For release on delivery
(7 p.m., Wednesday, October 12, 1966)

Summary of Remarks

by

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Board of Governors of the Federal Reserve System

at the

Joint Meeting of the Boards of Directors of the
Federal Reserve Bank of Cleveland

Moraine Country Club

Dayton, Ohio

October 12, 1966

Economic developments during the past year have been characterized by a sharp increase in defense expenditures for Viet Nam, and a continued--and probably over-exuberant--rise in business investment in plant, equipment, and inventories. The accommodation of our resources to these two expanding uses has been reflected in rising prices, increased demands for credit, and higher interest rates.

While we have moved fast and far in these areas, there are now hopeful signs that the exuberance is calming down. However, this is by no means certain from the evidence so far at hand. On the other hand, there is always the possibility that once demand slackens the process may go too far. Should that happen, monetary and fiscal policies would by necessity have to change accordingly.

The problem this past year has been to shift a relatively small amount of resources to increased defense and business spending. The actual cost of this shift has not been great in terms of output and employment but has been high in interest costs and psychologically. It has caused distress to numerous individuals, families and firms and to one or two major sectors of the economy, particularly housing.

Because of these negative developments it has been easy to overlook the favorable side. Productivity and employment have continued to rise rapidly. We reach new production heights each month. Industrial output has expanded at a fast pace and unemployment has approached desirable low levels.

The rise in Viet Nam expenditures and more than normal business expenditures threatened to raise total demand by 4 per cent or more above our real growth rate. Resources have been freed for these uses partly by increased taxes, partly by removal of some demand through higher interest rates and less available credit, and partly by price increases.

From the start I have argued that the impact both on the over-all economy, and on individuals in particular, would have been far less if more reliance had been placed on taxes to transfer these resources with correspondingly less reliance on monetary policy or on price increases.

There are indications that a transition stage may have been reached, if one can rely on recent press reports and surveys of business and consumer attitudes. It is possible, too, that the shift in leading indicators of the past few weeks may also be indicative of a change in the wind. The pressure from demand-pull incentives seems to have decreased.

The pressures will be lessened if it turns out that businesses are really cutting back on demand. This would ease the problem of transferring resources within the economy and would reduce pressure on banks and the credit markets. Pressures on these markets have also been reduced by the President's program to lower the impact of Government financing on credit markets. More weight also seems to be given now to his repeated assurances that if more resources are required for Viet Nam they will be balanced by reductions in other Government programs or by financing through higher taxes.

If the growth in demand should show positive signs of weakening the Government would have attractive alternative choices. It would not be necessary to raise taxes and steps could be taken to increase the flow of credit.

On the other hand, the price structure still seems out of balance. Wage bargains are going up and commodity price increases are still being announced with all too frequent regularity. A major problem on the inflationary side is that we may be left with the built-in possibilities for a wage-price spiral, particularly if reasonable adherence to price-wage guidelines cannot be re-established.

While we can be optimistic, the need remains greater than ever for alertness to the signs of significant change. No matter which direction changes take, alacrity will be required in adjusting monetary, credit, and fiscal policies to the evolving economic scene.