

REMARKS OF MR. ROBERT P. MAYO  
PRESIDENT, FEDERAL RESERVE BANK OF CHICAGO  
TO THE CALUMET AREA INDUSTRIAL COMMISSION  
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INFLATIONARY PROBLEMS AND  
ECONOMIC PROJECTIONS FOR 1980

IT IS A PLEASURE FOR ME TO BE HERE TODAY IN WHAT I CONSIDER TO BE THE INDUSTRIAL HEARTLAND OF CHICAGO AND THE MIDWEST. THIS GROUP REPRESENTS SOME OF THE MOST IMPORTANT INDUSTRIES AND FIRMS IN THE COUNTRY. I HAVE AND WILL LEARN MUCH FROM YOU ABOUT OUR ECONOMY--MORE THAN I'LL EVER BE ABLE TO LEARN FROM THE STATISTICS. WE COLLECT A LOT OF NUMBERS IN THIS COUNTRY BUT THEY NEVER TELL THE WHOLE STORY AND FREQUENTLY DON'T TELL THE RIGHT STORY. IT IS THROUGH MEETINGS SUCH AS THIS THAT I GET MY MOST VALUABLE INFORMATION. SO BE FOREWARNED, I'M NOT GOING TO SPEND ALL OF MY TIME MAKING FORMAL REMARKS. I HOPE THAT WE WILL HAVE AMPLE TIME FOR YOU TO COMMENT ON BUSINESS CONDITIONS AS YOU SEE THEM AS WELL AS MY RESPONDING TO YOUR QUESTIONS.

MOST PEOPLE WOULD AGREE THAT THE STATISTICS ON ECONOMIC CONDITIONS TODAY ARE VERY PUZZLING IF NOT DOWNRIGHT CONFUSING. SOME OF THE NUMBERS SUGGEST THAT THE ECONOMY IS WEAKENING, PERHAPS VERY RAPIDLY. THE LEADING INDICATORS SUGGEST THAT ACTIVITY IS DECLINING, DURABLE GOODS ORDERS ARE SOFTENING, AUTO SALES AT LEAST FOR DOMESTIC CARS ARE NOT DOING VERY WELL AND HOUSING IN THE MIDWEST, AS SOME OF MY REALTOR FRIENDS DESCRIBE IT, HAS COLLAPSED.

BUT ON THE OTHER SIDE WE ARE TOLD THAT CAPITAL EXPENDITURES ARE STILL MOVING AHEAD, COMMERCIAL CONSTRUCTION IS STRONG, RETAIL SALES PICKED UP IN NOVEMBER AND THE UNEMPLOYMENT RATE DECLINED. ARE WE OR ARE WE NOT IN A RECESSION OR MOVING INTO A RECESSION?

AS THE WALL STREET JOURNAL ARTICLE YESTERDAY SUGGESTED, THE MAJORITY OF FORECASTERS HAVE ACCEPTED THE VIEW THAT THE ECONOMY IS IN A SLUMP. BUT IF YOU READ THE WHOLE ARTICLE YOU HAVE TO CONCLUDE THAT MAYBE THE MAJORITY ARE SURE AND MAYBE THEY AREN'T. ECONOMISTS HAVE BEEN ACCUSED FOR MANY YEARS OF BEING TWO ARMED--ON THE ONE HAND BUT ON THE OTHER HAND. NOW I WONDER IF ECONOMISTS SHOULD NOT BE ACCUSED OF BEING OCTOPUSES--THEY SEEM TO HAVE SO MANY HANDS.

THIS IS TOUTED AS THE MOST WIDELY FORECAST DOWNTURN IN U.S. HISTORY. PERHAPS SO. IT WAS ANTICIPATED IN EARLY 1978, THEN FORECASTS FOR MID-1978, A SURE BET IN THE FALL OF 1978, A SOLID PROJECTION FOR EARLY 1979, CLEARLY IN PLACE IN THE SUMMER OF 1979, WELL, MAYBE THE FALL OF 1979, A HIGH PROBABILITY BY THE END OF THIS YEAR AND NOW MAYBE IT WON'T REALLY SHOW UP IN THE NUMBERS, UNTIL THE FIRST QUARTER OF 1980. IF YOU MUST FORECAST, FORECAST OFTEN!

I DON'T WANT TO BE TOO HARD ON ECONOMISTS. FORECASTING IS A DIFFICULT ART EVEN IF SOME SHROUD THEIR ART WITH HUNDREDS OF EQUATIONS AND HOURS OF COMPUTER TIME--AND BESIDES, I'M AN ECONOMIST TOO. BUT I CAN'T HELP BUT FEEL THAT MANY ECONOMISTS HAVE FALLEN INTO TWO TRAPS. ONE, THE FEELING THAT THEY ARE ONLY USEFUL AND SUCCESSFUL WHEN THEY IDENTIFY A RECESSION--SOMETIMES DEFINED AS TWO QUARTERS OF DECLINE IN THE REAL OUTPUT OF GOODS AND SERVICES IN THE ECONOMY--REAL GNP, TOTAL OUTPUT ADJUSTED FOR PRICES. AND SECOND, MANY ECONOMISTS HAVE NOT ADJUSTED TO THE FACT THAT HISTORY IS NOT REPEATING ITSELF WITHOUT MODIFICATION; THAT IS, THINGS ARE DIFFERENT TODAY BECAUSE WE ARE BEING AFFECTED BY 15 YEARS OF RISING INFLATION.

NOW THE FIRST POINT, THAT ECONOMISTS ARE TRYING TOO HARD TO SPOT WHAT EVERYONE ELSE WOULD AGREE IS A RECESSION MAY SEEM UNIMPORTANT. BUT IT ISN'T. SOME ECONOMISTS HAVE BEEN LOOKING SO HARD FOR THE TREES THAT THEY HAVE FORGOTTEN THE FOREST. THEY HAVE BEEN LOOKING SO HARD FOR TWO QUARTERS OF NEGATIVE FIGURES IN REAL GNP THAT THEY HAVEN'T EMPHASIZED ENOUGH WHAT HAS BEEN HAPPENING THROUGHOUT THIS YEAR. AS A RESULT THEY HAVE GIVEN POLITICIANS AND BUSINESSMEN THE IMPRESSION THAT ONLY SOMETHING IDENTIFIED AS A RECESSION IS IMPORTANT. OBVIOUSLY, THAT ISN'T TRUE. I WOULD SUSPECT THAT NONE OF YOU CARE FROM THE STANDPOINT OF YOUR BUSINESS WHETHER OR NOT THE ECONOMY IS IDENTIFIED BY THE OFFICIAL ARBITER OF SUCH MATTERS, THE NATIONAL BUREAU OF ECONOMIC RESEARCH, AS BEING IN A RECESSION. YOU ARE UNDERSTANDABLY MORE INTERESTED IN THE STRENGTH OF DEMAND IN YOUR MARKETS, WHETHER LIKELY TO WEAKEN OR IMPROVE IN THE MONTHS AHEAD. CERTAINLY, AN OVERALL WEAKNESS IN THE ECONOMY WITH NO GROWTH IN REAL OUTPUT IS IMPORTANT TO YOU BUT WHAT TAG SOMEONE PUTS ON IT IS NOT.

THE FACT IS--EMPHASIZED ONLY RARELY BECAUSE OF THE SEARCH FOR SOMETHING TO WHICH THE NAME RECESSION CAN BE ATTACHED--THAT WE HAVE BEEN LIVING IN A SLUGGISH ECONOMY THROUGHOUT THIS YEAR. REAL ECONOMIC GROWTH OF JUST OVER ONE PERCENT AT AN ANNUAL RATE FOR THE FIRST NINE MONTHS OF THE YEAR IS HARDLY THE PICTURE OF A STRONG ECONOMY. AN ECONOMY, WHERE IN SPITE OF WEAKNESS, PRICES CONTINUE TO SOBER AND ACCELERATE IS HARDLY SOMETHING TO APPLAUD.

THESE ARE THE DEVELOPMENTS THAT HAVE ENTERED INTO YOUR PLANNING AND ACTIVITIES. AND THESE ARE THE DEVELOPMENTS THAT CONCERN US AT THE FED. NOT WHETHER OR NOT WE SHOULD PUT A NAME TAG ON THEM. NOT WHETHER WE'VE HAD ONE OR TWO QUARTERS OF NEGATIVE GROWTH. BUT RATHER HOW DOES ONE PROCEED TO CORRECT WHAT APPEARS TO BE A LONGER TERM PROBLEM FOR OUR SOCIETY.

UNFORTUNATELY, FOCUSING ON THE TAG OF RECESSION CAN LEAD US ASTRAY. SUCH A TAG DOES TEND TO BE IMPORTANT IN THE HALLS OF CONGRESS AND IN THE WHITE HOUSE. WHEN A SLOWDOWN IS NAMED AS A RECESSION POLITICIANS TEND TO REACT. AND TO REACT IN TRADITIONAL TERMS OF STIMULATING THE ECONOMY. THEY OPT FOR FASTER GROWTH MEANING A HIGHER RATE OF INFLATION. HARDLY SOMETHING NEEDED.

I CAN'T KEEP ECONOMISTS FROM USING THE TERM RECESSION. WHAT BOTHERS ME IS THAT THE NAME RECESSION BECOMES A CONCEPT, AN IDEA, THAT INFLUENCES THINKING BY POLITICIANS AND ECONOMISTS ALIKE ABOUT WHAT THE PATTERN OF ACTIVITY WILL BE OVER THE PERIOD AHEAD. THE PATTERN THAT GET LOCKED IN IS THAT IF WE ARE MOVING INTO A RECESSION, ACTIVITY WILL DECLINE, UNEMPLOYMENT RISE, PRICE PRESSURES MODERATE AND THEN THE ADJUSTMENT OUT OF THE WAY, ACTIVITY WILL INCREASE, AND EMPLOYMENT RISE. IN OTHER WORDS, AN INTERRUPTION TO OUR ECONOMY--SOMETHING TEMPORARY.

I THINK THAT THIS IS THE WRONG WAY TO LOOK AT IT. WE NEED TO TAKE A LONGER LOOK AT WHAT IS GOING ON IN OUR ECONOMY. WE WILL GO ASTRAY ESPECIALLY IN PUBLIC ECONOMIC POLICY IF WE SIMPLY CONTINUE TO LOOK FOR THE TEMPORARY DISRUPTION OF A RECESSION AND USE THAT AS A BASIS FOR OUR ACTIONS.

WE ARE LIVING IN A DIFFERENT WORLD. AND THAT IS THE SECOND TRAP THAT I THINK ECONOMISTS HAVE FALLEN INTO. WHY ALL OF THESE ERRONEOUS PROJECTIONS OF A RECESSION? BECAUSE THE OLD RELATIONSHIPS AMONG ECONOMIC VARIABLES DON'T HOLD IN THE SAME WAY. AND THE MAJOR REASON FOR THIS IS THAT OUR ECONOMIC LIFE HAS BECOME INCREASINGLY DISTORTED BY THE RAVAGES OF A 15 YEAR INFLATION.

ECONOMISTS HAVE HAD DIFFICULTY IN IDENTIFYING A RECESSION BECAUSE THE BLOWDOWN THAT WAS OCCURRING AROUND THEM DID NOT HAVE THE USUAL SIGN-

POSTS. THERE HAVEN'T BEEN LARGE INVENTORY FLUCTUATIONS INDUCED BY SPECULATION. THERE HADN'T BEEN A FIXED INVESTMENT BOOM WHICH WOULD LEAD TO A DOWNTURN. HOUSING, UNTIL RECENTLY AND EVEN THEN ONLY IN SCATTERED LOCALITIES, WAS HOLDING UP WELL--AFTER ALL 1.8 MILLION HOUSING STARTS ISN'T BAD. THE UNEMPLOYMENT RATE WASN'T RISING; IN FACT, EMPLOYMENT CONTINUED TO GROW.

SO YOU COULDN'T BE IN OR HEADING INTO A RECESSION. BUT YET SOMETHING WAS VERY WRONG. INFLATION. IT HAS BEEN THE MAJOR PROBLEM FOR THE ECONOMY. IT HAS BEEN THE CAUSE OF WEAKNESS--DISGUISED TO MANY BECAUSE, IN DOLLAR TERMS, THINGS WERE GOING WELL. ALMOST EVERYONE MAKING NEW RECORDS IN DOLLAR TERMS. BUT NOT IN REAL TERMS. CONSUMER SPENDING AFTER ADJUSTMENT FOR PRICE INCREASES HAS BEEN MOVING DOWN ALL YEAR. REAL PURCHASING POWER HAS BEEN DECLINING, NOT FROM A SLIPPAGE OF EMPLOYMENT OR A DECLINE IN NOMINAL INCOME, BUT FROM INFLATION.

ONE CAN ONLY GUESS WHAT THE IMPACT OF INFLATION HAS BEEN ON OUR ECONOMIC BEHAVIOR. THERE IS NO WAY OF MEASURING THE DISTORTIONS TO OUR DECISIONS, OUR EFFORTS TO PROTECT OURSELVES, OR THE TRUE VALUE OF THE ASSETS WE HAVE TRIED SO HARD AS BUSINESSMEN AND INDIVIDUALS TO OBTAIN.

BUT, IN SPITE OF THE COMPLEXITIES OF THE INFLATION PHENOMENON, I HAVE NO DOUBT THAT IT IS THE PRIMARY FORCE LEADING TO THE PERCEIVED WEAKNESS IN OUR ECONOMY. AND IT IS THE COURSE OF INFLATION THAT WILL BE THE MAJOR DETERMINANT OF OUR ECONOMIC HEALTH IN THE MONTHS AND YEARS AHEAD.

NOW WHERE DOES ALL OF THIS LEAD US? THE ECONOMY HAS BEEN WEAKENING ALL YEAR AS A RESULT PRIMARILY OF INFLATION. THAT WEAKNESS WILL BECOME MORE PRONOUNCED AS WE MOVE INTO 1980 AND MAY WELL CONTINUE THROUGH THE FIRST HALF OF NEXT YEAR. LEAVING ASIDE DEVELOPMENTS IN THE MIDEAST, WHICH COULD CHANGE THE WHOLE PICTURE--MOST LIKELY FOR THE WORSE, THIS

PATTERN IS PRETTY MUCH IN PLACE. WHERE WE GO FROM THERE IS SIGNIFICANTLY RELATED TO WHAT KIND OF PUBLIC ECONOMIC POLICY WE TURN TO.

IF WE REACT TO A "RECESSION," AS I MENTIONED EARLIER, AND ATTEMPT TO STIMULATE DEMAND THROUGH PUBLIC POLICY, WE WILL GET SOME OUTPUT GAINS BUT, IN MY VIEW, NOT MUCH. THE OLD TRADEOFF IS NOT LIKELY TO BE THERE. WE WILL GET MORE INFLATION BOTH ACTUALLY AND ANTICIPATED. SO MAYBE A RESPITE IN THE FALL OF 1980 AND THEN OFF AND RUNNING TO A MORE SERIOUS SITUATION IN 1981 AND BEYOND.

WE HAVE TO MOVE TO MORE LONGER TERM, TO MORE FORWARD LOOKING ECONOMIC POLICIES. THE BASIC ENVIRONMENT HAS CHANGED. WE ARE NOW LIVING IN A SOCIETY IN WHICH RESOURCE CONSTRAINTS ARE VERY REAL. OUR GROWTH, OUR EXPANSION IS SUPPLY CONSTRAINED. OIL IS THE MOST OBVIOUS. THE INCREASES IN PRICE THAT HAVE OCCURRED HAVE CHANGED THE CAPITAL VALUE OF OUR EXISTING PRODUCTION PROCESSES. WE ARE ALL POORER--IT COSTS US MORE IN REAL RESOURCES TO GET THE SAME OUTPUT. AND WE ARE CONSTRAINED BY OUR PRODUCTIVITY. THE PERFORMANCE HAS BEEN MISERABLE IN THIS AREA.

WE HAVE A SECULAR NOT A CYCLICAL PROBLEM. INFLATION, OIL AND PRODUCTIVITY ARE ALL LEADING TO SLOWER GROWTH IN OUR ECONOMY. THIS IS WHAT WE MUST TACKLE--NOT AS A RECESSION PHENOMENON BUT AS A LONG TERM ISSUE. THESE ARE BUDGETARY AND TAX DECISIONS TO BE MADE IN WASHINGTON.

BUT WHAT ABOUT MONETARY POLICY? HERE I AM TALKING ABOUT OUR NEEDS FOR OTHER TYPES OF ECONOMIC POLICIES WITHOUT SAYING A WORD ABOUT THE ONLY REAL POLICY ACTION IN TOWN--THE ECONOMIC POLICY AREA PRAISED OR CONDEMNED BY ALMOST EVERYONE.

MONETARY POLICY HAS AN ESSENTIAL ROLE TO PLAY IN CORRECTING WHAT I HAVE IDENTIFIED AS THE MAJOR INITIATOR OF THE WEAKENING ECONOMY--INFLATION. THE ACTIONS TAKEN ON OCTOBER 6 AND SO WIDELY PUBLICIZED AND DISCUSSED ARE

NEITHER MYSTERIOUS NOR OBSCURE. THE FEDERAL RESERVE SYSTEM IS ACTING TO BRING DOWN THE RATE OF MONETARY GROWTH WHICH, IN THE LONG TERM, IS THE MAJOR ELEMENT IN OUR INFLATION. REDUCING THE RATE OF MONETARY GROWTH BY SUPPLYING FEWER RESERVES TO THE BANKING SYSTEM HAS MEANT AN INCREASE IN INTEREST RATES SINCE THE DEMAND FOR FUNDS HAS EXCEEDED THE RATE AT WHICH THEY ARE SUPPLIED.

WE HAVE ALREADY SEEN SOME MODERATION IN THE RATE OF MONETARY GROWTH AND IN THE FACE OF A WEAKENING ECONOMY, INTEREST RATES HAVE ALREADY BACKED OFF FROM THEIR PREVIOUS HIGHS. WHILE TEMPORARY FACTORS SUCH AS THE IRANIAN CRISES MAY CAUSE INTEREST RATES TO JUMP UP AGAIN, THE LONGER TERM TREND WITH THE MONETARY AGGREGATES GROWING AT A SLOWER PACE AND ECONOMIC ACTIVITY LESS VIGOROUS, SHOULD BE DOWN. BECAUSE INFLATION DOES AFFECT INTEREST RATES, THE EXTENT OF THE DECLINE WILL BE CONSTRAINED BY THE PROGRESS THAT IS MADE ON INFLATION.

MONETARY POLICY HAS BEEN ERRONEOUSLY ACCUSED OF PRECIPITATING THE ECONOMIC DOWNTURN. NONSENSE! AS I INDICATED, THE SLOWING WAS UNDERWAY LONG BEFORE OCTOBER 6. THAT OUR MORE RESTRICTIVE ACTIONS WILL IMPACT ON REAL ECONOMIC ACTIVITY, I DON'T DENY BUT THEY ARE NOT OF SUFFICIENT MAGNITUDE TO PRECIPITATE A SEVERE DOWNTURN NOR WOULD THEY REMAIN AS RESTRICTIVE IN THE FACE OF A SIGNIFICANT AND SHARP REVERSAL OF OUR ECONOMIC FORTUNES.

MONETARY POLICY CANNOT, BY ITSELF, BE THE TOTAL SOLUTION TO OUR PROBLEMS—IN A REALISTIC SENSE NOT EVEN THAT OF INFLATION. IT REQUIRES THE SUPPORT OF OUR OTHER TOOLS OF PUBLIC POLICY. BUT WHAT WE HAVE PUT IN PLACE IS A SET OF POLICIES IN THE MONETARY SPHERE THAT ARE CONSISTENT WITH A SOLUTION TO AT LEAST THE INFLATIONARY PROBLEM IF OUR OTHER PUBLIC POLICIES CAN BE BROUGHT INTO LINE. MY CONCERN IS THAT THE LIMITED PROGRESS WE HAVE

MADE IN MONETARY POLICY AND THE ATTENDANT, ALBEIT UNDESIRABLE, WEAKENING  
IN THE ECONOMY, WILL LEAD THOSE IN PUBLIC LIFE TO THE DECISION THAT WE  
HAVE DONE ALL WE CAN IN SOLVING OUR ECONOMIC PROBLEMS. I HOPE NOT,