CURRENT MONETARY POLICY PROBLEMS

An Address to the

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by

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All of us at the Federal Reserve Bank of Atlanta are extremely appreciative of your making the Federal Reserve Bank of Atlanta an honorary member of the Puerto Rico Bankers Association. From the beginning of our efforts to provide for the currency needs of Puerto Rico, we have received numerous courtesies and evidences of cooperation. These have made fulfilling our responsibilities much easier. We hope that our efforts in the future will merit this honor you have given us. The Board of Directors of the Federal Reserve Bank of Atlanta, the Bank's officers, and our employees all say, "Thank you."

We need hardly to be reminded today of the great economic interdependence of the various parts of the world. The energy crisis is painfully teaching us that no part of the world's economy can operate in isolation. The improved level of living and the economic growth we have enjoyed would not have happened without the interchange of people, materials, and money that has increasingly developed. It cannot possibly continue without continued worldwide economic cooperation.

As bankers, we ought to realize this economic interdependence more than anyone else. We live with it every day. There are no boundaries within the United States, including the Commonwealth of Puerto Rico, to stop the flow of money and capital investment funds. Money flows where economic opportunity beckons. Indeed, the barriers have been breaking down that impede the flow of funds between the various countries of the world.

Money can now travel in seconds between distant parts of the world. It can travel far faster than any jet liner can take us. Thus, whether we like it or not, our local economies have become immediately sensitive to economic conditions thousands of miles away.

We find evidence of this interdependence in the greater number of economic ties between the Commonwealth of Puerto Rico and that part of the United States served by the Federal Reserve Bank of Atlanta. The Atlanta Bank with its branches serves the states of Alabama, Florida, and Georgia, the eastern two-thirds of Tennessee, and the southern halves of Louisiana and Mississippi.

One piece of evidence is the greater amount of travel between the two areas. For example, from 1968 through 1972 air traffic between Puerto Rico and the Sixth District increased 17.3 percent. Greater personal ties have been established by the increasing number of persons of Puerto Rican heritage living in the area served by the Federal Reserve Bank of Atlanta. Between 1960 and 1970 their number increased by 33.2 percent.

Apparently, people in our area like to talk with people in Puerto Rico and vice versa. In July 1973, for example, there were 26,924 telephone messages from Atlanta, Miami, and New Orleans to Puerto Rico.

Our financial ties have also increased. At the present time, Puerto Rican commercial banks have correspondent relationships with at least 13 commercial banks in the Atlanta Federal Reserve District. Unfortunately, we do not have data to document what we know is the tremendous growth in financial flows. But one of the most impressive demonstrations of these growing ties between Puerto Rico and the southeastern part of the United States is the honor you have given us today.

Thus, I do not need to elaborate on how closely our economic and financial well-being is bound together. Your economic and financial problems are our problems, and our economic and financial problems are your problems. Because this is so, I thought you might be interested in a few informal remarks on some of the current monetary and economic policy problems the Federal Reserve is facing today.

If we confine ourselves to looking at only some of the measures of the way the American economy is behaving, we would be hard put to make a convincing case that there are any economic problems at all. The economy of the United States is now 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.

The unemployment problem has been diminishing. The fraction of unemployed workers declined to 4.5 percent in October, the lowest rate so far in the Seventies.

The budgetary position of the Federal government is becoming less of a problem. The fiscal 1973 Federal deficit was down considerably from 1972. Before the energy crisis developed, we had viewed the genuine prospect of a balanced budget in fiscal 1974 for the first time since 1969.

Is there a problem in respect to credit availability? If we measure availability by the amount being borrowed, the answer is "No." American consumers and businessmen and investors are borrowing more funds and financial institutions are lending more than ever before. At commercial banks in the United States, bank credit 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 5 percent greater than it was a year ago.

If we look at the United States balance of trade, we can argue that the long-standing problem of a trade deficit is disappearing. The United States enjoyed a substantial favorable balance in the third quarter of this year, and all the experts are optimistic about the future. Business profits? They are running 25 to 30 percent higher than they were in 1972.

What then are the problems with which monetary policy must deal? American production is high, incomes have risen, consumption is larger, unemployment has declined, and our balance of trade has improved.

Nevertheless, you and I know that the United States is facing some serious economic problems despite the basic strength shown by the developments just discussed. We had these even before the emergence of the energy crisis associated with the reduction of petroleum supplies from the Middle East.

The continued high rate of growth in the American economy was being seriously limited by developing shortages of basic commodities. Lack of construction materials is slowing down completion of many projects; deliveries are slowing generally. On top of this, it is becoming harder and harder to secure qualified and efficient labor. The lack of unused productive capacity and available labor has been reflected in the slower pace of growth in the nation's real output.

Moreover, there are those who see problems ahead associated with an expected lower consumer demand and a cut in residential construction.

But the great and overwhelming problem is that of inflation: The rise in food prices, as you know, has been spectacular, but other prices have risen too much for comfort. Moreover, we seem to be caught up in a world-wide inflation that in most parts of the world is worse than in the United States.

Quite obviously, Federal Reserve policy would like to preserve the high-level prosperity we have been enjoying while at the same time dealing adequately with the inflationary pressures.

Is this something that monetary policy can do? Since current inflationary pressures and shortages are worldwide problems, the effect of Federal Reserve policy is obviously limited. But even if it is admitted that the effects of Federal Reserve policy actions are distinctly limited, policy can do something to help deal with our current problems.

Even though we recognized the limitations of policy, we had been reasonably optimistic that, profiting from past mistakes and with the help of a rational fiscal policy and assuming some progress in solving the international financial problems, Federal Reserve policy could contribute to a continuance of high-level production in the United States while at the same time seeing some abatement of inflationary pressures.

However, we are now having to face a new element in our assessment of the proper role that should be played by Federal Reserve policy. The war in the Middle East and the subsequent reduction in the availability of petroleum from that area has added new complications to the ever difficult task of determining Federal Reserve policy.

You will have to rely upon those persons who have more expertise than I possess to give the specific facts about the effect of the energy crisis on the American economy. Even the experts are having difficulties assessing the possible impacts on the economy, especially on specific sectors. We shall probably learn only from experience how dependent our entire economic system is on abundant energy.

But if we cannot be specific, I think we can say with some confidence that efforts to deal with the energy crisis are going to put upward pressures on costs and will probably intensify inflationary pressures. It's not only going to cost more for the petroleum products we get and the raw materials derived from them, but developing other sources of energy is going to be extremely costly.

If the developments related to the energy crisis are viewed solely from their possible inflationary impact, continuation of a monetary policy designed to help curb inflation would be an appropriate policy for the Federal Reserve to follow.

Recently, the Federal Reserve has made some contribution toward reducing inflationary pressures by moderating the rate of monetary expansion. Indeed, as Chairman Burns has recently reported, monetary growth in the United States during 1972 and the first half of 1973 was much lower and steadier than in other major industrial countries. He also noted that the rate of growth in the money supply in 1972 was just about the same as the rate of growth in real output. As the economy has neared full capacity operations, the rate of monetary expansion has slowed, with the money supply in the third quarter having increased at an annual rate (seasonally adjusted) of only 5.6 percent since the last quarter of 1972.

Even without the emergence of the energy crisis, it would, in the words of Chairman Burns, "take some time for the forces of inflation... to burn themselves out." He also noted that worldwide inflationary forces complicated the problem and that more help was needed from fiscal policy. However, keeping a fairly tight rein on monetary expansion seemed to be the only defensible policy to follow under the circumstances.

There are some persons who see recessionary developments of substantial proportions resulting from the disruption of the flow of petroleum from the Middle East. They see the energy crisis creating production difficulties and possibly slowing down the rate of economic expansion even more than is currently being projected by economic forecasters. Energy shortages could disrupt supply, especially of raw materials, causing bottlenecks in manufacturing. Plans for plant expansions might also be affected. Energy shortages could curtail demand for such fuel-consuming products as autos, boats, and recreation vehicles. This weakening in the economic outlook, they claim, suggests that the Federal Reserve should shift to a much more expansive policy immediately.

In short, the major policy decision that must be made is this: Should the Federal Reserve continue its present policy of supplying reserves to the banking system so as to moderate inflationary pressures, or should it move toward greater ease in the hope of relieving some of the recessionary tendencies that might develop out of the energy crisis?

At the outset, we need to keep the idea ever before us that the contribution Federal Reserve policy can make toward solving the energy crisis is extremely limited. Moreover, at the present moment, although we can recognize the possibility of a weakness developing in the economy, the evidence of the future effects of the energy crisis is by no means clear. We need to remember the basic strengths of the American economy and avoid precipitous action. On the other hand, we do know that inflationary pressures are strong and may become stronger. Thus, the long-range policy of providing enough credit to facilitate the moderate economic expansion possible within the limits of the American productive capacity but not too much continues to be appropriate at the present time.