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THE ECONOMY AND BANKING IN 1979

Remarks of

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at the

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The Economy and Banking in 1979

In my opinion the first and foremost threat to the economic, financial and political power of the United States is the high and rising rate of inflation. History tells us that when people begin to spend their money at an accelerating velocity and seek new investment havens from inflation, even at the risk of borrowing beyond their means, their nation is approaching the danger point of runaway inflation and serious deterioration in the value of their currency. I think we are traveling this road and without firm action to combat inflation we may suffer the ultimate consequences. None of us want a serious recession with its financial and social penalties. Nor do we want the traumatic experience of a severely depreciating currency. So our only real choice is to force a slowdown in credit extensions and real growth rates until the acceleration and expectations of inflation subside.

We can defer a slowing in our economy by continued stimulus from Government spending and high money growth rates but only at the cost of higher inflation and severe recession later on. On the other hand, we may slow the economy to recession levels with only minimal progress in reducing inflation this year.

These are indeed "no-win" choices for the Federal Reserve and the entire economic stabilization program. How much additional restraint can be imposed to bring a slower growth rate without risking a recession of unknown dimensions is a matter of judgment and timing. But by holding to a steady posture, the nation's economic policymakers risk continued expansion in the economy, further growth of consumer demand and inflationary expectations, and with little unused labor or plant capacity, an acceleration of inflationary pressures. Of course, an easing of monetary policy would exacerbate all of these problems and also bring renewed depreciation of the value of the dollar in international exchange.

While the recent administration effort to curtail the rising rate of government spending may provide considerable help in reducing inflationary pressures over the next three years, the immediate problem for 1979 is not likely to be affected by the degree of fiscal caution presently under discussion. Similarly, the wage-price guidelines may be helpful in the long-run fight to contain inflation, but in the 1979 environment, the price pressures will be more responsive to both cost and demand pressures, especially for food, raw materials, and energy. Moreover the notion that inflation can be contained by a long-run program without intensified short-run restraint, may reflect both a procrastination of hard policy choices and an unrealistic view of market forces.

As policymakers and as prime financial intermediaries, we should reappraise the costs and benefits of our present policies and the need for protection of our fundamental strength in coming months. To me the costs of sustaining our present level of economic activity in terms of present and potential inflation are not acceptable. If the parameters of our policy choices are an accelerating inflation or a severe recession then an intermediate course must be found. The nation must not pay the cost of a dangerously accelerating inflation, but it should also avoid the costs of serious recession.

In the current situation, with sharply divergent growth and inflation rates among the major industrial nations and consequent differing balance of payments positions, the U.S. flexibility in stabilization policies is considerably restricted. While a particular set of policies may be desirable for domestic purposes, they may create undesirable results for our balance of payments, exchange rate relationships, or balance of economic strength.

In the world of horror scenarios, probably the worst for the economic scene in the United States would be an economic recession, rising unemployment, a declining dollar exchange rate, and continued inflationary pressures. Certainly none of us would advocate policies leading to such a situation. However, the dangers are certainly visible and appropriate policies must be taken to counteract them.

Much of our efforts in economic stabilization are integrally tied to timing of policy moves. An early move to restrain before expectations of even greater imbalances develop is a better choice than policy actions after a momentum of inflationary expectations has been created. Today we are unfortunately in the latter situation, but even now we are in a better posture to take needed action promptly than to procrastinate until economic or financial forces exacerbate the untenable combination of rising inflation, speculative credit demands, and serious further deterioration of the dollar.

In my opinion the United States is rapidly approaching full utilization of its resources, unsustainable consumer demands, accelerating inflation and threatened further exchange market turmoil. If I am correct, then action will be forced upon us whether we like it or not. The most extreme actions could include mandatory wage and price controls, an allocative credit policy, import surcharges or quotas, limits on foreign lending and other exchange controls. But such extreme measures are incompatible with the basic philosophy of U.S. policy. We attempt to operate in a free market system, both at home and abroad, and would accept such draconian measures only under the most severe conditions. But to insure that such conditions do not develop requires a high degree of self discipline and an intensive use of the aggregate restraints of monetary and fiscal policy.

So we come to the central question--do Americans individually and collectively have the will to exercise such restrictive self discipline and support aggregate measures of government restraint to avoid the use of specific controls? I think we do if we become sufficiently informed and concerned about the adverse alternatives we face.

For you in the banking industry, as leaders of community awareness, and as principal elements in credit markets of the nation, there is a unique set of responsibilities for financial statesmanship. In the operation of your own banks you should press for responsible credit use. You have a special responsibility to insure the safety and soundness of your institutions--to be conservative in the granting of credit, especially when faced with such broad-scale economic uncertainties.

Bankers should be molding public thinking toward recognition of the hard choices ahead and the need for restraint in public spending at local and state levels. In addition bankers should be leading the way toward developing public support for economic stabilization measures to combat inflation.

The banking industry has a special responsibility to inform itself about the economic and financial conditions of the nation and the ways in which banking can strengthen the financial fabric of the country. As spokesmen for a large segment of the financial community, bankers should be using their influence to foster desirable legislation or combat unwise legislative efforts.

In conjunction with the Federal Reserve and Treasury, bankers should be seeking new approaches to stabilize our international financial affairs and be sure that banks are not a source of instability. In particular the larger banks should be aware of their role in the overall international picture and the potentials for damange which could develop from excessive lending or unwise concentrations of credit in other countries, industries or individual firms. With a more volatile international financial exchange mechanism, banks need to support the programs of the International Monetary Fund, especially in countries where conditional extensions of IMF credit have been made.

You may not have known that you joined an industry with such extensive public responsibilities, but your basic jobs of managing and investing other people's money and your participation in the nation's money and credit markets bring with them special public visibility and trust. It is my pleasure to recognize your industry's great contributions to the public good. But we must call upon you for even greater efforts and self-discipline if our nation is to maintain its economic strength and regain its financial health.

Specifically let me suggest the following policies I think we need in today's situation:

1. Redouble your efforts to justify each loan both as to the creditworthiness of the borrower and the contribution it may make to the profitability of the bank against the risk accepted.

2. Reappraise your loan program for this year to take account of the broad economic and financial risks, especially in the fields of mortgage and consumer credit.

3. Resist the temptation of high-rate, high-risk loans, and limit asset growth to your reasonable capital coverage.

4. Restudy your terms of credit, such as maturities and downpayments for consumer credit or margins of equity in stock.

5. Refuse to be stampeded into competitive excesses in bidding for new funds or straining for the marginally acceptable credits.

6. Restrain your competitive urge to stretch all dealings to the limit of regulations, such as remote disbursement of checks.

7. Re-analyze your bank's productivity and costs to limit the need for rate increases and to maintain net returns.

8. Re-emphasize your support for fiscal and monetary restraint and for the principles of wage and price caution.

9. Recognize your position of leadership in community thinking and support programs of prudence in financial affairs.

Let us be sure we understand each other. I am suggesting a healthy new dose of caution in the banking business. I am not suggesting that you close the loan window or retrench, unless you are already in an exposed position.

Lest you think I am placing the whole responsibility of correcting current excesses on the banking system, I have a list of government actions which I think are needed to stabilize our financial affairs. Among these are:

1. Creating a new energy program to stimulate production of oil and gas and develop new sources of energy.

2. Making a further cut in government spending by at least $20 billion beyond that proposed in the budget document.

3. Eliminating ceilings on interest rates so that savings will be encouraged and subsidies to borrowers discouraged.

4. Creating new U.S. inflation bonds with 9 percent interest in $1,000 denominations.

5. Encouraging capital investment by rapid write-offs and capital gains tax reductions.

6. Imposing reserve requirements on all deposits for all depository institutions and restricting availability of credit.

7. Encouraging wage moderation by limiting minimum wage increases and creating a teenage minimum.

8. Enforcing anti-dumping laws and countering foreign export subsidies.

In summary, in my opinion we must pull together to solve this nation's inflationary problem and restore our country's financial health.

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