

THE BEST OF TIMES, THE WORST OF TIMES

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by

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"It was the best of times, it was the worst of times...." This was the phrase Charles Dickens chose to begin A Tale of Two Cities. It was an apt way to characterize France and England at the time of the French Revolution.

It is an apt characterization of economic conditions today. To an unusual degree, the various aspects of our economy's performance group themselves near the extremes of good and bad. In many ways, it is the best of times. In many ways, it is the worst of times. My purpose today is to survey both sides and to strike a balance between the two.

The Best of Times

First, what makes this the best of times?

It is the best of times because our economy is generating more income and more products than ever before. I am not talking about inflation making

all the numbers bigger; I am talking about the real purchasing power of our incomes and the real physical amount of our products. This is true per capita, per family, and for the nation as a whole. American incomes will buy more products than ever before; American industry is producing more products than ever before.

It is the best of times in terms of American employment. The fraction of unemployed workers declined to 4.7 percent in July, the lowest rate so far in the Seventies.

It is the best of times in quite a while for the budgetary position of the Federal government: The fiscal 1973 Federal deficit was down considerably from 1972. In fiscal year 1974, we view the genuine prospect of a balanced budget for the first time since 1969.

Do you measure the best of times by the amount of credit available? American consumers and businessmen and investors are borrowing more funds and financial institutions are lending more than ever before. At our commercial banks, lending is 15 percent higher than it was a year ago. What we call the money supply--checking account balances and currency in the hands of the public--is 7 percent greater than it was a year ago.

If you measure the best of times in terms of our international balance of trade, there is strength there, too. Our current accounts with the rest of the world are close to balance for the first time in years, and all the experts tell us the tide has turned. Business profits? You are probably more familiar with what is happening there; they are running 25 to 30 percent higher than they were in 1972.

Is this the best of times? It is the best of times for American production, for incomes, for consumption, for employment, for the Federal deficit, for the amount of credit available, for our balance of trade, and for business. We would not like to have these measures any different.

I wish I could stop right here. But I know you did not invite me here today to talk only about the good things. I know this because more and more persons keep asking me questions about the state of the economy and what the Federal Reserve is going to do about it. In many ways, it is the best of times. But it is evident from these questions that in many ways it is also the worst of times.

The Worst of Times

"How can you boast about the nation's record output?" some of you may ask, when as businessmen you find it hard to get hold of the materials you need to produce. Unemployment is low, but this means some of you can't find all the trained and willing workers you want. Improvements in productivity are coming hard. The papers talk about layoffs because of shortages of basic commodities, and new bottlenecks are developing. It is the best of times, but it is also the worst of times.

And while it is true that the nation's output is setting records, there are also signs of slowdown. The economy's real production grew at a 2 1/2-percent rate in the second quarter--a weak showing after 8 percent in the first quarter and 6 1/2 percent in 1972. Even the most optimistic forecasters see slow growth ahead. How, in the face of these prospects, can we call this the best of times?

I would have a hard time finding a Winston-Salem housewife who would call this the best of times. July food prices were about 13 percent higher than they were a year ago. And who knows what will happen under Phase 4? It is not just food prices, either; the index for all consumer items rose

about 6 percent in the same period. Wholesale prices show still more inflation, with farm and food prices far in the lead. With inflation bad and apparently getting worse, how can we call this the best of times?

We seem to be caught in a worldwide inflation. Consumer prices are up in practically every country of the world, in most places at rates even worse than ours. While American consumer prices went up 6 percent, Japanese prices increased 12 percent, Italian prices rose 11 percent, British prices 10 percent, and Swiss and Canadian prices 8 percent. These figures are symptoms of a worldwide inflation that is also operating on our economy. How can this be the best of times?

How can this be the best of times when the international monetary system is in turmoil? As many of you have discovered lately during your travels abroad, the dollar buys less and less overseas. Since 1970, it has declined one-fifth in value against major industrial currencies. International trade is disrupted by export controls and by the worldwide shortages they were imposed to combat.

Back in this country. I can hear you say to me, "It's all very well to talk about more credit being available, but what about the high interest rates?"

"When the U. S. Government has to pay 9 percent to borrow," you may add, "something must be wrong. Moreover, lenders are asking, and borrowers are paying, interest rates that would have seemed preposterous a few years ago."

"At interest rates like these," you ask, "how can anyone expect to finance the home building or the business expansion scheduled for next year? This is not the best of times."

"Furthermore," you may say, "the Federal Reserve is raising interest rates just when the economy seems to need lower interest rates." Knowledgeable bankers may point to the recent increase in the discount rate, the rate the Federal Reserve charges banks. It was 4 1/2 percent at the end of last year; it is now 7 1/2 percent. The Federal Reserve also raised reserve requirements, making it harder for banks to make loans.

"My banker friends," you might continue, "also tell me that the Federal Reserve has supplied so few reserves to the banking system that banks are paying 10 or 11 percent to borrow from each other." The Fed has also raised the rates banks can pay for time deposits.

"So far as credit conditions are concerned," you may conclude, "this is the worst of times."

Reconciling the Best of Times and the Worst of Times

What we would like to do, obviously, is to preserve the features of our economy that make this the best of times and to improve the features that make it the worst of times--to keep what's good and to change what's not. But from my vantage point this is also the most frustrating of times because the policies necessary to improve what's not good in our economy are also likely to work against the good features we would like to keep.

In particular, it is our high level of production and prosperity which has brought shortages, inflation, and high interest rates. Moreover, it is our rapid rate of economic growth recently which virtually guarantees a slowdown soon. The rapid expansion has brought us near full employment, which makes it physically impossible for the economy to expand now as it did when idle labor, materials, and machines were available. Rapid economic growth can occur only when the economy is recovering from a recession and has idle resources to employ; we have used up the slack.

The interest rate and price picture is equally frustrating. Even under ordinary circumstances, strong increases in production create strong demands for credit, bidding up interest rates despite sizeable additions to the supply of credit. When the demand for credit outpaces the supply, even a substantial supply, interest rates rise, even in ordinary circumstances.

But these are not ordinary circumstances. Prices have risen more and interest rates have moved higher than they normally do in an expanding economy. At least two unusual forces are at work, compounding the frustration.

Foremost of these forces is the worldwide economic expansion. Boom conditions in practically every part of the world are adding to inflationary demands for this nation's resources, which can now be purchased with cheaper dollars.

The other frustrating force is closer to home: the legacy of a stimulative fiscal and monetary policy. Deficit financing by the Federal government may have been appropriate when the economy needed stimulating; but we do not need that stimulus today.

The same criticism might be applied to monetary policy. Liberal additions to the money supply are appropriate in a recession. But at full employment, they contribute to inflation. Our economy would probably be better off today if we at the Fed had recognized earlier the need for slowing down monetary expansion.

Why did we fail to adopt less expansive fiscal and monetary policies?

We have to plead humanness. Policymakers have no peculiar gift for reading the future, and most of us believed expansive policies were best at the time. I wonder, moreover, whether cuts in Federal expenditures would have been supported by the public, especially cuts for local programs.

Neither am I sure that the public would have been happy had the Fed moved more rapidly toward restraint than we did. In fairness, I should say that the Federal Reserve did initiate a restrictive policy last fall-- a policy that would probably have been successful in ordinary times. But again, these are extraordinary times, and ordinary policies of restraint have not been successful. The demand for credit has been stimulated extraordinarily by inflationary expectations.

The extraordinary rise in interest rates during 1973 demonstrates the extraordinary strength of credit demands. Interest rates are high, we need to remember, not because the Federal Reserve has reduced the supply of credit but because of extraordinarily strong credit demands. Quite candidly, I doubt that any realistic amount of monetary expansion would have held interest rates down this year.

We are now paying the price for complacent acceptance of inflation. We have listened too closely and far too long to arguments that inflation is all right. We thought we could avoid the measures necessary to bring inflation under control. Now we find those same measures forced upon us. More and more Americans are recognizing inflation as a pervasive economic problem, and more of us recognize that there is no quick way out of our difficulties.

People ask me, "When will we get some relief on interest rates?" I wish that I could give them a clear answer, but in all honesty I cannot.

Let me instead reply with another question: When will you stop trying to borrow so much money? High credit demands have pushed up interest rates; reduced credit demands will reduce them. So long as the demand

pressures continue, we are going to have pressures on interest rates.

The Federal Reserve can help to reduce these demand pressures by holding down the growth of money and credit, not to zero but to a rate consistent with sustainable economic growth. As Chairman Burns has indicated, the Federal Reserve is prepared to do all it can to achieve that goal.

Fiscal policy, too, can help to reduce the strains on our economy. Also, success will come more quickly if we have restraint in wage demands by labor and in the pricing and expansion plans of business.

Meanwhile, the Federal Reserve is determined to avoid a repeat of the credit crunch we had in 1966 and 1969. At that time, banks and thrift institutions were not allowed to bid for funds because of Federal interest-rate ceilings. They could not lend funds to businesses and home buyers because they had no uncommitted funds to lend.

This time the Federal Reserve, with the cooperation of the FDIC and Federal Home Loan Bank, has moved to avoid this sort of development. In the words of Chairman Burns, "Individual banks can obtain funds...if they-- and ultimately the business firms that are borrowing from them--are willing to pay the price."

On Balance

The best of times, the worst of times. Which comes out ahead?

My answer, I admit, is prejudiced. I have faith in the ability of the American people to solve their problems. In other words, I am optimistic enough to believe that we can keep most of the best and eliminate most of the worst.

We Americans have displayed an outstanding ability to get into trouble. Fortunately, we have displayed an equal ability to deal with our problems once we realize their seriousness. Compared with other parts of the world, over the long pull Americans have done a good job in dealing with economic difficulties. These are difficult times, these are frustrating times; but the difficulties are not too great to overcome. We are beginning to realize we cannot overcome our difficulties unless we take the necessary painful steps to reduce inflation.

I am encouraged by your interest today. I am encouraged by the efforts being made by the general public to understand our problems. I am encouraged by the willingness of Congress--in part as the result of pressures from its constituents--to grapple with budgetary problems. I am encouraged

by the cooperation we are getting from bankers, businessmen, and labor
leaders. I have confidence that, with patience and determination, we can
make the future indeed the best of times.