or release to afternoon newspapers
ednesday, March 4, 1959.

R E M A R K S

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before

THE WASHINGTON SOCIETY OF INVESTMENT ANALYSTS

cidental Restaurant,
shington, D. C.

Wednesday, 12:00 noon E.S.T.
March 4, 1959.

By the fourth quarter of 1958 the gross national product, at a seasonally adjusted annual rate of $453 billion, was already above the pre-recession high in current dollars and close to it in terms of physical volume of goods and services. In the present quarter GNP appears to be advancing further to new highs in both current dollars and physical volume. Industrial production in January was 143 per cent of the 1947-49 average, within two per cent of the prerecession level. Personal income in January was in record volume and available data suggest that corporate profits have rebounded rapidly from reduced levels.

Rapid recovery in output since the cyclical low last spring has reflected widespread increase in demands. Consumer spending, which declined little during the recession, has advanced rapidly over the past year. Sales of new automobiles have been substantially above the reduced levels of a year ago. Residential construction, as in 1954, has made an important contribution to recovery. So far as business demands are concerned, inventory liquidation--which was at an annual rate of $9.5 billion in the first quarter of 1958--ceased by the year-end and some rebuilding of stocks may be taking place currently. Business spending for fixed capital, after a sharp decline, now appears to be turning up.

As earlier highs in output are equalled and then surpassed, attention naturally turns to such problems as how far and how long the present revival will carry. It is in this area that problems of cycle and growth merge. Real gross national product has risen on the average about 3 per cent a year since the beginning of the century. The growth rate for the postwar period has been above this. For the period ahead, no one can say with assurance

what the growth rate will be, but there is every reason to believe that it will be sizable.

Many economic problems remain to be solved. Thus, reduction in unemployment has lagged behind gains in output. Concern has been expressed over present levels of unemployment, particularly in those durable goods, mining, and railroad centers which were especially affected by recession. Unemployment usually tends in the early stages of economic recovery to lag due to lengthening of the workweek, substantial gains in productivity, and normal growth in the labor force. In January 4.7 million persons were unemployed or, on a seasonally adjusted basis, 6 per cent of the civilian labor force. This rate compares with a recession high of 7.5 per cent last year.

Another fundamental problem is widespread acceptance of the view that creeping inflation is inevitable. Thus far in the present revival, this view has been manifested most clearly in financial markets. As is frequently the case in periods of cyclical revival, the rise in common stock prices last year anticipated and outpaced recovery in economic activity. Common stock prices have risen to new highs following some moderate declines early in the year. Yields on common stocks are below those on high-grade corporate debt securities.

Factors contributing to inflationary psychological attitudes were: the almost unprecedented rapidity of the turnaround in economic activity at a time when continuing business recession and credit ease were anticipated; the relative maintenance of industrial prices during the recession and their resumption of upward movement last summer; the continuing rise in wage rates;

and the rather abrupt realization last summer of a much larger Federal deficit. In the summer there was an abrupt upward shift of interest levels in central money markets as investors demanded an interest premium to cover the risk of depreciating purchasing power of invested funds. At the same time, there was a significant shift of funds to common stocks instead of fixed interest obligations, in part to hedge against an expected inflation.

Since mid-1958 the United States Treasury has found it increasingly difficult to encourage investors to acquire and hold United States Government securities, particularly issues of longer maturity. This fact was highlighted by the recent February Treasury refunding in which more than one-fifth of the publicly held maturing securities were turned in for cash, notwithstanding the fact that interest rates on the new issues offered in exchange were generally accepted as realistic. Recent Treasury debt management difficulties have reflected both the continuing need to borrow large cash sums to help finance the current fiscal year deficit, estimated at more than $13 billion, and the need to refund large blocks of maturing securities.

In commodity markets recent developments have been somewhat diverse. Wholesale prices of industrial commodities have been advancing in recent months and the average level now exceeds the earlier high by more than 1 per cent. Prices of many industrial materials have risen as industrial activity and purchasing have expanded, and there have been scattered increases among wholesale prices of finished goods. Prices of farm and food products have declined, as supplies have expanded. The consumer price index has changed little for several months.

Monetary policy during the past 18 months of recession and recovery has been flexibly adapted to changing circumstances. In late 1957 and

early 1958, when the recession was under way, Federal Reserve discount rate, open market, and reserve requirement instruments were applied in complementary fashion to foster ease in credit markets and encourage bank credit and monetary expansion. From late fall 1957 through April 1958, there were four reductions in Federal Reserve Bank discount rates--from 3-1/2 per cent to 1-3/4 per cent; through open market operations continuing to early last summer, the Reserve System supplied the commercial banks with some $2 billion of reserve funds; and in late winter and early spring there were three successive reserve requirement reductions.

In late spring of 1958, prompt economic revival set in, owing partly to the enlarged availability of money as a result of Federal Reserve actions. Rapid and widespread recovery in industrial production and other highly encouraging developments were accompanied, however, by spread of inflationary and speculative psychology, and, during last summer, the Federal Reserve began to moderate the policy of credit ease. System open market operations after mid-summer supplied only a portion of the reserves needed to meet rising credit demands and to offset the reserve drain of a continued gold outflow. Moreover, Reserve Bank discount rates were raised in late summer from 1-3/4 per cent to 2 per cent, and in mid-fall when they were raised to a level of 2-1/2 per cent.

Early in January 1958, the Board of Governors reduced the required margin on purchases of common stock from 70 to 50 per cent. With the increasing activity and rise in stock prices accompanying recovery, stock market credit rose sharply. Early last August the Board restored the required margin to 70 per cent, and in mid-October it raised the required margin to 90 per cent.

Monetary policy contributed to a very rapid increase in the active money supply in the first half of 1958. After July, expansion in the active money supply slackened. For the year as a whole, the increase in money supply amounted to about 3-1/2 per cent.