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THE ECONOMIC OUTLOOK IN THE BICENTENNIAL YEAR

Remarks of

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The economic forecasts that I have been reading seem to predict a Bicentennial year economy which is perhaps best characterized as one showing a continuing moderate recovery from recession. The forecasted recovery is expected to bear fruits in lower levels of unemployment and higher levels of production but does not seem to imply a strong surge of the sort that might cause pressure on capacity utilization. The economists also appear to have agreed that while the twin problems of unemployment and inflation will persist during 1976, each is expected to moderate in the coming year. The unemployment level is expected to decline by most observers but there is some deviation of position with regard to the rate of inflation with some expecting further declines and others expecting little change from 1975. Most economists agreed that there are threats to our price level from various sources with some stronger than others. The pressures of wage increases in the coming year appear to be one of the stronger price threats for the economy in 1976.

Internationally, as best I can find from the economists' forecasts, they expect progress to be limited in the recovery from recession in most major industrial countries. There is some expectation of further problems for the less developed countries, though perhaps of a somewhat differing character from those of 1974 and 1975. For the coming year, problems of the LDC's may focus upon the need for additional funds to service debt burdens which have been contracted over the past two years as well as capital funds for further development purposes in a world in which capital goods costs now sharply limit the product which a country can obtain for the funds which it has been accustomed to receiving. Very few observers have commented upon the new international monetary agreements of Jamaica, partly because of the vagueness of wording in the Jamaica Agreement, and partly because the real test of that Agreement will be in the operations under it. Some economists seem to believe the international monetary scene is still likely to be somewhat unstable during 1976 as floating rates change the relative positions between major currencies. Though few observers appear to be taking a position upon political stability worldwide, those that have made comments still see political stability as a goal and not an achievement during 1976.

With this broad background of the forecast for 1976, let us take a moment to review the progress of the recovery to date. You have all been aware of the well-announced changes in gross national product since the recession low of the first quarter of 1975 and especially the very sharp gain in real gross national product for the third quarter of 1975. Economic analysts appear to support a further gain in real gross national product at a rate perhaps in the four to seven percent range in the coming year. To some observers this is an unacceptably low percentage increase given the recession problems of the past year but to others this is an acceptable range in order to restrain any possibility of a resumption in the debilitating inflationary pressures of recent years. Real gross national product would appear likely to exceed its prior record level during 1976 by a narrow margin. Nominal gross national product for 1975's recovery period, appears to have gained more than $100 billion.

Industrial production likewise turned up rather sharply during 1975. After a low in April at an index level of 110 percent, the recovery has brought the industrial production index by the end of the year to nearly 118.5 percent or a gain of almost 8 percent. Durable goods manufacturing appears to have regained approximately 5 percent since the May trough, while non-durable goods manufacturing has gained almost 14 percent since its March trough. The value of new construction activity has moved ahead from an April level of $121 billion to more than $136 billion in October and private housing starts, after a low of 980,000 units in April, rose to an October level of 1,457,000 units, but then declined to 1,309,000 in December. Meanwhile, plant and equipment spending actually declined during 1975 on a deflated dollar basis.

With the many increases in physical production during the year, labor force and employment figures showed a remarkable advance. Total civilian labor force, from a 1975 low of 91,511,000 in February, increased beyond 93,200,000 in December for a gain of 1,700,000 since the February 1975 trough. Similarly, total employment has improved sharply from an 83,800,000 level in March to more than 85,500,000 in December. In manufacturing alone there has been an increase of more than 460,000. Trade, services, and government also provided strong employment demand during the year. The unemployment rate, after reaching a peak of 9.2 percent during May, declined to 8.3 percent by the end of the year. Retail sales were also increasing during 1975 and ended the year on an exceptionally strong note as consumer sales during both the Christmas and post-Christmas periods, were some of the best seen in many years.

These statistics, of course, do not portray the whole picture of the economy during 1975, partly because of the lack of emphasis upon the principal change or restructuring which went on during the year as businesses liquidated inventories drastically in the early part of 1975 then began to hold to a conservative inventory pattern toward the latter part of the year. One must also mention the price structure for the year as consumer prices continued to advance reflecting for the year as a whole a percentage increase of somewhat over 7 percent. On the other hand, wholesale prices after troughing in March advanced only 10 index points for the remainder of the year and would appear to have advanced only 4 percent for the full year.

Credit conditions this past year were a surprise for many observers. Interest rate movements did not follow the pattern many people expected for the year and rather than a consistent pattern of advance following the recession trough, there was a steadiness of decline until June followed by a fairly marked advance of approximately 100 basis points through July in short-term rates. From July to December there was another change as a rather consistent steadiness developed for the remainder of the third quarter and into the fourth quarter but then a new decline was noted. Long-term rates followed this pattern to some extent although the margin of change was not large. Long-term rates were fairly steady through the year declining only in recent weeks under the pressure of the second onslaught of short-term rate declines. Perhaps the most interesting features of the financial markets of 1975 have been the shifting expectations concerning inflation and the questions raised about monetary policy, municipal securities, and the potential private demands for credit which might be "crowded out" by heavy Treasury requirements.

Federal Reserve policy was basically accommodative but not excessively easy over the past six months and, in fact, did not reflect a posture of aggressive ease during most of the year. The nation's central bank did provide a large volume of bank reserves so that total Federal Reserve credit outstanding accelerated from $90,819,000 in March to more than $99 billion in December for a gain of nearly $9 billion during the past nine months. However, the central bank's policy did not have the same tone of aggressive easing which it had in response to some prior recessions. A part of this changed policy response is clearly a result of the current price level changes which have reflected further advances, even though unemployment levels have remained high. Nevertheless, sufficient credit was created which with a very significant increase in velocity, provided enough money to finance the more than $100 billion increase in gross national product.

While the "crowding out" theory had a number of supporters in the early part of 1975, this did not develop because loan demand on the part of businesses declined further and total bank credit demands were quite weak throughout the year. In contrast, of course, the Federal Government issued more than $76 billion of net new financing and there was a very heavy demand for capital credit on the part of both business and State and local governments.

The principal reasons for the weakness in bank loan demand lay in the steep liquidation of business inventories and the efforts of business to improve their liquidity positions by funding short-term debt. However, the slow bank credit growth can also be traced to some recent difficulties in the banking industry and to the rather strong move toward conservative lending policies on the part of many banks throughout the nation. A number of banks with heavy credits to the real estate industry were forced to place some of these loans on a non-accrual status. Similarly, foreign real estate loans came under a significant cloud. Another problem impacting upon some banks' willingness to expand lending has been the lessening of capital coverage for the sharp asset acceleration of the past five years and the enlarged losses charged to capital. The heavy publicity on individual bank problems and the forced disclosure by some has undoubtedly increased banker caution.

It does not seem either appropriate nor desirable that I comment on recent newspaper disclosures on individual New York banks. I would, however, like to spend a little time with you concerning the environment or attitudes which seem to engender such actions on the part of individuals. I think these unauthorized releases have been fostered in part by recent investigations and partly by a strongly developing trend for disclosure of banking transactions, balance sheets, and income statements, as well as the problem assets and liabilities. A part of this mania for disclosure has been evident in the special hearings which seem to be called for by every major newspaper story, including the one this past week or so about major New York banks. In my opinion, this road we appear to be traveling, is one fraught with many questions and considerable danger. If Congress, through its legislative actions and the Securities and Exchange Commission through its regulatory power, take the United States and its principal business and industry sectors into a full disclosure mode, there is little doubt in my mind that the public will not be treated to the best nor most interpretive type of information and may easily be misled by the plethora of new information.

For the banking industry, the central question appears to be whether this industry will be regulated by the discipline of the market place or by Government regulation or a combination of the two. Perhaps the question is the degree to which each of these will be relied upon to maintain a sound banking structure and to protect the investor, borrower, and depositor interests. In the past it has been quite evident that the banking industry has been one which was highly regulated with limited entry and to a considerable extent, protected markets. The Federal Reserve and others have been trying to improve the competition in the banking industry but at the same time to maintain a safe and sound condition in that industry. Recently we have moved to greater disclosures of broad banking aggregates in order to insure ourselves that the investor and depositor will have the information upon which to make an informed judgment in placing his funds either in the stock of the bank or in a deposit.

We have also, however, strongly accelerated our efforts to improve our regulatory control over the banking industry. We have suggested a variety of legislative actions to Congress to protect depositors and increase our ability to make sure that the random bad-managed or ill-advised bank can be brought back into the realm of sound banking practices. At the same time we have strengthened our supervisory work to improve our surveillance of banking activities and provide an early warning system to insure ourselves that any bank traveling a road toward excessive exposure will be caught in mid-stream and its policies corrected.

Returning then to the central question I raised, it would appear that the stockholder-investor interests of banks are to be regulated by the market through more complete disclosure and the depositor's interests are to be protected, in a sound banking sense, through the regulatory agencies. The banking industry, however, is one which both by tradition and by need has operated with confidential information. The disclosure pattern underway now seems to both threaten the confidentiality of banking records and run head long into another public interest policy of privacy for the individual. It will be most interesting to see how Congress resolves the public interest in greater disclosure and yet maintains the privacy of the individual. For the corporation, such disclosure can threaten both competitive and commercial interests as well as the interests of the private depositor, borrower, or even shareowner.

Another element of this strong push toward disclosure and open government is the bill before Congress entitled "Government in the Sunshine." If there were ever a bill designed for maximum exposure and disclosure of information, it is clearly this bill. It would require any multi-headed Federal Government agency to hold open meetings for all but a very few limited subjects. Thus, the Federal Reserve if discussing the application of a bank to acquire another might be forced to discuss this in open session or, if it were to fit under one of the exemptions, would be required to maintain a verbatim transcript to be later released to the public files. I am sure you can recognize the problems that such a policy would entail if we were to discuss the management capabilities or the individual deposit and loan positions of each bank or the potential violations of law of a particular bank. Perhaps most visible might be the situation where one of the banks is in a dangerously difficult position essentially requiring rescue. While this bill has not passed the full Congress, it did pass the Senate on a 94 to 0 vote and is now in a House committee. The Chairman of the Federal Reserve has testified against application of this bill to the Federal Reserve, pointing out that the only alternatives left to us, if the bill were to pass in its present form, would be to suffer the interference with our work or find a means of evasion, neither of which were acceptable choices to the Federal Reserve Board.

You may think it strange that I raise these matters of disclosure and Government in the Sunshine in a speech on the economic and financial outlook. I do so because I think these potential legislative and regulatory changes are ones which have a significant potential for disruption and ones which might reinforce the already hesitant banking environment for lending. If banks recognize their exposure to public listing of the types of loans which become classified or develop into a non-accrual status, perhaps even by industry, I suspect there will be a considerable dampening of their willingness to entertain such risks. The banking industry obviously is a risk industry and no banker who is really successful in serving his community can do so without taking risks. In a few cases, of course, his judgment is bad concerning the creditworthiness of the individual and in a few cases, adverse elements within the particular borrowers industry causes the loan to turn bad. But more generally over the past few years, especially in 1974-75, there have been broad movements in the economy which have caused significant losses for the banking industry. Whether such loans are classified or even written off the books may not necessarily mean a total loss forever. The banking industry has a track record of great recovery from losses even on loans which have been classified and charged off. But if we are to put further roadblocks in the way of the bankers' willingness to expand, we certainly have an element which could at least dampen, if not restrain, the rate of recovery of our economy in 1976. Essentially we are talking about a political problem--political in the sense that Watergate and other recent disclosures have induced an attitude demanding full disclosure and this is a political judgment.

We have other elements in the economic scene for 1976 which could easily be labeled political. It certainly is no news to you that 1976 will be an election year and each of the candidates, the whole House of Representatives and a third of the Senate as well as the President and Vice President of the nation will be up for election. Such election years are usually ones with considerable activity, extravagant promises and persistent investigations to keep the candidate's name before the electorate. I suspect 1976 will be another of those years but beyond the standard election rhetoric Congress is taking up some very important legislation designed to change and reform a number of different industries. The whole move toward de-regulation in the airline industry has major implications for efficiency, competitiveness and inter-company relations. Similarly, the efforts toward reform of the bank regulatory agencies and the structure of financial institutions of the United States is fraught with elements of disruption, and disequilibrium. I have strong doubts that many knowledgeable observers of the financial scene would disagree with the desirability for some reform. Agreement on the type of reform, however, is far from unanimous. Clearly independent local financial institutions would like to maintain their generally protected markets.

They do not like the concentration of power which they see in the bank holding company movement. They strongly dislike the control of the banking industry in the hands of a single Federal regulator and many of them appear to resist the idea of a strongly competitive thrift industry being granted banking powers. On the other hand, Congress appears to have the perception that broadening such powers for the thrift institutions may provide a greater stability of deposits and loans at least in a matched maturity sense, which would provide a broader and firmer basis to the mortgage market and eventually to the construction industry itself. All of these ideas are being debated daily before the hearings in the House and will likely be debated again before the Senate. We are probably some time away from the resolution of this problem and to the ultimate decisions which Congress will make on the reform of the financial institutions. It is my hope that this debate will clearly surface the important elements of the problem which Congress is seeking to correct and that the reform measures will be carefully analyzed to assure that there will be no substantive disruption in the financial institutions at a time when the economy will need their strong support for the recovery movement.

Beyond the legislative efforts already mentioned, there has been a rather concerted attack against the Federal Reserve itself. Some of the attack centers on policy, some on the organization of the central bank and some on the procedures by which the central bank accomplishes its tasks. We have been involved in a whole series of Congressional hearings and there have been, of course, thousands of pages of newspaper copy and magazine articles written about charges that the Federal Reserve has been slow in responding to the nation's money needs. Some officials seem to have bought the monetarists' aggregate approach of money supply as being the sole measure of Federal Reserve policy. I can assure you that at least for me such is far from the case. If the Federal Reserve were to rely solely upon money supply as its only indicator of need for credit, we would be in severe straits because the money supply figures have certainly behaved in a highly erratic manner, contrary even to the wishes and policy of the Federal Reserve during this past year. There is even a strong question as to the linkage of money supply to the real economy now that a good many individuals and businesses are holding an increasing portion of their normal transaction balances in time accounts which are not included in the nation's basic money supply.

While it has been an interesting year in 1975, one which I would prefer not to repeat, it is likely to be an equally interesting and probably harrassing year in 1976. If the standard forecast for a moderate recovery proves to be correct for 1976, then by the end of the year the nation should be well on track for further balanced growth in 1977. If, however, the standard scenario is out of phase and the nation instead finds the stimulant to expand strongly in 1976, then the chances for a growing imbalance in production, consumption, income, and credit, will become much greater by the end of the year. In this marvelously complex free choice economy of ours, there seems to be an inherent ability to expand almost despite serious obstacles. Perhaps we should rely to a greater extent on that inherent strength and until after the recovery has been firmly entrenched and the nation is again in a strong upward pattern, declare a moratorium on some of these more difficult pieces of legislation which may tend to disrupt and create instabilities.

Thus I am of two minds with regard to the economy for 1976. One says the signs are quite good for a balanced growth if we are willing to accept the gradualist approach to improvement and resist the temptation to force new stimulative measures to accelerate our growth. The other mind says there are potentials for disruption and imbalance which might develop from some of the activities in Congress which could hamper, dampen and even disrupt the rate of recovery for 1976.

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