Remarks

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It is good to be with you again. As you know, I am a native of Colorado and, though I have been away from there many years, I always welcome the opportunity to get back to the Rockies. As you also know, most of my life was spent in the field of agriculture and a few years ago I had the privilege of participating in your agricultural credit conference at Las Cruces. On this occasion your Secretary has asked that I discuss monetary policy, present and prospective, as it relates to the current state of the economy.

Let me hasten to say that, as your Secretary well knew, I cannot and would not if I could tell you what the future trend of interest rates will be nor when the next change in the discount rate will come. Neither do I intend to undertake an extensive review of economic developments for the past year nor a forecast for the future. You have already seen the economic report and the budget message of the President, together with the report of the Joint Economic Committee of the Congress. You have also seen some of the revised estimates of economic activity which seem to rise as each month's figures are released.

But, as bankers, I know that you are very much aware of the type of problems that arise in an economy that is operating at very close to capacity while demands still continue to grow at a rapid rate. How different these immediate problems are, I might add, from those that occupied the nation only a few years ago!
We were then most concerned with the high rate of unemployment that had persisted even during cyclical upturns. We were also concerned with our failure to match the growth rate achieved by many other developed countries. And we were concerned with how we were going to provide jobs for the graduates of the postwar baby crop in the face of increasing automation of productive processes. Of course, these and similar problems are likely still to be with us over the long run. At the moment, though, the pressing concerns are those of a prosperous economy that is trying to grow too fast.

Here let me digress a moment to consider some of the implications of growth as reflected by increased productivity. First, as I see it, productivity is a measure of the output of goods and services per man-hour of human labor. Basically it is brought about by the substitution of capital for labor in one of several ways. It may be the substitution of mechanical power for man power. It may be the result of research in the development of new and better raw materials or methods, or the breeding of more productive plants and animals. And, in any event, it is apt to require better trained people, which involves more investment in education and training. All of this involves a reallocation of resources; in other words, change. Even the most desirable change is disruptive of established patterns and habits and, if pressed too rapidly, the resultant discomfort may become painful or even unbearable.

We see an excellent illustration of this in the fantastic gain in productivity of American agriculture, which has given us
the highest level of nutrition at the lowest cost per man-hour of labor ever enjoyed by any nation at any time in history. This tremendous increase in productivity has also released the man power essential for the production of other goods and services that go to make up our American standard of living. But it has also brought its problems. Productivity has increased faster than our ability to absorb the released resources, particularly of man power, into other segments of the economy. As a result, we have had a continuing agricultural problem of farm surpluses and part-time or, in some cases, full-time farm unemployment.

These then are the dangers of too rapid growth either in productivity or in demand. Even though capital resources can be reallocated with a minimum lag, relocation and training or retraining of labor is inevitably slower due to the widespread human resistance to change. So much for that.

Now let us return to our current problems. Last year we experienced a stepping-up in the pace of the economic expansion. This took several forms. We are all perhaps most familiar with the increase in Government spending in connection with the military effort in South Vietnam. But most of the total gain was in private demands for goods and services. These expanded at a rate not foreseen by most forecasts made at the start of the year. Early in 1965 there was a flurry of activity as consumers caught up on car purchases after the auto strike, and as industry stock-piled steel in anticipation of a possible steel strike. These influences on sales were naturally temporary, but as the year
progressed the expected slackening in over-all business activity failed to occur. Consumers continued to purchase auto and other goods in record volume. And while steel inventories were run off following the labor contract settlement in that industry in September, accumulation of inventories in other lines, particularly in work-in-process and in nondurable goods, more than made up for this reduction. On top of this strength in sales or, more accurately, in response to it, businesses made sizable upward revisions in their capital spending plans as the year went on.

Where did this surge of activity take us, coming as it did on top of four previous years of expansion? First of all, it brought us to the point at which most of our productive resources were fully employed. Existing plants were being fully utilized in many lines, with national average utilization of capacity at the highest percentage in 10 years. In the labor field, we achieved the long-sought reduction in the unemployment rate, first hitting the Administration's interim target of 4 per cent at the close of last year and then breaking through to even lower levels in recent months.

With both human and material resources being utilized at these desirably high rates, it is virtually impossible to avoid shortages in some areas. For instance, skilled and professional workers were hardly in oversupply even when our over-all unemployment total was higher than we wanted it to be. Now, as the boom draws down the number of unemployed among the young and unskilled, shortages for various types of skilled workers and supervisors
have developed. The machine-tool industry is particularly pressed, for instance. In another manifestation of this situation, factory overtime is running at the highest rate of the last 10 years.

At the high level of operation, with some raw material costs up, with overtime necessary, and with older and less efficient plant being brought into operation, productivity gains become harder to achieve and unit costs rise. Some businesses with such experience have felt justified in raising their prices. While this chain of events has not yet become the general rule, it can be expected to occur with increasing frequency if pressures on resources continue to mount.

At the bargaining table, if labor sees business profits high and consumer prices rising, it feels justified in demanding more generous wage settlements. Coming at a time when the reservoir of unemployed labor is low and when the rise in productivity is slowing down, such settlements can put further upward pressure on unit costs and thereby on prices.

This, then, is another danger in expanding economic activity too rapidly at this time. Eventually, additional capital investment and growth and training of the labor force will ease the strains, but this will take time. In the short run, when business builds a new plant, it adds to current demands for labor and materials. If these are in short supply, this demand can only be met by curtailment of other demands brought about in one of three ways; namely, (1) by higher prices or inflation, if you please, which we all hope to avoid, (2) by rationing or other selective
controls which we also abhor, or (3) by the general restraint of monetary and fiscal policies in their over-all effect on the availability of money and credit backed by the intelligent self-restraint of individuals in allocating available resources to their most productive uses.

Needless to say, those of us charged with administering monetary policy have been following these economic developments intently. Broadly stated, we have striven to maintain monetary conditions that helped to keep the growth in total demand for goods and services in line with the expansion that we could get in our productive resources without posing an excessive threat to prices. In short, we sought policies that would promote continued economic growth at a sustainable rate, and have sought to avoid the boom and bust cycle of the past.

We have, therefore, been very concerned by the fact that spending by both consumers and businesses was increasing at a faster rate than their incomes. In so doing, they have relied heavily on borrowed funds. Credit extended by commercial banks, for example, rose by $27 billion in 1965, an increase of fully 10 per cent in only one year.

Business borrowing from banks increased by nearly a fifth, the largest rate of increase since 1956. Most of this was for inventory and other working capital, but there was also a large volume of new term loans that suggests that some businesses borrowed from banks to finance capital expenditures. Business borrowing accelerated
toward the end of 1965 and has continued very strong during the first quarter of this year.

Consumer loans at banks increased by over 15 per cent in 1965, the largest percentage rise since the business recovery year of 1959. This borrowing supported another record year in automobile sales as well as large purchases of other durable goods and services.

Now I don't have to tell bankers that an expanding economy needs and can handle increasing amounts of credit. We could hardly have economic growth if business had to finance all expansion out of past earnings. Our national way of life would surely be different if, for example, all young married couples had to do without furniture until they had saved up the money to pay cash. But when debt rises as fast as it did last year, and when one sees it to be financing a relatively large proportion of total spending, one is concerned that some businesses and consumers may be taking on more debt than they can handle. Moreover, one worries about what will happen to the level of demand for goods and services if and when this debt-financed expansion reaches a turning point. Will there be a sharp cut-back in spending while consumer debts are worked off? Will production and employment drop at that time as business inventories are drawn down and investment in new plant is no longer the need of the hour?

But along with concern for the future, the rapid expansion of debt brings concern for the present. Excessive borrowing to support spending on goods and services that are in short supply adds to price and wage pressures and thereby contributes to the imbalances that have led to the boom-bust cycles of the past.
Another development that has necessarily concerned monetary policy has been the imbalance that arose in credit markets last year because demands for credit exceeded the flow of savings. Total private savings increased by much less last year than in 1964, as individuals as a whole reduced the proportion of income that they saved. The surge in demand for credit ran up against this slowdown in investment funds and thus put heavy pressure on the alternative source of credit—an expansion of commercial bank credit based on reserves provided by the Federal Reserve.

Throughout the current long business expansion the Federal Reserve has aimed at supplying banks with enough reserves to accommodate the needs of a growing domestic economy, but hopefully not so much as to promote excessive and inflationary use of credit at home or to contribute to a worsening balance of payments situation internationally. For four years this relatively easy monetary policy, together with expanding flows of savings, permitted substantial credit growth at interest rates that remained below the highs that occurred in 1960. But as 1965 progressed, provision of enough reserves to support a continued strong rise in the money supply and in bank credit was still not enough to prevent market rates of interest from rising considerably.

It became increasingly clear that an excessively large volume of bank reserves would have been needed to halt the upward pressure on interest rates and to reverse the trends that carried money market rates above the discount rate and pushed time deposit rates against their ceilings. There was also growing evidence
that heavy demands for credit were likely to be with us for some
time to come. This increased the inflationary risks of coping with
the situation through a large additional increase in bank reserves.

This was the situation the Federal Reserve faced last
December. At that time the discount rates of the Federal Reserve
Banks were raised from 4 to 4-1/2 per cent, and maximum rates pay-
able by commercial banks on time deposits were raised to 5-1/2 per
cent. The broad purpose of the discount rate action was to keep
the price of reserves that member banks can obtain by borrowing
from the Federal Reserve Banks in line with the cost of their alter-
native sources of funds. The aim of the change in ceiling rates on
time deposits was to permit banks to continue to compete for funds
through this route.

We temporarily cushioned the effect of these increases
in rates on financial markets by a somewhat more generous provision
of bank reserves through purchases of Government securities by the
Federal Open Market Committee. This was to keep the usual year-end
pressures on the money market from becoming unduly restrictive.
More recently, however, the provision of nonborrowed reserves by
the Open Market Committee has again become more limited.

Developments since our actions of last December have
confirmed our judgment of the strong underlying economic situation.
As mentioned earlier, further sharp increases in business investment
plans have been reported. Projections of 1966 Gross National Product
have been generally raised. Unit labor costs in manufacturing have
risen, and increases in prices appear to be becoming more pervasive.
It seems clear that pressures on human, material, and financial resources will continue to be intense during the near-term future. Military expenditures, which began to accelerate in late 1965, are generally expected to continue to increase. New and outstanding orders for military equipment, which have an impact on private activity even before the Government actually spends the money, have also been on the rise. In the happy event that peace breaks out in Vietnam and military spending can soon taper off, an intensification of the war on poverty and increased outlays for other domestic programs would likely be undertaken.

It is impossible, however, to say what changes in monetary policy will be required from here on. We will continue to study the effects of the actions we have already taken, and of the Federal Government’s present and future fiscal policies. I can assure you, however, that we will always be doing our best to have a monetary policy that is contributing to sound and sustainable economic growth.

Now let me turn briefly to a word about the agricultural or, more particularly, the livestock situation. I am sure we are all delighted with the current, relatively favorable situation as contrasted with that of two years ago when you were faced with severe drought and low cattle prices.

Net earnings of New Mexico farmers rose sharply last year, mainly as a result of high livestock prices. For the same reason, national net farm income was higher than in any year since 1952, on record sales of $41 billion. The same sales volume is expected this year.
A sharp reduction in hog production last year was a substantial factor in the livestock price picture. It now seems quite definite that the low point in the hog production cycle has been reached, with larger supplies and lower prices in prospect by this fall. This should have some impact on demand for beef.

Beef supplies, however, are not likely to increase as much in the near future. The 1965 calf crop, which will be the major source of feeder cattle marketed around the end of this year, was not much larger than in 1964. In addition, improving range conditions may lead ranchers to hold back some animals in order to increase their cow herds. So, numbers of fed cattle marketed are unlikely to increase much for the next several years, though of course the pounds of beef produced can be increased by feeding to heavier weights.

All things considered, it therefore seems likely that beef prices will continue strong for some time. The temptation to increase cow herds will also be strong during this period, range conditions permitting. But before yielding to this temptation, some long-range thinking might be advisable. For reasons pretty much beyond the control of man, the result of herd expansion now will not reach the ultimate consumer until 1968 or even later. What kind of market will it find at that time?

For one thing, beef is definitely a growth industry. The population continues to increase, and consumers as a whole have repeatedly demonstrated that they prefer meat to most other foods, provided they can afford it, and that they like beef, also
provided that they can afford it. So if economic and population growth continues, it is a safe bet that ever-larger amounts of beef will be demanded.

However, income and population growth did not keep cattle prices from breaking in 1952 or from reaching bottom in 1956, in the midst of the economic boom. Nor did they prevent the plunge in 1963. Nor--to cite an example of the opposite condition--did the recession of 1957-58 keep cattle prices from making a significant recovery.

The point is that increasing population and national income should lead to optimism for the very long term, but not necessarily for the intermediate term. As we now look ahead to 1968, we might consider, for instance, that the hog production cycle is likely to have reached a peak by then. In fact, if hog producers behave the way they often have in the past, they may by then have glutted the market, with obvious consequences for the demand for beef.

The other factors to watch are the trends in cow numbers and range conditions in other areas. Because of the drought, New Mexico beef cow numbers are now down 13 per cent from the record high at the beginning of 1964. Nationally, however, the number of cows has just leveled off over the past two years after expanding steadily since 1958. Clearly, the advisability of further expansion at this time depends in part on what reaction ranchers elsewhere have to present prices.
If all of us, whether in agriculture, industry, banking, or government, base our present actions on the best possible information we can obtain about current and prospective developments, and if we are flexible and willing to adapt our policies and actions to ever-changing conditions, we can each contribute to continued and sound growth in economic activity.