For release on delivery
8:30 a.m. C.D.T., May 7, 1974
(9:30 a.m. E.D.T.)

BANKING AND INFLATION

Summary of Remarks by

Robert C. Holland

Member, Board of Governors of the Federal Reserve System

before the

Seventy-Seventh Annual Convention

Nebraska Bankers Association

Lincoln, Nebraska

May 7, 1974

I am happy to join you here this morning, but it is a very unhappy subject which I am addressing.

Inflation has come to be the dominant economic problem of today. This statement applies not only to the United States, but to virtually all the industrialized nations of the world.

In greater or lesser degree, this problem has been building here in America for a decade or longer. Its causes--and our attempted cures--have varied over those years, but never did we master it. In much of the latter half of the 1960's, the root cause of our inflation was excess demand, spurred by large deficits in our "guns and butter" Federal budgets. Occasionally during those years, and for a longer interval in the early 1970's, demand for goods and services was brought under control, but strong cost-push pressures kept prices climbing nonetheless. Then, in 1973 and 1974, shortages on the supply side--first of food, then of industrial raw materials, and finally of energy--triggered the sharpest new price advances of the decade, and the end is not yet in sight.

We have been fairly imaginative in the variety of tools we have tried to use to slow the inflation, but not altogether successful in their application. The Federal budget was finally pulled into surplus late last year, but already it is starting to slip back toward deficit and there is talk in Congress of actions that would deepen that deficit still more. That kind of fiscal policy cannot halt inflation. We tried wage and price controls, but after some initial successes their distortions chafed and they were battered by the latest inflationary outbursts; they died one week ago at their low point in credibility, and few bothered to mourn their passing. We have tried to encourage expanded supplies, but in most areas they are a long time coming. Thus far the only major result is sharply increased farm plantings. If this year's harvest measures up to its indicated abundant proportions, it will indeed exert a major force holding down food and related prices and be a significant brake on the inflationary spiral. But the thanks that the Midwestern farmer is due for his invaluable contribution may be accompanied by another cost-price squeeze on him, a poignant reminder that few counter-inflationary forces are painless.

The chief remaining instrument in our anti-inflationary arsenal is monetary policy. We have used it hard and often during the past decade to try to slow the inflationary spiral. I think it has helped from time to time, but not without some unpleasant side effects in the form of credit market distortions, disproportionate downward pressures on housing and several other areas, and historically high levels of interest rates. Yet now it once again bears a very heavy share of the burden of fighting inflation, for the very practical reason that no other public policy tool seems presently capable of doing more of the job.

In these circumstances, some people can be tempted to throw up their hands in despair. Floating along on the inflationary tide can be a beguiling prospect, with more and more contracts tied to rising price indexes, and public welfare programs primed to help out the laggards.

That course I hope we firmly reject. There are theoretical arguments against it. There are practical arguments against it. But the most compelling argument I know against it is that the average American citizen is against it. He doesn't like the idea of bobbing along on a swelling inflationary tide--he detests it. In the end, I believe that kind of broad national conviction will strengthen the will of both public and private policy makers to do what has to be done to bring inflation back to earth.

If that is to be done, and if monetary policy is to be a workhorse in that anti-inflationary endeavor, then I must say to you that banks are in for an uncomfortable time. The basic design of our financial system has banks at its core, and it makes banks the chief channel through which the bite of monetary restraint is spread through the economy. Your liabilities become costly and hard to support, your bond portfolios drop in market value, and you are pressed to speak in discouraging terms to your good loan customers, either in terms of higher interest rates or constrained loan totals or both. The Federal

Reserve talks of such unpleasantries to you as high reserve requirements and possibly increased interest rate ceilings on time deposits.

Plenty of causes of irritations will arise between us. There will be human mistakes in actions--misunderstandings will occur--and imperfections in institutions and markets may produce some jarring moments.

Your role and ours will be in some respects an unhappy one--but it will be absolutely essential to success in this battle. Whatever the irritations and secondary difficulties we face, we both must put first things first. We need to give top priority to those things that further the efforts to slow down inflation. It is the nation's number one economic enemy. It is your community's biggest economic enemy. It is your own bank's greatest economic enemy. The essence of banking is taking custody of people's dollars and promising to give them back in good shape. If the dollar which is your stock in trade continues to be a rapidly depreciating asset, then you are in a losing business.

So I appeal to you--in your own interest and the nation's--to be the leaders in the fight against inflation. Give your support, and your wisest counsel, to the makers of monetary and fiscal policy as they pursue this struggle. That struggle is so fierce and closely contested that you could help to make the difference.