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Opening Remarks
of

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My opening remarks will be brief, because I want to make a contribution of time that you can use in the question and answer period, since your questions and--I hope--our answers, can serve your particular interests in the subject area assigned to this panel more precisely than we can in our remarks.

There is little I have to say about the balance of payments. But little as it is, it is probably more than you want to hear after a week and more of extensive exposure to so many skillful persuasions using balance of payments trends, analyses and econometric projections.

The stability and performance problems of the domestic economy can, of course, be significantly affected by our international trading, investment and assistance activities. Even though in the aggregate these activities involve a relatively small share of the level or change of GNP, if we return to a strong surplus position on trade and services--by expanding our exports--the stimulative effect on our economy would be of significant magnitude.

Of course, the process will take time. Exchange rate adjustments have their effects only with a lag. Thus the domestic repercussions of the increase in our balance on goods and services should not be difficult to cope with.

I stress the need to correct our trade position by expansion of our exports, rather than a reduction of imports, because we ought not to lose sight of the great importance of imports to American consumers. Good imported products, reasonably priced, have enriched the choice of goods available to us and made our income go further. Such imports should be regarded as a boon, not a burden. At the same time, it has to be recognized that import competition can create problems of adjustment in the employment of our capital and labor. These are similar to the problems that would be created, even in a closed economy, by technological advance. The more serious of these problems should be dealt with, not by penalizing the American consumer and raising the price level of the American economy, but by domestic relief measures.

Emphasis on the advantages of imports suggests that there is a tradeoff between the interests of American consumers and those of U.S. foreign investors with respect to the structure of the U.S. balance of payments. If the United States were to aim for a large and unrestrained outflow of capital to developed countries, this would require an even larger trade surplus than is now being talked about or more constraints on imports. The achievement of such a surplus would one way or another require that imports become more expensive.

My own preference would be for a smaller capital outflow--even if it required an IET-type apparatus over the long run--and less costly imports.

Let me turn now to some domestic considerations. Those developments in the U.S. economy which ordinarily foreshadow business trends for the future have become considerably more difficult to interpret in light of the "freeze" and the uncertainties of financial markets and in the minds of businessmen, labor and consumers with respect to content and acceptance of the "Phase II" program. How the public will react to "Phase II" is an uncertainty that may persist for sometime, even after its conditions are known. While public acceptance of the "freeze" has been excellent, the task of dispelling expectation of a continuance or early resumption of inflation will take time and will require an extraordinary resolution on the part of all in the Government and in the public. While the price stability problem is a difficult one it is not impossible and we have certainly succeeded in one important aspect of dealing with it--namely, the elimination of excess demands in the economy.

In my opinion, we have passed the point of no return on our present policy course. That is to say, we are committed to surmounting whatever difficulties remain in the way of achieving reasonable stability,and our growth and employment goals are predicated on success in doing so. I would put the odds high that a reasonable stability will be achieved next year.

In the meantime, we seem to be moving slowly toward higher rates of real growth.

We appear to have achieved important adjustments in defense and space outlays, inventory levels, and manufacturing conditions. In some degree these adjustments provide a floor at which trends in output will be sustained or increased in the future. And any rise in utilization of plant is almost certain to have a favorable impact on workers' real earnings, profits and investor sentiment.

Some observers, mainly in the business community, see concrete evidence of these tendencies in their own operations and their confidence in recovery under prevailing conditions is rising. Number watchers, on the other hand, are more divided in their readings. Most shade their odds on the timing and the vigor of the upturn when pressed to be specific on quarter-by-quarter developments in the coming year.

I presume that on an occasion of this kind anyone from the Federal Reserve would be expected to say something about the money supply. To live up to your expectations, let me raise some of the questions I am frequently asked.

Which of the several definitions of money is most useful? Do changes in growth rates of the money supply, however defined, consistently reflect Federal Reserve action or intent? Do they portend changes in economic activity 3, 6, 9, or 12 months hence? These and related questions indicate to me that the financial community these days is deeply puzzled by money supply theories. Or it might be said anyone in that community who pays attention to money supply development has to become an expert, a disciple or a victim.

The money supply is not really something new in our financial environment but is something newly perceived by many people and hence has a faddish appeal as well as a real significance. In the early part of the year the money supply rose at virtually unprecedented rates: February, 14.0 per cent; March, 11.6 per cent; April 9.3 per cent, May 15.2 per cent; June 9.1 per cent and July 10.1 per cent. How significant were these rates of change? Did they portend a renewed inflationary virus? Against this background, how significant was a money supply growth of 3.2 per cent in August and the prospect of little or no change in the money stock in September?

To deal with these questions initially, let me note that near monies in today's economy are the major source of the liquidity for businesses and households. The demand for M_1 is the demand for transactions medium and is linked to changes in the payments mechanism. Thus, as currency and demand deposits have been used more efficiently the demand for them has declined. If the improvements in the functioning of the payments mechanism that have been taking place were to taper off, money demand would be pushed up by the economy's growth. Or if there were a sharp spurt in money efficiency accompanying, say, a more widespread use of Federal funds transfer, money demand could fall off sharply. It is instructive to look back on the effect of changes in money efficiency on the demand for money.

The only kind of money supply that has increased in relative terms over the past fifteen years is coin. Coin-in-use was .73 per cent of the annual rate of personal consumption expenditures fifteen years ago; today, because of the development of metering and vending machines, the demand for coins has increased nearly 40 per cent. Currency-in-use, both large and small denominations, on the other hand, has been declining in importance; its role has shrunk by nearly 30 per cent since 1955. Currency is being displaced by credit cards and checks as individual transactions are accumulated in charge accounts and subsequently settled by check. There is no indication this trend is abating; on the contrary, the demand for currency apparently will be shrinking for some time to come.

The major element in the money supply--demand deposits--has also declined substantially. Using GNP as a proxy for money demand, deposits declined 40 per cent between 1955 and 1970. The reason in this case is, that even though demand deposits are replacing currency and thus picking up some of that work load, they are also being used much more efficiently. Technology, a changed attitude of corporate treasurers, and the promotional efforts of the banking system have brought about a dramatic change in the economy's demand for deposit money.

The counterpart of this economization of demand deposit balances also appears in the steady growth in turnover or use of those balances. Since 1964--earlier data are not entirely comparable--total transactions by check have almost doubled-- to about $13,000 billion per year. In this period the demand deposit component of the money supply increased by less than 30 per cent. In the major financial centers turnover rates virtually doubled in those years and in other metropolitan areas, the increase was about 40 per cent.

Obviously, these changes in money use and technology have a very important bearing on judgments on an appropriate rate of monetary growth. A four-to-five per cent growth rate for money is absurdly low with the GNP proxy rising at 8-10 per cent unless money "productivity" is increasing sufficiently to make up the difference. Developments in transaction technology and banking practice have far more to do with longer term appropriate growth rates in the narrowly defined money supply than remote, in time or place, experience or Delphian pronouncements.

A partial explanation of the recent rapid rates of monetary growth may be found in technical statistical adjustments and shortcomings. Seasonal adjustments for this series are difficult because of the instability in timing and duration of certain seasonal events. The data themselves are a by-product of reserve accounting procedures and thus are exposed to several deficiencies which would not ordinarily exist in a set of numbers collected for statistical purposes only.

International and intermediary flows have been of unprecedented magnitude in 1971; but from available data they appear to have had significant effects on the demand for money mainly outside of financial centers.

The annual rate of money transactions for the country as a whole changed dramatically in three months--February, May and August--but most of the change took place in New York. There were increases of $800 and $600 billions in February and August and a decrease of over $500 billion in May. Most of the rise in New York transactions for February and August and the decline in May was accommodated by turnover changes. In February and August the annual turnover rate was close to a record 200 times per year.

Outside of New York and other financial centers transactions rose on an annual rate basis by over $100 billion in February, March, April and June. These increases were accommodated in significant measure by increases in deposits and, thus, we can identify in some degree the major source of deposit rise.

It may be sometime before the financial developments of the year can be fully traced and their impact on the average daily need for demand deposits appraised. But the very magnitude of financial flows suggests transaction deposit levels needed to accommodate them have been substantial and goes far to explain the very large money supply growth in the early part of the year.

The net of my comment on the money supply is in two parts. First, in light of technological changes in the payments system there is no known long-term rate for M_1 which can serve as a reliable guide. Second, the recent high rates of growth in M_1 probably can be explained by the unprecedented financial flows in 1971 and imperfections in the statistical measures of M_1.