

HOW IS BUSINESS?

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by

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"How is business?" is a question I get asked most often, and quite appropriately so. My answer right now is, "Good, with qualifications." Let me first tell you why I add the qualifier. Most economic numbers we see now still reflect the winter weather and natural gas shortage. The national composite index of leading business indicators for January was down; so were housing starts, durable goods orders, retail sales, and industrial production. Various February statistics look better than January's. But that's only to be expected, considering the improvement in both weather and fuel supplies in February. The February numbers are actually as difficult to interpret as January's because they too were weather affected.

What really counts is the underlying trend. And I tell you business activity, in those terms, is reasonably good. I am not going to bore you with a lot of statistics. But taking you back just one year to early 1976, you may remember the economy was moving up. Later, rather suddenly, it paused during the summer and early autumn. Economists called it a "lull." And then, almost as suddenly as it began, the pause, or lull, ended. Retail buying picked up solidly before the Christmas season. Auto sales and residential construction strengthened. Excess inventories were worked off. And businessmen were placing sizeable orders to rebuild their depleted stocks. So, a good economic pick-up developed some time before the bad weather struck early this year.

Had there been no freeze and plenty of natural gas, the early 1977 figures we see now would look better. But considering everything, they look surprisingly cheerful. Retailers, for example, report their January sales held up reasonably well, and sales seem to have improved in February.* The auto industry is bouncing back. And if we trust the employment statistics, so is construction.

At the moment, then, we find the economy rebounding and good omens for the near future are present. We are particularly encouraged by the National Association of Purchasing Managers' most recent report. This group reports orders from manufacturers are again on the rise-- a development that brightens the near-term prospects for production and employment. All of this makes us optimistic. We are, in fact, more optimistic about business prospects today than we were three months ago.

What is the basis of our optimism? We place the state of consumer confidence high on the list of major economic influences. Therefore, we are pleased that consumer confidence has held up remarkably well in recent months, considering the winter hardships. Consumers now seem freer in their spending than they have in some time. They seem especially eager to buy a home and a car. Neither is a bargain at today's inflated prices. But because interest rates are lower than last year and credit is readily available, it is understandable why consumers feel the way they do.

*Lacking a February retail sales figure at this point, I assume it by virtue of improved auto sales and national chain store sales.

The outlook for capital spending has also improved, following a sharp slump and sluggish expansion. For some time now, corporations have been reluctant to move ahead with their capital investment plans. There are recent indications that this may be changing. Manufacturers report a substantial rise in new money earmarked for investment in plant and equipment later this year. A resurvey of capital spending intentions further substantiates that spending plans have strengthened since last fall. Machinery orders, too, are up, all of which suggests brighter prospects for business capital spending in this country.

How vigorous this activity will grow, nevertheless, remains a question mark. Not all of it will go for expanding productive capacity or modernization. Some will merely fulfill anti-pollution, safety, and health control requirements. We further know that some companies, in direct response to gas interruptions and shortages, recently started buying equipment that will provide them with an alternative energy source. Money spent on such equipment in no way increases production capability, though necessary such a hedge against next year's winter may be. Fortunately, most major companies are already equipped with alternative heating equipment. We have also learned that whatever capital investment is now being made for this purpose does not appear to curtail regular expansion plans significantly, at least in our area of the country. So, feeling that 1977 will be a pretty good year, many companies in need of expansion or modernization are going ahead. A lot of this money is going for more efficient equipment. I also sense

an improving trend developing for major industrial construction projects, although a big push in that sector is not yet under way.

If the economy is on the rise, why is there a need for stimulating the economy? The advocates of extra fiscal stimulus contend the economy lacks sufficient momentum. They think the pick-up won't be large enough to make a significant dent on unemployment. And they think the economic rebound may not last. We, obviously, have no way of knowing whether their view is correct; only the future will tell.

But I don't mind telling you that the administration's \$31.2 billion fiscal package, a combination of tax reductions and spending increases, is not entirely to my liking. It is not the idea of a tax cut that troubles me. With so many people expecting some kind of tax reduction, the last thing I would want to see the Congress do is turn down tax relief. It would disappoint too many people.

It is the design of the proposed package and its size that trouble me. The bulk of the tax reductions proposed by the administration for 1977 will be in the form of a one-shot \$50 rebate. Experience has shown that one-time tax rebates have only a temporary effect on the economy. Assuming Congress goes along, consumers will receive their checks this spring when the economy makes up the losses caused by the cold weather. It is not the kind of program the economy needs.

The one major sector on which the momentum of the economic uptrend really depends is investment. And that sector, although it is going up, still shows restrained growth. A direct stimulus to investment,

such as a corporate income tax reduction, might provide just the spark needed to increase business investment. We relied rather successfully on this type of tax relief for business, along with higher depreciation allowances, in the 1960s. They are, unfortunately, not part of the program now under Congressional deliberation.

In considering the best possible fiscal remedy, we must not overlook another sound principle: The way to promote a durable economic expansion through fiscal means is by tax reduction rather than by increased government spending. The start-up time for many spending programs can be quite lengthy. This is particularly true of large public works projects. There is a danger that the economic impact of spending programs will not be felt when they are needed the most. It is often politically difficult to end some programs. And in providing employment, the private sector does a more efficient job than any large-scale public employment program.

I have mentioned problems in the design of the proposed fiscal package. Let me say a few words about its size. Frankly, I am not that wise to know whether \$10 billion, \$15 billion, or even \$20 billion is the right amount of fiscal relief. But two elements relating to the size of the fiscal package matter most of all. The first is whether the package is so large to alarm businessmen and, therefore, adversely affect confidence. Confidence is crucial to economic health. The last thing we want is to discourage the building of new facilities by businessmen in anticipation of future sales; for, quite clearly, more money spent on productive capacity is a necessary ingredient to the question of new jobs.

Yet another thing to be considered in deciding on the proper amount of stimulus is what possible impact the plan may have on prices. The administration's stimulus package has already heightened fears about inflation. The Treasury obviously doesn't have the money for financing rebate checks and spending increases, but it must borrow the money. So, fiscal relief will swell what already is a very large Treasury deficit. The outgoing administration had already predicted a \$57 billion deficit in the government's unified budget in fiscal 1977 and a \$47 billion deficit in fiscal '78. Incorporating the fiscal stimulus impact and other budgetary changes, the new administration calculates the '77 deficit at \$68 billion and next year's deficit, at \$58 billion. If these projections are right, the government over this and next fiscal year will be running \$126 billion "in the red." That is a large amount of money even in today's \$1.7 trillion economy. When you add to the current \$68 billion figure another \$10 billion in off-budget items, the Treasury will need to borrow nearly \$80 billion in this fiscal year alone.

Let me relate these deficit projections to inflation. Actually, I see, quite independently of the added deficit, virtually no chance for reducing inflation in 1977. On the contrary, more, rather than less, inflation is the likely prospect in view of rising energy and food prices.

In today's setting, there exists the possibility that too much fiscal stimulus might frighten businessmen, adversely affecting their

confidence. There is the further possibility that too much fiscal stimulus, when combined with private demand pressures, might create excess demand. Inflationary supply pressures might also intensify in the future, though perhaps not right away because the economy still has some slack. But I am worried over a possible combination of inflationary pressures confronting us in 1978 and beyond. Unless private investment and productivity increase more than we now expect, shortages and bottlenecks could develop sooner than we think. The necessity of exercising caution in the development of a short-term strategy of stimulation cannot be overemphasized.

I have found inflation to be one of the most intractable problems of our times. Fortunately for all of us, the inflation rate has come down in recent years. Everybody has a stake in the continuation of this process. Considering the current economic momentum and the energy and weather problems that confront us, this year's fight against inflation, and next year's, will be tougher than last year's. So the last thing we need is too much fiscal stimulus. If you will exercise your leadership on this point, there will be special reason for expecting business in the future to be improved over what it is today.