THE "GROWTH RECESSION"

Remarks of Mr. Robert P. Mayo, President
of the Federal Reserve Bank of Chicago
before the Board of Directors, Detroit Branch
and invited guests--Detroit, Michigan
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It is fascinating to look back over the past years and recall the economic "catch words." In 1966 it was the credit crunch; in 1967 we had a mini-recession. We worried about overkill in 1968 and talked about gradualism in 1969. Then earlier this year it was liquidity crises.

That "catch word" started to give way last month to the blah economy. As you've heard before I'm sure, this was a movement from a recession that wasn't quite a recession, to a recovery that wasn't quite a recovery.

But this has been superseded now by a new label from the National Bureau of Economic Research--a growth recession. The analysts at the Bureau decided that none of the historical patterns and labels fit the current situation. But that this slowing of growth without a reversal in overall activity or practically no rise or fall in activity was deserving of a name.

The whizzes in Detroit who coin new names for autos could probably come up with something more flashy but I think it will stick. It does sum up pretty well what has been going on in the economy.

Total employment, personal income, industrial production and GNP are all at, or near, all-time highs. Consumer outlays are growing. The fixed investment of business is being "reasonably" well maintained. In fact, the overall economic adjustment since the summer of 1969 has been milder than in any recession since World War II.

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Here's a good example. In retrospect, the recession of 1960-61 was the mildest of the postwar period. But even then industrial production fell almost 6 percent. Current figures indicate that industrial production is off about half that amount to the June low point. Similarly, the decline in total man-hours worked in nonfarm production has remained small in comparison with the 60-61 experience.

So where are we? Maurice Stans has suggested that the GNP will top one trillion dollars sometime in the next few months, and that we will reap an "economic harvest that is the greatest in the history of the world."

If the GM strike isn't overly long, this is a pretty good bet. GNP for the first quarter of 1970 was $959.5 billion. The second quarter posted a respectable increase. If we can achieve increases in the third and fourth quarter which would be termed modest in comparison to quarterly increases from the third quarter 1967 through the third quarter of 1969, we'll easily hit one trillion by the end of the year.

If we can wind up the year with a one trillion dollar GNP at the same time we're wringing out the inflationary pressures in the economy, then I think national economic policy must be given high marks for performing an exceptional tightrope act.

I also think that this situation indicates that we have achieved the middle ground we sought with regard to monetary aggregates. During the year, open market policy has been the principle instrument used to insure a renewal of moderate growth in the monetary aggregates, and the Federal Open Market Committee has placed a high priority on achieving a suitable growth rate of money and bank credit. In some quarters, this change in operating procedures was interpreted as a decision by the Federal Reserve to pursue fixed target rates of growth in the monetary aggregates on a generally continuous basis.

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Nothing could be further from the true intent. A mechanical application of monetary rules isn't realistic, and we in the Federal Reserve System know it. Erratic and unexpected short-run changes in demands for money and bank credit do occur. Preventing these shifts from disrupting the smooth functioning of the money and capital markets is one of our more important functions. We have not closed our eyes to these situations when they occur. And even as we fulfill our responsibilities in this area, we need not compromise on a longer-run objective of maintaining an orderly rate of monetary expansion. This is borne out by the large month-to-month changes which have occurred recently in the growth rate of the money stock due to unusual factors in public demand, while the annual growth rate averaged out to a little over 4 percent.

As the Federal Reserve views its responsibility, assuring a steady growth of the monetary aggregates over the longer run is only part of the picture. Promoting monetary conditions conducive to full employment, to rapid improvement in productivity, to reasonable price stability, and to equilibrium in the balance of payments are equally important objectives of the System. We will not permit a policy dedicated to any fixed growth rate of the money supply stand in our way.

About a year ago, in dealing with inflationary pressures which had risen to a dangerous degree, Federal expenditure programs were curbed, and monetary policies moved to a highly restrictive posture. The consequence of these policies has been slowing in the pace of total spending, an elimination of excess demand, and a period of sluggish economic activity.

No one argues that the adjustment was accomplished without cost. The effects of the slowdown are apparent in the labor market. We are not complacent about this development. But the alternative of letting inflation run rampant would have been disastrous. The good news is that the weaknesses which developed as a necessary corollary to the fight against inflation have been contained, and

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from all indications we have paved the way for a resumption of sustainable economic growth.

Look at the indicators

Industrial production was off slightly in August. Retail sales also declined in August. But these declines have been so small as to suggest virtually no change at all since the second quarter. The durable goods orders decline was more substantial but represented largely a decline in defense orders--an offset to a large pick-up in these orders in July. On balance then, this indicator is also turning in a relatively flat performance that appears to confirm that there is no further deterioration in the economic environment. This is not to say that further substantial declines are not possible, but they are not probable if economic policy continues on its present course.

While it is true that preliminary housing starts figures for August were down from July figures, permits were up in August, leading to expectations of increases in housing starts in coming months. Assuming more favorable credit conditions, the housing outlook for the remainder of the year is favorable.

Easier financial markets should also allow more rapid expansion of state and local outlays. Sales of long-term bonds by state and local governments in August were about $1.3 billion, the same as July. But with continued improvements in market conditions, the forward calendar is beginning to improve, and new offerings are expected to increase significantly in coming months.

There is still some uncertainty on budget outlays for defense spending because the defense appropriations bill is still being worked on in Congress. It is likely, however, that pressures from Congress and the Administration will result in a cut of about $1 million in defense spending.

Outlays for plant and equipment are moderating. Current plans indicate an increase in total outlays of about 7 percent over 1969,--down about 3 percentage

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points from the February survey. Past experience suggests further cuts in actual spending from planned outlays. The moderation in capital spending is not altogether unwelcome. Large annual increases in capital outlays eventually would raise excess capacity to a level threatening a serious investment decline later on. A slowdown in the capital goods boom will help reduce pressures on prices, costs and interest rates. This is added insurance that excess demand will not re-emerge as economic activity turns up.

There has been a marked change in the trend of productivity and unit labor costs in manufacturing. Last year, output-per-manhour showed almost no growth--partly because of labor hoarding. This year, as sales weaken and profit margins deteriorate, closer attention is being paid to costs. Firms have released their excess work force, overtime has been cut back, and other cost-cutting measures have been adopted. The result has been a distinct improvement in the trend of productivity, and a sharply reduced rise of unit labor costs in manufacturing.

Unduly large increases in wage rates have continued and I look on these with dismay. There is, however, the hope that as the rate of productivity continues to improve, we should see further abatement of upward pressures on unit labor costs, and on industrial commodity prices. As these elements work their way through to consumer prices, the prospects for lower and more reasonable wage settlements will be enhanced.

On the good news front--and we would all like to see more--price pressures are beginning to moderate. Wholesale prices declined from July to August as a result of a drop in prices of farm and food products, and a slower increase in prices of industrial commodities. The decline in the overall index was the first since April 1967. On Wednesday we received the news that consumer prices for August posted their smallest rise since December 1968. They rose at only a 2.4 percent annual rate in August. These data are volatile but putting the figures

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together for three month spans shows that we are making progress on the price front. For the last three months prices have moved up 3.5 percent; in the prior 3 months they rose at 6 percent and for the even earlier three months the gain was 7.3 percent.

The other good news item is the easing in financial markets. The 3-month Treasury bill rate has moved down to the 5.7 and 5.85 range. Federal funds have run at 5-1/2 to 6 but have shown slightly higher rates in the last few days.

Most banks argued that the cut in the prime rate was a reflection of competitive pressures rather than weaker loan demands. But banks do appear to be in easier positions. Business loan increases have not matched year ago performances. For large banks in this District, the gain in business loans since December is only half of the gain for the comparable period last year.

Our economic policies are beginning to bear fruit.

The economy has experienced unusual strains and stresses this year, but the psychology of the market is improving and the attitude of many businessmen appears less uneasy. Prospective credit demands for this fall appear quite large, but if bank credit continues to grow modestly these needs may be accommodated at declining interest rates.

The right course for economic policy still remains one of cautiousness. It is extremely important that we avoid the two extremes of inflation and recession. In recent months, economic policy has been following a path of moderate expansion. This path provides insurance that the economic slowdown will not gather momentum. At the same time, the expansion is consistent with a moderation of inflationary pressures later this year and on into 1971.

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