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The Economic Perspective for 1979

I appreciate the opportunity to talk with you this evening about the economic perspective for 1979. I realize that all of you have already heard or read a large number of forecasts from private economists, Administration and Congressional spokesmen and Federal Reserve officials --including Chairman Miller. You are aware that virtually all forecasters are talking about a slackening in the rate of economic growth in 1979. The differences that exist within this broad consensus relate to whether or not this expected slackening in the pace of activity will mean a recession. In turn, these differences are rather neatly compartmentalized. Private economists argue that there will be a mild recession. Governmental economists say that the slowing will not go that far. Government economists, of course, never officially forecast--or assume--a recession. It somehow is unpatriotic or reflective of Government policy failure.

Knowing this, you might well wonder about the need to listen to another discussion on the economic outlook. In fact, once I indicate where I stand within that forecast spectrum, you could probably fill in the arguments that I would use.

But my interest in economic developments in 1979--my economic perspective for 1979--goes beyond that of the forecast of the economy's performance for this calendar year. My interest extends to the possibility that this year will also usher in a new attitude about economic policy--a new posture based on longer term solutions to our economic problems rather than "quick fixes" that can't and don't work. I am excited about this possibility.

It seems to me that 1979 may well be a watershed year. Certainly there will be a dividing line in our economic performance. We will soon be entering our fifth year of economic growth since the recession trough in 1974. It will be difficult to sustain a continued pace of expansion. Slower growth in housing, personal consumption expenditures and business capital spending--and even Government spending all appear to be likely and would be expected to lead to a substantial moderation of the pace of economic expansion as the year progresses.

But, significantly, we also appear to be at the watershed for economic policymaking. The traditional national response to a widely held view of the prospect of a slackening in economic expansion or recession (commonly thought of as two quarters of negative real growth) would be to reverse the economic policy gears, backing off from immediate deep concern about inflation and starting to pump up the economy again.

But the reaction of economic policy to our reaching the watershed in economic performance could be significantly different this time. Economic policy may not be directed to reversing the gears but only to accepting a somewhat slower speed for the engine. Put more directly, it seems to me that there is substantial political receptivity to the view that slower growth in 1979, perhaps even slightly negative rates of growth for a time, would be acceptable as part of a long-run effort to reduce our stubborn inflation.

This is a significant development. If it continues and flourishes, it would be an important watershed for economic policy as we move away from short-run demand stimulation in the interest of longer term economic stability.

Opposition to "knee-jerk" policies--switching to stimulative policies whenever slower economic growth seemed likely--has, of course, existed for a long time. It has taken the pressure of persistent inflation, gathering momentum for well over 10 years now, to bring this nation to the point of making a significant and necessary change in its thinking about economic policy. But that change is occurring. Nowhere is it more evident than in the Economic Report of the President issued just a few days ago.

The Economic Report stresses that inflation must be brought under control if the strength of the economy is to be maintained. It emphasizes that unwinding an inflation that has been building for more than a decade will require monetary and fiscal restraint to moderate the pace of economic growth. Further, the Report forthrightly states "the inflationary problem can be dealt with most successfully by persisting with the discipline of anti-inflation policies for an extended period even if economic growth for a time should fall below the path that is now forecast."

One must applaud the intent shown by the Report. One must applaud the emphasis given to fiscal and monetary policy restraint. And one must applaud the "political guts" that is shown.

Perhaps more than any of you, I fully appreciate that there can be a wide canyon between rhetoric and action. But public identification of a position as clearly and firmly enunciated as this is, is worth something. I hope, a great deal. I am excited about it.

The President obviously feels sincerely that a political consensus exists in our country that inflation is the nation's most serious problem. As long as this is true then, even with slower economic growth, Congress may be able to see its way clear to provide the critically necessary support.

The biggest danger is, of course, that our political determination will weaken. Certainly, I see little reason to expect Congressional support (or for that matter Administration support) if the economic views of some that we need a much sharper contraction to wring inflation out of the system were to prevail. A deep, sharp recession would bring swift Congressional reaction with greater Government stimulation and even greater inflation. The best chance in perhaps two decades of ushering in a new attitude about economic policy would be lost.

The chances of obtaining appropriate Congressional support of the fight against inflation are, of course, heightened if the economy does perform within the range of most of the forecasts. My own view is that we are likely to see positive, but nonetheless slow, growth this year. We ended 1978 on a vigorous note. Employment, output, new orders, income and retail sales were all rising solidly. Some have expressed concern that the more than six percent rate of real economic growth in the fourth quarter may be signaling the start of a boom-and-bust bubble. I doubt that this is the case. I expect to see the figures coming through in a less vigorous fashion as the year progresses.

Housing has started to feel the impact of restrictive monetary policy. But it is the only sector so far showing signs of weakness--and even these with no signs of a decline anywhere near as steep as in 1974. Consumer spending, a major source of strength throughout this expansion, is likely to taper off a little bit. The rising burden of consumer debt has been frequently cited as a likely reason for moderation in consumer outlays. While certainly a factor, I don't see this as leading to any sharp cut-back in personal spending.

Business inventories have been moderate, even low, in relation to sales. As a result of cautious inventory policies, the reduction of inventories accompanying lower overall growth is not likely to be as serious as it was five years ago.

Indicators of the probable pace of capital investment are mixed. Currently, order backlogs for nonresidential construction and equipment indicate a further rise in capital spending. But business investment intentions surveys indicate a slower growth in spending. Higher interest rates and expectations of slowdown in economic activity are likely to result in some holding back of investment plans.

Purchases of goods and services by both Federal, State and local governments will be rising this year but the rise should be very modest in real terms. Further, they are not likely to offset reductions in housing and business fixed investment.

Our economy remains remarkably well balanced. There are really no significant excesses after almost five years of expansion. That's a remarkable record. It also strikes a very positive note since economic balance reduces the chances for sharp declines in activity. But neither does the economy have much room for rapid expansion. We are operating at or close to capacity in such vital sectors as transportation facilities, steel, cement, oil refining, and various types of equipment manufacturing. We have a larger percentage of our working age population employed today than at any previous time in our history. Additional economic stimulus would only exacerbate inflation.

Even with slower growth in the economy this year, I must confess I do not expect to see any sweeping strides in winding down inflation. The likely success of the President's wage and price standards program is still a question mark. Labor contract bargaining is sure to be vigorous. With continued rapid escalation of food prices, the newly effective increases in minimum wage and social security taxes, the unfortunate rise in OPEC oil prices, and the continued pass-through of higher prices for imports, the chances of significant moderation in price rises is small.

Undoubtedly, only modest improvement in reducing the rate of inflation along with slower economic growth can weaken the resolve of Congress. It will be difficult for the less courageous to continue to accept slower growth and attendant unemployment increases--even though they likely would be small--in the absence of dramatic price effects. Nevertheless, such a source is necessary.

There is, of course, a possibility that the inflation rate reductions will come somewhat more rapidly as consumers and business firms begin to lose some of their cynicism and accept the view that inflation will, indeed, be constrained. The high rate of inflation has generated responses by individuals and institutions that perpetuate a rising price spiral even in periods of economic slack. If expectations change about the future course of prices--even slightly--behavior will also be modified. The sooner we have confidence that a lower inflation rate is in prospect, the shorter the period for getting closer to reasonable price stability.

The watershed in economic policy in 1979 may not be dramatic but it can be extremely important. If those involved in economic policy revert to traditional stimulus in a drive to maintain a higher rate of growth, even as modest as 4 percent, accelerating inflation will be the result. And I would be very concerned about the prospects for our economy in 1980 and 1981. But if we can hold our ground--starting <u>now</u>--if we can maintain reasonable fiscal and monetary restraint, we should be able to make substantial progress toward a more stable, less inflationary economy for the years ahead.