

Remarks by Arthur F. Burns  
at the  
Financial Conference on Inflation,  
Washington, D. C., September 20, 1974

The purpose of this meeting is to seek the advice of this distinguished group. I as well as other governmental officials need your counsel. I want to learn all that I can from you. But I also deem it my responsibility to comment briefly on this country's financial condition and on the stance of Federal Reserve policy.

Our nation is now in the grip of a dangerous inflation, which has been gathering force over the past ten years.

As a result of the inflation, our nation's capacity to produce has suffered a setback. While shortages of materials, component parts, and equipment have diminished in the past three or four months, they remain acute in many of our industries.

As a result of the inflation, consumer purchasing power is being eroded. During the past year, the take-home pay of the typical worker declined 5 per cent in real terms.

As a result of the inflation, the real value of the savings deposits, pensions, and life insurance policies of the American public has diminished.

As a result of the inflation, corporate profits derived from operations have stagnated -- a fact that is concealed by accounting techniques that had been devised for inflation-free times.

As a result of the inflation, financial markets have been experiencing strains and stresses. Interest rates have soared. Some financial and industrial firms have found it more difficult to roll over their commercial paper or to raise needed funds through other channels. Savings flows to thrift institutions have sharply diminished, and stock prices have plummeted.

In short, as a result of the inflation, much of the planning that American business firms and households customarily do has been upset, and the driving force of economic expansion has been blunted.

It should not be surprising, therefore, that the physical performance of the economy has been sluggish in recent months, and that unemployment is now larger than it was last fall. We cannot realistically expect a resurgence of economic activity until confidence in our nation's economic future is restored. I do not think we can do this without making progress in checking the disease of inflation.

As you know, the Federal Reserve has lately been pursuing a policy of slowing down increases of money and credit, with a view to moderating the forces of inflation.

We have tried to apply the monetary brakes firmly enough to get results, but we have also been mindful of the need to avoid any general credit stringency. Thus, the supply of money and credit has continued to grow, although at a slower pace than in recent years.

The narrowly-defined money supply -- that is, currency plus demand deposits -- has grown so far this year at an annual rate of 5-1/4 per cent, in contrast to an average of 7 per cent during the past three years. If the time deposits of commercial banks, except for their large certificates of deposit, are also included in the money supply, the annual rate of growth this year has been 8 per cent, in contrast to an average of 10-1/2 per cent during 1971-73.

Clearly, the American economy -- taken as a whole -- is not being starved for funds. On the contrary, the growth of money and credit is still proceeding at a faster rate than is consistent with general price stability over the longer term.

Yet, the demand for money and credit has been rising at a very much faster pace than the supply. As a result of the huge demand for borrowed funds, credit markets tightened this year, and interest rates rose to levels such as we have not previously known.

These high interest rates have imposed a heavy burden on businesses and families across the nation. Homebuilding in particular, is highly sensitive to money market developments. Soaring interest rates and reduced availability of mortgage credit have greatly aggravated the condition of that industry which was already suffering from sharply higher land and construction costs, from erosion in the purchasing power of consumer incomes, and from the overbuilding of the last two years.

The overheating of the economy from which we have recently suffered is, however, now in process of being corrected. Federal Reserve policy has contributed to this development.

In view of the intensity of the inflation, a policy of moderate monetary restraint remains appropriate; but I also feel that it would be undesirable to further intensify monetary restraint.

In any event, market forces are no longer driving interest rates to ever higher levels. In fact, short-term market interest rates have recently receded from the extraordinary peaks reached this summer, and long-term market rates have stabilized or moved down a little. Mortgage interest rates and institutional interest rates are, however, sticky and traditionally lag behind market rates.

The recent movements of interest rates are encouraging, but we cannot count on any large or lasting decline of interest rates until borrowers and lenders in the market perceive that the Federal Reserve is no longer pursuing a lonely struggle against inflation.

Monetary policy is much too blunt an instrument to be relied upon exclusively in what should be a national effort to bring inflation under control. We at the Federal Reserve hope that financial institutions will proceed more cautiously in their lending policies but with a full sense of awareness of the basic needs of their communities. We also hope that fiscal policy will soon actively join in the struggle against inflation.

A fiscal policy that is tilted toward surpluses instead of deficits can make an enormous contribution to curbing inflation and to lowering interest rates.

I have referred earlier to the strains and stresses in financial markets. Let me add, in this connection, that while tensions in financial markets remain acute, they have been reduced to some degree in recent weeks. This is evidenced by somewhat smaller risk premiums on securities of borrowers of less than prime quality. Also, while it is still difficult to place lower grade issues of commercial paper or of corporate bonds, the flow appears to be better than in the early summer.

In closing, I want to make several terse observations on financial policy.

First, inflation cannot be brought under control without causing inconvenience, some disruption, and even hardship. By alleviating the harsh and uneven impact of its restrictive policies, the Federal Government will have a better chance of persevering in a policy of containing inflation.

Second, bankers and other financial managers have lately become more prudent, partly on their own account and partly because of increased vigilance by the bank regulatory authorities.

Third, the Federal Reserve System fully recognizes its responsibility as a lender of last resort and can be counted on to come to the assistance of financial institutions that are caught in a temporary liquidity squeeze.

Fourth, and finally, while the Federal Reserve must persevere in the struggle against inflation, we shall also see to it that the supply of money and credit continues to expand. There will be no credit crunch in our country.

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