

AMERICAN IRON AND STEEL INSTITUTE

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Introduction

- A. Thank-you for the invitation to speak tonight.
- B. I'd like to report on the state of the national and regional economies.
- C. I'd also like to talk about some of our concerns about inflation.

Fed Structure

- A. Important to understand because it enables us to make effective, long-term monetary policy. Works like a time-release capsule.
- B. Unusual, perhaps unique, among the world's central banks. Decentralized design with a mixture of public and private attributes.
- C. People think Fed policy emanates from Washington. True, but only in the sense that monetary policy decisions are made at meetings of Federal Open Market Committee.
 - 1. Decision-making process not restricted to Beltway. Ideas flow in, then out.
 - 2. 12 Reserve Banks and a 7-member Board of Governors
 - 3. We serve a five-state region. Headquartered in Chicago with branch offices.

4. I know most of you are from out-of-town, but please call and arrange for a tour if you have time. See money shredded. \$5 billion in the basement.
- D. Our mission is to foster a healthy, growing economy. Other responsibilities include monetary policy, etc.
1. Variety of different cultures.
 - a. Academic research center.
 - b. Government regulator.
 - c. Private company.
 - d. I have experience in all these areas.
- E. Fed designed to be insulated from partisan pressures.
1. 14-year terms for governors.
 2. Doesn't depend on appropriations from Congress, but Congress does review the budget, and vast majority of earnings turned over to the Treasury.
 3. Reserve banks are like private companies. We're not government employees.
 4. Each branch has a board of directors.
 5. Selection process of presidents differs from governors.

FOMC Responsibilities

- A. Fed's most important policy-making body, 7 governors and the presidents.
- B. Voting rotates.
- C. Decision by consensus, rarely a close vote.
- D. Regional input is crucial.
- E. Meeting a formal affair, but some lighthearted moments. Sometimes it's hard to describe the economy. Balloons, thermostats.
- F. Policy process is an ongoing endeavor.
- G. During meeting, presidents and governors give reports.
- H. Chairman Greenspan summarizes the views and suggests a course of action.
- I. Very impressed with the high level of discussion and preparation.

The Outlook – 1994: A Tough Act to Follow

- A. GDP connoisseurs should note that 1994 was a vintage year, with possibly the most favorable mix of real growth, low unemployment and moderate inflation in 20 years.
- B. Here are the national numbers.
 - 1. 4% hike in real GDP.
 - 2. 3.5 million new jobs and unemployment down to 5.5%, more than 1% below 1993 level.
 - 3. 2.7% hike in CPI, same as in 1993. Inflation increased less than 3% at retail level for 3rd consecutive year. First time since '60s. Accomplishment.
- C. Midwest leads the surge.
 - 1. Unemployment rates of our five states beat national average.
 - 2. Manufacturing employment leads the charge, up 2.5% in '94.
 - 3. Industrial output shows 11% hike for our District, 6% for the nation.

1995: Growth Will Slow in '95

- A. Outlook for the U.S.
 - 1. Some carry-over, but 1994 pace just isn't sustainable.
 - 2. Past monetary actions will affect economy in 1995.
 - 3. Surge in sale of durable goods, machinery and large appliances will moderate, though recent data shows continued strength.
 - 4. Other statistics indicate slower job growth and more moderate retail sales and housing activity.
 - 5. '95 growth in the realm of 2% to 2.5% GDP.
 - 6. Inflation to average 3.5%
 - 7. Year-end unemployment rate of 5.6%
- B. Outlook for the 7th District — Favorable
 - 1. Historically, interest rate hikes and higher inflation slow Midwest economy. Things like tractor and refrigerator sales flatten as economy slows.
 - 2. But, Midwest now more competitive and diversified, better able to compete.

C. What about Mexico?

1. Financial crisis will cut U.S. economic growth this year by .2 to .4%
2. But economy there will recover, tremendous potential.

D. Looking ahead for nation

1. We're like a runner who's just finished a four-minute mile. Time for moderate growth.

Thoughts About Inflation

A. Fed's most recent policy move was Feb. 1, when we raised discount rate and fed funds rate by half a percentage point.

B. Some people said that was not needed, but based on available data, I think it was very clear that the economy was continuing to expand and that inflationary pressures were building at the producer level.

C. Actions intended to forestall inflationary pressures and keep economy on an even keel.

D. Will we need to take further action? We're uncertain.

1. Some signs that growth is moderating — autos and housing.
2. Signs are tentative. Still too early to know. Need to remain vigilant for signs of wage and price pressures
3. There are signs that prices for raw materials are rising and labor markets tightening.
4. But a lingering sense of insecurity among workers discouraging wage growth.
5. We'll have to keep up-to-date and monitor it.

E. We'll need to keep in mind long-term objectives, still paying the price for letting inflation get out of control in the 70's.

1. Long-term rates have included a high premium for expected inflation.

F. But we've made progress

1. Since Fed rate hikes, interest rates on long-term Treasury securities have dropped more than one-half of a percentage point.
2. Fixed-rate mortgages also down. Decrease result of moderating demand combined with a renewed faith on the part of the market that inflation would be contained. Long-term rates might be higher than they are today if we had not moved to tighten policy.

In Conclusion

- A. Outlook positive for the nation and the Midwest.
- B. Key is to ensure price stability.
 - 1. Low inflation allows for efficient savings decisions.
 - 2. High inflation distorts incentives to save.
 - 3. Allowing inflation to increase might seem like a painless way to boost employment, but it's a macro-economic Ponzi scheme. No foundation.
 - 4. Price stability the surest way to achieve the goals that we all share — a healthy, growing economy.