

REMARKS BY ROBERT P. MAYO  
PRESIDENT, FEDERAL RESERVE BANK OF CHICAGO  
TO THE 1976 CORRESPONDENT BANKERS  
SPRING WORKSHOP  
DECATUR, ILLINOIS  
APRIL 15, 1976

I AM PLEASED TO HAVE BEEN INVITED TO JOIN YOU TODAY. I ENJOY MEETING WITH BANKERS -- EVEN IF SOME <sup>OF YOU</sup> AREN'T MEMBERS OF THE FEDERAL RESERVE SYSTEM. THESE SESSIONS ARE ~~VERY~~ VALUABLE IN KEEPING ME ABREAST OF YOUR INTERESTS AND CONCERNS. THE RAPIDITY AND NUMBER OF CHANGES IN BANKING HAVE, IN FACT, MADE <sup>SUCH</sup> ~~THESE~~ EXCHANGES ONE OF THE BEST WAYS OF KEEPING UP TO DATE.

*although naturally I think all of you should be*

I AM ALSO PLEASED TO HAVE BEEN ASKED TO BE <sup>YOUR</sup> ~~THE~~ KEYNOTE SPEAKER. THE ASSIGNMENT IS NO CHORE WHEN YOU HAVE THE OPPORTUNITY TO SET THE STAGE FOR A PROGRAM AS RELEVANT AS THIS ONE. THE WORKSHOP SESSIONS ON BANK HOLDING COMPANIES AND ON ELECTRONIC FUNDS TRANSFERS <sup>certainly</sup> HIT AT THE MAJOR ELEMENTS OF CHANGE AFFECTING BANKS.

AS A COMPLEMENT TO THESE SESSIONS, I WOULD LIKE TO TALK WITH YOU ABOUT DEVELOPMENTS IN OUR ECONOMY. THE FLOOD OF BANKING CHANGES HAS BEEN FED BY MANY STREAMS. MANY HAVE ARISEN FROM CHANGES IN TECHNOLOGY AND CHANGING COMPETITION AMONG BANKERS AND OTHER FINANCIAL INSTITUTIONS. BUT THAT IS ONLY PART OF THE STORY.

ONE OF THE MOST SIGNIFICANT IMPACTS ON AMERICAN BANKING HAS BEEN THE RAPIDLY CHANGING ECONOMIC SCENE -- ESPECIALLY THE SEVERE RECESSION FROM WHICH WE ARE NOW RAPIDLY EMERGING. THE MASSIVE <sup>change</sup> LIQUIDATION WHICH <sup>has been taking</sup> ~~TOOK PLACE~~ WAS A MAJOR REASON FOR THE EXTENSIVE PUBLIC DEBATE AND THE INCREASED LEGISLATIVE INTEREST IN OUR FINANCIAL STRUCTURE. CERTAINLY THE CHANGES IN SOCIETY'S <sup>'S</sup> ~~THE~~ ATTITUDES, INCLUDING THE WAVE OF CONSUMERISM, AND THE NEED FOR GREATER GOVERNMENTAL

RESPONSIVENESS TO THE PEOPLE, HAVE HAD AN IMPORTANT ROLE AS WELL. BUT THE VIGOR AND BREADTH OF THE REACTIONS HAVE BEEN ACCENTUATED BY ECONOMIC DEVELOPMENTS.

THESE EVENTS CONTINUE TO AFFECT THE PRESENT AND WILL AFFECT THE FUTURE AS WELL. THE SLATE CANNOT BE WIPED CLEAN.

WE ARE NOW MAKING TREMENDOUS STRIDES IN RECOVERING FROM THE MOST SEVERE SET-BACK THE ECONOMY HAS EXPERIENCED SINCE THE GREAT DEPRESSION OF THE 30'S. THE ECONOMIC RECOVERY IS WELL UNDERWAY. THE PROSPECTS FOR CONTINUED EXPANSION OF ACTIVITY ARE GOOD. BUSINESS AND CONSUMER CONFIDENCE HAS TAKEN A SHARP TURN FOR THE BETTER.

ECONOMISTS IN BUSINESS AND GOVERNMENT ARE VIRTUALLY IN AGREEMENT THAT THIS IS THE YEAR OF THE "MAGIC 6'S" OR THE 6 X 6'S -- A SIX PERCENT EXPANSION IN REAL ECONOMIC ACTIVITY AND A SIX PERCENT INCREASE IN PRICES. SINCE THE ECONOMY RESPONDS ONLY GRADUALLY TO <sup>MOST</sup> ~~THE MAJORITY~~ OF FORCES <sup>WHICH</sup> ~~LEADING~~ TO CHANGE, MY FORECAST ISN'T SIGNIFICANTLY DIFFERENT. UNLESS WE HAVE SOME INTERNATIONAL CALAMITY OR MAKE SOME HORRENDOUS <sup>SHORT-RUN</sup> ~~MISTAKES~~ ~~VERY SOON~~ IN ECONOMIC POLICY, IT IS HARD TO SEE HOW WE CAN ERR MORE THAN ONE PERCENT ON EITHER SIDE OF THE "MAGIC 6'S" *as far as 1976 is concerned.*

BUT WHAT ABOUT 1977 AND 1978? IS EVERYTHING IN PLACE TO GIVE US A CONTINUATION OF THE UPTURN?

WHILE SOME SECTORS AND MANY INDIVIDUAL FIRMS ARE STILL EXPERIENCING DIFFICULTIES, THE RECORD OF PERFORMANCE SO FAR IN THIS RECOVERY IS VERY GOOD. CERTAINLY THE RECOVERY STAGE ISN'T <sup>FAR FROM</sup> ~~OVER~~ WITH REAL OUTPUT <sup>BARELY</sup> ~~BACK~~ TO THE FOURTH QUARTER 1973 PEAK, BUT PROGRESS IS SATISFACTORY, IN FACT, <sup>IT IS</sup> EXCELLENT IF WE ARE TO <sup>ENJOY</sup> ~~ACHIEVE~~ A LONGER PERIOD OF SUSTAINABLE ECONOMIC EXPANSION.

IN COMPARISON WITH THE FIVE PRIOR ECONOMIC SET-BACKS IN THE POST-WAR PERIOD, ONE CAN ARGUE THAT THIS RECOVERY'S PERFORMANCE IS MODERATE. USING DATA UP THROUGH THE FOURTH QUARTER <sup>of 1975,</sup> THE ADVANCE FROM THE FIRST QUARTER 1975 LOW HAS BEEN ON THE ORDER OF 5% FOR REAL GNP. ALL PRIOR POST-WAR RECOVERIES, EXCEPT 1970, SHOWED FASTER EXPANSION. HOWEVER, REMEMBER THAT WE BUMPED ALONG ON THE BOTTOM IN THE SECOND QUARTER <sup>LAST YEAR</sup> AS WELL. IF WE TAKE ~~THAT~~ <sup>LAST SPRING</sup> AS THE BOTTOM, PERFORMANCE HAS BEEN SIMILAR TO THAT FOR ALL OF THE POST-WAR RECOVERIES EXCEPT 1949-1950 WHEN THE RECOVERY WAS SIGNIFICANTLY SHARPER.

BUT THERE IS REALLY NO <sup>SUCH THING AS A</sup> TYPICAL RECOVERY. THERE IS AN ENORMOUS VARIATION IN THE PATTERN OF ECONOMIC ACTIVITY DURING A RECOVERY WITH RESPECT TO TIMING, DURABILITY AND SOURCES OF GROWTH. THIS ONE APPEARS TO VARY, SO FAR, LARGELY IN INVENTORIES AND ~~HOUSING OR~~ RESIDENTIAL CONSTRUCTION, <sup>-- plus an unusually slow expansion of plant & equipment.</sup> TYPICALLY, THE EARLY SURGE IN REAL ACTIVITY IS ASSOCIATED WITH A SIZEABLE SWING IN INVENTORIES AND A PICK-UP IN THE HOUSING MARKET AND A COINCIDENT RESUMPTION OF GROWTH IN CONSUMPTION EXPENDITURES. BUT NOT THIS TIME -- AT LEAST NOT IN THE EARLIEST STAGES OF THE RECOVERY.

THIS IS NOT SURPRISING, SINCE <sup>E</sup> THIS DOWNTURN WAS ACCOMPANIED BY A MASSIVE LIQUIDATION PROCESS AND THE UPTURN CENTERED ON THE <sup>RESTORATION OF LIQUIDITY,</sup> RE-LIQUIDIFICATION WHICH HAS, IN EFFECT, DELAYED THE FULL IMPACT OF THESE ELEMENTS. BOTH INVENTORIES AND RESIDENTIAL CONSTRUCTION WERE KEY ELEMENTS IN THE CYCLICAL PERFORMANCE RELATED TO RAPIDLY ACCELERATING PRICES AND ATTENDENT SPECULATION.

IN LATE 1973 TO EARLY 1974 THERE WAS INTENTIONAL INVENTORY BUILDING AS PRICES ESCALATED AND FEARS OF AND ACTUAL SHORTAGES BEGAN TO DEVELOP. THEN IN EARLY 1974 TO MID-1974, INVENTORY ACCUMULATION CONTINUED, BUT IT WAS UNINTENTIONAL AS MARKETS FELL OFF BUT PRICES CONTINUED TO RISE RAPIDLY.

FOR MANY FIRMS THIS WAS A COSTLY EXPERIENCE, LEADING TO INCREASED CAUTION IN THE REBUILDING OF INVENTORIES AS THE UPTURN MATERIALIZED.

THE HOUSING IMPACT WAS EQUALLY AS SEVERE. EXTENSIVE SPECULATIVE BUILDING, ESPECIALLY IN MULTI-FAMILY UNITS, IN THE EARLY 1970'S TURNED INTO OVER-BUILDING. THE ADVERSE IMPACT ON LENDERS AS WELL AS BUILDERS WAS CHASTENING.

WITH THE SIGNIFICANT LIQUIDITY PROBLEMS OF MANY FIRMS, AND THE NEED AND DESIRE TO RESTRUCTURE BALANCE SHEETS, IT IS ALSO NOT SUPPRISING THAT CAPITAL INVESTMENT HAS SO FAR NOT SHOWN MUCH STRENGTH OR THAT FUTURE PLANS ARE STILL VERY MODEST ACCORDING TO THE SURVEYS.

ONE CANNOT EMPHASIZE ENOUGH THE TREMENDOUS INFLUENCE OF THE INFLATION OF THE LAST <sup>DECADE,</sup> ~~FEW YEARS,~~ NOT ONLY WAS IT THE MOST SIGNIFICANT ELEMENT LEADING TO OUR SEVERE RECESSION BUT IT HAS ALSO SHAPED OUR RECOVERY PATTERN.

UNTIL A FEW MONTHS AGO A SMALL GROUP OF FORECASTERS WERE SAYING THAT THE RECOVERY WOULD <sup>LIKELY</sup> GRIND TO A HALT IN LATE 1976. BUT WITH THE EVIDENCE OF STRENGTH IN THE RECOVERY INCREASING, EVEN THEY HAVE NOW SHIFTED FORWARD THEIR EXPECTED SLOWDOWN TO MID-1977, OR EVEN INTO 1978. I SUSPECT THAT, AS THE YEAR PROGRESSES, THE PESSIMISTS WILL BE PUSHING THEIR FORECASTS FURTHER AND FURTHER AHEAD IN TIME. THE ECONOMY SHOULD NOT ONLY MAKE UP SOME OF THE GROUND WHICH HAS BEEN LOST, BUT SHOULD CONTINUE TO GROW FASTER THAT THE LONG TERM AVERAGE FOR QUITE A WHILE.

MY REASONS ARE SEVERAL. FIRST, THIS HAS BEEN A CONSUMER-LED RECOVERY. DESPITE THE TREMENDOUS DROP IN CONSUMER CONFIDENCE AS MEASURED BY THE VARIOUS SURVEYS -- <sup>WITH PERSONAL</sup> ~~AND~~ SAVINGS RATES AT LEVELS WELL ABOVE THE LONG-TERM TRENDS -- THE CONSUMER HAS BEEN THE KEY FORCE WHICH HAS TURNED THE ECONOMY AROUND.

WE HAVE NOW REACHED A POINT IN THE RECOVERY WHERE THE CONSUMER SECTOR IS WELL PLACED TO CONTINUE ITS STRONG CONTRIBUTION TO RECOVERY. PERSONAL INCOME HAS BEEN RISING AT A RAPID RATE AT A TIME WHEN THE CONSUMER IS VERY LIQUID. IN THE PAST, INFLATION WAS THOUGHT TO INDUCE <sup>MORE</sup> CONSUMER SPENDING -- SPEND NOW BEFORE PRICES GO UP. BUT THE RECENT EXPERIENCE HAS BEEN EXACTLY THE REVERSE. CONSUMERS <sup>HAVE</sup> <sup>ED</sup> REACT TO INFLATION BY EXPANDING THEIR 'PURCHASING POWER RESERVES'. <sup>^</sup> THUS, THE SLOWING OF PRICE INCREASES IS RAISING CONSUMER CONFIDENCE LEVELS AND SPENDING.

SECOND, AS I INDICATED A FEW MINUTES AGO, THE HOUSING INDUSTRY HAS TYPICALLY LED RECOVERIES AFTER PAST RECESSIONS. THIS TIME, ALTHOUGH HOUSING STARTS HAVE CLIMBED SUBSTANTIALLY FROM THEIR VERY LOW LEVELS OF LATE LAST YEAR, HOUSING IS STILL LAGGING THE GENERAL RECOVERY. BUT THE ADVERSE IMPACT OF OVERBUILDING ON BOTH LENDERS AND BUILDERS IS GRADUALLY BEING OVERCOME. INFLOWS INTO HOUSING FINANCING INSTITUTIONS HAVE GROWN TREMENDOUSLY. THE DRAMATIC DROP IN HOUSING ACTIVITY FROM THE 1972 PEAK HAS BROUGHT STARTS CONSIDERABLY BELOW POTENTIAL DEMAND. WE ARE ENTERING AN EXTENDED PERIOD WHEN FAMILY FORMATIONS ARE GOING TO CLIMB AND THAT PLUS THE OBSOLESCENCE OF EXISTING DWELLINGS SHOULD RESULT IN A GROWING PRESSURE FOR NEW HOUSING. THIS FORCE WILL THEN COME ON STREAM LATER THAN NORMAL, <sup>IT</sup> BUT WILL WORK TOWARD ~~X~~ SUSTAINING ~~OF~~ THE EXPANSION OVER A LONGER PERIOD OF TIME.

THIRD, DESPITE STRONG RETAIL SALES, INVENTORIES ARE VERY LEAN. AS OF THE FOURTH QUARTER OF 1975 REAL INVENTORY STOCKS WERE STILL \$42 BILLION BELOW THEIR PRE-RECESSION LEVELS. THUS, A GOOD DEAL MORE ACCUMULATION IS REQUIRED TO BRING THE STOCK OF INVENTORIES BACK TO THE LEVEL THAT EXISTED PRIOR TO THE CONTRACTION. <sup>^</sup> MOREOVER, BECAUSE OF THE RECENT RECESSION EXPERIENCE THERE

APPEARS TO BE SIGNIFICANT CAUTIOUSNESS IN INVENTORY REBUILDING. CONSEQUENTLY, ONE MIGHT EXPECT THAT THE MORE IMPORTANT REBUILDING WILL BE DELAYED. THERE WILL BE A TENDENCY FOR FIRMS TO WAIT UNTIL THEY SEE THE 'WHITE OF THEIR EYES'. THEY WILL WAIT UNTIL THE RECOVERY IN SALES HAS GAINED MORE MOMENTUM. SO, IN THIS AREA TOO A SOMEWHAT LAGGING RESPONSE WILL ADD TO LONGER-TERM EXPANSION.

RECOVERY -- NEW PLANT & EQUIPMENT.  
THE MOST TALKED ABOUT LAGGARD IS CAPITAL INVESTMENT. SOME ECONOMISTS  
HAVE EXPRESSED A GREAT DEAL OF CONCERN ABOUT THAT SECTOR'S LACKLUSTER PERFORMANCE. THE INCREASE SO FAR IS BELOW THAT FOR ALL PREVIOUS POST-WAR RECOVERIES. THE SLOW RECOVERY OF BUSINESS FIXED INVESTMENT IS SOMEWHAT PARADOXICAL SINCE RECENT MOVEMENTS IN THE MAJOR DETERMINANTS OF CAPITAL SPENDING ACTIVITY -- THE ACCELERATION OF OUTPUT, A VASTLY IMPROVED PROFITS AND CASH FLOW POSITION, LOWER INTEREST RATES, AND FAVORABLE STOCK MARKET ACTIVITY -- HAVE ALL SHOWN AT LEAST TYPICAL CYCLICAL IMPROVEMENT, POINTING TOWARD STRENGTH IN THAT SECTOR. HOWEVER, IT APPEARS THAT AN EXCESS OF UNUSED CAPACITY IS ONE OF THE CONSTRAINTS ON CAPITAL SPENDING. BUT CAUTIOUSNESS IS ALSO PLAYING A PROMINENT ROLE HERE. INFLATION HAS CHANGED THE RELATIVE PROFITABILITY OF INVESTMENT. UNCERTAINTY ABOUT POLLUTION STANDARDS IS ALSO IMPORTANT. NEVERTHELESS, ASSUMING THAT THERE IS NO SIGNIFICANT DETERIORATION IN THE INFLATION OUTLOOK AND FINANCIAL POSITIONS CONTINUE TO IMPROVE, THIS SECTOR SHOULD COME ON STREAM AS WELL, WITHIN THE NEXT YEAR.

IT SEEMS TO ME, THEN, THAT THERE IS A REASONABLE SCENARIO FOR A MORE EXTENDED PERIOD OF ECONOMIC EXPANSION. BUILDING ON THE CONSUMER RECOVERY, HOUSING AND INVENTORY SPENDING WILL GRADUALLY INCREASE AND THEN, SOMEWHAT LATER, A PICK-UP IN THE CAPITAL SPENDING AREA IS MOST LIKELY TO OCCUR. ASSUMING REASONABLE ECONOMIC POLICIES, I AM INCLINED TO PLACE MYSELF ON THE SIDE OF THE MORE

~~OPTIMISTIC FORECASTERS WHO EXPECT EXPANSION TO LAST BEYOND 1977.~~

BUT OBVIOUSLY THERE ARE SOME POT-HOLES IN THE ROAD. <sup>IT'S BEEN A HARD WINTER,</sup> THE MOST SERIOUS IMPEDIMENT TO A CONTINUED HEALTHY EXPANSION IS INFLATION. A REACCELERATION OF INFLATION <sup>WOULD DAMPEN</sup> ~~WILL AFFECT~~ CONSUMER SPENDING, THE STOCK MARKET, PROFITS, FIXED INVESTMENT. <sup>WOULD</sup> ~~WILL~~ LEAD TO A SERIOUS DETERIORATION OF THE RECOVERY UNDERWAY NOW.

IT IS PARTICULARLY DANGEROUS AT THIS JUNCTURE TO TAKE THE POSITION <sup>JUST</sup> THAT <sup>1</sup> BECAUSE THE ECONOMY IS OPERATING AT LESS THAN FULL CAPACITY ~~THE~~ ECONOMIC POLICY SHOULD BE DIRECTED TOWARD ENGINEERING A MORE RAPID ADVANCE OR MORE VIGOROUS RECOVERY. SUCH ACTIONS WOULD HAVE THEIR IMPACT ON THE ECONOMY AT EXACTLY THE WRONG TIME -- JUST WHEN THEY ARE NOT NEEDED NEXT YEAR.

I AM WELL AWARE THAT IN THE CLIMATE OF IMPROVING PRICE PERFORMANCE AND THE CONCERNS GENERATED BY HAVING MORE THAN 7 MILLION PEOPLE UNEMPLOYED, THAT IT IS VERY EASY FOR MANY TO ACCEPT THE IDEA THAT INFLATION IS NOT THE PROBLEM TODAY. I DISAGREE, THE POTENTIAL FOR THE RE-EMERGENCE OF INFLATION IS GAINING MOMENTUM.

THE BIGGEST DIFFICULTY MAY WELL COME FROM LABOR COSTS. IN SPITE OF THE IMPROVEMENT IN REAL INCOMES RESULTING FROM A DE-ESCALATION IN THE RATE AT WHICH PRICES ARE ADVANCING, THERE ARE SIGNIFICANT PRESSURES BUILDING AMONG WORKERS TO RE-ESTABLISH THE GROWTH IN REAL INCOMES. <sup>RECENT</sup> THE <sup>1</sup> TEAMSTERS' SETTLEMENT IS A ~~LITTLE~~ <sup>has examples</sup> DISTURBING TO ~~ME~~. THE COST OF THE THREE-YEAR PACKAGE IS HARD TO EVALUATE. <sup>AN</sup> THE ESTIMATE OF A 10 PERCENT INCREASE IN WAGES AND FRINGES FOR EACH OF THE NEXT THREE YEARS MAY BE ON THE LOW SIDE. A DETROIT UNION OFFICIAL SAYS THAT MANY OVER-THE-ROAD DRIVERS PAID BY THE MILE COULD GET <sup>around</sup> <sup>0</sup> \$10,000 MORE PER YEAR BY THE END OF THE THREE YEARS, BOOSTING SOME DRIVERS INTO THE \$30,000 TO

*cost of living*

\$35,000 A YEAR RANGE. EVEN WITHOUT THE ~~COLA~~ INCREASE THE THREE-YEAR CONTRACT IS SAID TO CALL FOR A 33 PERCENT INCREASE IN COSTS.

BECAUSE OF THE UNIQUE NATURE OF THE TEAMSTERS' POSITION, THEIR CONTRACT ~~IS UNLIKELY TO SET A PATTERN,~~ <sup>PROBABLY WON'T</sup> BUT THE RUBBER INDUSTRY MAY. KNOWLEDGEABLE ANALYSTS ARE VERY CONCERNED ABOUT <sup>POSSIBILITY OF</sup> A SERIOUS RUBBER INDUSTRY STRIKE STARTING NEXT WEEK. FOR THE FIRST TIME, THREE OR FOUR OF THE LARGEST PRODUCERS MAY BE STRUCK SIMULTANEOUSLY. IN ADDITION TO THIS, WE STILL HAVE MAJOR CONTRACTS COMING UP IN MAY FOR CONSTRUCTION WORKERS, JUNE FOR ELECTRICAL WORKERS, AND SEPTEMBER FOR THE AUTO WORKERS.

I DO NOT GET MUCH SOLACE EITHER FROM THE POINT FREQUENTLY MADE THAT WE HAVE MORE EXCESS CAPACITY NOW THAN IS NORMAL IN THIS STAGE OF THE UPTURN. I DOUBT THAT THERE IS AS MUCH UNUSED CAPACITY AS THE FIGURES <sup>SEEM TO</sup> SHOW. WE HAVE COME THROUGH A PERIOD OF SIGNIFICANT INFLATION. AS PRICES ROSE RAPIDLY THERE WAS A LARGE SHIFT IN RELATIVE PRICES. AS A RESULT SOME OF OUR PLANT AND EQUIPMENT CAPACITY WAS MADE ECONOMICALLY OBSOLETE. MUCH OF OUR CAPITAL SPENDING HAS ALSO BEEN DIRECTED TO MEETING POLLUTION STANDARDS. THESE INVESTMENTS HAVE NOT ADDED TO OUR PRODUCTIVE CAPACITY. CONSEQUENTLY, I THINK THAT IT IS LIKELY THAT PRODUCTIVE CAPACITY PRESSURES WILL APPEAR FAR SOONER IN THIS UPTURN -- AT LEAST EARLIER IN RELATION TO THE LEVEL OF UNEMPLOYMENT.

A SIGNIFICANT -- PERHAPS THE MOST SIGNIFICANT ELEMENT IN THE PICTURE IS GOVERNMENT ECONOMIC POLICY. THERE ARE STILL THOSE WHO ARGUE THAT WE SHOULD BE FOLLOWING A MORE STIMULATIVE POLICY -- THAT THE UNEMPLOYMENT RATE WILL BE TOO HIGH FOR TOO LONG AND THAT WE SHOULD BE TARGETING AN 8 TO 10 PERCENT RATE OF REAL GROWTH RATHER THAN <sup>THE MAGNETISM OF THIS FAIRLAND</sup> 6 OR 7 PERCENT. I HOPE THAT <sup>THIS CAN BE</sup> RESISTED. BUSINESS AND CONSUMERS ARE SHELL-SHOCKED, AND DON'T NEED OR DESERVE

ANOTHER SHOT OF DOUBLE DIGIT INFLATION -- JUST WHAT SUCH A PRESCRIPTION CALLS FOR. YOU DON'T CURE ANEMIA BY GIVING THE PATIENT HIGH BLOOD PRESSURE. THE ANEMIA OF UNEMPLOYMENT CANNOT BE CURED WITH THE HIGH BLOOD PRESSURE OF INFLATION.

THERE ARE, HOWEVER, VERY GOOD ODDS THAT GOVERNMENT ECONOMIC POLICY WILL BE REASONABLY WELL EXECUTED. THE NEW BUDGETING PROCESS IN THE CONGRESS WORKED WELL DURING THE TRIAL PERIOD FOR FISCAL 1976. I AM ANTICIPATING GOOD RESULTS FROM THE DELIBERATIONS WHICH WILL SET FISCAL POLICY FOR 1977. IT IS PROBABLY A FOREGONE CONCLUSION THAT THE CONGRESS WILL DECIDE ON MORE SPENDING AND LESS TAX REDUCTION THAN THE ADMINISTRATION HAS PROPOSED. HOWEVER, THE RESULTING FISCAL POLICY WILL STILL BE BASED ON A THOUGHT-OUT TOTAL PLAN FORMULATED BY A CONGRESS WHICH IS GETTING EXPERT ADVICE, RATHER THAN THE OLD HAPHAZARD RESULT OF THE ACCUMULATION OF <sup>UNRELATED</sup> INDIVIDUAL APPROPRIATIONS AND TAX ACTIONS.

AN ADDITIONAL FAVORABLE ELEMENT IS THAT THE MEMBERS OF CONGRESS HAVE BECOME UNUSUALLY SENSITIVE THESE DAYS TO THE SIZE OF THE <sup>FEDERAL</sup> DEFICIT. THEY ARE CLEARLY FOCUSING ~~IN~~ ON EFFORTS TO KEEP AWAY FROM \$75 BILLION DEFICITS. A \$45-\$55 BILLION DEFICIT IS STILL MUCH TOO LARGE, BUT IT DOES REPRESENT A <sup>SIZEABLE</sup> REDUCTION IN FISCAL STIMULUS.

I HAVE EVEN MORE CONFIDENCE IN THE LIKELY COURSE OF MONETARY POLICY -- BIASED THOUGH I MAY BE. IT IS NOW NEARLY A YEAR SINCE CHAIRMAN BURNS, IN TESTIMONY BEFORE THE CONGRESS, PUBLICALLY REAFFIRMED THE POLICY THAT MONETARY POLICY WOULD BE CONDUCTED WITH A VIEW OF SUPPLYING SUFFICIENT MONETARY GROWTH TO ASSURE RECOVERY WITHOUT REKINDLING ACCELERATING INFLATION. THE EVIDENCE INDICATES THAT THIS IS JUST WHAT HAS HAPPENED THUS FAR. I SEE

NO REASON TO EXPECT THAT EITHER THAT POLICY GOAL OR OUR RECORD IN ACHIEVING IT WILL NOT CONTINUE. THIS DOES NOT MEAN THAT THE PRESENTLY ANNOUNCED GOALS FOR MONEY SUPPLY GROWTH ARE IMMUTABLE. IT DOES MEAN THAT THE ADJUSTMENTS WHICH WILL BE MADE IN THOSE GOALS WILL BE CONSISTENT WITH THE MORE BASIC GOALS OF SOUND ECONOMIC GROWTH WITH DECLINING INFLATION.

IN SPITE OF <sup>THE</sup> POSSIBLE POT-HOLES IN THE ROAD, <sup>the overall outlook for</sup> ~~I AM OPTIMISTIC ABOUT~~ THE ECONOMY'S FUTURE PERFORMANCE, <sup>looks good!</sup> I AM INCLINED TO PLACE MYSELF ON THE SIDE OF THE MORE OPTIMISTIC FORECASTERS -- THOSE WHO EXPECT THE PRESENT EXPANSION PHASE OF THE RECOVERY TO LAST BEYOND 1977.

<sup>PROVIDE</sup> THIS SHOULD ~~BE~~ AN EXCELLENT ECONOMIC CLIMATE FOR BANKING. WITH THOSE FEW BANKS WITH PROBLEMS HAVING AN OPPORTUNITY TO CORRECT THEM, AND WITH MANY BANKS GAINING FROM THE LESSONS OF RECENT EXPERIENCE, THE NEED FOR PUBLIC CONCERN WITH BANKING <sup>ABOUT SOUNDNESS (and the adequacy of banking regulation)</sup> ~~WILL~~ MODERATE. WE WILL <sup>THEN</sup> HAVE ANOTHER DEMONSTRATION <sup>should</sup>

OF THE FUNDAMENTAL STRENGTH OF THE AMERICAN ECONOMIC SYSTEM THAT THE POLICING <sup>INHERENT IN OUR</sup> ~~BY~~ PRIVATE MARKETS <sup>SYSTEM</sup> IS A POWERFUL FORCE.