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Remarks of J. L. Robertson  
Member of the Board of Governors  
of the  
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## "Monetary Policy in a Dynamic Economy"

I am glad to have been invited to speak here in Des Moines. While it is true my home was in Broken Bow, Nebraska, Iowa was a sort of second home because I went to school in Grinnell College. As a matter of fact, I was lucky enough to crowd into two years spent there as much fun as most people get out of four, and in the process picked out a wife - who was born in Cuppy's Grove, allegedly the garden spot of Iowa. So you can see why I have a soft spot in my heart for this state.

At Grinnell we had a famous professor who was very solicitous about his students. He would take us to his home - one by one - converse a while, and then tell us how he sized up our character and future prospects. I am sure his counseling helped many a student.

I can well remember when my turn rolled around. I swaggered over in my football sweater, only to find that I soon had to shed it, roll up my sleeves, and work for a couple of hours helping him wax a big chest he was refinishing. All the time he kept questioning me, and in response I told him, with some mixture of pride and braggadocio, the facts of my long life - (I was then nineteen). I told him, for example, that I had worked as a ranch hand, during the summers, from the time I could straddle a horse, and spent my free time, during the school years, serving both morning and evening newspaper routes, janitoring the Presbyterian Church, and jerking sodas at the drugstore - my unfree time being devoted exclusively to football. Nor shall I forget soon his summation: "Now son," he said, "you are a good boy but don't go to the city and try to match wits with the bright boys. You go back to Broken Bow and get a nice job in a filling station."

Although at the time all the wind was taken out of my sails, I am certain now - and you will be, too, by the time I finish - that both you and I would have been better off if I had followed his advice, gone back to Broken Bow, and stayed there.

I hope that not too many of your members have been discouraged by the somewhat hackneyed title of my remarks -

"Monetary Policy in a Dynamic Economy". The only justification is that it happens to state with considerable precision what I want to speak about today. I would like to speak about monetary policy, for that is my business, and to relate it to the dynamic nature of our economy because that is becoming, more and more, the crucial factor in our economic equation.

Now, generally, the term dynamic is used in a favorable sense. We seldom apply the adjective to anything we disapprove or deplore. A dynamic economy is one that is growing rapidly, adopting new techniques, and adapting its products and its ways of doing business to changing needs, tastes and circumstances. The dynamic nature of the American economy was illustrated by de Tocqueville more than one hundred years ago in this way: "I accost an American sailor", he said, "and inquire why the ships of his country are built so as to last for only a short time; he answers without hesitation that the art of navigation is every day making such rapid progress that the finest vessel would become almost useless if it lasted beyond a few years. In these words, which fell accidentally, and on a particular subject, from an uninstructed man, I recognize the general and systematic idea upon which a great people direct all their concerns."

We need to recognize, however, that the process of rapid change is accompanied by many difficulties. By its very nature, a dynamic economy cannot be a problem-free economy. Being a central banker, it is my task not just to praise the workings of our economy but to be aware of its problems - particularly those that the central bank can help to solve.

In order to properly place the central bank in the picture, one must understand the basis for its interference in the monetary system. It is found in the simple proposition that "money does not manage itself". Although you as bankers may manage your own affairs with the utmost prudence and wisdom, and each business may conduct itself sensibly in accordance with its own best interests, as may each farmer and each consumer, nevertheless, the sum total of these simultaneous activities may produce undesirable effects. Specifically, inflation or depression may occur even when each unit in the

economy is acting sensibly, according to its own best interests as it sees them. Because of this we have learned over the years, sometimes very painfully, that there is a fundamental need for monetary policy and for other public policy in the economic field.

Both monetary policy and other public policies can and do influence economic activity and economic values, including prices of commodities, wages of labor, capital assets such as farm and urban land and structures, and stocks and bonds. Governmental economic policy, if wisely formulated and executed, serves to support and strengthen the capacity of free men dealing in free markets to provide more of the good things of life for themselves - and for future generations as well.

Monetary policy is only one aspect, although a strategic one, of general public policy which is directed toward the twin goals of vigorous economic progress and economic stability. (At times that seems like trying to carry the ball simultaneously to the two goals on a football field.) It has its influence on economic activity and values mainly by means of its effect on bank reserves and thereby on bank credit and the money supply. Sometimes we achieve this effect by changing reserve requirements of member banks, but for day-to-day and week-to-week operations we rely on open-market transactions and the discount functions, which complement each other as credit-control instruments.

In employing these instruments, we do not attempt to determine the specific channels into which bank credit flows. That is left to the multitude of decisions of lenders and borrowers. But in determining the total volume of bank reserves, the Federal Reserve does exert a major influence on general economic values because it affects the extent to which the banking system is in a position to finance expenditures by business, consumers, and governments.

However, it should be clearly understood that monetary policy is not the all-powerful instrument some would make of it. Far from it. It cannot determine the course of the economy. It does not absolutely determine the level

of interest rates. It cannot even assure stability of individual or average prices - prices are determined by the tastes, desires, and wherewithal of buyers in relation to productive capacity and costs. Monetary policy cannot guarantee a demand for any product or service at any price the seller wishes to ask - and this applies even when the price of the service is called "wages". On the other hand, it is certain that in the presence of upward price pressures an unlimited supply of credit will stimulate speculative commitments and encourage rampant inflation.

While I am about it, let me also point out that monetary policy, by itself, cannot assure the maintenance of full employment. We learned that in the 1930's. If important sectors of the economy have expanded too much or too fast or are endeavoring to maintain prices higher than buyers are willing (or able) to pay, some unemployment is bound to result until appropriate adjustments have been made or shifts of resources to other sectors have been effected.

Furthermore, monetary policy cannot - without becoming an engine of inflation - assure the financing of the government debt at low rates of interest at a time when other demands for credit are strong. We learned that in the 1940's. The Treasury must compete with other would-be borrowers for the available supply of lendable funds, and hence must price its securities on a basis that will attract investors. But this does not mean that we must abandon public and social objectives. This country is rich enough to devote large amounts of resources to such uses - national defense, education, social security, and the like. It simply means that there must be a corresponding restriction on other public and private activities. Put succinctly, appropriate monetary policies do not conflict with or prevent the attainment of public policy objectives - rather, they are an essential means of adjusting private demands so as to facilitate the attainment of public objectives.

Although monetary policy is subject to all these limitations - and more - it still is able to exercise a strong counterbalancing influence against those forces which would

otherwise cause inflation or depression. In fact, the provision of appropriate credit and monetary supplies is essential for the smooth and efficient functioning of the economy and particularly for sustained growth. The remarkable thing about economic developments in this country in the postwar period is not that we have had some inflation, which is certainly undesirable, or that we have occasionally had considerable unemployment, which is of great concern to us. Much more important is the fact that we have had a high rate of growth and general prosperity without a wild speculative boom followed by a disastrous and prolonged depression. Monetary policy is entitled to some of the credit for this generally favorable course of events.

As you know, monetary policy brings its influence to bear on the economic situation as that situation is created by the actions of businesses, consumers, and governments. It does so, as I indicated earlier, mainly through its control over bank reserves, by which it influences the lending and investing activities of commercial banks. I do not want to minimize the importance of this influence, but I should like to point out that the direct effect of Federal Reserve action is sometimes overshadowed by what may be called the psychological effects.

One psychological effect is exemplified at times by an exaggerated response to Federal Reserve actions. Another consists of occasional anticipations of forthcoming actions on the basis, not of economic factors, but of whatever events here or abroad seem to be newsworthy at the moment. Responses and anticipations of these types have had a lot to do with developments in financial markets in the past few months. But before I turn to that, let me sketch a bit of background.

As you know, the United States economy is presently thrusting itself with vigor out of a recession that began about a year ago. Seldom have the dynamic qualities of our economy been more strikingly exhibited.

In its industrial performance, the economy a year ago moved into a sharp downslide. This followed a three-year

boom based on a surge of spending, first by consumers and then by producers. These waves of spending stimulated overall economic activity and enlarged the productive capacity of the economy, but the pace of expansion was too rapid and in the process pressures were generated that led to rising prices and living costs and to spreading inflationary sentiment. Hence the imbalances that led to the 1957 downturn.

As the recession deepened last winter and spring, to many observers the outlook for an early return of prosperity appeared unfavorable. The decline in activity was greater than in either of the two previous recessions of the post-war period. In the eight months after August 1957, industrial production fell 13 per cent. Output of durable manufactures declined 20 per cent. Business outlays for capital goods dropped fast and reported plans for such outlays promised no pickup until well into 1959, or later. Business inventories were large and strong efforts were being made to reduce them. Unemployment had risen sharply and was continuing at a high level. Consumers were demonstrating a distinct lack of enthusiasm for most of the products of the automobile industry and were paying off debt in significant amounts.

In spite of these seemingly unfavorable signs, and to the surprise of most analysts, the low point was passed in April. Since then production has been rising at an unusually rapid pace. From April to September the Federal Reserve index of industrial production rose 9 per cent, thus regaining two-thirds of the earlier decline. Instead of a saucerlike low, such as occurred in the preceding recession, when production touched bottom in the spring of 1954 but recovery did not get under way until autumn, this time the cyclical contour took the shape of a V.

Even before it became apparent generally that the recession had touched bottom and was being followed promptly by a strong revival, the stock market began to advance. The advance started early in the year and at a time when corporate profits were at sharply reduced levels. Since then

stock market optimism and activity has increased considerably and stock prices have reached successive new highs. This enthusiasm of the stock market is not entirely reassuring. It may be correctly anticipating a much higher level of profits than that reported in the latest official figures. There are good reasons to think that profits are rising rapidly; the volume of business operations is expanding and productivity has been rising unusually fast. But the stock market rise may also be a symptom of something else - the growing acceptance of the doctrine of the inevitability of inflation. If this belief is a significant factor in that market or any other market, to that extent it and the economy are vulnerable to potentially destructive forces.

As it became increasingly clear outside the stock market that the low point in activity had been passed last spring, pessimism dissipated with remarkable speed. One of the most reassuring evidences of renewed confidence in business prospects was the announcement that the latest official survey of business spending for new plant and equipment found that, contrary to indications from previous surveys, outlays had leveled off in the third quarter and would possibly turn up during the rest of this year.

Now these evidences of economic recovery are very gratifying. We can rejoice in the knowledge that our economy has shown such resilience and buoyancy and is springing back with speed toward full use of our human and material resources. This is indeed dynamic!

While rejoicing, however, we can hope and endeavor to assure that the recovery is a healthy one; that is, broadly based and not too exuberant for its own good. After all, an economy is not like a runner of the 100-yard dash, who can sprint through the tape that marks his objective. If the economy runs through the goal representing full use of resources, it runs right into inflation. It is desirable, therefore, that the recovery be encouraged but also that the economy approach its constantly rising capacity-ceiling at a growth rate that can be maintained. We want no more inflationary booms and no more busts. We want progress to be as rapid and as steady as we can make it.



In financial markets, events have moved swiftly since last June. In that brief period interest rates have shot back up with great rapidity. Long-term yields have returned to their peak levels of a year ago, when economic activity was considerably higher and monetary policy much more restrictive than in the past three months. Short-term yields have also advanced rapidly, but they are still well below last year's high levels.

The sharp break in medium and long-term market rates in July was associated with the speculative activity that developed in the Treasury's mid-June refunding operation. Acting on the basis of expectations of further reductions in interest rates (particularly in the longer-term area) and consequently of a "free ride" on government securities from their issue price, many investors were induced to take speculative positions in the June exchange offering of 2-5/8 per cent bonds. As we now know, many of these speculative purchases were made on little or no margin, by investors with little experience in the government securities market.

I need not dwell on the details of this unfortunate episode. For our present purposes, the important point is that, shortly after the bonds were issued, a combination of events conspired to confound the speculators and, instead of getting a "free ride", they found themselves faced with margin calls as their recently acquired security dropped below par. Their efforts to sell out in order to meet margin calls or to minimize losses gave bond prices a strong downward impetus.

However, the reversal in interest rate movements - from a downward tilt in the spring to a steep upward climb in the summer - cannot be ascribed solely to speculation. It undoubtedly magnified the swing in interest rates and bond prices, but in itself did not cause it.

For a basic explanation of the interest rate reversal, we must look, in part at least, to the growing public awareness that the economy was moving out of recession (in June alone industrial production rose more than 4 per cent), and that there would be expanding public and private demands for

funds and probably a more restrictive monetary policy. Furthermore, the notion that continued inflation is inevitable had gained increasing acceptance, and the continued rise in consumer prices during the recession must have given further strength to this view. This notion was not diminished by the much-publicized fact that one result of actions taken to cure the recession would be a large federal deficit. (What was designed as medicine for the economy six months ago is now dangerous, because while the patient's condition has changed the dosage cannot be reduced fast enough.)

It would have been surprising if the expectations of investors in financial markets had not been affected by this picture. As it happened, the investing public did anticipate the advance in market interest yields and, by their actions, caused it to occur sooner.

Given the increased public awareness of even moderate swings in business activity, the spread of the creeping inflation doctrine, and the speculative psychology that seems prevalent in financial markets, what can we do to promote sustainable recovery and growth without inflation? What can we do if we are confronted with continuing relatively high unemployment and unused industrial capacity and at the same time speculative trends in financial markets that exert strong upward pressures on interest rates?

There is no widely-accepted answer. But clearly the first step must be to diagnose the problem. My diagnosis leads me to the view that belief in the inevitability of inflation is close to the center of the problem. This belief must be attacked at its roots to prevent its proliferating until it becomes so widely accepted that productive processes are disrupted, distortions develop, and the thesis is proved false by a drastic fall in prices and capital values and these are followed by very high levels of unemployment.

We must look at the underlying forces, avoid accepting the economic fads of the day, and offer leadership to the people everywhere who stand to lose most from inflation and its aftermath. We must develop effective means for discouraging the innocent and unwary from accepting the plausible but false doctrine of creeping inflation. We must encourage

financial markets to become stronger, to develop greater depth and to be more resilient in meeting the needs of the people and in adjusting to shifts in the market forces. We must encourage financial and economic analysts to greater efforts in appraising the forces of supply and demand, rather than devoting so much of their attention to outguessing the Federal Reserve. A market preoccupied with trying to outguess governmental actions is weaker and less self-reliant than a market conditioned to penetrating beneath the surface of economic events in making its decisions.

As for preventing inflation, some contend that monetary policy, by itself, has power so great that if it were exercised to the fullest extent, with no other consideration in view, it alone could stop even a runaway inflation dead in its tracks. Unfortunately, this would be like stopping a runaway train by putting an immovable barrier across the rails. The train would be stopped all right, but both it and its occupants would be shaken up pretty badly, and considerable time would elapse before the trip could be resumed!

I need not take the time to identify the other steps that should be taken to keep our economic streamliner on the track and moving along at a fast speed that is also safe and can be maintained indefinitely. Suffice it to say that on this train there are a number of firemen who must exercise judgment and restraint regarding the amount of fuel supplied to the engine, and there are several sets of brakes that must be judiciously applied from time to time.

Putting aside figures of speech, let me say plainly that the Federal Reserve is not merely paying lip-service to a noble sentiment; we are determined to use our powers, as wisely as we can, to maintain the integrity of the dollar and thereby foster the maximum sustainable economic progress of the United States. This job is not one that can be done effectively through monetary policy unaided and alone; but it can be done.

The task is difficult because mankind is not so civilized that various groups readily subordinate group interests

to the broader good of the nation as a whole. In recent decades we have seen increasingly the power of public opinion. The work in which the Federal Reserve System is engaged can be conducted successfully only if it has the support of public opinion based on real understanding of what is involved. If that understanding can be widely achieved, it will not only safeguard the sound institutions of our economic and governmental system, but will also lead to statesmanlike and public-spirited policies on the part of consumers, industry, and labor.

It is my sincere conviction that this task of achieving widespread understanding of monetary problems and monetary policies today presents to the banking community of America its most meaningful call to energetic and dedicated leadership.