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TO THE WISCONSIN INSTALLMENT BANKERS ASSOCIATION
MILWAUKEE, WISCONSIN
APRIL 21, 1977

SPRING IS HERE

IT IS A PLEASURE TO BE IN MILWAUKEE ON A FINE SPRING DAY. IT IS ESPECIALLY PLEASANT TO TALK WITH YOU WHEN IT IS SPRING FOR THE ECONOMY AS WELL.

GOOD NEWS ON THE ECONOMY HAS BEEN APPEARING AT A RAPID FIRE PACE. CLEARLY, WE HAVE SURVIVED THE MOST SEVERE ECONOMIC WEATHER SINCE THE 1930'S AND WE ARE ENTERING THE THIRD YEAR OF EXPANSION ON A BRIGHT NOTE. THERE IS NO REASON TO DOUBT THAT THE ECONOMIC EXPANSION IS FIRMLY ESTABLISHED. WE ARE REACHING OR EXCEEDING THE LEVELS OF OUTPUT AND REAL INCOME THAT PREVAILED BEFORE THE SETBACK. WE ARE PRESSING ON TO NEW RECORDS MONTH BY MONTH IN THE TOTAL LEVEL OF EMPLOYMENT. RETAIL SALES HAVE BEEN VERY STRONG. MANUFACTURING ACTIVITY IS INCREASING. RESIDENTIAL CONSTRUCTION IS MOVING AHEAD AT A BRISK PACE. EVEN CAPITAL SPENDING IS SHOWING SOME SIGNS OF PICKING UP.

THE SEVERE COLD WEATHER THAT AFFECTED SO MANY, RESULTED IN ONLY A HIATUS FOR ECONOMIC ACTIVITY. IT SET BACK HOUSING ACTIVITY, INDUCED OTHER PRODUCTION DISRUPTIONS AND ATTENDANT LAYOFFS, INCREASED FUEL PRICES, REDUCED CONSUMER PURCHASING POWER, AND AFFECTED SOME FOOD PRICES. BUT THERE WAS NO PERMANENT DAMAGE. IN FACT, IN AN OBVERSE WAY, THE SEVERE WEATHER WAS A PLUS BECAUSE IT MOVED THE ENERGY PROBLEM ONTO CENTER STAGE. IT FOCUSED OUR ATTENTION ON A PROBLEM THAT MUST BE ADDRESSED.

YOU WILL ALL RECALL THAT LAST FALL THERE HAD BEEN A HESITANCY IN ECONOMIC ACTIVITY. THAT HESITANCY, OR SOME WOULD SAY PAUSE, BECAME THE

RATIONALE FOR EFFORTS TO STIMULATE THE ECONOMY. BUT EVEN BEFORE THE SEVERE WEATHER HIT, ECONOMIC ACTIVITY HAD AGAIN STARTED TO ACCELERATE. THAT ACCELERATION HAS OBVIOUSLY SURVIVED THE WINTER, AND THE NEED FOR ECONOMIC STIMULUS HAS CLEARLY EVAPORATED.

THE CONSUMER HAS CERTAINLY BEEN PERFORMING WELL. WITH THE EXPANSION OF JOBS, THE RELATIVE DECLINE IN INFLATION, AND THE IMPROVEMENT IN LIQUIDITY, CONSUMER SENTIMENT HAS IMPROVED MARKEDLY. AND THAT MORE OPTIMISTIC VIEW HAS BEEN TRANSLATED INTO PURCHASES. RETAIL SALES IN MARCH ROSE 2.4 PERCENT ON THE HEELS OF A FEBRUARY GAIN OF 2.7 PERCENT. AUTOS, ESPECIALLY THE LARGER MODELS, HAVE BEEN SELLING EXTREMELY WELL. SO HAVE OTHER BIG TICKET ITEMS SUCH AS APPLIANCES AND FURNITURE. WE ARE TOLD BY MAJOR RETAILERS IN THE MIDWEST THAT THEY ARE PLEASED WITH THE SALES OF MOST CLASSES OF MERCHANDISE.

WITH MORE AGGRESSIVE BUYING, BUSINESS PURCHASES HAVE INCREASED. BUT EVEN THOUGH GAINS IN THE BOOK VALUE OF INVENTORIES HAVE BEEN LARGE, INVENTORIES ARE WELL WITHIN DESIRED RANGES. EXCESSIVE INVENTORIES ARE NOT A PROBLEM. THE INVENTORY-SALES RATIOS HAVE CONTINUED TO DECLINE.

HOUSING CONTINUES TO BE A VERY BRIGHT SPOT TOO. NOT ONLY NEW HOMES BUT EXISTING HOME SALES CONTINUE TO BE VERY STRONG. AND THERE ARE EVEN SOME SIGNS OF PICKUP IN THE MULTI-FAMILY MARKET.

YOU HAVE ALL HEARD MANY TIMES ABOUT THE POOR PERFORMANCE OF CAPITAL SPENDING UPON WHICH THE CONTINUATION OF EXPANSION DEPENDS. THAT TOO SEEMS TO BE IMPROVING. ORDERS FOR VARIOUS TYPES OF MACHINE TOOLS, CRANES, AND HOISTS ARE UP. THE DEMAND FOR COMPONENTS SUCH AS CONTROLS, BEARINGS, AND CASTINGS ARE IMPROVED. AND THE SIGNIFICANT THING IS THAT A LARGER SHARE OF THESE NEW ORDERS ARE FOR ORIGINAL EQUIPMENT RATHER THAN REPLACEMENT.

STEEL ORDERS HAVE INCREASED SIGNIFICANTLY SINCE THE FIRST OF THE YEAR. MOST ANALYSTS HAVE RAISED FORECASTS OF STEEL SHIPMENTS FOR THE SECOND QUARTER AND FOR THE YEAR.

SO SPRING HAS APPEARED ON MANY FRONTS. AND THAT SPRING SHOULD TURN INTO SUMMER. CONSUMER CONFIDENCE BUOYED BY RISING EMPLOYMENT AND INCOMES WILL LEAD TO INCREASED SPENDING. INVENTORIES IN GOOD BALANCE, OR PERHAPS EVEN LOW IN THE FACE OF RISING SALES, WILL HAVE TO BE BOOSTED. THE IMPROVED LIQUIDITY OF SAVINGS INSTITUTIONS BODE WELL FOR FURTHER GAINS IN HOUSING. IMPROVED FINANCIAL MARKETS BECOME SPURS TO INCREASED CAPITAL SPENDING.

BUT IS ALL THIS A SCENARIO OF HOPE RATHER THAN REALITY? IS IT A SNAPSHOT OF WHAT COULD BE RATHER THAN WHAT WILL BE?

AS A STUDENT OF THE DISMAL SCIENCE I HAVE TO ADD A FEW CAVEATS TO THE SANGUINE PICTURE. FOR THE PERIOD IMMEDIATELY AHEAD -- THE NEXT FEW QUARTERS -- I DON'T SEE THE ECONOMY DEPARTING SIGNIFICANTLY FROM THIS PATTERN. THE MOMENTUM IS THERE AND UNLESS THERE ARE SOME HORRENDOUS MISTAKES IN PUBLIC POLICY, THE REAL PERFORMANCE WILL CONTINUE TO BE GOOD. OH, NOT AS GOOD AS ANYONE WOULD LIKE RELATIVE TO EITHER UNEMPLOYMENT OR INFLATION RATES, BUT RELATIVE TO THE IMMEDIATE PAST, GOOD.

BUT FOR THE LONGER RUN, IT ISN'T NECESSARILY IN THE BAG. NOT THAT IT COULDN'T BE; IT COULD BECOME ANOTHER OF THOSE RARE BUT LONG ECONOMIC SUMMERS. THE KEY IS HOW WE HANDLE OUR INFLATION PROBLEM.

I KNOW, YOU'VE ALL HEARD THIS CONCERN WITH INFLATION EXPRESSED OVER AND OVER AGAIN. SOME OF YOU MAY FEEL THAT THIS IS AN OVER-EMPHASIS ON INFLATION AND THAT THIS STRESS ON INFLATION HAS TENDED TO OBSCURE EFFORTS TO DEAL WITH THE MORE SERIOUS PROBLEM OF UNEMPLOYMENT. OTHERS OF YOU WILL AGREE

THAT INFLATION IS THE SIGNIFICANT ISSUE, BUT LIKE THE OLD ADAGE ON THE WEATHER, FEEL THAT IT IS SOMETHING EVERYONE TALKS ABOUT BUT NO ONE DOES ANYTHING ABOUT.

BUT THERE IS SOME HOPE. WE'VE MADE SOME PROGRESS ON THE INFLATION FRONT. THE RATE OF INFLATION HAS BEEN CUT IN HALF. BUT THAT STILL ISN'T ENOUGH AND ALMOST EVERYONE SEEMS TO RECOGNIZE THAT IT ISN'T.

OBVIOUSLY, MANY PARTICIPANTS IN THE MARKETS HAVE BEEN LOOKING ACROSS THE SIGNS OF NEAR-TERM STRENGTH IN THE ECONOMY AND HAVE BEEN WORRYING ABOUT THE THREAT OF INFLATION TO CONTINUED EXPANSION IN THE LONGER RUN. THOSE CONCERNS HAVE AFFECTED DECISIONS ON FUTURE COMMITMENTS ON PRODUCTION, PURCHASES, WAGES, PRICES, AND INTEREST RATES. WE ARE LIVING IN A WORLD IN WHICH EXPECTATIONS ON PRICES PLAY A VERY PROMINENT ROLE. THAT IS WHY PRICES CAN BE RISING AT 5 TO 6 PERCENT A YEAR EVEN THOUGH UNEMPLOYMENT IS ABOVE 7 PERCENT AND CAPACITY UTILIZATION IS IN THE LOW 80'S.

THERE IS A DEBATE GOING ON AMONG ECONOMISTS ABOUT HOW PRICE EXPECTATIONS ARE FORMED. DO DECISION MAKERS LOOK AT THE PAST BEHAVIOR OF PRICES OR HAVE THEY BECOME MORE SOPHISTICATED LOOKING INSTEAD AT THE IMPLICATIONS OF CURRENT OR PROSPECTIVE ECONOMIC POLICIES? I'M INCLINED TO THINK IT IS THE LATTER. BUT I SUPPOSE THAT UNTIL RECENT PERIODS IT DIDN'T MAKE MUCH DIFFERENCE HOW PRICE EXPECTATIONS WERE FORMED. IF YOU LOOKED AT THE SIGNIFICANT RUN-UP OF PRICES OVER THE LAST 5 TO 10 YEARS, YOU'D HAVE TO EXPECT FURTHER RATES OF PRICE INCREASE. AND, UNFORTUNATELY, IF YOU LOOKED AT THE IMPLICATIONS OF \$60 AND \$70 BILLION DOLLAR FEDERAL GOVERNMENT DEFICITS YOU WOULD HAVE TO DRAW THE SAME CONCLUSIONS ABOUT ACCELERATING INFLATION.

BUT, AS I SAID EARLIER, THERE IS SOME HOPE. THERE HAVE BEEN SOME EVENTS THAT HAVE TENDED TO COOL THE EXPECTATION OF EVEN MORE RAPID PRICE INCREASES. WHEN THE ADMINISTRATION PULLED BACK FROM THE TAX REBATE PROPOSAL, THE STOCK MARKETS AND THE FINANCIAL MARKETS REACTED FAVORABLY AS YOU KNOW.

THERE WAS AN IMPACT ON PRICE EXPECTATIONS. PRESIDENT CARTER'S ANTI-INFLATION PROGRAM ANNOUNCEMENT HAS ALSO HAD A FAVORABLE IMPACT. WHILE SLIM ON SPECIFICS, IT WAS NOT SLIM ON IMPORTANT CONTEXT. THE ACKNOWLEDGEMENT OF CONCERN WITH INFLATION BY THE ADMINISTRATION WAS IN ITSELF A VERY FAVORABLE ELEMENT. THE RENEWED COMMITMENT TO BUDGET BALANCE WAS A STRONG PLUS AND STATEMENT OF A SPECIFIC GOAL OF 4 PERCENT INFLATION BY 1979 MUST BE HELPFUL IN DEVELOPING A MORE POSITIVE FEELING THAT INFLATION IS A CRITICAL ISSUE.

MY ACCEPTANCE OF THE VIEW THAT PRICE EXPECTATIONS ARE AFFECTED BY CURRENT AND PROSPECTIVE ECONOMIC POLICIES AND THE REFERENCE TO RECENT ADMINISTRATION ACTIONS REFLECT MY VIEW THAT OUR PRICE PERFORMANCE DEPENDS IN THE LONGER RUN ON GOVERNMENT ECONOMIC POLICIES. IN THE FINAL ANALYSIS, GOVERNMENTS ARE RESPONSIBLE FOR INFLATION. THEY CREATE IT OR ACQUIESCE TO EXCESSES.

SO NOW I HAVE SET UP THAT USUAL ECONOMISTS' HEDGE. THE OUTLOOK FOR THE ECONOMY LATE THIS YEAR AND ON INTO 1978 DEPENDS ON WHAT THE GOVERNMENT DOES WITH ECONOMIC POLICY. BEING APPROPRIATELY CAUTIOUS I WILL ALSO ADD A SPECIFIC HEDGE ON THE ENERGY PROGRAM. THIS IS SUCH A BROAD PROGRAM WITH SO MANY POSSIBLE RAMIFICATIONS THAT I CAN'T POSSIBLY GIVE YOU AN INSTANT ANALYSIS. BUT THEN, IT WILL BE SOMETIME BEFORE ANYONE WILL BE ABLE TO SORT OUT THE PRICE AND PRODUCTION IMPACTS OF THE PROPOSALS. AND THEN THE WHOLE JOB WILL HAVE TO BE REDONE WHEN THE ACTUAL LEGISLATIVE CHANGES ARE MADE.

LET ME FOCUS TODAY THEN ON WHAT MAY APPEAR TO BE SOME OF THE MORE SOLID STATEMENTS THAT CAN BE MADE ABOUT FISCAL AND MONETARY POLICIES.

FIRST, ON FISCAL POLICY, I MUST APPLAUD THE RENEWED EMPHASIS GIVEN BY PRESIDENT CARTER TO BALANCING THE BUDGET. IT IS CLEAR THAT CONTINUED FEDERAL DEFICITS ARE THE PRIMARY ENGINES OF INFLATION. AND GIVEN THE NATURE OF PRICE EXPECTATIONS IN OUR ECONOMY, WE CAN GET INFLATION IMPACTS BEFORE WE BUMP INTO CAPACITY RESTRAINTS OR RESOURCE LIMITATIONS.

MY HOPE IS THAT THE INDICATION OF FISCAL RESTRAINT COMING FROM THE WHITE HOUSE WILL BE SHARED BY THE CONGRESS. SINCE 1960 WE HAVE HAD ONLY ONE SURPLUS IN OUR UNIFIED BUDGET. THE TOTAL DEFICIT ON A UNIFIED BUDGET BASIS FOR THE LAST 15 YEARS HAVE BEEN OVER \$300 BILLION. IF THE OFF-BUDGET AGENCIES ARE ADDED THE TOTAL IS ALMOST \$340 BILLION.

WE HAVE BEEN FORTUNATE IN THE LAST YEAR THAT THE TOTAL OF GOVERNMENT AND PRIVATE FUNDING NEEDS HAVE BEEN SMALLER THAN ANTICIPATED SO THAT THE COMPETITION FOR FUNDS HAS NOT YET DRIVEN UP INTEREST RATES. BUT AS THE BUSINESS EXPANSION CONTINUES, THAT COMPETITION SURELY WILL DEVELOP UNLESS GOVERNMENT NEEDS MODERATE.

I CONTINUE TO FIND IT SURPRISING THAT IN SPITE OF ALL OUR EXPERIENCES THAT THERE ARE INDIVIDUALS WHO CHOSE TO IGNORE GOVERNMENT DEFICITS AS A FIRST CAUSE OF INFLATION AND BLAME THE FED INSTEAD. HUGE DEFICITS ALWAYS PUT THE FED IN A 'LOUSY' POSITION. SUPPLYING THE FUNDS DEMANDED WITHOUT ALLOWING INTEREST RATES TO RISE LOOKS LIKE A GOOD OPTION TO SOME. AFTER ALL, IT IS ARGUED, THEN WE GET THE OUTPUT NEEDED AND THAT REDUCES PRICE PRESSURES. IT JUST ISN'T SO. WE SIMPLY ADD TO PRICE PRESSURES IN THE MONTHS AND YEARS AHEAD. AND EVEN MORE RAPIDLY NOW BECAUSE EXPECTATIONS OF INFLATION ARE EXACERBATED BY THE DEFICIT AND MONETARY ACTIONS WHICH MONETIZE THE DEFICITS.

ON THE OTHER HAND, WE HAVE THOSE THAT ARGUE THAT THE FED SHOULD IGNORE THE DEFICIT AND KEEP THE MONETARY AGGREGATES STABLE. SO THEN, THE GOVERNMENT GETS THE RESOURCES AND THE PRIVATE SECTOR GETS STARVED OUT.

BOTH OF MY RESPONSES MAY BE SIMPLISTIC BUT THEY DO HIT AT THE HEART OF THE INFLATION ISSUE AS I SEE IT. RESTRAINT FROM GOVERNMENT IS AN ESSENTIAL ELEMENT FOR ANY EFFECTIVE LONG-TERM CONTROL OF INFLATION.

THE NEW CONGRESSIONAL BUDGET PROCEDURES WILL BE OF SOME HELP IN CURBING

EXCESSES. THE FIRST YEAR EXPERIENCE WAS SUCCESSFUL IN ONE IMPORTANT WAY. IT CLEARLY CONCENTRATED THE ATTENTION OF CONGRESS ON FISCAL POLICY AS A WHOLE: TOTAL EXPENDITURES, TOTAL REVENUES AND THE SIZE OF THE SURPLUS OR DEFICIT. FURTHERMORE, IT HAS PROVIDED A FRAMEWORK FOR CONGRESS TO DEBATE FISCAL POLICY IN THE LIGHT OF BROAD ADVICE ON THE STATE AND LIKELY COURSE OF THE ECONOMY AND THE IMPACT OF FISCAL POLICY ON THAT COURSE. THIS IS A CLEAR STEP FORWARD FROM A POLICY WHICH RESULTED FROM THE AGGREGATED ACTIONS OF CONGRESS ON THOUSANDS OF INDIVIDUAL FEDERAL PROGRAMS. IN ADDITION, I SUSPECT, ALTHOUGH I CANNOT PROVE IT, THAT THE ESTABLISHMENT OF OVERALL EXPENDITURE TOTALS BEFORE DETAILED PROGRAM EXPENDITURES HAS TENDED TO RESTRAIN FEDERAL SPENDING TO LOWER LEVELS THAN WOULD HAVE RESULTED OTHERWISE, WITH ATTENDANT GOOD RESULTS FOR ALL OF US AS TAXPAYERS WHO ULTIMATELY PAY THE BILL AND AS CONSUMERS FEEL THE RESULTS OF EXCESSIVE DEFICITS AS INFLATION.

THE LONGER-TERM CONTROL OF INFLATION ALSO REQUIRES MUCH MORE. MUCH MORE EMPHASIS SHOULD BE GIVEN TO CONSIDERATION OF TAX POLICY FOR THE IMPROVEMENT IN THE CLIMATE OF BUSINESS. THE STIFLING AND EXPENSIVE IMPACT OF GOVERNMENT REGULATION OF BUSINESS THAT CONSTRAINS THE FREEDOM OF THE MARKETPLACE MUST BE MODERATED. THE PACE AT WHICH SAFETY, ENVIRONMENTAL AND OTHER PUBLIC OBJECTIVES ARE IMPLEMENTED MUST BE MODERATED TO ALLOW AN ADEQUATE LEVEL OF INVESTMENT FUNDS FOR PRIVATE ENTERPRISE JOB CREATION.

THE LIST COULD BE MADE EVEN LONGER AND EACH OF YOU COULD UNDOUBTEDLY ADD AN ITEM OR TWO. UNFORTUNATELY, WITH THE CRUSH OF THE ENERGY PROGRAM, I AM CONCERNED THAT CONGRESSIONAL ATTENTION MAY BE DIVERTED FROM SOME OF THESE AREAS. NEVERTHELESS, IT SEEMS TO ME THAT THERE IS A GOOD POSSIBILITY OF SOME OVERALL FISCAL RESTRAINT THAT WILL SERVE TO MODERATE THE INFLATIONARY PRESSURES.

THE FED HAS AN OBVIOUS ROLE IN HELPING TO TURN THIS SPRING INTO AN EXTENDED SUMMER. WE HAVE FOR SOME TIME BEEN COMMITTED TO A COURSE OF ADEQUATE BUT NOT EXCESSIVE MONETARY GROWTH THAT WE BELIEVE WILL LEAD TO REASONABLE ECONOMIC GROWTH IN AN ENVIRONMENT OF REDUCED PRICE PRESSURES.

THERE IS NO QUESTION THAT EXCESSIVE MONETARY GROWTH LEADS TO TROUBLE. BUT AS I NOTED EARLIER, RESTRAINING THAT GROWTH IS NOT ALWAYS EASY. EFFORTS TO KEEP THE FINANCIAL INPUTS COMING AT A REASONABLE PACE CAN LEAD TO HIGHER INTEREST RATES. AND UNFORTUNATELY CONGRESS AND THE COMMUNITY FREQUENTLY "WANT THEIR CAKE AND TO EAT IT TOO", THAT IS, THEY WANT STABLE INTEREST RATES BUT A MODERATE PACE OF MONETARY GROWTH.

WE HAVE BEEN FORTUNATE IN THIS COUNTRY TO HAVE A RELATIVELY INDEPENDENT CENTRAL BANK. AS A CONSEQUENCE, THE DECISION TO HOLD MONEY GROWTH IN CHECK CAN AND HAS BEEN MADE WITHOUT DICTATION BY SHORT-TERM POLITICAL PRESSURES.

IF OUR FISCAL POLICIES' ACTIONS DO PROVE TO BE OF MORE MODEST PROPORTIONS, IF THE FEDERAL GOVERNMENT CAN DEMONSTRATE BY ACTIONS THAT THEY ARE CONCERNED WITH INFLATIONARY IMPACTS, IT WILL BE MUCH EASIER TO KEEP A TIGHT REIN ON MONEY AND CREDIT EXPANSION. THE GROWING CREDIT DEMANDS OF THE PRIVATE SECTOR IN A STRONG EXPANSION COMBINED WITH EVEN MODERATED GOVERNMENT CREDIT DEMANDS WILL, OF COURSE, PUT SOME PRESSURE ON INTEREST RATES AS THE YEAR PROGRESSES. BUT IF INFLATIONARY EXPECTATIONS CAN ALSO BE HELD IN CHECK BY THE DEMONSTRATION OF FISCAL AND MONETARY RESPONSIBILITY, THE INFLATIONARY PREMIUM BUILT INTO INTEREST RATES WILL GRADUALLY DECLINE, AND THE INTEREST RATE GAINS COMING FROM INCREASED PRIVATE DEMANDS WILL NOT BE AS LARGE AND CERTAINLY WILL NOT BE DISRUPTIVE TO NORMAL ECONOMIC GROWTH.

OBVIOUSLY, I AM NOT ARGUING THAT THE ECONOMIC WORLD WILL BE PERFECT IN THE PERIOD AHEAD. EVEN ON INTO 1978 AND BEYOND WE WILL FALL SHORT OF

OUR INFLATION AND UNEMPLOYMENT GOALS. IT WILL TAKE A WHILE YET TO UNWIND
OUR PROBLEMS. BUT I FEEL MORE COMFORTABLE TODAY THAN I HAVE FOR SOME
TIME THAT IT COULD BE A VERY GOOD AND LONG SUMMER.