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I AM PLEASED TO HAVE BEEN INVITED TO RICHMOND AND TO HAVE THIS OPPORTUNITY TO MEET WITH ALL OF YOU THIS EVENING. I HAVE ALREADY LEARNED A GREAT DEAL FROM THOSE WITH WHOM I'VE VISITED SO FAR TODAY AND I HOPE THAT I WILL HEAR EVEN MORE LATER TONIGHT ABOUT ECONOMIC DEVELOPMENTS IN YOUR AREA OF INDIANA AND YOUR VIEWS ON SOME OF THE ECONOMIC ISSUES THAT CONFRONT OUR NATION.

WE APPEAR TO BE GOING THROUGH ANOTHER OF THOSE PERIODS OF TIME IN WHICH ECONOMIC DEVELOPMENTS ARE GIVEN MORE THAN USUAL ATTENTION. BUSINESSMEN, BANKERS, ECONOMISTS AND THE MEDIA ARE PUBLICALLY PICKING APART EACH SHRED OF ECONOMIC EVIDENCE FROM EVERY POINT OF VIEW. AND WITH EACH NEW BIT OF INFORMATION (OR SPECULATION) FROM WASHINGTON, THE ANALYSIS STARTS ALL OVER AGAIN.

VISITS SUCH AS THIS ONE TO RICHMOND GIVE ME A FIRST HAND OPPORTUNITY TO FIND OUT THE EXTENT TO WHICH THE INTENSITY OF THE PUBLIC DEBATE REFLECTS PROBLEMS NOT YET EVIDENT IN THE STATISTICS OR SPECIAL CONCERNS AND UNCERTAINTIES ABOUT THE FUTURE COURSE OF ECONOMIC EVENTS. THE DISTINCTION BETWEEN ACTUAL EVENTS AND ANTICIPATED DEVELOPMENTS IS OBVIOUSLY EXTREMELY IMPORTANT IN SETTING ECONOMIC POLICY.

AT THE PRESENT TIME, I AM INCLINED TO THE VIEW THAT MANY OBSERVERS ARE FAR MORE PESSIMISTIC ABOUT THE ECONOMIC OUTLOOK THAN IS WARRANTED. SOME POINT UNCOMFORTABLY TO THE FACT THAT THE ECONOMIC EXPANSION IS NOW MORE THAN TWO AND A HALF YEARS OLD AND THEREFORE, ON AVERAGE, IS NOT LIKELY TO BE SUSTAINED TOO MUCH LONGER. THEY BUTTRESS THIS POSITION WITH OBSERVATIONS ON THE STICKINESS OF THE UNEMPLOYMENT RATE AT 7 PERCENT, SOME SLUGGISHNESS IN RECENT RETAIL SALES NUMBERS, LESS RAPID PERSONAL INCOME GROWTH, A rate of real GNP growth in the third quarter, and a failure of capital spending to grow rapidly.

To a surprising extent, much of the current data and the questions which are being asked about the possibilities for continued economic expansion are similar to those of about a year ago. At that time, the economy was beginning to show signs of what has since come to be known as the "pause" in the recovery. Looking back on the relatively slow growth which occurred during the second half of 1976, we can now see that two things occurred. The consumer slowed his spending from the exuberant pace of the first half of the year. In addition, inventory growth in the first half outpaced sales gains and so later in the year we went through a minor inventory liquidation cycle. By late last fall there was no shortage of dire predictions that the recovery had aborted and that we were slipping back into recession. There were calls for a variety of drastic measures to get the economy moving again—particularly by the Federal Government. With the infallible precision of hindsight, we can now see that the economy was actually poised for very strong progress.

Now it would be easy to add to the list of unfavorable current economic news I have already mentioned and join the pessimists in suggesting that the economy is, at best, repeating last year's "pause," or even joining those who are suggesting another recession. But I don't think that history repeats itself that exactly. In fact there are significant differences between conditions today and those of 1976, which suggest that a strong case can be made for expecting average or above-average economic growth and further slow declines in the unemployment rate over the next few quarters.

The capital goods industry has been a laggard throughout the present recovery. However, capacity utilization has been increasing steadily, and pressure is beginning to build in many companies to start moving in the

DIRECTION OF NEW PLANT CONSTRUCTION. THIS PRESSURE IS EVIDENT IN INCREASES IN ORDERS FOR NON-DEFENSE CAPITAL GOODS. THIS IS AN ERRATIC SERIES, PARTICULARLY HARD TO SEASONALLY ADJUST, BUT HAS RISEN IN FIVE OF THE LAST SIX MONTHS. AND THE MACHINERY COMPONENT OF THIS SERIES--A MORE RELIABLE INDICATOR OF UNDERLYING INVESTMENT TREND--HAS SHOWN GAINS OVER THE PAST YEAR. IN ADDITION, A SIGNIFICANTLY HIGHER LEVEL OF DEFENSE PROCUREMENT HAS BEEN AUTHORIZED FOR FISCAL 1978 (WHICH STARTS OCTOBER 1), AND THIS WILL BE MAKING AN IMPACT ON ORDERS FOR DEFENSE CAPITAL GOODS LATER IN THE YEAR. BACKLOGS OF MACHINE TOOL MANUFACTURERS ARE RISING STEADILY. HOUSING STARTS HAVE BEEN STRONG ALL YEAR AND WE ARE SEEING NEW STRENGTH IN THE PREVIOUSLY DEPRESSED MULTIFAMILY SECTOR. BUILDING PERMIT LEVELS SUGGEST THAT THE STRENGTH OF HOUSING SO FAR THIS YEAR WILL CONTINUE. INVENTORIES SEEM UNDER CONTROL AND, AS OTHER CAPITAL SPENDING GROWS, THEY TOO WILL BE MAKING A CONTRIBUTION TO GROWTH. ALL IN ALL, THE ENTIRE CAPITAL GOODS AREA APPEARS READY TO CONTRIBUTE A MUCH GREATER SHARE TO SUSTAINED EXPANSION. BUT WE ARE UNLIKELY TO SEE A CAPITAL SPENDING BOOM IN THE IMMEDIATE FUTURE.

THE GOVERNMENT SECTOR, WHICH HAD, IN CONSTANT DOLLAR TERMS, BEEN ESSENTIALLY STAGNANT THROUGHOUT ALL OF 1976 AND THE FIRST QUARTER OF 1977 SEEMS POISED FOR RAPID INCREASE. FEDERAL PURCHASES OF GOODS AND SERVICES HAVE BEEN MOVING UP. THERE ARE INDICATIONS THAT STATE AND LOCAL SPENDING IS ALSO BEGINNING TO HEAD UP. THE NEWLY AUTHORIZED FEDERAL FUNDS FOR PUBLIC SERVICE JOBS AND PUBLIC WORKS ARE BEGINNING TO FLOW INTO STATE AND LOCAL COFFERS AND SHOULD SOON BE SHOWING UP ON THE ECONOMY. IN ADDITION, DESPITE A FEW REAL HEADACHES LIKE NEW YORK CITY, STATE AND LOCAL GOVERNMENTS ARE BEGINNING TO ACCUMULATE SUBSTANTIAL SURPLUSES AS TAX RECEIPTS REFLECT THE GENERAL IMPROVEMENT IN THE ECONOMY. AS THESE SURPLUSES MOUNT, IT SEEMS LIKELY TO ME THAT THE AUSTERITY WHICH REIGNED AT ALL LEVELS FROM STATE HOUSES

TO VILLAGE HALLS WILL RELAX, FOR BETTER OR FOR WORSE, AND THESE SURPLUSES WILL FURTHER ADD TO ECONOMIC GROWTH. LET US HOPE THE SPENDING REINS WON'T BE RELAXED TOO FAR.

I ALSO DO NOT DISCOUNT THE CONSUMER. WHILE WORRIES HAVE BEEN EXPRESSED ABOUT THE RECENT RAPID GROWTH IN CONSUMER CREDIT AND THE LOW LEVELS OF THE PERSONAL SAVINGS RATE DURING THE FIRST HALF, I DON'T THINK CONDITIONS ARE COMPARABLE TO THE SECOND HALF OF LAST YEAR. THEN, CONSUMER INCOME, ADJUSTED FOR INFLATION, WAS GROWING MORE SLOWLY. FURTHERMORE, THE DECREASE IN WITHHOLDING TAXES WHICH OCCURRED IN JUNE WAS SMALLER THAN THE AMOUNT NEEDED TO ADJUST FOR THE 1977 TAX CHANGE. REFUNDS NEXT SPRING ARE LIKELY TO GROW BY MORE THAN THE NORMAL AMOUNT. THE INCREASE IN SOCIAL SECURITY PAYMENTS BEGUN WITH JULY'S PAYMENT, INCREASES THIS FALL IN FEDERAL PAY SCALES, AND GENERALLY RISING PAY LEVELS, WILL ALL CONTRIBUTE TO A CONTINUING INCREASE IN REAL PERSONAL DISPOSABLE INCOME OVER THE NEXT SEVERAL MONTHS. WHILE I DO NOT THINK THIS WILL LEAD TO A BOOM IN CONSUMER SPENDING, I DO EXPECT THAT THE CONSUMER WILL BE MAKING A POSITIVE CONTRIBUTION TO ECONOMIC GROWTH.

FINALLY, I EM ENCOURAGED BY THE RECENT NEWS ON THE PRICE FRONT. THE SEPTEMBER FIGURE FOR THE CONSUMER PRICE INDEX SHOWED ONLY AN 0.3 PERCENT INCREASE, WHILE FARM AND WHOLESALE PRICES HAVE BEEN WORKING TOWARD A MORE STABLE PRICE LEVEL FOR TWO OR THREE MONTHS. THE BATTLE AGAINST INFLATION IS NOT WON, BUT IT DOES APPEAR THAT THE ABNORMAL INCREASES CAUSED BY LAST WINTER'S SEVERE WEATHER HAVE FINISHED WORKING THEIR WAY THROUGH THE ECONOMY.

SO FAR I HAVE SUGGESTED A REASONABLY FAVORABLE PICTURE OF THE MONTHS AHEAD WHICH SHOULD PRODUCE BETTER ECONOMIC NEWS THAN SOME OF THE RECENTLY RELEASED DATA MIGHT SUGGEST. IN A NUTSHELL, WE SHOULD SEE GROWTH FAST ENOUGH TO SEE GRADUAL FURTHER REDUCTION IN THE UNEMPLOYMENT RATE. AT THE SAME TIME WE SHOULD NOT SEE A BOOM WHICH QUICKLY LEADS TO SEVERE PRICE PRESSURES

AS SHORTAGES DEVELOP DURING THE MONTHS AHEAD.

BUT, OF COURSE, WE HAVE NO GUARANTEES. FUTURE EXTERNAL SHOCKS LIKE THE QUADRUPLING OF OIL PRICES OR LAST JANUARY'S SEVERE WEATHER COULD ADVERSELY AFFECT THE OUTLOOK EVEN THOUGH THE BASIC CONDITIONS FOR SUSTAINED GROWTH ARE PRESENT. AND I DO NOT FORESEE A FUTURE WITHOUT PROBLEMS. BOTH THE UNEMPLOYMENT RATE AND THE INFLATION RATE ARE UNCOMFORTABLY HIGH. BOTH PROBLEMS HAVE SIGNIFICANT STRUCTURAL ASPECTS THAT ARE READILY ATTACKED BY THE CONVENTIONAL MOVES OF MONETARY AND FISCAL POLICY AND WHICH WILL BE MAJOR CHALLENGES OVER THE YEARS AHEAD.

BUT LET ME STEP BACK FROM THESE LONGER-TERM STRUCTURAL PROBLEMS AND RETAIN THE FOCUS ON THE NEAR-TERM BUSINESS OUTLOOK. AS YOU HAVE UNDOUBTEDLY NOTICED, I HAVE SKETCHED AN ECONOMIC OUTLOOK SCENARIO FOR YOU THAT HAS NOT SPECIFICALLY MENTIONED MONETARY POLICY. OBVIOUSLY, MONETARY POLICY IS IMPORTANT AND SO YOU MUST CONCLUDE, THEREFORE, THAT I AM EXPECTING THAT MONETARY POLICY WILL BE CONSISTENT WITH THIS PATH OF MODERATE GROWTH. YOU ARE RIGHT.

THE ECONOMY CERTAINLY HAS NOT BEEN STARVED FOR FUNDS THESE PAST TWO YEARS. INSTALMENT CREDIT HAS EXPANDED AT A SIGNIFICANT RATE SO FAR THIS YEAR. MORTGAGE CREDIT FLOWS HAVE BEEN OF RECORD MAGNITUDE. BUSINESS FIRMS HAVE PLACED HEAVIER DEMANDS ON CREDIT MARKETS. NET FUNDS RAISED BY NON-FINANCIAL CORPORATIONS HAVE INCREASED SIGNIFICANTLY. CREDIT DEMANDS BY STATE AND LOCAL GOVERNMENTAL UNITS HAVE BEEN VERY LARGE. ONLY FEDERAL GOVERNMENT BORROWING HAS DECLINED FROM LAST YEAR. THIS REFLECTS BOTH THE RECOVERY OF TREASURY REVENUES AND THE SHORTFALL IN SPENDING.

THE EXPANSION IN THE ECONOMY AND THE ATTENDANT CREDIT DEMANDS HAVE BEEN REFLECTED IN A RISE IN INTEREST RATES SINCE THE BEGINNING OF THE YEAR. VIRTUALLY ALL OF THE INCREASE IN INTEREST RATES HAS OCCURRED IN THE SHORT-

TERM AREA. LONG-TERM INTEREST RATES--THE MORE CRITICAL INTEREST RATES IN TERMS OF IMPACT ON REAL ECONOMIC ACTIVITY (PARTICULARLY HOUSING)--HAVE SHADED UP ONLY SLIGHTLY.

UNFORTUNATELY, ON THE HEELS OF THE WEAKER ECONOMIC STATISTICS, THE RECENT INCREASES IN SHORT-TERM RATES HAVE LED TO CHARGES THAT THE FED IS TIGHTENING UP ON MONETARY POLICY AT THE WRONG TIME. REGRETTABLY, THE CRITICISM SEEMS TO IGNORE ANOTHER KEY ELEMENT IN THE FINANCIAL PICTURE-- THE RAPID PACE OF MONETARY EXPANSION. PRIOR TO, AND COINCIDENT WITH, THE CONCERN ABOUT RISING INTEREST RATES, THE INCREASE IN THE MONEY STOCK WAS BEING VIEWED WITH DISMAY BY SOME OF THE SAME CRITICS AND WE WERE CHARGED WITH FLOODING THE ECONOMY WITH MONEY THAT WOULD LEAD TO A NEW INFLATIONARY BINGE.

NOW I AM NOT ONE WHO WILL SLAVISHLY FOLLOW A FIXED RATE OF MONETARY GROWTH DAY IN-DAY OUT, WEEK IN-WEEK OUT OR EVEN MONTH IN-MONTH OUT. IT IS IMPOSSIBLE TO OPERATE WITH SUCH PRECISION. AND IT ISN'T NECESSARY TO ACHIEVE YOUR GOALS FOR THE ECONOMY. AND IF YOU TRIED YOU WOULD CREATE SERIOUS PROBLEMS FOR FINANCIAL MARKETS RATHER THAN GAINS FOR THE REAL ECONOMY. BUT THERE IS NO QUESTION THAT OVER LONGER PERIODS OF TIME EXCESSIVE MONETARY GROWTH LEADS TO TROUBLE.

THE PACE OF MONETARY EXPANSION HAS BEEN UNUSUALLY RAPID DURING RECENT MONTHS. THIS IS ESPECIALLY TRUE OF THE NARROWLY DEFINED MONEY SUPPLY (M_1) WHICH OVER THE PAST SIX MONTHS HAS INCREASED AT AN ANNUAL RATE OF 9.5 PERCENT. THIS RATE OF EXPANSION IS WELL ABOVE THE FEDERAL RESERVE'S STATED LONGER-RUN PATH.

SINCE THE RECENT EXPANSION IN THE MONETARY AGGREGATES HAS TENDED TO RUN ABOVE EXPECTATIONS, SYSTEM OPERATIONS HAVE BEEN DIRECTED TOWARD HOLDING DOWN ON THE PROVISION OF BANK RESERVES. JUST AS ANY OTHER MARKET, THE MORE LIMITED AVAILABILITY OF RESERVE SUPPLIES RELATIVE TO DEMANDS HAS MEANT THAT THE PRICE

OF MONEY--IN THIS CASE, THE RATE OF INTEREST--HAS GONE UP ON DAY-TO-DAY BANK BORROWINGS FROM EACH OTHER (FEDERAL FUNDS) AND OTHER VERY SHORT-TERM SOURCES OF FINANCING. THE RATE PAID ON FEDERAL FUNDS, FOR EXAMPLE, IS UP ABOUT 2 PERCENTAGE POINTS FROM THE LOWS PREVAILING EARLY THIS YEAR. OTHER SHORT-TERM MARKET INTEREST RATES ALSO HAVE BEEN AFFECTED, BUT LONGER-TERM INTEREST RATES, WHICH AS I INDICATED EARLIER ARE OF MUCH GREATER SIGNIFICANCE TO THE ECONOMY, HAVE NOT INCREASED MUCH ON BALANCE, DESPITE THE FIRMING IN SHORT-TERM MARKET CONDITIONS.

SOME WOULD ARGUE THAT THE FEDERAL RESERVE SHOULD HAVE RESPONDED MORE FORCEFULLY TO THE EARLIER BULGES IN THE MONEY SUPPLY. INDEED, A FEW WOULD SAY THAT THE RESERVES NECESSARY TO SUPPORT THE DEPOSIT EXPANSION SIMPLY SHOULD NOT HAVE BEEN PROVIDED, LETTING FINANCIAL MARKETS AND THE ECONOMY SUFFER WHATEVER CONSEQUENCES MIGHT RESULT. BUT I CONTINUE TO BELIEVE THAT THE WISER COURSE IS TO LIMIT THE SPEED WITH WHICH MONEY MARKET CONDITIONS ARE ADJUSTED TO CHANGING MONETARY GROWTH RATES. I BELIEVE THIS PARTLY BECAUSE THE MONETARY AGGREGATES--PARTICULARLY M_1--HAVE PROVED TO BE INHERENTLY UNSTABLE IN THE SHORT RUN. PRUDENCE IN OUR ACTIONS IS DICTATED ALSO BY THE FACT THAT THE RELATIONSHIP BETWEEN THE VARIOUS MEASURES OF MONETARY GROWTH AND THE PERFORMANCE OF THE ECONOMY IS LOOSE AND UNRELIABLE IN THE SHORT RUN.

YOU MAY HAVE SEEN SOME COMMENTS IN THE FINANCIAL PRESS TO THE EFFECT THAT MONETARY POLICY--THE FEDERAL RESERVE--IS CAUGHT IN A "BOX." IT IS ARGUED THAT ATTEMPTS TO RESTRAIN THE GROWTH OF THE MONETARY AGGREGATES WILL RESULT IN HIGHER INTEREST RATES WHICH WILL STIFLE THE ECONOMIC EXPANSION. ON THE OTHER HAND, IT IS ARGUED, ALLOWING THE AGGREGATES TO CONTINUE TO GROW AT EXCESSIVE RATES WILL LEAD TO INCREASED INFLATIONARY PRESSURES.

WHEN SET UP IN THIS WAY, THE CHOICE SEEMS EXCEPTIONALLY DIFFICULT SINCE EITHER RESULT IS UNDESIRABLE. HOWEVER, THESE EXTREMES ARE NOT THE

ONLY CHOICES AVAILABLE--IN SPITE OF THEIR APPEAL TO THE MEDIA EXCITED EITHER ABOUT OVER-SIMPLIFIED SOLUTIONS OR DESIRING TO STRESS CONFRONTATION. THERE IS NO SUCH THING AS A SIMPLE CHOICE BETWEEN UNEMPLOYMENT AND INFLATION.

THE RATE OF MONETARY EXPANSION MAY WELL BE MODERATED BY LESS VIGOROUS INTEREST RATE MOVES THAN PRESUMED IN THIS EXTREME ARGUMENT. IN ADDITION, THE IMPACTS ON LONGER-TERM RATES MAY BE MINIMAL BECAUSE INFLATIONARY EXPECTATIONS ARE REDUCED BY EFFORTS TO KEEP THE MONETARY AGGREGATES ON MORE MODERATE GROWTH PATHS. FURTHER, THERE ARE NO GOOD ECONOMIC REASONS FOR TAKING EXCESSIVELY STERN MOVES TOWARD MONETARY RESTRAINT; THAT IS, TO ATTEMPT TO OFFSET IMMEDIATELY THE "OVERSHOOT" IN MONETARY GROWTH. SOMEWHAT MORE GRADUAL OR JUDICIOUS EFFORTS WILL SERVE US FAR BETTER NEITHER ADDING TO INFLATION OR CONTRIBUTING TO CONDITIONS IN THE CREDIT MARKETS THAT MIGHT HARM PROSPECTS FOR SUSTAINED ECONOMIC RECOVERY.

SUCH A COURSE FOR MONETARY POLICY WOULD BE CONSISTENT WITH MODERATE CONTINUED ECONOMIC EXPANSION. OBVIOUSLY, HOWEVER, MONETARY POLICY IS ONLY ONE ELEMENT IN OUR ECONOMIC POLICY MIX. THE FUTURE COURSE OF THE ECONOMY ALSO DEPENDS CRITICALLY ON THE RESOLUTION OF THE UNCERTAINTIES SURROUNDING GOVERNMENT POLICIES ON ENERGY, TAXATION AND REGULATIONS. THE ISSUES IN THOSE AREAS OF ECONOMIC POLICY WOULD TAKE A LONG SERIES OF DISCUSSIONS TO COVER. FOR THIS EVENING, LET ME SIMPLY SAY, THAT IF WE ARE ALSO JUDICIOUS IN SETTING SOUND ECONOMIC POLICY OUTSIDE THE MONETARY SPHERE, WE SHOULD BE ABLE OVER THE YEARS AHEAD TO LET MONETARY POLICY LEND ITS FULL WEIGHT TO CONTINUED PROGRESS IN OUR FIGHT TO RETURN TO ECONOMIC STABILITY.