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THE MONETARY ENVIRONMENT

Remarks of

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at the

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The Monetary Environment

The subject for this evening is the monetary environment including the factors affecting the stability of the United States economy. Particular emphasis will be on the question of the need for new stimulants and their effectiveness in the present situation, as well as the balance of benefit and cost of such moves.

The starting point of our analysis should be the economic situation and the problems we are likely to face over the coming year.

For the United States, 1976 was a year of economic growth at a pace normally associated with a generally satisfactory environment. The real gross national product rose 6.2 percent as industrial production expanded about 6.8 percent and new housing starts increased a significant 33 percent. This productive activity supported a large increase of 2.8 million people in total employment and a 9.5 percent gain in personal income. These in turn permitted a 10 percent advance in personal consumption expenditures. Despite these sizable gains, there was a mood of dissatisfaction with the total performance of the economy originating in the pattern of slowing growth from early to late in the year, in the continuing high level of unemployment, in the expectation of further price inflation, and in the slow gains in capital spending.

In the financial picture, relatively steady to declining short-term interest rates and the growth of liquidity throughout the economy were strongly positive elements. Similarly, the increase in savings and corporate profits improved the tone of financial markets. A primary fact permeating both economic and financial affairs was the reduced rate of inflation which fell from 7.0 percent in 1975 to 4.8 percent in 1976, measured by the Consumer Price Index. With this overall picture one could expect considerable satisfaction with the financial trends of the nation, but again there were worrisome developments which clouded the picture. Among these were the lack of growth of business loans at banks, and the pattern of price changes reflecting overall stability in food prices but substantial increases in prices of services, energy and durable goods. The increase in wholesale prices of industrial commodities, especially crude materials, during 1976 constitutes a threat to future stability which policymakers can ill-afford to ignore. The large shift to a record deficit in our balance of trade, and the repetitive international financial crises and concommitant volatility of exchange rates, were also unsettling developments.

In broad terms, the U.S. economy has been making good progress but in certain sectors it has been at an unsatisfactory pace and in others, developing trends may point toward unsettled conditions during the coming year. With this overall assessment, the newspapers have been full of possible remedies to the unsatisfactory elements of progress. Among possible alternatives, there have been discussions of tax cuts and/or rebates to stimulate consumer and business spending, government public service and public works spending to reduce unemployment, monetary stimulus to cut interest rates and foster greater borrowing for housing and capital expenditures and subsidies to selected high priority spending or investment programs.

It is not my purpose in this speech to recommend any particular program. Nor will I attempt to select elements from those mentioned above as particularly appropriate ones for public policy in 1977. Instead I want to return to basic principles and objectives and see if we can sort out where we want to go and what path leads in that direction.

I believe that most Americans favor a free enterprise, profit system with maximum leeway to the individual to reach for his or her economic dream. We expect our government to offset the imbalances inherent in this system without excessive interference but with a stabilizing influence which will encourage private endeavors and maintain a high employment, low inflation, progressive economy. While government is not perfect, ours did a reasonably satisfactory job along these lines in the post-war period until the late 1960's.

Recently, however, the successive shocks of sharply rising government deficits, twin devaluations of our currency, an abortive wage-price control program, and the costs of a quadrupling of energy prices created instability in our economy, causing significantly higher inflation which brought the most severe recession since the 1930's. We are now well into the recovery period from that recession and, as demonstrated by the data cited above, have resumed a growth path to even higher standards of living for most of our people.

However, the unsatisfactory elements of excessive unemployment, too rapid inflation and too slow capital spending are matters of concern. In past periods of slow growth, we have adopted stimulative fiscal and monetary policies to strengthen the forces of growth. Unfortunately, such policies often were adopted too late in the recovery period so that their impact accentuated price pressures and contributed to an excessive expansion leading to another recession.

Particularly disturbing, has been the continuity of large budget deficits in years of prosperity and recession. We have not learned the lesson that excessive government spending with large deficits is a sure way to ignite inflation and is a poor road toward economic stability.

With these general comments, let us review our goals for the U.S. economy in the coming year. It seems to me that a reasonably attainable set of objectives for 1977 should be:

1. To continue our economic growth at about the overall rate of 1976.
2. To encourage greater capital spending so as to create long-term job opportunities and support the economic expansion.
3. To develop new short-run job-creating programs to reduce unemployment particularly for minorities and younger job-seekers.
4. To seek greater international trade and exchange rate stability for ourselves and others.
5. To accomplish the above in an environment of declining inflation and an atmosphere of reduced inflationary expectations.

If these are indeed our primary goals for 1977, what should we be doing to achieve them? I submit that the prospects for further growth are already excellent, and that we should be wary of efforts to stimulate beyond the foreseeable horizon. The judgment that economic prospects for 1977 are excellent for continued growth at a rate commensurate with longer-range expansion is predicated upon a number of trends already evident in the economy. First, there is evidence of renewed strength in the leading indicators series which has risen each month since September. Second, the data on new orders also reflects new strength as new orders for non-defense capital goods have increased 5.9 percent in the past six months. Third, retail sales have bounced back from a June to September lull of almost no growth to a gain of 6 percent from September through December. This improvement has led to a better inventory balance and underlying support for further increases in industrial production. Moreover, the great sensitivity of retailers to sales and orders and their prompt translation into production increases or decreases augers well for continued equilibrium in the volatile inventory segment of the economy. Fourth, the record level of employment and the resumption of rapid growth in recent months, point toward further strength in personal income and consumption. Moreover, there are possibilities of a reduction in unemployment both by some slowing in the rise in the labor force and by the greater job opportunities of an expanding economy.

Fifth, the economy is well supplied with funds for consumer and business borrowing even if government financing needs are somewhat higher than last year. Savings have been at a very high level during 1976 and a base has been laid for a major credit expansion whenever demands develop.

Finally, it seems to me that with the election uncertainties behind us, the mood of the consumer has become much more optimistic and business attitudes are likely to follow suit.

It is recognized that one could construct a series of interpretations of recent economic developments which might point toward a less optimistic forecast. In my opinion, some of the most significant questions on the economic and financial horizon are those concerning international financial developments including (1) the viability of credits to a number of less-developed countries which are already struggling to meet heavy debt service requirements, (2) the effectiveness of recent rescue efforts for a few large countries, (3) the instabilities reflected in exchange rate movements, and, (4) the trend toward price inflation of some basic materials, energy fuels, and a few consumer items. Domestically, there might be a temporary setback in many economic indicators for early 1977 because of the very severe winter weather and fuel shortages. Also drought conditions in some crop areas may cause more limited harvests in the spring. However, these are temporary and random influences which should be overcome by the basic strengths elsewhere. Overreactive measures to stimulate an economy, already in an expansion phase, could be excessive and ill-timed if effective, and might possibly be ineffective but damaging to our long-run interests.

It seems to me that our goal of prompt reductions in unemployment can be achieved most effectively and efficiently by limited, carefully-directed and highly selective programs of government spending or encouragement to others. Longer-range job creation, I think, requires measures to foster private capital expansion perhaps including marginal investment tax credits which must be respent in new capital programs.

In my opinion, we should be reaching for new and more effective international cooperative agreements to both support stabilizing exchange rate movements and limiting the destabilizing effects of mass money movements between nations. On the other hand, international cartels to force price increases can only be a devisive trend, splitting nations into barter groups and threatening the long-term viability of world trade.

The objectives for 1977 seem to me to call for a program of highly responsive but relatively conservative monetary policies both at home and abroad. We should have learned that excessive monetary creation over the long-run will fuel inflation. However, in short-run periods, the use of monetary action to counter destabilizing trends in the credit markets can have a salutary and quieting effect and monetary policies have an important role in stimulating or restraining an economy.

Finally, in this period of extremely sensitive reactions to minute changes in the unemployment rate or the annualized seasonally adjusted rate of money supply change, government policies should, in my opinion, be exceptionally cautious for fear of creating unwanted and unwarranted destabilizing expectations. This augers for slow, deliberate, and modest policy moves which can be offset or reversed if business or consumer reaction is undesirable.

None of the above should be interpreted as saying that no measures should be taken to try to improve the near-term tone of economic growth or selectively provide support to those areas characterized as unsatisfactory. Instead, I am only suggesting that the efforts be proportionate to the short-term needs rather than extending over a longer-term period and that the extent of the proposals be limited in recognition of the already favorable position of the economy.

Moreover, my comments should not be interpreted as meaning an outright rejection of any specific effort. Obviously, I have reservations about the effectiveness or efficiency of some methods in reaching toward my objectives. Nevertheless, there are some reasonable trade offs between different methods including some in the monetary and fiscal areas. Perhaps before the program is settled, such trade offs will be analyzed and the results factored into the final decision. Even monetary policy measures to provide a short-run stimulus could be considered but the dangers of a lasting impact well into 1978 are perhaps greater than for some of the more moderate ones contemplated in fiscal policy. On balance, the risks of over-reacting by monetary measures seem greater unless the fiscal policy actions produce unacceptably high or long-lasting increases in government deficits.

In summary, my counsel for 1977 is one of caution, to avoid any addition to inflationary pressures, or rebuilding of expectations of inflation, to constrain any stimulative effects on consumer spending and to limit government spending programs for job creation to the most efficient needed, but to strengthen capital spending for long-run opportunities, and to provide a foundation for continued stable growth.

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