

REMARKS OF MR. ROBERT P. MAYO
PRESIDENT, FEDERAL RESERVE BANK OF CHICAGO
TO THE ROTARY CLUB OF CHICAGO
JANUARY 10, 1978

THE ECONOMY AS WE ENTER 1978

I AM PLEASED TO HAVE THIS OPPORTUNITY TO MEET AGAIN WITH THE ROTARY CLUB OF CHICAGO AND, WHILE PERHAPS A LITTLE LATE, TO WISH YOU A HAPPY NEW YEAR. I KNOW THAT EACH OF YOU WILL FIND YOUR ASSOCIATION WITH ROTARY AS FULFILLING THIS YEAR AS YOU HAVE IN THE PAST.

AS YOUR CHAIRMAN INDICATED IN HIS KIND INTRODUCTION, I WOULD LIKE TO SPEAK TO YOU TODAY ABOUT THE ECONOMIC SITUATION AS WE ENTER 1978, AND TALK A BIT ABOUT LIKELY DEVELOPMENTS FOR THE NEW YEAR. SOME OF YOU MAY FEEL THAT THIS PRESENTS ME WITH A RATHER UNCOMFORTABLE ASSIGNMENT. ECONOMIC DIFFICULTIES REPORTED IN RECENT MONTHS, RANGING FROM DECLINES IN FARM INCOME TO FOREIGN COMPETITIVE IMPACTS ON STEEL AND TV SETS, AND MORE RECENT EXCHANGE MARKET DEVELOPMENTS AS WELL AS LONGER STANDING PROBLEMS OF UNEMPLOYMENT AND INFLATION, MAY GIVE SOME THE IMPRESSION THAT WE ARE STARTING A NEW YEAR ON A PESSIMISTIC NOTE AND THAT THE FORTUNES OF THE ECONOMY FOR 1978 ARE SOMEWHAT DIM. I DO NOT DISCOUNT THE IMPORTANCE OF THESE PROBLEMS. THEY ARE SERIOUS. NEVERTHELESS, I DON'T ENTER THE NEW YEAR WITH PESSIMISM BUT WITH OPTIMISM.

IN SPITE OF ALL OF OUR DIFFICULTIES, THE NATION'S ECONOMY IS IN FAIRLY GOOD SHAPE AND THE PROSPECTS FOR FURTHER ECONOMIC ADVANCE SEEM GOOD. WE CAN ALSO SAY THE SAME FOR CHICAGO. THE ECONOMY ENDED 1977 ON A MORE VIGOROUS NOTE THAN MANY HAD EXPECTED. OUR TOTAL OUTPUT OF GOODS AND SERVICES, ADJUSTED FOR PRICE CHANGES, ROSE MORE THAN 5 PERCENT IN THE THIRD QUARTER--A VERY RESPECTABLE RATE OF ADVANCE. THE FOURTH QUARTER JUST ENDED SHOULD SHOW AN EVEN BETTER GAIN IN REAL OUTPUT. THE DEMAND FOR GOODS AND SERVICES BY CONSUMERS CONTINUES TO BE STRONG. AUTO SALES

HAVE BEEN SOMEWHAT DISAPPOINTING, REFLECTING IN PART CONSUMER RELUCTANCE TO PURCHASE THE DOWNSIZED 1978 MODELS. BUT GENERAL MERCHANDISE SALES IN THE CHRISTMAS AND POST-CHRISTMAS PERIOD HAVE BEEN STRONG, WITH BUSINESS EXPECTATIONS THAT THERE WILL BE A REBUILDING OF UNINTENTIONALLY DEPLETED INVENTORIES. RESIDENTIAL CONSTRUCTION HAS BEEN VERY GOOD, WITH HOUSING STARTS, SEASONALLY ADJUSTED OF COURSE, AT THE HIGHEST RATE IN SEVERAL YEARS. TOTAL EMPLOYMENT HAS BEEN RISING RAPIDLY. THE ECONOMY HAS CREATED MORE THAN SEVEN MILLION NEW JOBS SINCE MARCH 1975— A TREMENDOUS PERFORMANCE. A LARGER PERCENTAGE OF OUR POPULATION IS AT WORK TODAY THAN AT ANY PREVIOUS TIME IN OUR NATION'S HISTORY. INDUSTRIAL PRODUCTION HAS CONTINUED TO INCREASE. INVENTORIES ARE GENERALLY IN GOOD BALANCE, PERHAPS EVEN LOW IN SOME RETAIL LINES. AND WHILE BUSINESS SPENDING FOR PLANT AND EQUIPMENT IS NOT GROWING RAPIDLY, IT DOES CONTINUE TO SHOW GAINS, WITH REPORTS SUGGESTING CONTINUING ADVANCE.

THE DOMESTIC FINANCIAL PICTURE HAS A SIMILARLY PLEASANT TONE. CREDIT IS READILY AVAILABLE AND, ALTHOUGH SHORT TERM INTEREST RATES ARE UP, THERE IS NO RELUCTANCE TO LEND OR TO BORROW. SERIOUS DISINTERMEDIATION—THAT IS, THE MOVEMENT OF MONEY OUT OF TIME AND SAVINGS ACCOUNTS IN BANKS AND SAVINGS AND LOAN ASSOCIATIONS INTO GOVERNMENT SECURITIES, HAS NOT MATERIALIZED. ALMOST ALL COMMERCIAL BANKS HAVE ADEQUATE LIQUIDITY TO HANDLE THE CREDIT NEEDS EXPECTED TO BE PLACED UPON THEM. AND LONG-TERM INTEREST RATES—CONSIDERED BY MOST PEOPLE TO BE THE MOST RELEVANT RATES SINCE THEY REFLECT LONGER TERM INVESTMENT JUDGEMENTS—HAVE REMAINED RELATIVELY FLAT.

WHEN I LOOK AT DEVELOPMENTS IN ALL OF THESE AREAS, I SEE THE ECONOMY HAVING ENDED 1977 ON SOLID GROUND. AND I SEE NO REASON FOR ARGUING THAT WE CANNOT ACHIEVE A CONTINUATION OF MODERATE ECONOMIC EXPANSION ON

THROUGH 1978. THE MOMENTUM IS THERE AND LACKING SHOCKS FROM GOVERNMENT ECONOMIC POLICY OR EXTERNAL SHOCKS, THE ECONOMY SHOULD PERFORM REASONABLY WELL THIS YEAR.

I AM STRUCK BY THE NUMBER OF SIMILARITIES IN THE THINKING ABOUT THE ECONOMIC OUTLOOK TODAY AND THE OUTLOOK STATEMENTS OF A YEAR AGO. I KNOW THAT IT IS DANGEROUS, IF NOT INAPPROPRIATE, TO PUT ALL ECONOMIC FORECASTERS INTO THE SAME POT--ALTHOUGH SOME WOULD SAY THAT'S THE BEST PLACE FOR US, ESPECIALLY IF IT IS FILLED WITH BOILING OIL. BUT, AS I RECALL, THE EXPECTATION EARLY IN 1977 WAS THAT THE BUSINESS UPTURN, IN SPITE OF A PRIOR SLOWING, WOULD EXTEND WELL INTO 1977. THE SAME EXPECTATION IS HELD BY MANY FORECASTERS NOW AND IS ELABORATED IN MUCH THE SAME WAY; THAT IS, IN SPITE OF THE THIRD QUARTER SLOWING IN THE ECONOMIC ADVANCE (LESS EVIDENT NOW IN THE REVISED FIGURES), THE BASIC FORCES OF EXPANSION REMAIN INTACT AND THE ECONOMIC UPTURN SHOULD CONTINUE WELL INTO THE NEW YEAR.

CONCERN WAS EXPRESSED A YEAR AGO ABOUT THE ABILITY OF CONSUMERS TO CONTINUE TO SUPPORT THE UPSWING. THE SAME COMMENTS ARE HEARD TODAY.

INVENTORIES SEEMED LEAN AND IT WAS EXPECTED THAT ACCUMULATION WOULD OCCUR AT A FASTER PACE IN 1977. AGAIN THERE IS A SIMILARITY.

IT WAS THOUGHT THAT GREATER STIMULUS WOULD BE COMING FROM PLANT AND EQUIPMENT SPENDING DURING 1977. THAT IS ALSO THE HOPE FOR 1978.

RESIDENTIAL HOUSING WAS EXPECTED TO EXPAND AT MODERATE RATES IN 1977. HOUSING DID SOMEWHAT BETTER THAN EXPECTED BUT MAINTENANCE OF MODERATE EXPANSION FOR 1978 IS STILL EXPECTED BY MANY.

THE FINANCING NEEDS OF MAJOR SECTORS IN THE ECONOMY WERE EXPECTED TO BE LARGE. THAT SEEMS TO BE THE VIEW FOR 1978 AS WELL.

FOR 1977, PRIVATE SHORT-TERM CREDIT DEMANDS WERE EXPECTED TO GROW, THE SAME IS EXPECTED FOR 1978 IN THE VIEW OF MANY FINANCIAL OBSERVERS,

CONSUMER BORROWING WAS NOT EXPECTED TO RISE MUCH ABOVE THE RELATIVELY HIGH LEVEL OF 1976. BUT IT DID AND NOW THE FORECASTS TEND TO BE STATED IN A SIMILAR MANNER; CONSUMER BORROWING MAY NOT RISE MUCH FROM ITS CURRENT HIGH LEVEL,

THE TREASURY WAS EXPECTED TO SEEK SUBSTANTIAL FUNDS IN THE MARKETS IN 1977. THE SAME EXPECTATION IS HELD FOR 1978; THE HUGE FEDERAL DEFICIT HAS TO BE FINANCED SOMEWHERE,

ONE IS ALSO STRUCK BY THE SIMILARITIES IN THE UNCERTAINTIES ABOUT PUBLIC POLICY IN EARLY 1977 AND NOW IN 1978. THERE WAS UNCERTAINTY AS TO THE THRUST OF THE NEW ADMINISTRATION'S ECONOMIC POLICIES. WHILE THE ADMINISTRATION IS NOT QUITE SO NEW ANY LONGER, ITS POLICY THRUST IS STILL PERPLEXING TO MANY,

WOULD THERE BE AN EFFECTIVE ENERGY SOLUTION IN 1977? WILL THERE BE ONE IN 1978? HOW ABOUT TAX REFORM? TAX REDUCTION?

AS FAR AS THE FEDERAL RESERVE IS CONCERNED, THERE WAS SOME EXPECTATION OF A FIRMER STANCE BUT THE BETTING WAS ON AN ACCOMMODATIVE MONETARY POLICY IN 1977. IF YOU WATCH ONLY SHORT-TERM INTEREST RATES YOU MIGHT CONCLUDE THAT FED POLICY WAS FIRMER THIS YEAR. BUT LOOKING AT THE 1977 INCREASES IN MONEY AND CREDIT FLOWS YOU WOULD HAVE TO SAY THAT IT HAS BEEN ACCOMMODATIVE. WHAT ABOUT 1978? ON BALANCE I THINK THAT THE FINANCIAL MARKET OBSERVERS HAVE SIMILAR EXPECTATIONS FOR 1978. SOME LOOK FOR A FIRMER COURSE FOR MONETARY POLICY, BUT THE MAJORITY APPEAR TO FEEL THAT IT WILL BE REASONABLY ACCOMMODATIVE,

AND, OF COURSE, THERE ARE ALSO SIMILARITIES BETWEEN LAST YEAR AND THIS YEAR ON THE BROADER ISSUES THAT CONFRONT OUR ECONOMY. THEN WE WERE

SEEING THE IMPACTS OF OUR RISING TRADE DEFICIT AND THE RISING TRADE SURPLUSES IN GERMANY AND JAPAN ON THE FOREIGN EXCHANGE MARKETS, WE CERTAINLY SEE THEM TODAY--IN EXPANDED FORM. THEN, WE WERE PAINFULLY AWARE OF THE IMPACTS OF INFLATION AND UNACCEPTABLE LEVELS OF UNEMPLOYMENT UPON OUR SOCIETY. ALTHOUGH WE HAVE MADE A LITTLE PROGRESS, THOSE TWIN STUBBORN EVILS STILL REMAIN.

ONE MUST, OF COURSE, BE CAREFUL NOT TO ARGUE THAT BECAUSE EXPECTATIONS ARE SIMILAR TO A YEAR AGO THAT THE OUTCOME WILL BE THE SAME. AFTER ALL, WE ARE STARTING FROM A DIFFERENT BASE, A SOMEWHAT DIFFERENT ENVIRONMENT. NEVERTHELESS, AS I LOOK AT THE PRIVATE, REAL ACTIVITY OF OUR ECONOMY, I DO NOT SEE ANY REASON TO BELIEVE THAT WE CANNOT AGAIN HAVE A CONTINUATION OF A MODERATE ECONOMIC EXPANSION ON THROUGH 1978. THE DIFFERENCE IN PERFORMANCE THIS YEAR, IF IT OCCURS, IS MOST LIKELY TO ARISE FROM THE PUBLIC POLICY ARENA; THAT IS, THERE ARE OBVIOUS PUBLIC POLICY EFFORTS NOW BEING DEBATED WHICH IF ENACTED WILL IMPACT SIGNIFICANTLY UPON THE ECONOMY.

PLEASE DO NOT MISUNDERSTAND ME, I AM NOT FORECASTING PUBLIC POLICY ACTIONS IN 1978 THAT WILL DAMAGE OUR FUTURE EXPANSION. THE DEBATE ON MANY OF THESE PROGRAMS, FROM ENERGY TO TAXES, IS STILL GOING ON. I CAN, AS YOU CAN AS WELL, THINK OF PREFERRED SOLUTIONS TO THE ISSUES BUT I STILL REMAIN AS UNCERTAIN AS YOU ARE AS TO THE ACTUAL OUTCOME.

WE COULD, OF COURSE, PLAY THE "WHAT IF" GAME. BUT THERE ARE SO MANY PERMUTATIONS AND COMBINATIONS AND I WILL RESIST THE TEMPTATION. EVEN MY COMPUTER WOULD COLLAPSE UNDER SUCH A STRAIN. IN FACT, IT MAY BE SUFFICIENT IN LOOKING AT 1978 TO LUMP THE CONCEIVABLE PUBLIC POLICY ACTIONS TOGETHER AND ARGUE VERY SIMPLY, FIRST, THE IMPACT OF SUCH ACTIONS

IS NOT LIKELY TO HAVE SIGNIFICANT IMPACT ON THE COURSE OF THE ECONOMY FOR MUCH OF 1978. ITS PRIMARY IMPACT WILL BE IN THE YEARS BEYOND. AND SECOND, THE VERY ACT OF CLARIFYING POLICY THRUST-- THE REMOVAL OF OUR MAJOR PUBLIC POLICY UNCERTAINTIES--SHOULD HAVE A MOST FAVORABLE IMPACT ON ATTITUDES AND THUS THE ECONOMY'S PERFORMANCE.

AT THIS JUNCTURE IT APPEARS LIKELY THAT THE MOST SIGNIFICANT PUBLIC POLICY ACTIONS IN 1978 WILL BE IN ENERGY AND TAXATION. THE DEBATE ON THE ENERGY PROGRAM WILL BE CONTINUED WHEN CONGRESS RETURNS IN MID-JANUARY. AS I'VE SAID BEFORE I DON'T KNOW WHAT THE PROGRAM WILL LOOK LIKE IN FINAL FORM OR HOW LONG IT WILL TAKE INTO FEBRUARY BEFORE SOMETHING HAPPENS. HOWEVER, WE DO KNOW THAT TAX INCREASES ARE AN INTEGRAL PART OF THE ENERGY PROGRAM. THOSE INCREASES, ALONG WITH THE ALREADY PASSED INCREASES IN SOCIAL SECURITY TAXES AND THE MINIMUM WAGE WILL BOOST BUSINESS COSTS AND WILL BE PASSED ON TO THE CONSUMER. AT THE SAME TIME, DEPENDING IN PART ON HOW THE ENERGY TAX REVENUES ARE USED, THE PACKAGE OF "TAX" INCREASES COULD BE DRAINING PURCHASING POWER FROM CONSUMERS AND BUSINESSES AND FURTHER INHIBIT NEEDED CAPITAL INVESTMENT.

THIS PUTS A VERY HEAVY BURDEN ON THE PROPER SHAPING OF EXPECTED TAX LEGISLATION. IT MUST TAKE INTO ACCOUNT THE SIZABLE TAX INCREASES ALREADY APPROVED--INCREASES WHICH IN TOTAL HAVE BEEN CHARACTERIZED AS THE LARGEST TAX INCREASES IN OUR PEACE-TIME HISTORY--AND ALSO THE NEED TO ENCOURAGE BUSINESS TO INVEST IN PLANT AND EQUIPMENT TO INSURE THE ECONOMIC GROWTH THAT WE ALL DESIRE.

AS I INDICATED EARLIER, THE MOMENTUM OF THE ECONOMY FROM ACTIONS ALREADY TAKEN SHOULD CARRY US THROUGH MUCH OF 1978. THESE PUBLIC PROGRAMS MAY, CONSEQUENTLY, HAVE LITTLE DIRECT IMPACT ON ECONOMIC GROWTH MEASURES UNTIL LATE IN THE YEAR. HOWEVER, THEIR FORM WILL UNDOUBTEDLY HAVE AN

IMPACT ON THE TONE OF THE ECONOMY—HOPEFULLY IMPROVING IT SIGNIFICANTLY: WHO KNOWS? IT MIGHT EVEN BE ENOUGH TO TURN AN OVERLY PESSIMISTIC STOCK MARKET AROUND.

THE OTHER AREA OF PUBLIC POLICY WHICH I'VE LEFT TO THE LAST IS, OBVIOUSLY, MONETARY POLICY. IN TERMS OF IMPACT ON THE REAL ECONOMY, MONETARY POLICY CLEARLY OPERATES WITH VARIABLE TIME LAGS AND THE ACTIONS ALREADY TAKEN HAVE SET UP MOST OF WHAT MONETARY POLICY CAN CONTRIBUTE FOR THE FIRST SIX OR NINE MONTHS OF 1978. BUT FOR FINANCIAL MARKETS GENERALLY, FEDERAL RESERVE ACTIONS COULD HAVE A STRONG INFLUENCE IN 1978, PARTICULARLY ON MARKET PSYCHOLOGY.

AS YOU ALL KNOW, WE SOON WILL HAVE A NEW CHAIRMAN OF THE FEDERAL RESERVE. THIS HAS LED TO EXTENSIVE SPECULATION IN THE PRESS ABOUT THE IMPLICATIONS OF HIS APPOINTMENT FOR MONETARY POLICY AND THE COURSE OF THE ECONOMY. I DO NOT KNOW CHAIRMAN-DESIGNATE BILL MILLER PERSONALLY BUT MY FRIENDS IN BOSTON ARE UNRESERVED IN THEIR POSITIVE ASSESSMENT OF HIS ABILITIES. AND IT IS FAR TOO EARLY TO SPECULATE AS TO MR. MILLER'S VIEWS ON SPECIFIC MONETARY POLICY ISSUES. I DO KNOW THE OTHER MEMBERS OF THE FEDERAL RESERVE BOARD AND THE FEDERAL OPEN MARKET COMMITTEE VERY WELL. THAT LEADS ME TO BE CONFIDENT IN SAYING THAT I SEE NO REASON WHY THERE SHOULD BE ANY EARLY CHANGE IN THE COURSE OF MONETARY POLICY. THE OBJECTIVES OF MONETARY POLICY DO NOT CHANGE WITH THE COMPOSITION OF THE BOARD OR THE FOMC. THEY DID NOT CHANGE WHEN ARTHUR BURNS SUCCEEDED BILL MARTIN AS CHAIRMAN EIGHT YEARS AGO. THOSE OBJECTIVES WILL CONTINUE TO RELATE DIRECTLY TO THE PERFORMANCE OF THE ECONOMY. WE WILL CONTINUE, I AM SURE, TO STRIVE TO REDUCE UNEMPLOYMENT AND INFLATION AND TO STRIVE FOR CONTINUED AND STABLE ECONOMIC GROWTH TO THE MAXIMUM EXTENT THAT WE BELIEVE MONETARY POLICY CAN CONTRIBUTE TO

THOSE GOALS,

IN MY VIEW, FAR TOO MUCH IS MADE OF DIFFERENCES THAT MAY EXIST IN WHAT I MAY CALL MONETARY POLICY PROCEDURES--IN THE WAY WE GO ABOUT OUR EFFORTS TO KEEP THE ECONOMY ON A TRACK OF REAL GROWTH WITH REDUCED INFLATIONARY PRESSURES. YOU HAVE ALL HEARD ABOUT THE DEBATE AS TO WHETHER INTEREST RATES OR MONEY SUPPLY ARE MORE IMPORTANT AS THE INTERMEDIATE TARGETS FOR MONETARY POLICY. THAT IS REALLY A TECHNICAL DEBATE ABOUT WHICH ROUTE IS MORE EFFECTIVE IN REACHING THOSE ULTIMATE TARGETS FOR THE ECONOMY. IT IS AN OVERSIMPLIFIED DEBATE AND IS ONLY SECONDARY TO WHAT WE ARE REALLY STRIVING FOR.

I DON'T KNOW WHETHER OR NOT THERE WILL BE A CHANGE IN THE MONTHS AHEAD AS TO THE EMPHASIS GIVEN TO INTEREST RATES OR MONEY SUPPLY IN SETTING THE PATH FOR GOOD POLICY. I STRONGLY SUSPECT, HOWEVER, THAT THE ROUTE TAKEN WILL ONLY BE SUBTLY ALTERED IN THE MONTHS AHEAD AS WE CONTINUE TO PAY CAREFUL ATTENTION TO BOTH INTEREST RATES AND THE SUPPLY OF MONEY.

IN ATTEMPTING TO REACH OUR GOALS FOR THE ECONOMY, WE WILL BE CONTINUING TO WEIGH CAREFULLY ECONOMIC EVENTS AS THEY UNFOLD, CONSIDERING SHORT-TERM GAINS IN RELATION TO LONG-TERM COSTS. BY THIS I MEAN THAT STIMULATIVE MONETARY POLICY EFFORTS SEEKING A QUICK SOLUTION TO OUR UNEMPLOYMENT PROBLEMS MAY HAVE SIGNIFICANT LONGER TERM INFLATIONARY CONSEQUENCES THAT WOULD, IN TURN, MAKE OUR LONGER TERM UNEMPLOYMENT PICTURE EVEN LESS SATISFACTORY.

MANY WILL CONTINUE TO ARGUE, AS THEY HAVE IN 1977, FOR MORE MONETARY STIMULUS BECAUSE IT IS THOUGHT THAT IT WOULD HAVE ONLY A NEGLIGIBLE IMPACT ON PRICES. THAT MIGHT BE TRUE FOR 1978, BUT I AM SKEPTICAL. BUT EVEN IF IT WERE TRUE, WHAT ABOUT THE YEARS AHEAD? CONTINUED HIGH

RATES OF MONEY GROWTH INEVITABLY DO LEAD TO HIGHER RATES OF INFLATION, THE HISTORICAL RECORD ON THIS IS CLEAR. THROUGH BITTER EXPERIENCE, OUR NATION IS BECOMING INCREASINGLY AWARE OF THE SIGNIFICANT COSTS OF INFLATION TO CONSUMERS AND TO BUSINESS. HOPEFULLY OUR PEOPLE WILL ALSO BECOME INCREASINGLY AWARE THAT THE SO-CALLED TRADE-OFF BETWEEN EMPLOYMENT AND GENERAL PRICE INCREASES IS VERY WEAK AND THAT YOU BUY VERY LITTLE IN THE WAY OF EMPLOYMENT GAINS WITH SIZABLE GENERAL PRICE RISES.

BUT LET ME CONCLUDE BY TRYING TO BE SOMEWHAT MORE SPECIFIC ABOUT THE LIKELY COURSE OF MONETARY POLICY IN 1978. FROM MY STANDPOINT, I SEE POLICY AS ACCOMMODATIVE OF A CONTINUED MODERATE ADVANCE IN ECONOMIC ACTIVITY. AT THIS STAGE, THE ANNOUNCED MONETARY AGGREGATE PATHS OF 4 TO 6 1/2 PERCENT FOR M-1 AND 6 1/2 TO 9 PERCENT FOR M-2 FROM THE THIRD QUARTER OF 1977 TO THE THIRD QUARTER OF 1978 SEEM CONSISTENT TO ME WITH A 4 TO 5 PERCENT GAIN IN REAL GROWTH THIS YEAR. GIVEN THE CURRENT CONDITIONS IN THE ECONOMY, AND OUR PAST RECORD, STRIVING FOR HIGHER AGGREGATE GROWTH RATES THAN THESE COULD LEAD TO FURTHER INFLATIONARY PRESSURES.

HOLDING CLOSE TO THESE RANGES IN AN ECONOMY WHICH HAS THE STRENGTH I PERCEIVE, MAY NOT BE EASY. THE SUBSTANTIAL CREDIT GROWTH THAT HAS ALREADY OCCURRED SO FAR IN THIS EXPANSION, HAS NATURALLY AND APPROPRIATELY LED TO HIGHER SHORT-TERM INTEREST RATES. THOSE CREDIT DEMANDS ARE NOT LIKELY TO DISAPPEAR SOON. NOR DO WE WANT THEM TO IF WE HOPE TO CONTINUE OUR ECONOMIC ADVANCE. BUT CLEARLY THIS MEANS THAT ECONOMIC GROWTH WILL GENERATE FURTHER UPWARD PRESSURE ON INTEREST RATES IN THE YEAR AHEAD.

I HAVE NO DOUBT THAT THERE WILL CONTINUE TO BE CRITICISM OF OUR LETTING INTEREST RATES GO UP--OR INDEED "FORCING" THEM UP. TO THE EXTENT,

HOWEVER, THAT THESE PRESSURES ON RATES ARISE FROM A CONTINUED ADVANCE IN ECONOMIC ACTIVITY AND RISING DEMANDS FOR CREDIT, THEY SHOULD NOT BE RESISTED BY A MORE ACCOMMODATIVE MONETARY POSTURE. OUR EXPERIENCE IS VERY CLEAR. SUCH EXPANSIONARY ACTIONS TEND TO BE COUNTER-PRODUCTIVE, LEADING ULTIMATELY TO EVEN HIGHER SHORT AND LONG TERM RATES.

I AM ALSO WELL AWARE THAT RISING INTEREST RATES, EVEN THOUGH RESULTING FROM REAL ECONOMIC GROWTH RATHER THAN A GROWTH IN INFLATIONARY EXPECTATIONS, WILL BECOME INCREASINGLY VISIBLE IN A SOCIETY IN WHICH THE STICKINESS OF THE UNEMPLOYMENT RATE AT 7 PERCENT OR JUST BELOW HAS BECOME OF INCREASING NATIONAL CONCERN. I AM KEENLY AWARE OF THE COST OF UNEMPLOYED HUMAN RESOURCES AND SYMPATHETIC TO EFFORTS TO CORRECT THAT DIFFICULTY. A WASTE OF HUMAN RESOURCES IS CERTAINLY EVEN MORE REPRESENTABLE THAN A WASTE OF ENERGY. BUT MEASURES OTHER THAN DEMAND MANAGEMENT OR EXCESSIVE MONETARY EASE MUST BE MUCH MORE HEAVILY RELIED ON IF WE ARE TO MAKE ANY PROGRESS ON UNEMPLOYMENT.

THAT, HOWEVER, IS ANOTHER SPEECH. FOR NOW LET ME CLOSE BY SIMPLY INDICATING THAT IT IS MY EXPECTATION, AT LEAST, THAT YOU WILL FIND MONETARY POLICY DURING 1978 TO BE SUPPORTIVE OF A CONTINUED STRONG ECONOMIC ADVANCE WHILE MAKING EVERY EFFORT TO MODERATE INFLATIONARY PRESSURES. IF OTHER POLICYMAKERS CHART AND ACHIEVE SIMILAR GOALS, IT SHOULD BE A HAPPY NEW YEAR FOR US ALL.