For release on delivery
3:00 p.m. C.D.T., May 9, 1974
(4:00 p.m. E.D.T.)

BANKING AND THE ECONOMY

Summary of Remarks by

Robert C. Holland

Member, Board of Governors of the Federal Reserve System

before the

Eighty-Seventh Annual Convention
Kansas Bankers Association
Kansas City, Kansas

May 9, 1974

I am pleased to join in this pleasant occasion and to share in your Kansas hospitality. But for all our momentary good spirits, we are aware that we are passing through difficult times as a nation. Troubles afflict us in a number of areas, but not least in the sphere of business and finance where to some extent you and we are stewards of the nation's trust.

There is a very unhappy mix of economic trends presently underway. We find shortages--actual and threatened--of a number of the products that have helped to make life pleasant in the past. Partly because of those shortages--or concerns about them--we find production cutbacks, sales shortfalls, and unemployment bulges in a number of business areas. At the same time, those supply shortages, plus generally strong spending patterns, have combined to produce one of the most sharply rising price levels this country has ever had to suffer.

Clearly, a lot has gone wrong. Trying to understand the causes of our difficulties can be helpful, but searching for scapegoats cannot. These economic troubles were not deliberately sought. For the most part, I believe both public and private policy makers have been trying to do what they thought best at the time. But we, and much of the world along with us, have been victimized by an unhappy interplay of events. There have been significant unforeseen misadventures, ranging from migrating anchovies to stubborn Arab sheiks. There have been a sprinkling of mistaken ideas. And there have been lots of good intentions frustrated in execution.

By no means have all of the results been bad. The economic fortunes of some sectors have blossomed for a time; occasionally, however, those blossoms have withered. Last year's soaring agricultural prices brought a boom in farm incomes, for example, but this year's partial reversal in those prices is being accompanied by further rises in farm costs that are already raising the spectre of a renewed cost-price squeeze on the farmer.

That is ironic, for right now the American farmer looks like the most effective inflation-fighter in the world. His big 1974 harvest in prospect may do more than any other single action to brake the spiral in food costs and hence in the cost of living.

What can general economic stabilization policies do to help in this set of circumstances? I want to be careful not to be too optimistic about them. Fiscal policy has the capacity to help through selective programs focused on the most disadvantaged, such as the pockets of unemployment in depressed areas. On the other hand, there does not seem to be much practical chance this year for any overall fiscal belt-tightening that could trim the general demand impetus to the present inflation.

Price and wage controls have been tried and found wanting in the public's eyes. After some initial successes in 1971 and 1972, distortions began to chafe unbearably and the controls were overwhelmed by the subsequent inflationary outburst. By the time they expired at the end of last month, few persisting believers in them could be found.

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.

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.