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THE JOB OF THE FEDERAL RESERVE SYSTEM

The Federal Reserve System's most important job is to help to protect national prosperity from damage by inflation. In doing its part of the job, the Federal Reserve System relies on the determination and resourcefulness of the American people to cope as successfully with inflationary problems as they did with post war readjustment problems when national production was greatly increased and living standards raised within the same short space of time that it was also possible to be of major assistance to our friends abroad. Teamwork accomplished those remarkable economic feats and teamwork at all levels of public and private life and activity is essential to overcoming the threat of inflation.

The general object of teamwork must be to keep the total of public and private expenditures in proper balance. This is because the concern felt about inflation has focused on the drift toward higher prices and, therefore, to the extent that total expenditure is the source of the pressures which force prices up, holding them within reasonable bounds helps to abate pressure on the price structure and to preserve the purchasing power of the dollar. In line with this reasoning, public bodies have been urged to adopt fiscal policies holding their expenditures within the most conservative limits that are practical. Conservatism in the area of private expenditure is equally desirable and it is there that the work of the Federal Reserve System can be most useful through the anti-inflationary influence of its power to regulate the supply of credit.

The economic importance of the Federal Reserve System's job of regulating the volume of credit lies in the fact that the use of credit leads to expenditures that become a part of the total stream of expenditures. As Federal Reserve System policy of recent times has been to restrain the expansion of credit, the effect has been to limit additions to the stream of total expenditures and thereby to moderate upward price pressures that would otherwise originate from credit sources.

Business activity during the period that the Federal Reserve has sought to restrain the expansion of credit has been at a high level, as has also been true of the demand for credit, which accounts for the rise in interest rates. It is true that if the Federal Reserve System had not acted to restrain the expansion of credit, and a larger supply of credit had been available, interest rates presumably would not have risen as strongly as has been the case but the stream of expenditures would have been swollen proportionately and inflationary influences aggravated that much more. Moreover, although interest is seldom a decisive business cost, it is a cost factor to be reckoned with in business planning. As that is so, higher interest rates tend to exert a restraining influence on economic activity at times when booming conditions deserve the touch of a cautionary hand. By the same token, a higher cost of interest probably has some effect on the thinking of individuals planning to purchase homes or consumer durable goods through the use of credit by encouraging their greater use of savings and lesser use of credit for carrying out their projects.

Under present conditions, the use of savings to finance business expansion is preferable to bank created credit because such a use of savings permits the advancement of capital expansion programs with a minimum of inflationary impact. It therefore follows that where higher interest rates tend to stimulate savings and to draw them into economically sound projects, a good purpose has been served.

All told higher interest rates are a natural phenomenon of the present state of business and in their effects help to serve the ends of a national economic policy seeking to preserve a sound prosperity. What may be hoped for from the public and private teamwork necessary to insure the continuance of generally prosperous conditions is that the economic factors and credit resources which during recent years have found varying active employment in one sector of the economy after another will continue to circulate and as their need at one point has lapsed will move on to find still other useful employment. This is the process that is known as a rolling readjustment which as it may now be occurring might witness a shift in economic activity away from the area of capital investment back, for example, into the area of home construction. The transfer of economic factors and credit resources that would accomplish this shift might be expected to stimulate and increase demand for the output of the enlarged plant capacity that has been put in place as a service to the American consumer. A new balance between national production and consumption should come from this kind of development and without burdening the American people with an additional load of debt as would be the case if an attempt should be made to artificially stimulate consumption through a greater use of credit. The high level of employment and of individual incomes give promise that consumers have the means to absorb the output of our magnificent plant. Their willingness to do so depends on their confidence that all vestiges of inflation can be eliminated and the purchasing power of the dollar maintained. Teamwork to protect prosperity is essential to justify that confidence.

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Summary of remarks at the Joint Directors'
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Federal Reserve Bank of Kansas City