Secretary, Office of the Secretary, Board of Governors

Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Messrs. Alexander, Hooper, and Ms. Johnson, Associate Directors, Division of International Finance, Board of Governors

Mr. Reinhart, Deputy Associate Director, Division of Monetary Affairs, Board of Governors

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

Mr. Conrad (Chicago), and Mses. Holcomb (Dallas) and Pianalto (Cleveland), First Vice Presidents, Federal Reserve Banks of Chicago, Dallas, and Cleveland respectively

Messrs. Beebe (San Francisco), Eisenbeis (Atlanta), Kos (New York), and Lang (Philadelphia), Senior Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, New York, and Philadelphia

Messrs. Altig (Cleveland), Cox (Dallas), and Evans (Chicago), Vice Presidents, Federal Reserve Banks of Cleveland, Dallas, and Chicago respectively

Mr. Bryan (Cleveland), Assistant Vice President, Federal Reserve Bank of Cleveland

Ms. Yucel (Dallas), Research Officer, Federal Reserve Bank of Dallas

Transcript of Federal Open Market Committee Conference Call
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CHAIRMAN GREENSPAN. Good morning. This telephone conference was set up on short notice because of a decision that needs to be made within the next few hours. The general impression I have gotten from speaking to a number of you in recent days is that there seems to be some disposition to move rates down at our meeting on September 29. I have not spoken to all of you, obviously, but a number of events have occurred that I suspect have moved you, as many of you have told me, to be inclined toward doing something on Tuesday of next week.

The economy has been holding up, but it is now showing clear signs of deterioration, including anecdotal indications of some softening that we now are picking up at an increasing pace. As best I can judge, the indications of weakness are becoming more pervasive but by no means dangerous thus far. At the same time, the sharp widening in yield spreads is suggesting significant tightening in private debt markets, and the decline in the stock market has had an equivalent effect on the equity side. When we feed this information into our various models, they inevitably, as we might expect, engender a quite considerable softening. The Federal Advisory Council with whom the Board met on Friday seemed to be more gloomy than usual. Without giving very many specifics about changes in their loan demand or its composition, they said that they were observing a good deal of pessimism among their customers. I think that growing pessimism is probably the case more generally. I would suspect that unless things change quite significantly in the next several days and unless I have misread what a number of Committee members have told me, we will be easing our policy next Tuesday.

My basic concern....

[Secretary's note: The conference call was interrupted for a short period at this point because of transmission difficulties].

CHAIRMAN GREENSPAN. Are we okay now?

MS. MINEHAN. Yes, and could you go back over the last few comments you made?

VICE CHAIRMAN MCDONOUGH. We lost you just after you mentioned the widening of spreads and the stock market.

CHAIRMAN GREENSPAN. Okay. With regard to the cost of capital, yields on lower grade private debt securities are up while those on U.S. Treasuries have gone down as a consequence of a flight to safety, and AAA yields are about unchanged. But on average private sector debt yields have risen and obviously equity prices have gone down, so the cost of capital has moved up. When we filter recent developments through different models, or simply evaluate them, the conclusion is that the outlook for the immediate future has deteriorated. I think all of you are picking up anecdotal evidence that is quite significant in that regard. We have picked up similar comments at recent meetings here with business people. The members of the FAC were particularly gloomy at our recent meeting with them.

Ordinarily in these circumstances I think we would have no difficulty going directly into the next meeting scheduled for September 29 and essentially achieving the objective I discussed with some of you at our August meeting in Jackson Hole, namely to find a way to hold our current policy stance until that meeting and then act as a Committee rather than risk indicating a sense of panic or even any sense of disturbance, which would occur were we to move or have to move in advance of the meeting itself.

As a consequence of that, I tried to create some sense of movement in our thinking in my speech at Berkeley on the 4th of this month and in my comments at the hearing of the House Banking Committee last Wednesday. I thought my remarks were generally consistent with the objective and, if anything, moved a bit more toward expressing increased concern about the outlook and possible need for a policy easing action. My remarks reflected my continuing conversations with a number of people. Unfortunately, some of my comments were misread when I indicated in response to questions that there were no discussions going on with respect to the issue of a simultaneous, coordinated reduction of rates by central banks. Those comments had nothing whatever to do with what the Committee might do on September 29, but regrettably that notion did not come through at all. Indeed, my response seems to have been taken as an indication that we were backtracking in some form or another.

I am particularly concerned that given the international financial turmoil that continues to increase, the general sense of persisting deterioration with no policy responses, and a widespread perception of policy incoherence coming from the G-7 and others, that we could run into a major problem, especially given Japanese developments. As a consequence, I would feel more comfortable if I were able to accept a standing invitation from the Senate Budget Committee to appear Wednesday afternoon along with Larry Summers essentially to review the international financial turmoil. I am concerned, however, about going up there unless I can signal even indirectly that we may be moving next Tuesday, because that signal in and of itself will help to contain any significant deterioration that might otherwise occur in the interim. I think the probability of such deterioration over the next week is quite small, but its consequences are, of course, extraordinarily important and could put the FOMC well behind the curve with respect to taking action. If I go up there--and I have not communicated yet to the Budget Committee that I will, and Larry Summers has indicated that if I accept he will likewise--I don't want to go up there unless I have a sense from this Committee that it is all right to go ahead and signal even obliquely that we will be moving the federal funds rate lower next Tuesday.

This is the purpose of this consultation and I would very much appreciate comments, insights, recommendations, wisdom from members of the Committee.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, there is no question in my mind that if this were September 29 I would be in favor of lowering the federal funds rate. I believe that the deterioration in markets, especially in credit markets last Thursday and Friday, and the continuation of that turmoil today all tell me that your accepting the invitation to appear on Wednesday and in your inimitable fashion guiding the listeners there and in the markets to anticipate that we are likely to be moving on the 29th is something that is highly desirable. I agree with you that the likelihood of significant further market deterioration in the near term is not high, but I think it is important enough for the members of the FOMC to endorse your giving that signal on Wednesday.

MS. RIVLIN. This is Alice Rivlin. I strongly agree with what Bill McDonough just said. I had come to the conclusion myself that the case for moving the rate down on Tuesday was very strong, largely because of what is going on around the world. It is not such a strong case purely domestically, but because there is also a significant, although we hope not an overwhelming, possibility that things might move south in the interim, communicating something about the possibility of a policy easing move is a good thing for the Chairman to do.

CHAIRMAN GREENSPAN. Cathy.

MS. MINEHAN. I agree with what I heard both Alice Rivlin and Bill McDonough say. I do not believe things have to get worse for us to be inclined in the direction of moving. I think they probably have gotten, if you will excuse the phrase, "worse enough." In that regard, I am wondering if you are still of the opinion that it would show a degree of panic if, for example, we were to move this week as opposed to next week?

CHAIRMAN GREENSPAN. Cathy, I do not think we need to move this week if I go to the Budget Committee hearing and hint about the possibility of an easing move next Tuesday. In my view we will get enough of a response in the marketplace without foregoing what has become a very useful procedure, namely our practice over the last several years of making decisions only at meetings. I do not deny that we may not be able to follow that procedure indefinitely. But the ability to adhere to it has, I think, been a plus. I would be reluctant to forego the procedure. If the Committee is sufficiently supportive, I can communicate as much as I need to without actually speaking for the Committee on this issue and in the process preserving its prerogatives until next Tuesday.

MR. PARRY. Mr. Chairman, this is Bob Parry. I definitely support, in fact I strongly support, your suggestion. It seems to me that it makes a great deal of sense for us to move at the upcoming meeting. I see that as a fairly riskless insurance policy that we can take out. In addition, I agree that moving before the meeting would perhaps convey an undesirable sense of panic. At the same time, I am sure that there are statements that you could make in your testimony that would be helpful leading up to the meeting. So I strongly support your recommendation.

MR. BOEHNE. Mr. Chairman, Ed Boehne. Even though the case for moving is largely based on what is happening globally, I think increasing concern is developing with regard to the domestic economy. While the economy is still operating at a relatively high level, I have sensed a notable change in sentiment in recent weeks. It had been largely in the manufacturing area, but it now appears to have spilled out into broader sectors of the economy. Based on the experience in 1994 when we were preemptive on the other side, I think such a move now can be justified in terms of developments in the domestic economy. In my view it is particularly helpful to do that. I certainly agree that there is a strong case internationally.

As to whether we move this week or next week, if this were several weeks ago and the need was seen as acute, I don't think it would be desirable to get hung up on whether we take action at a meeting or not. But since we are about a week away from the next meeting and you have this convenient opportunity on Wednesday, I think we will get 90 percent of the benefit of an easing action with your statement at that time. So I support a move next week based on what I know now, and I support your tactics for getting the word out.

MR. HOENIG. Mr. Chairman, this is Tom Hoenig. Let me begin by saying that I support what you are suggesting today. I do have an observation and a question. The observation is that the economy in our part of the country, and the domestic economy more generally as others have said, remains relatively strong. In fact, it is unusual to be thinking about easing when we have an unemployment rate of about 4-1/2 percent. We have an unusual set of circumstances. My question relates to the liquidity issue. Maybe you or Bill McDonough could comment on some of your observations and discussions in the international arena that are of particular concern to us. I would be very interested in getting your impressions.

CHAIRMAN GREENSPAN. Bill McDonough, why don't you take a shot at it!

VICE CHAIRMAN MCDONOUGH. Tom, the reference I was making to the concern about markets relates mainly to domestic markets, especially the fixed income markets. We have seen a tremendous widening of spreads even in the Treasury market between the on-the-run Treasury securities and the other Treasury securities where there might be a difference in maturity of three months, and we have started to see evidence that people are reducing their involvement in financial markets. We see people cutting back on counterparty exposure lines. The market is in one of those periods where it is starting to feed on itself in a rather dangerous way. This development is evident in fixed income markets more generally and in other G-7 countries, let alone in markets for some of the more exotic financial instruments such as debt and equity derivatives. It is my strong feeling that markets are no longer functioning very well that leads me to believe that we should not only take action next week but that it is quite important for a signal to be given this week to prepare the way for that action. We should not let the week go by without the Fed through the Chairman's testimony promoting a little smoothing.

MR. HOENIG. Thank you very much. I will say that that is consistent with some of the conversations we have had out here. While we still see a lot of activity in financial markets, there is a great deal of concern about liquidity and increased caution in those markets. To return to your question, Mr. Chairman, I can support what you are suggesting here today.

CHAIRMAN GREENSPAN. Tom, let me just go a step further and point out the one thing that I find particularly bothersome. It is that this element of disengagement, fear, uncertainty, and the like is really pervasive around the world and it is occurring in the same time frame. In other words, we see a very dramatic rise in the yields on the stripped Bradys for virtually every emerging economy. Concurrently, we are seeing junk bond yields in the United States going up very sharply against Treasuries and indeed the junk market is virtually shutting down. We are beginning to see a squeeze in a lot of the middle market lending, which is related in some respects to BAA and similar credits. Effectively, what we are seeing is a very rapid change in views toward commitments. While we have yet to see this in the real variables of the U.S. economy, except at the margins, it is very hard if history is any guide to believe that growth above 3 percent is possible in the context of the types of decisions that are being made for capital investment and inventories. Those decisions feed into the gross domestic product, and we clearly are beginning to see their effects very early on in the financial markets. As I recall, the opening of spreads in the corporate area is the largest that we have seen in such a short period of time in at least a decade. BAAs are showing their highest spreads since 1991 and that clearly is true across the board in related markets. It is now a global-U.S. issue. The international financial maelstrom is beginning to have some obvious impacts directly in our markets.

MR. HOENIG. I appreciate that. Thank you very much.

MR. BROADDUS. Mr. Chairman, this is Al Broaddus. I support what you propose to do, though maybe a little less strongly than some of the others who have spoken. I have had a chance to talk to a number of people in the last week or so. We had our small business and agricultural advisory council meeting last week, and it is clear that there has been a change in sentiment. But I do not think it has been pronounced as of yet, at least in our area. There may be a little Main Street/Wall Street dichotomy here. Against that background, I think that in doing this you will probably want to be cautious and convey the notion that we still have an open mind in order to avoid inducing perhaps more concern than might yet be warranted, given the still high level of economic activity.

CHAIRMAN GREENSPAN. In fact if I go forward with this, I will basically give both sides of the story because I think it is necessary to do so. But I would tilt my remarks very clearly in the process.

MR. BROADDUS. I can support that.

MR. STERN. Mr. Chairman, this is Gary Stern. I too support what you are proposing to do in testimony on Wednesday. Having said that, I must say that at least as I perceive the global situation, it is not clear to me that a change in domestic monetary policy is the preferable response, but it may be the only available response. Under those circumstances, I am certainly comfortable with what you are proposing.

CHAIRMAN GREENSPAN. I agree with that.

MR. GUYNN. Mr. Chairman, this is Jack Guynn in Atlanta. Let me piggyback on Al Broaddus and Gary Stern because I think their thinking is probably closest to my own. I certainly have not sensed any collapse of confidence or a significant deterioration in the outlook among my contacts in this region. Having said that, my small business advisory group that met with me last week clearly has shifted its overall sentiment substantially since the previous time they were here. Three weeks ago I met in Miami with some Latin American bankers who were telling real live stories about the movement of money out of Latin America. It is the sort of thing that clearly catches one's attention. I am certainly supportive of your conveying our readiness to move next week if that is where we are then.

CHAIRMAN GREENSPAN. Okay.

MR. POOLE. Mr. Chairman, this is Bill Poole in St. Louis. I certainly do support a decision to testify and provide some indication of our likely direction. I think that is an excellent idea. I have an observation and a question. My observation is this: At the moment the needs of the U.S. economy and the international economy are clearly aligned. That may not always be the case. It seems important to me to focus our move on the requirements for the U.S. economy. Otherwise we may set up some misleading expectations at some time in the future.

My question relates to the size of the move we are contemplating, which we have not talked about. Maybe that needs to be discussed a little also.

CHAIRMAN GREENSPAN. My inclination would be 25 basis points because the mere act of moving at that time will create a very major shift in market sentiment. We do not need much more than that. My personal view, but it could change depending on the general views that the members bring to the table next Tuesday, is that we will get all of the clout we need with 25 basis points. It is always prudent to hold our powder for other occasions if we possibly can.

MR. POOLE. I would support that view. Thank you.

MR. CONRAD. Chairman Greenspan, this is Bill Conrad in Chicago substituting for Michael Moskow. I think for all the reasons that we have heard in the discussion that we could indicate support from the Seventh District as well.

CHAIRMAN GREENSPAN. Thank you.

MS. PIANALTO. Mr. Chairman, this is Sandy Pianalto in Cleveland, and I am substituting for Jerry Jordan. Obviously, I can not commit to what Jerry's position will be at next week's meeting. However, I am fairly certain that Jerry would raise some objection to revealing an action that the FOMC might take without a full deliberation of the members. But again, I can not commit to what his position will be next week.

CHAIRMAN GREENSPAN. Sandy, remember that I have no intention of indicating what the Committee will do if the Committee has not voted. I will endeavor to suggest possibilities, not commitments because I can not do that.

MS. PIANALTO. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Is Bob McTeer there?

MR. MCTEER. I am here! Welcome aboard everybody! [Laughter]

CHAIRMAN GREENSPAN. You had to say that didn't you!

MR. MCTEER. Mr. Chairman, I agree with your approach and it is very likely that I will argue for 1/2 point at the meeting. I think we ought to be decisive, but that remains to be seen.

CHAIRMAN GREENSPAN. Would any of the Board Members like to comment?

MR. KELLEY. Mr. Chairman, I will simply say that I concur with the thrust of the comments that have been made and support your going ahead with this. But I would also like to say that on the basis of purely domestic considerations I have some of the same slightly hesitant thoughts that Al Broaddus and Gary Stern mentioned.

CHAIRMAN GREENSPAN. You know, I do, too. So I will join you in that. The problem that we are confronted with as I see it is that we have to weigh evidence one way or the other. I think that even though the erosion thus far is quite marginal, the probability of reversing it at this stage and seeing the expansion reaccelerate is reasonably low, given especially the pressures that are coming from outside the country. I would not have said that a month or so ago.

MR. KELLEY. I concur with that, Mr. Chairman. I think this probably is more a matter of timing than anything else. But I am very comfortable with your proposal.

MR. GRAMLICH. This is Ned Gramlich, Mr. Chairman. I support it too. I was all set to undertake the preparation of my arguments for lowering our rates next Tuesday, and I am delighted that I will not have to work so hard at that. [Laughter]

CHAIRMAN GREENSPAN. Does anybody else have anything they wish to discuss? Thank you all very much. I look forward to seeing you next week.

END OF SESSION