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Remarks

by

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before the

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RECENT ECONOMIC TRENDS AND FEDERAL RESERVE POLICY

Recovery in economic activity has been proceeding at a rapid rate. Within a relatively short period, industrial production has recovered more than half the 13 per cent decline from August 1957 to the low in April of this year.

The recent increases in activity have been widespread and, it is important to note, have included advances in industries producing capital equipment. This is in contrast to the continued declines experienced in equipment industries after the total index of industrial production had reached its low in the two earlier postwar recessions. Significantly, the recently completed survey of prospective dollar outlays for plant and equipment indicates outlays for the third quarter of this year will hold level rather than decline as indicated earlier, while in the fourth quarter outlays will show a moderate rise. So far, construction of industrial buildings has continued to decline, but private housing starts have risen sharply--to the highest level in over two years. Altogether, construction activity has risen about 5 per cent since mid-spring.

Meanwhile, output of steel and most other major material for manufacturing and construction uses has increased considerably since spring when business inventories were being rapidly liquidated.

While the increase in employment has been moderate and the rate of unemployment has changed little after allowance for the usual seasonal influences, personal income has reached a new record high. Consumer buying has expanded again, and it is close to the record highs of the summer of 1957. Expenditures for goods and services other than autos--which currently are undergoing the annual change-over to new models--have reached new highs.

On the price front, where attention focused on advances in prices of some sensitive industrial materials last spring and in steel prices last summer, wholesale prices of most finished goods have changed little recently, and the very slight further increase in consumer prices in July, latest month for which figures are available, has been followed by a period in which retail prices of foods may have declined somewhat.

So far, so good. But essential as it is to have a recovery under way, carrying with it promise of expanding job opportunities for those seeking work, it is still more essential that it be a recovery that lasts, and thus provides jobs that also will prove lasting.

It is to this end, the establishment of a basis for a sound prosperity that will endure, that the Federal Reserve System is devoting its efforts. In those efforts, it is necessary for the System to recognize that inflation is not merely a phenomenon of rapidly rising prices. Indeed, if we wait until that stage is reached, we will have waited too late to be effective against the inflationary pressures that brought about the price increases.

The System, therefore, must be alert to the causes of inflation, most particularly those causes of inflation that are monetary in character and hence tend to escape the notice of the millions who have no time, and little inclination, to study closely each day the financial pages of their newspapers. For the System must recognize at all times that the first signals of inflation can appear in the monetary field--to which the System's powers apply exclusively--manifesting themselves in distrust of the dollar and a consequent trend to unhealthy speculative tendencies that may undermine the developing recovery and plunge us into a worse recession than that from which we have recently emerged.

No one who gives careful daily attention to the financial pages could have missed the appearance of such danger signals--nor have failed to notice that the Federal Reserve has been acting to check them, although its actions have been steady and progressive rather than dramatic and drastic.

The increase in margin requirements ordered by the Board of Governors, effective August 5, amounted to a restoration of the 70 per cent margin requirement that prevailed before a reduction to 50 per cent last January 16. The January reduction was ordered at a time when there had been a decline in the use of credit for purchasing and carrying stocks. The August restoration was ordered to prevent the excessive use of credit for this purpose at a time when the volume of such credit, as measured by stock market customers' debit balances, had reversed course and risen to the highest level recorded since debit balance figures have been compiled.

Increases in discount rates from 1-3/4 to 2 per cent have been approved by the Board thus far for 10 of the 12 Federal Reserve Banks, since August 15, on recommendation of the Board of Directors of those Banks. Between last mid-November and early May of this year, the discount rates of the 12 Federal Reserve Banks were reduced, in view of the downward course of business and business sentiment over that period, from 3-1/2 to 1-3/4 per cent, in four stages. The last of those reductions was from a 2-1/4 per cent level that had prevailed in April's first half. The increase in discount rates since the middle of last month has amounted to a restoration of one-half of the last of those four reductions, in recognition of the change in business conditions and recent manifestations of inflationary sentiment.

Federal Reserve Open Market operations, used in combination with reserve requirement reductions during the recessionary phase to help enable an increase in the money supply that reached the annual rate of 8 per cent in the early months of this year, also have been adapted to the change in economic conditions. Instead of fostering a further rapid increase in the bank lending potential, which might lead to further rapid expansion in the money supply when changed conditions made that no longer appropriate, the Federal Reserve Open Market Committee has permitted seasonal demand for credit to absorb a goodly part of the idle bank reserves that were appropriate to the conditions prevailing in early 1958 but inappropriate to the different circumstances of the present.

There has been no drive to cut back bank credit or the money supply, although attention has been directed to moderating expansion in tune with the changed times. Interest rates, on the other hand, have risen markedly in recent times--chiefly, perhaps, because lenders and investors suffering from almost psychotic fears of inflation in the future--have been reluctant to lend or to invest in bonds carrying a fixed return because of fear that the dollars they get in repayment eventually will be worth less than the dollars they lend or invest today. That is something deserving a second thought by those who have advocated "creeping inflation" as an economic necessity or benefit, and by those who have favored monetary expansion as a means of getting interest rates down. Just ask yourself the question, how ready would you be to lend $100 dollars for ten years--or even one year--if you expected the dollars you eventually get back would be worth 2 or 3 per cent less each year before you get them? And would you be inclined to accept less interest than you had been getting, or would you want not only the old rate of interest plus an additional 2 or 3 per cent to compensate for the deterioration you feared in the buying power of your dollars when you finally got them back?

The destabilizing force of expectations of inflation can be a very serious thing--for the economy, for the unemployed man who needs to get a job to support his family, and for the municipalities and states, as well as for the Federal Government, which have only one means of borrowing money--the sale of bonds--to raise funds needed for construction of schools, hospitals and like community improvements. The hardest, most tragic way to prove the folly of the notion that there can be any such thing as "permanent inflation" is to let a little inflation snowball into a big one that must in time collapse with consequences heavy in human hardship. The other, more sensible way is to pursue a course that will make for a sound, stable dollar, and thus overcome expectations of inflation by demonstrating they are groundless. It is this latter course that the Federal Reserve, within the limits of its powers over credit conditions, is now pursuing.

In that course, the Federal Reserve will continue in the future, as in the past, its constant practice of adapting its operations to whatever developments occur to help maintain, as fully as its powers permit, the soundness of the dollar to the end that we may also have sound growth in business and in employment.