# A TIME OF CHALLENGES

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AT

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BALL STATE UNIVERSITY GRADUATE SCHOOL OF BUSINESS
MUNCIE, INDIANA

OCTOBER 15, 1975

I AM PLEASED TO HAVE AN OPPORTUNITY TO MEET WITH YOU TODAY

--TO TALK ABOUT OUR ECONOMY

--TO TALK ABOUT OUR NATION'S ECONOMIC POLICIES

--TO TALK ABOUT A TIME OF CHALLENGES.

THIS NATION IS NOW EMERGING FROM THE SHARPEST DECLINE IN REAL ECONOMIC ACTIVITY IN THE POST-WORLD WAR II PERIOD. WE HAVE FOR THE SEVENTH TIME SINCE WORLD WAR II WEATHERED ANOTHER ECONOMIC DOWNTURN. WE SHOULD BE RELIEVED; WE SHOULD BE LOOKING AHEAD WITH CONFIDENCE. BUT MANY IN OUR SOCIETY ARE UNEASY AND UNCERTAIN. THINGS ARE DIFFERENT THIS TIME. WE ARE COMING OUT OF THIS RECESSION WITH THE HIGHEST UNEMPLOYMENT, THE HIGHEST FEDERAL DEFICIT, THE HIGHEST INTEREST RATES AND THE HIGHEST RATE OF INFLATION OF ANY CORRECTION IN THE PEACETIME, POSTWAR PERIOD. NO WONDER THE CURRENT ECONOMIC SITUATION AND PROSPECTS ARE VIEWED WITH LESS THAN EUPHORIA. THE "SCENE", AS THE YOUNGER GENERATION WOULD CALL IT, IS LOADED WITH CHALLENGES.

THE BASIC CHALLENGE FOR ECONOMIC POLICY IS TO ACHIEVE A SUBSTANTIAL AND SUSTAINABLE EXPANSION IN REAL OUTPUT AND EMPLOYMENT

WITHOUT FURTHER ESCALATION OF THE RATE OF PRICE INCREASES. AND WE MUST DO SO WITHIN THE CONTEXT OF OUR FREE ENTERPRISE ECONOMY AND WITHOUT LOSS OF PERSONAL FREEDOM. MY DIRECT INTEREST TODAY, OF COURSE, IS THE CONTRIBUTION THAT MONETARY POLICY CAN AND SHOULD MAKE IN MEETING THAT OBJECTIVE. I STRESS THE WORD CONTRIBUTION SINCE MONETARY POLICY CAN NOT BE OUR SOLE ECONOMIC POLICY TOOL. THIS POINT HAS BEEN FAR TOO FREQUENTLY IGNORED IN PUBLIC DEBATES WHERE EFFORTS ARE MADE TO FIND A SINGLE, SIMPLE SOLUTION TO OUR DIFFICULTIES. THIS CONFUSION RANKS ALONG WITH WHETHER OUR ECONOMIC PROBLEM IS EITHER INFLATION OR UNEMPLOYMENT--A CHOICE DOESN'T EXIST; IT'S BOTH--AS MAJOR IMPEDIMENTS TO PUBLIC UNDERSTANDING AND SUPPORT OF APPROPRIATE ECONOMIC POLICIES.

LET'S BEGIN OUR EXAMINATION OF THE POTENTIAL CONTRIBUTION OF MONETARY POLICY TO OUR BASIC ECONOMIC OBJECTIVE BY ASSESSING THE PROGRESS THAT HAS BEEN MADE IN GETTING THE AMERICAN ECONOMY ON THE RECOVERY COURSE--INCLUDING THE ROLE PLAYED SO FAR BY MONETARY AND FISCAL POLICY. WE NEED TO KNOW WHERE WE ARE AND WE NEED TO KNOW THE OBSTACLES THAT LIE IN OUR PATH BEFORE WE CAN FOCUS ON POLICY ISSUES.

THE ECONOMIC RECOVERY IS UNDERWAY. IT STARTED SOMETIME IN THE SECOND QUARTER. ALL SECTORS ARE STILL NOT PARTICIPATING IN THE RECOVERY BUT A SOLID FOUNDATION HAS BEEN LAID.

IN THE SECOND QUARTER OF THIS YEAR, REAL GNP, THE TOTAL OUTPUT OF GOODS AND SERVICES IN THE ECONOMY, INCREASED, ALBEIT ONLY SLIGHTLY, FOR THE FIRST TIME SINCE THE LAST QUARTER OF 1973. INDICATIONS ARE

THAT THIRD QUARTER GROWTH WILL TURN OUT TO BE SIGNIFICANTLY STRONGER. TOTAL INDUSTRIAL PRODUCTION HAS RISEN AT A COMPOUNDED ANNUAL RATE OF 8.4 PER CENT OVER THE FOUR MONTHS THROUGH AUGUST, AND SEPTEMBER SHOULD SHOW ANOTHER NICE GAIN.

PROGRESS IS BEING MADE ON THE EMPLOYMENT FRONT ALSO. TOTAL CIVILIAN EMPLOYMENT, AS MEASURED BY THE LABOR DEPARTMENT'S MONTHLY SURVEY OF HOUSEHOLDS, ROSE AGAIN IN SEPTEMBER FOR THE SIXTH MONTH IN A ROW. SEPTEMBER'S INCREASE OF 180,000 JOBS IN THE MANUFACTURING SECTOR IS ESPECIALLY GRATIFYING. THIS WAS THE LARGEST INCREASE SINCE DECEMBER 1970. AFTER REACHING A PEAK OF 9.2 PER CENT LAST MAY, THE UNEMPLOYMENT RATE HAS FALLEN NEARLY A FULL PERCENTAGE POINT TO 8.3 IN SEPTEMBER.

THE RECOVERY STARTED IN THE CONSUMER SECTOR. EARLY IN THE YEAR, WHEN BUSINESSES BEGAN TO MAKE PRICE CONCESSIONS AND WITH PERSONAL INCOMES INCREASING, CONSUMER PURCHASES BEGAN TO RISE. OVER THE FIRST EIGHT MONTHS OF THIS YEAR, IT IS ESTIMATED THAT RETAIL SALES HAVE INCREASED AT A SEASONALLY ADJUSTED COMPOUNDED ANNUAL RATE OF ABOUT 16 PER CENT AS COMPARED WITH ABOUT A 2 PER CENT INCREASE IN THE PREVIOUS EIGHT MONTHS. THE INCREASES IN CONSUMER SPENDING WERE INITIALLY CONCENTRATED IN NONDURABLES, BUT AS CONSUMER CONFIDENCE AND LIQUIDITY HAS IMPROVED, INDIVIDUALS HAVE BECOME MORE WILLING TO DIP INTO THEIR SAVINGS OR TO INCUR NEW INDEBTEDNESS IN ORDER TO STEP UP THEIR PURCHASES OF DURABLE GOODS. EVIDENCE OF THE RESURGENCE IN CONSUMER DEMAND IS REFLECTED IN THE INCREASES IN CONSUMER CREDIT OUTSTANDING WHICH HAVE OCCURRED.

Of course, other sectors of the economy have also played a role in leading us out of the recession. One of these is foreign trade. Throughout 1974, our merchandise trade balance was unfavorable. It reached an unprecedented $7.2 billion annual rate of deficit in the third quarter. But due to the recession, our imports were reduced sharply, our exports increased, and the net result was a swing in our trade position to a surplus of over $13 billion on an annual basis in the second quarter of this year. This swing in the trade balance has contributed to the rise in the value of the dollar in foreign exchange markets.

The upsurge in purchases by foreigners and American consumers has made it possible for businesses to reduce substantially their excess inventories. In the second quarter of this year the rate of decline in inventories in relation to GNP was the largest in any quarter in the postwar period. Recent increases in industrial production indicate that a better balance between inventories and sales has now been achieved.

Part of the groundwork for the recovery was laid by adjustments in the private economy that served to redress imbalances that had produced the recession. One of the most important of these adjustments was the reduction in the inflation rate. By the second quarter of 1975, the annual rate of change in the implicit price deflator for GNP--probably the best overall measure of inflation--was down to 5.1 per cent as compared to 14.4 per cent in the fourth quarter of last year. Although we have made great strides in reducing the rate

OF PRICE INCREASES, WE MUST KEEP IN MIND THAT THE RATE OF INFLATION REMAINS HIGH BY HISTORICAL STANDARDS. FURTHERMORE, THE RATHER LARGE INCREASES IN THE WHOLESALE PRICE INDEX DURING JULY AND AUGUST ARE A REMINDER THAT THE FIRES OF INFLATION CAN BE REIGNITED WITHIN A VERY SHORT PERIOD OF TIME.

IN ADDITION TO ADJUSTMENTS IN THE PRIVATE ECONOMY, FISCAL AND MONETARY POLICIES HAVE ALSO PLAYED A ROLE IN PROMOTING ECONOMIC RECOVERY. IN THE AREA OF FISCAL POLICY, PUBLIC EMPLOYMENT PROGRAMS WERE EXPANDED, UNEMPLOYMENT INSURANCE WAS LIBERALIZED, AND INCOME TAXES WERE REDUCED. IN ADDITION, CHANGES IN THE INVESTMENT TAX CREDIT ALLOWANCE HAS STRENGTHENED INCENTIVES FOR BUSINESS INVESTMENT IN FIXED CAPITAL.

ON THE MONETARY SIDE, INTEREST RATES--PARTICULARLY SHORT TERM RATES--HAVE FALLEN DRAMATICALLY FROM THEIR 1974 HIGHS AS A RESULT OF DECLINING CREDIT DEMANDS AND A MORE ACCOMMODATIVE MONETARY POLICY. SINCE THE BEGINNING OF THE YEAR, $M_1$ (PRIVATE DEMAND DEPOSITS PLUS CURRENCY AND COIN HELD BY THE NONBANK PUBLIC) HAS INCREASED ABOUT 5 PER CENT ON A SEASONALLY ADJUSTED BASIS AND $M_2$ ($M_1$ PLUS CONSUMER TYPE TIME DEPOSITS AT COMMERCIAL BANKS) ABOUT 9 PER CENT. BY HISTORICAL STANDARDS, THE GROWTH RATES IN THE MONETARY AGGREGATES ARE ON THE HIGH SIDE, BUT WERE NEEDED, GIVEN THE SEVERITY OF THE RECESSION.

CORPORATIONS HAVE TAKEN ADVANTAGE OF THE EASIER CREDIT CONDITIONS BY IMPROVING THEIR LIQUIDITY POSITIONS THROUGH THE FUNDING OF A GREAT PORTION OF THEIR SHORT-TERM DEBT. BANKS AND OTHER FINANCIAL INSTITUTIONS HAVE ALSO USED THE PERIOD OF SLACK CREDIT DEMAND TO REPAIR

THEIR LIQUIDITY POSITIONS. CONSUMERS, TOO, PUT THEIR FINANCIAL HOUSES IN ORDER BY PAYING DOWN INDEBTEDNESS AND MAKING ADDITIONS TO THEIR LIQUID FINANCIAL ASSETS. ALL OF THESE FACTORS SERVED TO FORM A SOLID FOUNDATION UPON WHICH THE RECOVERY COULD BE BUILT.

AS I NOTED EARLIER, THE MAIN OBJECTIVE OR GOAL OF MONETARY POLICY AT THE PRESENT TIME IS TO CONTRIBUTE TO A SUBSTANTIAL AND <u>SUSTAINABLE</u> EXPANSION IN REAL OUTPUT AND EMPLOYMENT. I EMPHASIZE SUSTAINABLE BECAUSE THE ECONOMIC EXPANSION MUST OCCUR WITH A MINIMUM AMOUNT OF INFLATION. IF INFLATION ACCELERATES, THE ECONOMIC RECOVERY WILL BE SHORT-LIVED. AN OVERLY-EXPANSIVE MONETARY POLICY COULD QUICKLY LEAD TO HIGHER ACTUAL AND ANTICIPATED RATES OF INFLATION. THE PUBLIC WOULD SOON CALL FOR ANTI-INFLATIONARY FISCAL AND MONETARY POLICIES WHICH, WHEN ENACTED, COULD PLUNGE THE ECONOMY BACK INTO RECESSION. BUT TOO RESTRICTIVE A MONETARY POLICY WOULD TEND TO RETARD THE ECONOMIC ADVANCE AND PERHAPS EVEN ABORT THE RECOVERY. WHAT THEN ARE THE APPROPRIATE GUIDES FOR MONETARY ACTION?

AS YOU KNOW, THE FEDERAL RESERVE ATTEMPTS TO ACCOMPLISH ITS OBJECTIVES BY ACTING TO INFLUENCE THE LEVEL AND THE RATE OF CHANGE OF MONEY AND CREDIT IN THE ECONOMY. IT DOES THIS BY INFLUENCING THE AMOUNT OF RESERVES--THE DEPOSITS OF MEMBER COMMERCIAL BANKS AT THE FEDERAL RESERVE BANKS. CHANGES IN RESERVES IN TURN AFFECT THE AMOUNT OF BANK CREDIT EXTENDED, THE LEVEL OF BANK DEPOSITS, AND INTEREST RATES.

THE POLICY DECISION IS TO DETERMINE HOW MUCH RESERVES ARE TO BE CHANGED SO AS TO ACHIEVE THE FINANCIAL CONDITIONS NECESSARY

TO ATTAIN THE OBJECTIVE OF SUSTAINABLE ECONOMIC EXPANSION. SINCE THE FINAL GOAL ISN'T ACHIEVED INSTANTLY, POLICY MAKERS TEND TO USE, AS GUIDES TO ACTION, SO-CALLED INTERMEDIATE TARGETS SUCH AS INTEREST RATES AND $M_1$--DEMAND DEPOSITS AND CURRENCY--THAT ARE RELATED TO THE ULTIMATE ECONOMIC GOALS.

ONE OF THESE INTERMEDIATE TARGETS THAT RECEIVES A LOT OF PLAY IN THE PRESS IS $M_1$. ALTHOUGH MANY OUTSIDE THE FEDERAL RESERVE SYSTEM BELIEVE THAT $M_1$ SHOULD BE OUR SOLE TARGET, WE FEEL THAT IT MAY HAVE CERTAIN DRAWBACKS. IN THE PAST 20 YEARS OUR COUNTRY HAS EXPERIENCED RAPID ADVANCES IN FINANCIAL TECHNOLOGY. WITH THE ADVENT OF CERTIFICATES OF DEPOSIT, BANK CREDIT CARDS, INTEREST BEARING DEPOSITS THAT CAN BE USED FOR TRANSACTION PURPOSES, MONEY-MARKET MUTUAL FUNDS, AND AN INCREASE IN THE LEVEL OF SOPHISTICATION OF MANAGING CASH ASSETS ON THE PART OF THE GENERAL PUBLIC, THE DEMAND FOR CURRENCY AND CHECKING DEPOSITS HAS AND CONTINUES TO UNDERGO CHANGES. AS A RESULT, CHANGES IN THE RELATIONSHIP BETWEEN $M_1$ AND GNP MAY ALSO BE OCCURRING. SOME OF THESE CHANGES CAN BE PREDICTED FAIRLY ACCURATELY, BUT OTHERS CANNOT.

BECAUSE NO SINGLE DEFINITION OF MONEY DESCRIBES COMPLETELY THE SPENDABLE FUNDS HELD BY THE PUBLIC, THE FEDERAL RESERVE TAKES INTO CONSIDERATION THE BEHAVIOR OF A NUMBER OF MONETARY AND CREDIT AGGREGATES, INCLUDING TIME DEPOSITS AND EVEN DEPOSITS AT ALL FINANCIAL INSTITUTIONS. IN ADDITION TO THE AGGREGATES, WE ALSO MONITOR THE CONDITION OF FINANCIAL MARKETS--THAT IS, MOVEMENTS IN INTEREST RATES

AND THE LIQUIDITY NEEDS OF BUSINESSES AND FINANCIAL INSTITUTIONS. ATTENTION IS ALSO PAID TO DEVELOPMENTS IN THE FOREIGN EXCHANGE MARKETS. THE BEHAVIOR OF ALL THESE VARIABLES ENTERS INTO THE DECISION MAKING PROCESS WITH DIFFERING WEIGHTS DEPENDING ON THE EXISTING ECONOMIC ENVIRONMENT.

BUT I WOULD LIKE TO MAKE IT CLEAR THAT WHILE ONGOING MONETARY POLICY DECISIONS MAKE USE OF MANY INPUTS, THE LONGER TERM PATH OF MONETARY AGGREGATE GROWTH DOES HAVE SIGNIFICANCE. EXTENDED PERIODS OF TOO RAPID OR TOO SLOW A GROWTH OF THE MONETARY AGGREGATES WILL TAKE A TOLL IN MORE RAPID INFLATION OR IN A SLUGGISH OR ABORTED RECOVERY. BECAUSE OF THIS, THE FEDERAL RESERVE CONCENTRATES ON SETTING MONETARY AGGREGATE TARGETS OVER LONGER PERIODS OF TIME.

LAST SPRING, FOR EXAMPLE, THE FEDERAL RESERVE MADE PUBLIC ITS YEARLY GROWTH RATE TARGETS FOR THE MONETARY AND CREDIT AGGREGATES. FOR THE 12-MONTH PERIOD RUNNING FROM THE SECOND QUARTER OF 1975 TO THE SECOND QUARTER OF 1976, THE TARGETED GROWTH RATE RANGE FOR $M_1$ WAS SET AT 5 TO 7 1/2 PER CENT, WITH $M_2$ INCREASING IN THE 8 1/2 TO 10 1/2 PER CENT RANGE. THESE TARGETS ARE NOT ETCHED IN STONE, HOWEVER. GOOD MONETARY POLICY MAKING REQUIRES THAT THEY BE REVIEWED PERIODICALLY AND CHANGED IF ECONOMIC CIRCUMSTANCES WARRANT.

WITH THIS BACKGROUND IN MIND, THEN, WHAT CAN BE SAID ABOUT THE PROBLEMS FOR MONETARY POLICY IN THE CURRENT ECONOMIC ENVIRONMENT, WHICH ON ONE HAND APPEARS TO REQUIRE VIGOROUS EFFORTS TO ALLEVIATE UNEMPLOYMENT BUT ON THE OTHER HAND EQUALLY VIGOROUS EFFORTS TO REDUCE INFLATION? ONE OF THE PROBLEMS THAT MUST CONCERN THE FEDERAL RESERVE

AND IN FACT ALL OF US IS THE ISSUE OF THE FEDERAL DEFICIT AND TREASURY FINANCING PLANS. TREASURY FINANCIAL NEEDS HAVE BEEN--AND WILL CONTINUE TO BE FOR A LONGER TIME THAN WE WOULD LIKE--ONE OF THE GREATEST ELEMENTS OF CONCERN TO FINANCIAL MARKETS. THE DILEMMA IN WHICH THE FEDERAL RESERVE SYSTEM HAS BEEN PLACED IS NOW COMMON KNOWLEDGE. IF NOT ACCOMMODATED BY THE FED, HEAVY TREASURY BORROWING PILED ON TOP OF REVIVING PRIVATE CREDIT DEMANDS COULD FORCE INTEREST RATES EVEN HIGHER, CROWDING OUT MANY NON-FEDERAL BORROWERS. YET FULL ACCOMMODATION BY THE FED MIGHT HOLD INTEREST RATES DOWN TEMPORARILY, INSURE NON-FEDERAL BORROWER ACCESS, BUT LEAD QUICKLY TO HIGHER RATES OF INFLATION AND HIGHER INTEREST RATES IN TURN.

IN MY VIEW, THERE WAS SOME OVERREACTION BY THE MARKET TO THESE FEARS IN THE EARLY STAGES OF THE RECOVERY, FORCING INTEREST RATES HIGHER THAN WAS JUSTIFIED BY THE UNDERLYING DEMAND AND SUPPLY CONDITIONS. CERTAINLY, PRIVATE CREDIT DEMANDS HAVE NOT AS YET TAKEN OFF AND WE ARE STILL SEEING MORE REACTION TO ANTICIPATED PROBLEMS THAN ACTUAL PROBLEMS.

I DO NOT AND CANNOT TAKE A SANGUINE VIEW OF THE TREASURY DEFICIT, HOWEVER. THE CURRENT TREASURY ESTIMATE OF $44 TO $47 BILLION OF NEW CASH IN THE SECOND HALF OF 1975 MUST BE VIEWED WITH CONCERN. A CONTINUATION OF DEFICITS ON THE CURRENT SCALE CANNOT BE COUNTENANCED BY ANYONE TRULY CONCERNED WITH THE VIABILITY OF THE PRIVATE SECTOR OF THIS ECONOMY.

FOR MY PART, I SEE NO BASIS FOR THE FED TO ACCOMMODATE ALL BORROWING DEMANDS--BOTH FEDERAL AND PRIVATE--BY TRYING TO KEEP INTEREST

RATES ARTIFICIALLY LOW. TO DO SO WOULD MEAN GIVING UP EFFORTS TO REACH ULTIMATELY FULL EMPLOYMENT WITH STABLE PRICES--EVEN WHEN WE DEFINE BOTH OF THESE TERMS RATHER FLEXIBLY. BUT NOT ACCOMMODATING ALL OF THE GROWING NON-FEDERAL NEEDS IN THE FACE OF CONTINUING BUDGET DEFICITS OF THIS MAGNITUDE MEANS FEDERAL GOVERNMENT CONTROL OVER A LARGER AND LARGER PORTION OF OUR TOTAL SPENDING. THIS DISTURBS ME GREATLY BUT I AM CONVINCED THAT MONETARY POLICY CANNOT AND SHOULD NOT BE REQUIRED TO MAKE THE DECISION ON THE ALLOCATION OF SPENDING BETWEEN THE PRIVATE AND THE PUBLIC SECTORS. FORTUNATELY, WE HAVE RECENTLY ESTABLISHED PROCEDURES TO IMPROVE THE FEDERAL GOVERNMENT'S APPROACH TO PLANNING NATIONAL PRIORITIES. HOPEFULLY, THE FULL IMPLEMENTATION OF THE CONGRESSIONAL BUDGET AND IMPOUNDMENT CONTROL ACT OF 1974 WILL SERVE TO LIFT THIS UNWANTED AND INAPPROPRIATE BURDEN FROM THE SHOULDERS OF MONETARY POLICY.

BUT THAT WILL TAKE TIME. FOR THE NEAR TERM, THE FINANCIAL OUTLOOK DEPENDS CRITICALLY ON WHETHER OR NOT THE FEDERAL DEFICIT CAN BE HELD AT OR NEAR THE ADMINISTRATION'S TARGET. AND, OF COURSE, THE RECORD ON THE GROWTH OF PRIVATE CREDIT DEMANDS IS STILL TO BE WRITTEN. I MUST CONCEDE THAT IF THE RECOVERY IS STRONG, THEN THE ATTENDANT PRIVATE CREDIT DEMANDS CANNOT HELP BUT PUT SOME PRESSURE ON INTEREST RATES. MY HOPE IS THAT RENEWED VIGOR IN THE ECONOMY AND TIGHT BUDGETARY CONTROL WILL ALLOW THE MARKETS TO HANDLE THE EMERGING CREDIT DEMANDS IN A REASONABLE MANNER DURING THE PERIOD AHEAD. OF ONE THING I AM CERTAIN, HOWEVER. THE INTEREST RATE LEVELS WHICH WILL EMERGE WILL BE FAR LOWER IF WE CONTINUE TO HEW TO A

LONGER-TERM PATH OF MODERATE MONETARY EXPANSION THAN THEY WOULD BE IF WE GAVE IN TO THE SHORT-RUN MONETARY OVER-STIMULATORS WE FIND AROUND US.

As I ALLUDED TO EARLIER, RISING INTEREST RATES WILL NECESSARILY CROWD OR RATION SOME PRIVATE BORROWERS OUT OF THE CREDIT MARKETS. ONE SECTOR THAT SEEMS TO BEAR MORE THAN ITS FAIR SHARE OF THIS CROWDING OUT EFFECT IS THE HOUSING INDUSTRY. HOUSING IS USUALLY HURT MUCH LATER IN THE EXPANSIONARY PHASE OF THE BUSINESS CYCLE. BUT WE ARE STARTING THIS RECOVERY WITH INTEREST RATES AT MUCH HIGHER LEVELS THAN IN PAST RECOVERIES, PARTLY BECAUSE OF THE HUGE FEDERAL BORROWING AND PARTLY BECAUSE OF A HIGHER BASE RATE OF INFLATION. ALREADY THE HARBINGERS OF DISINTERMEDIATION ARE APPEARING, EVIDENCED BY THE SLOWING OF DEPOSIT FLOWS INTO THRIFT INSTITUTIONS AS GREATER NUMBERS OF SAVERS ARE BEING TEMPTED BY NEW SHORT- AND INTERMEDIATE-TERM TREASURY ISSUES YIELDING IN EXCESS OF 8 PER CENT.

WE AT THE FEDERAL RESERVE ARE EVER MINDFUL OF THE IMPORTANCE OF THE HOUSING SECTOR, BOTH SOCIALLY AND ECONOMICALLY, AND OF THE SPECIAL PROBLEMS THAT IT ENCOUNTERS AS INTEREST RATES RISE. BUT WE CANNOT TURN AWAY FROM OUR HIGHER RESPONSIBILITIES TO THE ENTIRE NATION OF PROMOTING ECONOMIC GROWTH WITH PRICE STABILITY. AGAIN, IF WE ATTEMPT TO HOLD INTEREST RATES TOO LOW IN ORDER TO PROTECT ONE SECTOR OR GROUP, WE WILL SUCCEED, AT BEST, ONLY TEMPORARILY. OVER A LONGER PERIOD, INTEREST RATES WILL RISE AND OUR COUNTRY WILL SUFFER EVEN GREATER INFLATIONARY RAVAGES.

There are also problems for price stability--and for monetary policy--by continuing fuel and food price increases. As a rough guess, decontrol, removal of the import fee, and an OPEC price increase could raise gasoline prices by something like 3 to 5 cents a gallon. The economy will have to make adjustments to accommodate the increase. The Soviet purchases will also have an impact on prices.

It is clear to me, however, that the more important elements in determining the rate of advance in food prices during the rest of the year are the expected cost increases in transportation, processing, and marketing--not in the cost of the basic commodities at the farm level. Consequently, we need to be cautious about attributing all of the prospective food price increases to the Soviet Union. Furthermore, it should be noted that a rise in the price of food resulting from increased foreign demand for our grain does not necessarily imply that our general cost of living will increase. We are not giving away grain to the Russians but selling it for hard cash. The increased demand for dollars on their part will tend to raise the value of the dollar <u>vis-a-vis</u> foreign currencies. As a result, goods that we import will be cheaper in terms of dollars. In addition, this will put downward pressure on the prices of domestically produced goods that compete with imports.

In my view, the adverse effects on the economic recovery of these increases are not likely to be substantial in the sense that they would abort the recovery. However, they will be adverse and

WE CAN'T VIEW THEM WITH COMPLACENCY. THE GENERAL PRICE LEVEL WILL BE AFFECTED. BUT ALSO IMPORTANT IS THE FACT THAT THE ADJUSTMENTS OF THE VARIOUS PARTS OF THE ECONOMY TO THESE JUMPS IN PRICES WILL TAKE TIME. THEREFORE, I ARGUED AT THE TIME OF THE INITIAL OIL PRICE INCREASE--AND I CONTINUE TO ARGUE NOW--THAT THE INCREASES MUST BE PARTIALLY ACCOMMODATED BY MONETARY POLICY AS THEY MATERIALIZE. WE WOULD BE FOOLISH TO IGNORE THEM COMPLETELY. THIS ACCOMMODATION MUST, HOWEVER, BE ONLY A SHORT-RUN ACTION. WE CANNOT AND SHOULD NOT ALLOW THESE SHOCKS TO OUR PRICE LEVEL TO TURN MONETARY POLICY INTO AN INFLATION ACCELERATOR.

THE MAJOR PROBLEM CONFRONTING US, HOWEVER, IS THE TRADITIONAL ONE OF PUBLIC EXPECTATIONS OUTRUNNING OUR CAPACITY TO ACHIEVE THEM--AT LEAST IN THE TIME FRAME DESIRED. WE HAVE UNFORTUNATELY BEEN CONDITIONED AS A SOCIETY TO "INSTANT ON" TELEVISION SETS, INSTANT MASHED POTATOES, AND INSTANT SUCCESS. I AM AFRAID THAT PARTLY BECAUSE OF THE OVERSELLING OF THEIR PRODUCTS BY SOME ECONOMISTS AND POLICY MAKERS IN THE 1960S, THE AMERICAN PEOPLE HAVE COME TO EXPECT INSTANT SOLUTIONS TO THEIR ECONOMIC PROBLEMS. I THINK THAT WE ARE NOW BEGINNING TO REALIZE THAT SOME OF THESE PROBLEMS CANNOT BE SOLVED AT A MOMENT'S NOTICE. ONE OF THEM IS THE HIGH LEVEL OF UNEMPLOYMENT. IF WE HAVE LEARNED ANYTHING IN RECENT YEARS, IT IS THAT WE CANNOT INFLATE OUR WAY INTO HIGHER LEVELS OF PERMANENT EMPLOYMENT. IT IS FOR THIS REASON THAT THE FEDERAL RESERVE HAS OPTED FOR A MODERATE COURSE IN MONETARY POLICY--A COURSE THAT I BELIEVE WILL PROMOTE

SUSTAINABLE ECONOMIC GROWTH AND AT THE SAME TIME WILL CONTINUE TO BANK THE FIRES OF INFLATION. I REALIZE THAT THIS POLICY PRESCRIPTION MAY NOT REDUCE THE UNEMPLOYMENT RATE AS FAST AS WE ALL WOULD PREFER. BUT A PERMANENT REDUCTION IN THE RATE WILL REQUIRE FURTHER SACRIFICE. WITH UNEMPLOYMENT INSURANCE, FOOD STAMPS, MEDICAID, AND OTHER TYPES OF INCOME MAINTENANCE PROGRAMS, THE MISERY SUFFERED BY THE UNEMPLOYED HAS BEEN LESSENED AND THE BURDEN IS ALSO BEING SHARED BY THE EMPLOYED, SINCE IT IS THIS LATTER GROUP THAT MUST FUND THESE PROGRAMS.

WE ARE ALSO BEGINNING TO REALIZE THAT INFLATION IS VERY COSTLY. POLICIES LEADING TO INFLATIONARY PRESSURES RESULT IN THE LONG RUN IN THE DESTRUCTION OF JOBS, NOT IN THEIR CREATION. THE VERY GROUPS WHICH ARE TO BE HELPED ARE HURT THE MOST. THE OPERATION OF OUR TREMENDOUSLY PRODUCTIVE ECONOMY BECOMES DISTORTED AND IN THE FINAL ANALYSIS THE VERY FABRIC OF SOCIETY IS AFFECTED.

THE COUNSEL OF PATIENCE IS NEVER VERY POPULAR. BUT IT IS APPROPRIATE IN THIS SETTING. WITH A WILLINGNESS TO ACCEPT A LONGER HORIZON, THE COUNTRY CAN AGAIN ENTER AN ERA OF STEADY ECONOMIC GROWTH. I AM CONVINCED THAT WE WILL DO SO.