

REMARKS OF MR. ROBERT P. MAYO
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TO THE SOUTH COOK COUNTY FEDERATION OF BANKERS
GLENWOOD, ILLINOIS
APRIL 25, 1978

I APPRECIATE THE OPPORTUNITY TO BE WITH YOU THIS EVENING. IT IS ALWAYS A PLEASURE TO MEET WITH FELLOW BANKERS. WE SHARE SO MANY INTERESTS AND CONCERNS THAT THERE IS NEVER ANY DIFFICULTY IN FINDING SOMETHING TO DISCUSS. BUT WITH LIMITED TIME THERE IS A PROBLEM OF DECIDING WHICH TOPICS TO COVER. AND, IN MAKING THE SELECTION, THERE IS ALWAYS A RISK THAT SOME WILL BE DISAPPOINTED WITH THE CHOICE.

BUT I DON'T FEEL THAT SELECTION OF A TOPIC CARRIES MUCH RISK OF DISAPPOINTMENT TONIGHT. THE EMERGENCE IN RECENT WEEKS OF SHARPLY CONFLICTING VIEWS ON CURRENT AND PROSPECTIVE ECONOMIC DEVELOPMENTS AND CONCERN WITH POSSIBLE INTEREST RATE INCREASES IN THE PERIOD AHEAD SUGGEST THAT A DISCUSSION OF ECONOMIC PROSPECTS AND MONETARY POLICY WOULD BE QUITE APPROPRIATE, ESPECIALLY FOR A GROUP OF BANKERS.

OVER THE LAST FEW WEEKS I HAVE NOTED AN INCREASED DEGREE OF UNCERTAINTY ABOUT OUR ECONOMIC PROSPECTS. A NUMBER OF FACTORS PROBABLY ACCOUNT FOR THIS. IN PART, CONCERN IS UNDERSTANDABLE ON THE GROUNDS THAT THIS IS A VERY OLD ECONOMIC UPTURN. SINCE THE MID-1800s, THERE HAVE BEEN ONLY TWO PEACE-TIME PERIODS WITH EXPANSIONS OF 37 MONTHS OR MORE. THIS ONE IS IN ITS 37TH MONTH. THERE IS ALSO A HEIGHTENED CONCERN THAT THE SEVERE WINTER WEATHER AND THE EXTENDED COAL STRIKE MAY HAVE UNDERMINED THE UNDERLYING STRENGTH OF THE ECONOMY. THE DEVELOPMENTS IN THE INTERNATIONAL TRADE PICTURE HAVE NOT BUOYED OUR SPIRITS. AND THE PROSPECT OF INCREASED INFLATIONARY PRESSURES HAVE INTENSIFIED THE UNCERTAINTY ABOUT THE SUSTAINABILITY OF THE ADVANCE.

LAST WEEK THE FIRST QUARTER FIGURES ON GNP--THE TOTAL OUTPUT OF GOODS AND SERVICES--WERE RELEASED. AFTER ADJUSTMENT FOR PRICES, OUTPUT DECLINED IN THE FIRST THREE MONTHS OF THIS YEAR--THE FIRST TIME IN THREE YEARS THAT WE HAVE EXPERIENCED A DECLINE IN REAL OUTPUT. THIS PERFORMANCE SUBSTANTIATED THE FEARS OF SOME THAT THE EXPANSION WAS OVER. FOR OTHERS IT MEANT INCREASED CAUTIOUSNESS ABOUT THE ECONOMY'S FUTURE PERFORMANCE. I WAS PARTICULARLY STRUCK BY COMMENTS MADE ON RADIO AND TELEVISION TO THE EFFECT THAT THE FIGURES SHOWED THAT THE ECONOMY WAS IN TROUBLE.

DON'T BELIEVE IT! LIKE MARK TWAIN'S COMMENT, THE REPORTS OF THE DEMISE OF THE ECONOMY'S EXPANSION ARE EXAGGERATED. CERTAINLY, THE BAD WEATHER AND THE COAL STRIKE HAD A BIG INFLUENCE ON THE JANUARY AND FEBRUARY DATA. BUT NO PERMANENT DAMAGE WAS DONE AND BY MARCH, THE MOMENTUM OF THE ECONOMIC UPTURN WAS FIRMLY REESTABLISHED.

CONSUMER SPENDING HAS REVIVED. CONSUMER CREDIT IS BEING USED MORE FREELY. HOUSEHOLD APPLIANCE SHIPMENTS SURGED IN MARCH. MOTOR VEHICLE SALES LOOK STRONGER AGAIN. IMPROVED AUTO SALES IN MARCH ENCOURAGED PRODUCERS TO INCREASE OUTPUT SCHEDULES OF THEIR MORE POPULAR MODELS. THE WINTER'S GLOOM APPEARS TO BE OVER. PEOPLE ARE IN A SPENDING MOOD. LOOK AT TOURISM AND AIRLINE TRAFFIC.

EMPLOYMENT HAS CONTINUED TO EXPAND AT A RAPID PACE. TOTAL NONAGRICULTURAL WAGE AND SALARY EMPLOYMENT IS ALMOST 4 PERCENT ABOVE A YEAR AGO. THE SEASONALLY ADJUSTED UNEMPLOYMENT RATE IS DOWN TO 6.2 PERCENT AND A LARGER PROPORTION OF OUR POPULATION THAN EVER BEFORE IS NOW AT WORK.

DEMAND FOR PRODUCER EQUIPMENT HAS STRENGTHENED. SOME OF OUR FRIENDS REPORT ORDERS 50 TO 75 PERCENT ABOVE A YEAR AGO. THESE ARE BY FAR THE MOST BULLISH REPORTS FROM THESE COMPANIES SINCE 1973-74. IT NOW SEEMS LIKELY FROM REPORTS IN THE CAPITAL GOODS, CONSTRUCTION, EQUIPMENT COMPONENTS AND MATERIALS INDUSTRIES THAT THERE WILL BE A LARGER RISE IN PLANT AND EQUIPMENT

THAN THE 11 PERCENT GAIN ESTIMATED IN THE LATEST DEPARTMENT OF COMMERCE SURVEY. ORDERS FOR TRUCKS, CONSTRUCTION EQUIPMENT, MACHINE TOOLS, MATERIALS HANDLING EQUIPMENT, DIESEL ENGINES AND CASTINGS ARE ALL STRONG.

ALMOST EVERY WEEK BRINGS ADDITIONAL NEWS OF GREATER PROSPECTIVE ACTIVITY IN THE COMMERCIAL AND INDUSTRIAL CONSTRUCTION SECTORS. AND HOUSING DEMAND HAS REMAINED STRONG IN SPITE OF CONCERNS ABOUT THE REDUCED AVAILABILITY OF CREDIT.

A NUMBER OF OTHER ELEMENTS OF STRENGTH COULD BE NOTED FROM THE GAINS IN PERSONAL INCOME TO THE INCREASES IN INDUSTRIAL PRODUCTION. BUT IT SEEMS TO ME THAT IT IS NOT NECESSARY TO RECITE FURTHER EVIDENCE. THE ECONOMY IS CURRENTLY VERY STRONG.

THE ISSUE, OF COURSE, IS WHETHER OR NOT THE EXPANSION IS SUSTAINABLE. IT IS ON THIS POINT THAT WE ARE BEGINNING TO SEE AN INCREASED DIVERGENCE OF VIEWS. MOST FORECASTERS ACCEPT THE PROPOSITION THAT THIS QUARTER WILL SEE A SIGNIFICANT REBOUND IN ACTIVITY. THE DIFFERENCES IN OUTLOOK OCCUR FOR LATER THIS YEAR AND ON INTO 1979.

I AM IN AGREEMENT WITH THE LARGER GROUP OF FORECASTERS THAT EXPECT NO DOWNTURN IN GENERAL ECONOMIC ACTIVITY DURING 1978. THERE ARE NO SIGNIFICANT FACTORS ON THE HORIZON THAT WOULD LEAD ME TO THE VIEW THAT THE ECONOMIC ADVANCE HAS PEAKED. THERE ARE NO EXCESSES IN THE ECONOMY, LEAVING ASIDE FOR THE MOMENT, THE FEDERAL GOVERNMENT'S DEFICIT. THE RATE OF GAIN OVERALL WILL BE MODERATED FROM LAST YEAR'S PACE BUT WILL STILL BE IN A SATISFACTORY RANGE, HISTORICALLY SPEAKING.

IN GENERAL WE CAN EXPECT SOMEWHAT LESS RESIDENTIAL BUILDING ACTIVITY LATER ON THIS YEAR AS A RESULT OF LESS ACCOMMODATIVE MORTGAGE MARKET CONDITIONS. THERE IS STILL SOME QUESTION AS TO THE EXTENT TO WHICH THESE SMALLER GAINS WILL BE OFFSET BY CONSUMER AND BUSINESS SPENDING, AS THEY WERE IN 1977.

FOR SEVERAL YEARS NOW, THERE HAS BEEN A VIEW THAT CONSUMER SPENDING COULD NOT CONTINUE TO BE A MAJOR STIMULATIVE FORCE. BUT IN SPITE OF RISING CONSUMER DEBT RELATIVE TO INCOME AND SOME NEGATIVE CONSUMER CONFIDENCE SURVEYS, CONSUMER SPENDING HAS CONTINUED TO BE A MAJOR POSITIVE ELEMENT IN THE ECONOMIC PICTURE. SOME MODERATION IN THE PACE OF CONSUMER SPENDING IS CERTAINLY POSSIBLE BUT I DON'T SEE IT AS A MAJOR CONCERN IN THE ECONOMIC OUTLOOK EVEN IF THE CONGRESS SHOULD FAIL TO AGREE ON A TAX CUT IN THE LATTER PART OF THE YEAR.

THE BUSINESS SECTOR IS LIKELY TO CONTINUE TO BE A SOURCE OF STRENGTH. ADEQUATE CORPORATE LIQUIDITY AND FURTHER GROWTH IN CORPORATE PROFITS ARE EXPECTED TO MAINTAIN GAINS IN REAL FIXED INVESTMENT.

THE INTERNATIONAL SITUATION CONTINUES TO BE A SOURCE OF CONCERN. ADMITTEDLY, THE PROSPECTS FOR A SIGNIFICANT REDUCTION IN THE TRADE DEFICIT THIS YEAR ARE NOT GOOD. BUT AN END TO THE DETERIORATION IN THE U.S. NET EXPORT BALANCE COULD STIMULATE OVERALL GAINS IN ECONOMIC ACTIVITY THIS YEAR. THE END OF THE RECENT DECLINE OF THE DOLLAR IN FOREIGN EXCHANGE MARKETS MAY ALSO BE NEAR AT HAND.

THE MAJOR NEGATIVE ITEM IN THE OUTLOOK IS THE PROSPECT FOR INCREASED PRICE PRESSURES. INFLATION HAS GAINED NEW IMPETUS FROM THE BAD WINTER, THE COAL STRIKE, SLOW PRODUCTIVITY GROWTH, RESTRICTIONS ON IMPORTS, AND THE PROSPECT OF A TAX CUT IN THE FACE OF A HUGE PROSPECTIVE DEFICIT.

THERE ARE SEVERAL REASONS TO EXPECT THAT INFLATIONARY PRESSURES ARE BUILDING STEADILY AND THAT THERE ARE UPSIDE RISKS TO THE INFLATION RATE. FOOD PRICES WERE UP SHARPLY IN THE FIRST THREE MONTHS OF 1978. SMALLER THAN EXPECTED CATTLE AND HOG HERDS, COMBINED WITH A HARSH WINTER, PORTEND EVEN HIGHER MEAT PRICES. THE ADMINISTRATION HAS RAISED ITS FOOD PRICE ESTIMATE TO 6 TO 8 PERCENT. MEANWHILE, NONFOOD CRUDE MATERIALS HAVE BEEN RISING AT

A 20 PERCENT ANNUAL RATE OVER THE PAST FOUR MONTHS. THESE COSTS MUST BE ABSORBED OR PASSED THROUGH.

THE EXPECTATION CITED BY THE ADMINISTRATION OF AN UNDERLYING RATE OF INFLATION OF 6 TO 6 1/2 PERCENT IN 1978 IS BASED ON THE EXPECTATION THAT EMPLOYEE COMPENSATION WILL RISE 8 1/2 PERCENT AND OUTPUT PER WORKER WILL INCREASE 2 PERCENT. BUT LABOR CONTRACTS NEGOTIATED IN 1977 CALLED FOR A 9.6 PERCENT INCREASE IN WAGES AND BENEFITS FOR THE FIRST YEAR. WITH THE ADDED PRESSURE OF THE MINIMUM WAGE INCREASE AND THE INCREASED SOCIAL SECURITY TAX, IT IS VERY OPTIMISTIC TO THINK THAT COMPENSATION GAINS CAN BE HELD TO 8 1/2 PERCENT. AND PRODUCTIVITY GROWTH OF 2 PERCENT WOULD BE ABOVE THE TREND OF THE LAST TEN YEARS AND WILL DEPEND ALMOST ENTIRELY ON CONTINUED GROWTH IN CAPITAL PER WORKER AND A STRONG, GROWING ECONOMY.

A WORRISOME STATISTIC THAT GETS A LOT OF ATTENTION IS THE FEDERAL BUDGET DEFICIT. FROM 1975, THE YEAR THE RECOVERY STARTED, THROUGH 1977, THE CUMULATIVE DEFICIT WAS \$173 BILLION. BY THE END OF 1978 IT WILL BE \$233 BILLION. BY COMPARISON, THE CUMULATIVE ACTUAL DEFICIT BETWEEN 1971 AND 1974 WAS ONLY \$46 BILLION. THE CONCLUSION SEEMS TO BE THAT FISCAL POLICY HAS BEEN UNNECESSARILY STIMULATIVE. AND IT CONTINUES TO BE SO, EVEN THOUGH WE ARE WELL INTO THE MATURE PHASE OF THE CURRENT BUSINESS CYCLE WHERE A BALANCED BUDGET OR EVEN A SURPLUS SHOULD BE SHOWING UP.

FINALLY, THE COAL STRIKE, JUST RECENTLY SETTLED, WILL CONTRIBUTE TO INFLATIONARY PRESSURES. WE HAVE ALREADY SEEN A BOOST IN STEEL PRICES BY SEVERAL LARGE PRODUCERS. AND AS THE PRICE OF COAL RISES IN RESPONSE TO HIGHER WAGE COSTS, ELECTRICITY PRICES WILL BE FORCED HIGHER IN MUCH OF THE NATION. FURTHER, THE GENEROUS LABOR SETTLEMENT IN THE COAL INDUSTRY STIMULATES EMULATION BY OTHER UNIONS.

THE CARDS THUS APPEARED TO BE STACKED AGAINST ANY MODERATION IN THE 6 TO 6 1/2 PERCENT RATE OF INFLATION. IN FACT, THE PERVASIVENESS OF UPSIDE RISKS, WITH PRACTICALLY NO FACTORS MILITATING AGAINST ACCELERATING INFLATION,

LEADS TO THE CONCLUSION THAT WE MAY WELL SEE HIGHER RATES OF INFLATION.

THE ADMINISTRATION NOW APPEARS TO BE COMING TO THE SAME VIEW. BUT MANY WOULD ARGUE IT IS DOING SO ONLY BELATEDLY AND RELUCTANTLY AND WITH A RESPONSE WHICH IS LESS THAN IDEAL. WHILE EVERYONE MAY HOPE THAT "JAWBONING" AND EXAMPLE SETTING WILL HAVE A DESIRABLE IMPACT ON WAGE AND PRICE SETTING IN THE PRIVATE SECTOR, LITTLE CONFIDENCE IN SUCH A COURSE HAS EMERGED SO FAR. MANY, INDEED, HAVE ARGUED THAT THE ADMINISTRATION HAS LITTLE CREDIBILITY BECAUSE OF ITS ROLE IN REACHING A 37 PERCENT THREE-YEAR CONTRACT FOR COAL MINERS.

HAVING PROPERLY TURNED AWAY FROM WAGE AND PRICE CONTROLS, THE MAJOR CONSTRUCTIVE TOOL FOR FIGHTING INFLATION IN THE NEAR TERM THAT IS AVAILABLE TO THE ADMINISTRATION IS TIGHT CONTROL OVER GOVERNMENT SPENDING, SOMETHING EXTREMELY DIFFICULT TO OBTAIN. WITHOUT TIGHT CONTROL A DISPROPORTIONATE SHARE OF THE BURDEN FOR UNWINDING INFLATION INEVITABLY MUST FALL ON THE FED.

THE STRATEGY OF ADMINISTRATION ECONOMIC POLICY APPEARS TO BE BASED ON SEVERAL ASSUMPTIONS. FIRST, THE UNDERLYING INFLATION RATE OF 6 TO 6 1/2 PERCENT IS THE RESULT OF PRIOR EXCESSES--A TEN YEAR PHENOMENON--WHICH WILL UNWIND ONLY VERY SLOWLY. SECOND, THE ECONOMY IS STILL NOT OPERATING AT FULL CAPACITY AND, THEREFORE, FURTHER INCREASES IN AGGREGATE DEMAND ARE NOT LIKELY TO PRODUCE AN ACCELERATION OF INFLATION IN THE NEAR TERM. AND, THIRD, VOLUNTARY COOPERATIVE EFFORTS CAN SERVE TO REDUCE THE RATE AT WHICH INDEPENDENT PRICE INCREASES SUCH AS THOSE FOR FOOD ARE PUSHED THROUGH THE ECONOMY.

THE BUDGET PROPOSALS WHICH WERE DESCRIBED BY THE ADMINISTRATION AS "RESTRAINED" APPARENTLY ARE CONSISTENT WITH THESE ASSUMPTIONS. BUT THE PACKAGE LEAVES THE ADMINISTRATION WITH VERY LITTLE ROOM TO MANEUVER. IF THE VOLUNTARY APPROACH DOESN'T WORK AND IT TURNS OUT THAT WE ARE CLOSER TO CAPACITY THAN THE ADMINISTRATION CONTEMPLATED, THE CHANCES OF ACCELERATED INFLATION INCREASE SIGNIFICANTLY.

IT SEEMS TO ME THAT ONE SHOULD TAKE A VERY CAUTIOUS STANCE AT THIS JUNCTURE ABOUT OUR ABILITY TO USE STIMULATIVE GOVERNMENT POLICIES TO ENHANCE PRODUCTION AND EMPLOYMENT. SOME SHORTAGES ARE ALREADY BEGINNING TO SHOW UP. PRODUCTIVE CAPACITY MAY NOT BE AS GREAT AS EARLIER BECAUSE OF ENERGY COSTS AND ENVIRONMENTAL CONTROLS. EFFECTIVE FULL EMPLOYMENT OF OUR LABOR RESOURCES IS LIKELY TO BE IN THE 5-6 PERCENT UNEMPLOYMENT RATE RANGE--NOT THE HISTORIC 2 1/2 PERCENT OR THE MORE RECENT 4 PERCENT. AND INFLATIONARY EXPECTATIONS EMERGE MORE QUICKLY TODAY. WE HAVE FASTER PUBLIC RESPONSE TODAY, THANKS TO MASS MEDIA, THAN EVER BEFORE.

THUS, IT SEEMS TO ME THAT THE PRESSURE TO RESTRAIN SPENDING IS BECOMING INCREASINGLY IMPORTANT. IT IS TIME TO BEGIN ACTING AGAINST EXCESSIVE DEMAND PRESSURES. AND A FAILURE TO DO SO WILL PUT EVEN A LARGER BURDEN ON THE FED TO RESTRAIN INFLATIONARY PRESSURES.

WHAT IS THE ROLE OF THE FED? THE CENTRAL BANK IS CERTAINLY WELL EQUIPPED TO PLAY AN IMPORTANT ROLE IN THIS DRAMA CALLED "THE FIGHT AGAINST INFLATION." BUT IT CANNOT AND NEVER SHOULD BE THE ONLY ACTOR ON THE STAGE.

THE ARGUMENT IS FREQUENTLY MADE BY OUR MONETARISTS FRIENDS THAT THE FIGHT AGAINST INFLATION IS EXCLUSIVELY THE FED'S JOB SINCE INFLATION IS PURELY A MONETARY PHENOMENON. IF WE DIDN'T "MONETIZE" THE DEFICIT BY EXPANDING THE MONEY SUPPLY, INFLATION WOULD NOT OCCUR.

I AGREE THAT IN THE LONG RUN INFLATION IS A MONETARY PHENOMENON. BUT IT DOES NOT FOLLOW LOGICALLY THAT, THEREFORE, THE FED HAS THE SOLE RESPONSIBILITY FOR PRICE STABILITY.

I THINK THAT THE REASON FOR MY POSITION CAN BE EASILY EXPLAINED. RESTRICTION OF MONETARY GROWTH IN THE FACE OF GOVERNMENT DEFICITS MEANS THAT A SMALLER AMOUNT OF MONEY IS AVAILABLE TO BE ALLOCATED AMONG ALL OF THOSE DESIRING THE FUNDS. A LARGE DEFICIT IN A STRONG ECONOMY MEANS THAT THERE ARE MANY DEMANDERS OF FUNDS--OF RESOURCES--THE GOVERNMENT AS WELL AS THE PRIVATE

SECTOR. WHO GETS "RATIONED OUT?" NOT THE GOVERNMENT. NO SIR! IT CAN ALWAYS PAY WHATEVER IS REQUIRED. IT IS THE PRIVATE SECTOR. AND EVEN WITHIN THE PRIVATE SECTOR, COST AND AVAILABILITY INFLUENCE DIFFERENT SECTORS IN DIFFERENT WAYS; FOR EXAMPLE, CONSTRAINED MONETARY GROWTH CAN HAVE SEVERE IMPACTS ON RESOURCE ALLOCATION WITH RESPECT TO HOUSING AS COMPARED TO BUYING FOOD.

IN A NUTSHELL THEN, GIVING THE INFLATION FIGHTING JOB SOLELY TO THE FED, IN AN ENVIRONMENT OF STRONG FINANCIAL DEMANDS MEANS THAT THE FED IS GIVEN THE JOB OF ALLOCATING RESOURCES IN OUR ECONOMY. MONETARY POLICY IS FORCED TO MAKE THE CHOICE AS TO SPENDING BETWEEN THE PUBLIC AND PRIVATE SECTORS AND EVEN WITHIN THE PRIVATE SECTOR.

IT IS NOT AT ALL CLEAR THAT THIS IS UNDERSTOOD BY MEMBERS OF CONGRESS, LET ALONE THE GENERAL PUBLIC. CERTAINLY, SOME DO UNDERSTAND BUT THE ARGUMENT IS MADE THAT ONCE THE SOCIETY SEES THE IMPLICATION FOR RESOURCE ALLOCATION, CONGRESS WILL BACK OFF AND REDUCE THE LEVEL OF GOVERNMENT SPENDING. I CAN'T ACCEPT THIS VIEW OF "CRISES" SOLUTIONS THAT SAYS IF THINGS GET BAD ENOUGH, WE'LL CHANGE OUR BEHAVIOR. EXPERIENCE SUGGESTS VERY STRONGLY THAT CREDIT CRUNCHES ARE NOT BLAMED ON OUR GOVERNMENTAL SPENDING AND TAXING DECISIONS. THEY ARE ALWAYS BLAMED ON THE CENTRAL BANK.

IT ISN'T AT ALL STRANGE, THEREFORE, TO HEAR THOSE OF US INVOLVED IN MONETARY POLICY EXPRESSING CONCERN WITH THE FEDERAL BUDGET DEFICIT. IT ISN'T A "COP OUT." THE RESPONSIBILITY FOR ECONOMIC CHOICES SHOULD NOT BE IN THE HANDS OF THE MONETARY AUTHORITIES. IT IS PROPERLY IN THE HANDS OF THE PRIVATE ECONOMY AND--ALAS-- THE GOVERNMENT SPENDERS AND TAXERS. MONETARY POLICY CANNOT APPROPRIATELY FULLY OFFSET THOSE EXCESSES WITHOUT TAKING ON THE RESPONSIBILITY FOR OFFSETTING, IN PART, THE PRIORITY DECISIONS MADE BY OUR OWN ELECTED REPRESENTATIVES.

THIS DOES NOT MEAN THAT THERE NEVER IS AN UNWARRANTED INCREASE IN THE MONEY SUPPLY. THE CENTRAL BANK CAN AND HAS MADE MISTAKES IN SETTING THE PROPER RATES OF MONEY AND CREDIT GROWTH. IN RETROSPECT, IT NOW APPEARS THAT LAST YEAR'S RATES OF MONEY GROWTH WERE, IN MY VIEW, A LITTLE ON THE HIGH SIDE. BUT THAT'S A SEPARATE SUBJECT. THE POINT I WANT TO COVER NOW, IS THE ROLE OF MONETARY POLICY IN THE CURRENT ENVIRONMENT.

THE EXISTENCE OF A LARGE BUDGET DEFICIT IN THE FACE OF STRONG PRIVATE CREDIT DEMANDS PLACES A DIFFICULT BURDEN ON THE FED. THE LONGER THE FED IS IN THE FIGHT AGAINST INFLATION, THE MORE DIFFICULT THAT BATTLE BECOMES. ACCEPTING THE ALLOCATIVE DECISIONS IMPLICIT IN CONGRESSIONAL AND ADMINISTRATION ACTIONS AND PROVIDING FOR ALL PUBLIC AND PRIVATE MONEY AND CREDIT GROWTH AT STABLE INTEREST RATES WILL OBVIOUSLY GENERATE A PATTERN OF RAPIDLY ACCELERATING INFLATION. ON THE OTHER HAND, TO SHARPLY REDUCE MONEY GROWTH TO STOP INFLATION DEAD IN ITS TRACK COULD SHAKE UP THE ECONOMY TO ITS VERY ROOTS.

THE CHOICE OBVIOUSLY LIES SOMEWHERE IN BETWEEN. WE MUST MAKE AN EFFORT TO MODERATE THE SUPPLY OF MONEY AND CREDIT TO CONSTRAIN INFLATIONARY PRESSURES, BUT STILL BE MINDFUL OF THE REAL ECONOMIC IMPACTS OF OUR ACTIONS.

YOU ALL KNOW VERY WELL THAT EFFORT TO RESTRAIN MONETARY AND CREDIT GROWTH IN A STRONG ECONOMY MEANS THAT INTEREST RATES WILL RISE. YOU CAN'T HAVE BOTH STABLE INTEREST RATES AND MODERATE MONETARY GROWTH IN AN ADVANCING ECONOMY WITH LARGE CREDIT DEMANDS FROM BOTH THE PRIVATE AND PUBLIC SECTORS.

IF WE CAN RESTRAIN OUR GOVERNMENT SPENDING, EVEN MODESTLY, I AM OPTIMISTIC ABOUT OUR ABILITY TO MODERATE OUR RATES OF MONETARY AND CREDIT GROWTH SO AS NOT TO ADD TO INFLATIONARY PRESSURES. I KNOW OF NO WAY, HOWEVER, THAT WE CAN OR SHOULD ATTEMPT TO "LICK" INFLATION WITHIN A VERY SHORT PERIOD OF TIME. A MODERATE COURSE FOR MONETARY POLICY WOULD BE CONSISTENT WITH MODERATE CONTINUED EXPANSION. BUT THAT DEPENDS VERY IMPORTANTLY ON THE

FISCAL POLICY STANCE TAKEN IN THE MONTHS AND QUARTERS AHEAD. MONETARY POLICY CAN SUPPORT GOOD ECONOMIC POLICIES. IT CAN DO SO ENTHUSIASTICALLY AND SUCCESSFULLY. IT CANNOT CREATE THE IDEAL WORLD. IF WE ARE JUDICIOUS, THEREFORE, IN SETTING SOUND ECONOMIC POLICY OUTSIDE THE MONETARY POLICY SPHERE, WE SHOULD BE ABLE TO LET MONETARY POLICY PLAY ITS APPROPRIATE ROLE.