

REMARKS OF MR. ROBERT P. MAYO  
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AT THE CHICAGO CHAPTER OF THE NORTHWESTERN UNIVERSITY  
MANAGEMENT ALUMNI ASSOCIATION  
NOVEMBER 17, 1977

I AM PLEASED TO HAVE BEEN INVITED TO JOIN YOU TODAY. AS SOME OF YOU MAY KNOW, BOB STROTZ, PRESIDENT OF NORTHWESTERN IS DEPUTY CHAIRMAN OF MY BOARD OF DIRECTORS. SO ALTHOUGH I AM NOT AN ALUMNUS OF NORTHWESTERN, MANY OF MY CLOSE FRIENDS AND ASSOCIATES ARE, AND I OBVIOUSLY HAVE MANY CLOSE TIES WITH YOUR ALMA MATER.

I AM PLEASED TO HAVE THIS OPPORTUNITY TO TALK WITH YOU FOR ANOTHER REASON AS WELL. AND THAT IS, IT GIVES ME A CHANCE TO CORRECT WHAT I CONSIDER TO BE SOME OF THE MISINTERPRETATIONS IN THE PRESS AND ON TV AND RADIO ABOUT SEVERAL CURRENT ECONOMIC ISSUES--IN PARTICULAR THE BEHAVIOR OF THE FEDERAL RESERVE SYSTEM.

AS BUSINESS PEOPLE WITH A KEEN INTEREST IN ECONOMIC AFFAIRS YOU ARE CERTAINLY AWARE THAT SIGNIFICANT DISAGREEMENTS HAVE APPEARED AMONG ECONOMIC ANALYSTS AS TO THE STRENGTH OF THE CURRENT ECONOMIC EXPANSION, ITS SUSTAINABILITY ON INTO 1978, THE PROPER COURSE FOR ECONOMIC POLICY IN GENERAL AND THE FED'S ROLE IN PARTICULAR. THIS IS A VERY LARGE SET OF CONCERNS WHICH I OBVIOUSLY CANNOT HOPE TO COVER COMPLETELY IN A SHORT LUNCHEON SPEECH. HOWEVER, I WOULD LIKE TO HIT SOME OF THE HIGH SPOTS IN AN EFFORT TO SOFTEN SOME OF THE DISCORDANT TONES WE ARE HEARING AND TO IDENTIFY MORE CLEARLY WHERE THE DIVERSITY OF VIEWS REFLECT HONEST DIFFERENCES IN JUDGMENTS.

THE FIRST AREA OF DISAGREEMENT THAT I WOULD LIKE TO CONSIDER IS THE NEAR-TERM ECONOMIC OUTLOOK--THE ECONOMIC PROSPECTS FOR THE NEXT 6 TO 9 MONTHS. HERE MY JUDGMENT DIFFERS FROM THAT OF A NUMBER OF ANALYSTS--OR AT LEAST DIFFERS FROM THE EMPHASIS GIVEN TO THEIR VIEWS IN PRESS REPORTS. I FEEL THAT MANY OBSERVERS TODAY ARE FAR MORE PESSIMISTIC ABOUT THE ECONOMIC OUTLOOK THAN IS WARRANTED.

I SUSPECT THAT MANY ARE UNCOMFORTABLE BECAUSE THE CURRENT ECONOMIC EXPANSION IS NOW MORE THAN TWO AND A HALF YEARS OLD. THEY FEAR, THEREFORE, THAT IN COMPARISON WITH EARLIER CYCLES IT IS AN "OLD" EXPANSION, AND MAY NOT BE SUSTAINED MUCH LONGER. THEY BUTTRESS THIS POSITION WITH OBSERVATIONS ON THE STICKINESS OF THE UNEMPLOYMENT RATE AT 7 PERCENT, SOMEWHAT LESS RAPID PERSONAL INCOME GROWTH, THE SLOWER RATE OF REAL GNP GROWTH IN THE THIRD QUARTER, THE FAILURE OF CAPITAL SPENDING ON INDUSTRIAL PLANT AND EQUIPMENT TO GROW RAPIDLY, AND AN ABYSMAL PERFORMANCE BY THE STOCK MARKET.

BUT REPORTS OF THE SERIOUS ILLNESS OF THE CURRENT ECONOMIC EXPANSION ARE CLEARLY EXAGGERATED. THERE IS REALLY NO BASIS FOR ARGUING THAT WE ARE NEAR THE PEAK OF THE EXPANSION STAGE OF THIS CYCLE, OR EVEN WORSE, THAT WE ARE ALREADY IN THE CONTRACTION PHASE. THE CURRENT INFORMATION FLOW DOESN'T CONFIRM IT. CERTAINLY THE PACE OF EXPANSION DID SLOW IN THE THIRD QUARTER, BUT FROM A VERY RAPID AND UNSUSTAINABLE FIRST-HALF PACE. NATIONALLY, THE CONDITIONS FOR FURTHER ECONOMIC EXPANSION REMAIN IN PLACE.

WE ARE ALL AWARE, OF COURSE, THAT HISTORY NEVER REPEATS ITSELF EXACTLY. TO ARGUE FOR THE DEMISE OF THIS EXPANSION ON THE BASIS OF HISTORY IS PARTICULARLY DISCONCERTING BECAUSE THE PRIOR CIRCUMSTANCES WERE SO DIFFERENT FOR THIS CYCLE. THE MAJOR ELEMENT FROM THE PAST THAT IS STILL CASTING A HEAVY SHADOW ON OUR ECONOMIC AFFAIRS IS THE INFLATION OF 1972-74. THERE IS LITTLE QUESTION THAT THIS OVERHANG HAS REDUCED THE PACE OF THE ECONOMIC ADVANCE, AND IF FURTHER PROGRESS IS NOT MADE IN THE FIGHT AGAINST INFLATION THIS OVERHANG WILL DAMAGE US MORE IN THE FUTURE. BUT THE EFFORT TO GAIN CONTROL OVER THE MONSTER AND THE PARTIAL SUCCESS WE HAVE HAD IS LIKELY TO GIVE US A LONGER-THAN-AVERAGE EXPANSION PERIOD—IF FUTURE ECONOMIC POLICIES ARE APPROPRIATELY FRAMED.

FOR THE NEAR TERM, 6 TO 9 MONTHS, THE PROSPECTS FOR A CONTINUED MODERATE ECONOMIC ADVANCE ARE GOOD. ALL ONE NEEDS TO DO IS TO GO DOWN THE MAJOR SECTORS OF OUR ECONOMY TO SEE THAT THIS IS SO.

CONSUMERS ARE STILL CONTINUING TO BUY. RETAIL SALES FIGURES HAVE BEEN VERY GOOD. RETAILERS APPEAR TO BE PLANNING FOR A STRONG CHRISTMAS SEASON. MUCH OF THE RETAIL STRENGTH IS IN HARD GOODS--REFRIGERATORS, ELECTRIC RANGES, MICROWAVE OVENS AND DRYERS. INSTALMENT CREDIT IS BEING USED FREELY, INDICATING CONSUMER CONFIDENCE, AND THE DELINQUENCY EXPERIENCE TO DATE IS GENERALLY CONSIDERED TO BE EXCELLENT. THE 1978 CARS ARE BEING WELL RECEIVED.

EVERYONE HERE KNOWS THAT THE CAPITAL GOODS INDUSTRY HAS BEEN THE LAGGARD IN THIS RECOVERY. BUT CAPACITY UTILIZATION HAS BEEN INCREASING STEADILY. PRESSURE IS BEGINNING TO BUILD IN MANY COMPANIES TO START MOVING IN THE DIRECTION OF NEW PLANT. CAPITAL OUTLAYS ARE STILL INCREASING AND WE THINK THAT THE PACE MAY HAVE QUICKENED A LITTLE IN RECENT MONTHS.

HOUSING STARTS HAVE BEEN STRONG ALL YEAR AND WE ARE SEEING NEW STRENGTH IN THE PREVIOUSLY DEPRESSED MULTI-FAMILY SECTOR. BUILDING PERMIT LEVELS SUGGEST THAT THE STRENGTH OF HOUSING WILL CONTINUE. HOUSING ANALYSTS, EXPECT THAT STARTS IN 1978 WILL BE ABOUT THE SAME AS THIS YEAR, WITH APARTMENTS SOMEWHAT HIGHER AND ONE-FAMILY UNITS SOMEWHAT LOWER. RENTS ARE GRADUALLY RISING TO A POINT THAT IS ENCOURAGING PROMOTERS OF NEW APARTMENT BUILDINGS.

NONRESIDENTIAL CONSTRUCTION ACTIVITY IS IMPROVING. OFFICE BUILDINGS LEAD THE UPTREND BUT INDUSTRIAL BUILDING IS ALSO PICKING UP. OUTLAYS TO BUILD OR REPAIR HIGHWAYS AND HIGHWAY STRUCTURES AND TO BUILD SEWER AND WATER SYSTEMS ARE RATHER STRONG.

THESE DEVELOPMENTS SHOULD CONTINUE INTO THE MONTHS IMMEDIATELY AHEAD. WHILE CONSUMER CREDIT HAS GROWN RAPIDLY, AN ANALYSIS OF THE BURDEN DOES NOT SUGGEST THAT DEBT BURDENS ARE OUT OF LINE. REAL DISPOSABLE INCOME SHOULD CONTINUE TO RISE AND WHILE I DO NOT THINK THERE WILL BE A BOOM IN CONSUMER

SPENDING, I DO EXPECT THE CONSUMER TO MAKE A POSITIVE CONTRIBUTION TO FURTHER ECONOMIC GROWTH.

THE ENTIRE CAPITAL GOODS AREA IS LIKELY TO CONTRIBUTE A LARGE SHARE TO SUSTAINED EXPANSION. FROM MACHINE TOOLS THROUGH HOUSING AND NONRESIDENTIAL CONSTRUCTION THERE APPEARS TO BE A BASIS FOR EXPANSION. AND THEN IF YOU ADD THE GOVERNMENT SECTOR, STATE AND LOCAL AS WELL AS FEDERAL, WE SHOULD SEE A CONTINUATION OF MODERATE EXPANSION ON WELL INTO 1978.

THE SCENARIO OF MODERATE AND APPROPRIATE EXPANSION INTO 1978, AT LEAST TO THE EXTENT THAT WE ARE TALKING ABOUT THE FIRST HALF OF NEXT YEAR, IS NOT SIGNIFICANTLY DIFFERENT FROM THAT PRESENTED BY MOST OBSERVERS. MOST EXECUTIVES AND ANALYSTS SHARE THE OPINION THAT ACTIVITY WILL CONTINUE TO GROW AT LEAST THROUGH THE FIRST HALF OF 1978. THE CONCERN IS WITH THE CONTINUATION OF THE EXPANSION BEYOND THAT TIME.

I THINK THAT IT IS IMPORTANT TO STRESS THIS POINT THAT IT IS THE FUTURE SOME NINE TO TWELVE MONTHS AHEAD THAT IS THE FOCUS OF DISCUSSION. FAR TOO MANY OF THE PUBLIC COMMENTARIES HAVE IMPLIED THAT THE EXPANSION IS ALREADY ILL. BUT CLEARLY THAT IS NOT THE CASE. THERE IS NO SET OF FIRM DEVELOPMENTS OR TRENDS THAT PRE-ORDAIN A DECLINE IN THE ECONOMIC ADVANCE. THE NEAR-TERM FUTURE HAS BEEN LARGELY SET BY ECONOMIC FACTORS ALREADY IN PLACE. BUT THE LONGER-TERM ECONOMIC FUTURE DEPENDS ON EVENTS YET TO TAKE PLACE--- WHETHER THEY ARE EXTERNAL SHOCKS SUCH AS FURTHER OIL PRICE INCREASE OR ANOTHER BOUT OF SEVERE WEATHER OR INTERNAL DEVELOPMENTS SUCH AS THE FORM OF OUR GOVERNMENT'S ECONOMIC POLICIES.

A SIGNIFICANT PART OF THE CONCERN FOR THE LONGER TERM FUTURE MUST REFLECT THE ELEMENTS OF UNCERTAINTY THAT HAVE BEEN SO WIDELY DISCUSSED. BUSINESS MUST ALWAYS OPERATE TO SOME DEGREE IN AN ATMOSPHERE OF UNCERTAINTY. BUT WHEN THAT UNCERTAINTY IS UNUSUALLY GREAT, IT TENDS TO DELAY EFFORTS TO MOVE

IN NEW DIRECTIONS AND TO SEIZE OPPORTUNITIES. ENERGY, ENVIRONMENTAL AND TAXATION UNCERTAINTIES CLEARLY EXIST. AND WHILE WE MAY HOLD DIFFERENT VIEWS AS TO THE PROPER SOLUTIONS TO THESE AREAS OF CONCERN, THE ESSENTIAL ASPECT IS NOT SO MUCH THE FORM OF THE SOLUTION AS THE KNOWLEDGE OF WHAT THE RULES OF THE ECONOMIC GAME WILL BE.

IN SUGGESTING THIS, I DON'T MEAN TO IMPLY THAT THE DIRECTION IN WHICH WE MOVE IN SOLVING THESE SIGNIFICANT PROBLEMS IS UNIMPORTANT. THAT IS SURELY NOT THE CASE. BUT IN MAKING OUR PROJECTIONS FOR THE FUTURE WE MUST DISTINGUISH BETWEEN THE EFFECTS OF UNCERTAINTY AND THE LIKELY IMPACTS OF OUR ECONOMIC POLICIES.

I AM AMONG THOSE, FOR EXAMPLE, THAT FEEL VERY STRONGLY ABOUT THE NEED TO DEVELOP EFFECTIVE ECONOMIC POLICIES FOR THE STIMULATION OF CAPITAL INVESTMENTS. AS I NOTED EARLIER, THERE HAS BEEN SOME INCREASE IN THE PACE OF CAPITAL SPENDING. THE LONGER-TERM ECONOMIC FUTURE, HOWEVER, DEPENDS CRITICALLY ON A CONTINUATION OF THAT SPENDING AT A SOMEWHAT MORE EXPANSIVE PACE. FOR MANY YEARS NOW WE HAVE BEEN ADDING LESS TO OUR PRODUCTIVE PLANT HERE IN THE U. S. THAN HAVE OTHER INDUSTRIALIZED ECONOMIES. AND WE CONTINUE AS A PEOPLE TO ASK, INDEED EXPECT, EVER GREATER OUTPUT AND HIGHER LIVING STANDARDS. ATTEMPTS TO BRING ABOUT A MORE EXTENSIVE UTILIZATION OF OUR LABOR FORCE WILL NOT MEET THOSE NEEDS WITHOUT CAPITAL SPENDING AS WELL. INDEED, THE EXPANSION OF BUSINESS CAPITAL SPENDING CAN BE THE EFFECTIVE DRIVING FORCE FOR THE MORE EXTENSIVE USE OF OUR LABOR FORCE.

AND IN THE LONGER RUN, THE EXPANSION OF OUR PRODUCTIVE CAPACITY WILL HAVE A SIGNIFICANT BEARING ON OUR ABILITY TO REDUCE THE RATE OF ADVANCE IN PRICES. INFLATION IS OFTEN VIEWED ONLY AS A MONETARY PHENOMENON, BUT IT HAS AN IMPORTANT SUPPLY DIMENSION AS WELL.

BUT TO RETURN TO THE BASIC THRUST OF MY REMARKS, ANOTHER REASON FOR THE DIVERGENCE OF VIEWS ON THE LONGER-TERM OUTLOOK, APPEARS TO BE THE RESULT

OF DIFFERENT INTERPRETATIONS OF RECENT FINANCIAL DEVELOPMENTS. THE ELEMENTS OF UNCERTAINTY AND THE SHAPE OF ECONOMIC POLICIES FOR THE PERIOD AHEAD ARE INTERTWINED, AS THEY ALWAYS ARE, WITH DEVELOPMENTS IN THE FINANCIAL MARKETS. I WISH TO STRESS THE INTERTWINING OF ECONOMIC FACTORS, THE INTER-RELATIONSHIP OF ALL THE IMPORTANT ELEMENTS IN OUR ECONOMY, IN ORDER TO EMPHASIZE THAT INTEREST RATES, MONETARY AGGREGATE GROWTH--INDEED IN A BROADER CONTEXT MONETARY POLICY--ARE NOT INDEPENDENT ELEMENTS OF OUR ECONOMIC LIFE. UNFORTUNATELY, MUCH PUBLIC DISCUSSION HAS SET MONETARY POLICY APART AS A UNIQUE ELEMENT WHICH SOMEHOW WILL DETERMINE THE COURSE OF THE ECONOMY IN LATE 1978 AND ON INTO 1979. IT DOES NOT AND CAN NEVER HAVE THAT ROLE IN OUR ECONOMY.

I HAVE BEEN PARTICULARLY DISMAYED BY THE EFFORTS WHICH WERE WIDESPREAD IN THE MEDIA, FINANCIAL LETTERS AND ADVISORY SERVICES TO PLAY UP A CONFRONTATION BETWEEN THE FEDERAL RESERVE SYSTEM AND THE ADMINISTRATION. FORTUNATELY, THE INTENSITY OF THE SUPPOSED DISCORD HAS BEEN REDUCED RECENTLY. BUT I SUSPECT THAT IT MAY BE REOPENED AGAIN. IF SO, SOME OF THE DOWNRIGHT SILLY IMPLICATIONS DRAWN ON OCCASION MAY AGAIN EMERGE AND I THINK THAT IT MAY BE USEFUL FOR ME TO TRY TO CLARIFY JUST WHAT ELEMENTS ARE SIGNIFICANT.

THE INTEREST RATE VS. MONETARY GROWTH DEBATE IS NOT A CONFRONTATION BETWEEN THE ADMINISTRATION AND THE FEDERAL RESERVE SYSTEM. THE QUESTION OF HOW MUCH EMPHASIS TO PLACE ON INTEREST RATES AND HOW MUCH EMPHASIS TO GIVE TO MONETARY AGGREGATES IN THE CONDUCT OF MONETARY POLICY IS AN ECONOMIST'S ARGUMENT, NOT A POLITICAL ARGUMENT. THE ECONOMIC PROFESSION AS A WHOLE HAS BEEN DEBATING THIS ISSUE FOR MANY YEARS. IT IS DEBATING THE ISSUE TODAY AND I SUSPECT WILL STILL BE DOING SO MANY YEARS FROM NOW.

THE CONCERN THAT SOME ARE EXPRESSING NOW IS THAT INTEREST RATES MAY BE RISING TO LEVELS THAT MAY IMPEDE REAL ECONOMIC GROWTH. THE ARGUMENT THAT INTEREST RATES AFFECT ECONOMIC ACTIVITY IS A REASONABLE ONE. OF COURSE THEY

DO. TO SAY THAT INTEREST RATES DON'T MATTER IS AS FOOLISH AS SAYING THAT THE RATE OF MONETARY GROWTH DOESN'T MATTER.

I SEE NO EVIDENCE THAT THE INTEREST RATE INCREASES WE HAVE SEEN IN RECENT MONTHS HAVE HARMED ECONOMIC GROWTH. A MAJOR REASON IS THAT THE INCREASES IN LONGER-TERM RATES HAVE BEEN MODEST AND THESE HAVE THE GREATEST IMPACT ON DECISIONS TO SPEND OR INVEST. AT SOME POINT, OF COURSE, ATTRACTIVE RATES ON SHORT-TERM INSTRUMENTS, SUCH AS TREASURY BILLS, COULD RESULT IN OUTFLOWS OR REDUCED INFLOWS INTO COMMERCIAL BANKS AND THRIFT INSTITUTIONS. WHILE TIME AND SAVINGS FLOWS HAVE SLOWED A BIT, THERE IS NO EVIDENCE OF SIGNIFICANT DISINTERMEDIATION OR A REDUCTION IN THE ABILITY OF MORTGAGE INSTITUTIONS TO PROVIDE NECESSARY FUNDS. NO ONE CAN BE CERTAIN AS TO THE "TRIGGER" LEVEL OF INTEREST RATES, BUT I THINK THAT WE CAN BE REASONABLY CERTAIN THAT THERE ARE NO IMMEDIATE PROBLEMS.

BUT IN FRAMING MONETARY POLICY, THE MONETARY AGGREGATES--CURRENCY PLUS DEPOSITS--CANNOT BE IGNORED EITHER. I AM CERTAIN THAT ALL OF YOU ARE AWARE OF THE SCHIZOPHRENIA OF THE REPORTS ON THE FED'S ACTIONS. ON ONE HAND, INCREASES IN SHORT-TERM RATES ARE REPORTED AS "TIGHTENING" BY THE FED. BUT REPORTING ON THE RAPID GROWTH OF THE MONETARY AGGREGATES, WE ARE TOLD THAT THE FED IS PURSUING AN EXCESSIVELY EASY MONETARY POLICY. ALL OF WHICH ONLY SUGGESTS, I THINK, THAT THINGS WOULD BE A LOT BETTER IF WE GOT RID OF OUR SHORT-HAND WAY OF DESCRIBING MONETARY POLICY AS EASY OR TIGHT--OR, AT LEAST, IDENTIFIED CLEARLY WHAT WAS MEANT. THE FACT IS THAT MONETARY POLICY IS NOT CONDUCTED IN TERMS OF EASE OR TIGHTNESS IN THIS OR THAT VARIABLE BUT IN TERMS OF THE FINANCIAL CONDITIONS NECESSARY TO FOSTER THE SOUND EXPANSION OF THE ECONOMY WHILE RETURNING AS FAR AS WE CAN TOWARD REASONABLE PRICE STABILITY.

THE MONETARY AGGREGATES ARE IMPORTANT BECAUSE WE FULLY APPRECIATE THAT THERE IS A LINK BETWEEN MONEY CREATION AND INFLATION. 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 THAT WE DO SO TO ACHIEVE OUR 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 ( $M_1$ )—CURRENCY PLUS DEMAND DEPOSITS ONLY—WHICH OVER THE PAST SIX MONTHS HAS INCREASED AT AN ANNUAL RATE OF 8.2 PERCENT. THIS RATE OF EXPANSION IS WELL ABOVE THE FEDERAL RESERVE'S STATED LONGER-RUN DESIRED PATH.

SINCE THE RECENT EXPANSION IN THE MONETARY AGGREGATES HAS TENDED TO RUN ABOVE EXPECTATIONS, SYSTEM OPEN MARKET 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 OTHER BANKS (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 MOVED UP COMPARABLY, BUT ARE NO HIGHER TODAY THAN THE 1975 AVERAGES. AND AT THE SAME TIME, LONGER-TERM INTEREST RATES, WHICH AS I INDICATED EARLIER ARE OF MUCH GREATER SIGNIFICANCE TO THE REAL ECONOMY, HAVE INCREASED VERY LITTLE ON BALANCE.

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 FROM WHAT WOULD PRESUMABLY BE



A VERY SHARP RISE IN INTEREST RATES. 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 RATHER CONCLUSIVELY 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 VERY 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, IN TURN, 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. ESPECIALLY SINCE GREATER INFLATION ALMOST INEVITABLY LEADS TO GREATER UNEMPLOYMENT.

RECENTLY, THE NUMBERS COMING IN ON THE MONEY SUPPLY SUGGEST THAT SOME MODERATION IN THE PACE OF MONETARY GROWTH MAY BE OCCURRING. THE IMPACT OF EARLIER ACTIONS MAY BE TAKING EFFECT. IF SO, THE EXCESSIVE RATE OF MONETARY EXPANSION MAY WELL BE MODERATED WITHOUT FURTHER OR ONLY MODEST CHANGES IN OUR RESERVE SUPPLYING ACTIVITY. AND 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.

SOME STANCH ADHERENTS TO THE SO-CALLED "MONETARIST" POSITION, NOTING THAT WE ARE ABOVE DESIRED GROWTH PATHS FOR THE MONETARY AGGREGATES INSIST THAT WE SHOULD MOVE PROMPTLY--I WOULD SAY PRECIPITOUSLY--TO LOWER LEVELS OF THE MONEY STOCK. 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 NOR 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. HOWEVER, AS I INDICATED MUCH EARLIER, MONETARY POLICY DOES NOT STAND ALONE IN OUR ECONOMIC POLICY MIX. IT CANNOT OFFSET THE UNCERTAINTIES ARISING FROM OTHER AREAS. IT CANNOT SUBSTITUTE FOR SOUND ECONOMIC POLICIES ON ENERGY, TAXATION, ENVIRONMENT AND REGULATION OF ECONOMIC ACTIVITY. MONETARY POLICY IS AN IMPORTANT TOOL. IT CAN SUPPORT. IT CANNOT ALONE CREATE THE IDEAL ECONOMIC WORLD. THUS, IF WE ARE 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.