

SOME THOUGHTS ON THE ECONOMIC OUTLOOK

Remarks by

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I am delighted to be in your beautiful state today and to participate in this annual New Mexico Bank Week press luncheon. When I was invited to take part in this event, I was pleased--for two reasons. One is that I always enjoy visiting with New Mexico bankers, who we believe are doing an excellent job in meeting the banking needs of their communities. I might add that over the years a number of New Mexico bankers have ably served the Federal Reserve Bank of Kansas City and the System--particularly as directors on our Denver Branch board.

You all knew the late Bob Tripp--a conscientious banker and community leader we all respected and admired. Similarly, Bill Vernon of Santa Fe, now on the Denver board, and Jack Brandenburg of Taos, a former member, have generously shared their counsel with us over the last decade or so. It is a pleasure to say publicly here how much we value their contributions.

A second major reason I am pleased to be here is because of the nature of the event itself--a meeting of news media people and bankers together. Despite some opinion to the contrary, I believe that banks and the press have a great deal in common. Both professions are looked to for leadership in their communities and both share the goal of community betterment--both in the narrow and broad sense of that term. While a free press is the cornerstone that insures stability in our democratic political system by illuminating it, a responsive banking system, on the other hand, helps turn the wheels of commerce and industry--and our capitalistic free enterprise system--by marshalling the savings of the nation's citizens and lending and investing these funds toward productive ends.

The marriage of democracy and free enterprise has brought forth the most productive economic system in history. As many of you know, our system is generally poorly understood

by the typical American. Yet the preservation of both our political and economic systems depends on information--information needed to create an environment in which we all can make informed judgments. Understanding is the key to these judgments. In these times of doubt and mistrust of many of our public institutions, it seems to me to be essential that banks and the press should exert their natural leadership in support of understanding--or I fear that our economic system, which contributes to the sustenance of our political system, will be in increasing jeopardy. In keeping with that theme of economic understanding, I want to focus today on the economic environment and also offer some thoughts on our direction as a nation.

Many of you have firsthand knowledge--as participants or observers--of the broad sweep of economic events of the 1970's: an energy crisis which involved an embargo and later a quadrupling of the price of imported oil stock, credit crunches, double digit inflation, deep recession, and so forth. You may also remember that it was just two years ago that the nation's economy hit bottom and began to recover from the deepest and most severe recession since the 1930's. Then, following five quarters of rather rapid growth, the economy experienced the so-called "economic pause" of 1976 during the late summer and fall of last year. Recent data now confirm that following the pause the economy's strength re-emerged and picked up momentum toward yearend. Many observers--including myself--believe that much of the recent increase in business activity is the result of the workings of normal self-corrective forces present in the economy.

Most recently, it appeared that the harsh winter weather and related energy shortages experienced in many parts of the nation and which resulted in temporary unemployment and lost production would have a serious negative effect on the renewed economic recovery. As it looks now, however, those weather and energy troubles of early 1977 apparently will have a lesser impact on the overall economy than had been earlier feared. Of course, those em-

ployers and workers most affected by the severe winter weather did suffer in a very direct way, but the economy as a whole appears to have escaped with only minimal damage. I would expect that most of the short fall of lost wages and production will be made up in the second quarter of this year.

A potentially more serious problem for the nation and its consumers is the worsening drought in much of the western half of the United States. While recent snowfall and rainfall have eased the situation in some areas, many of the food producing regions are suffering extended dry conditions which threaten food production and, ultimately, higher food prices, with an obvious impact on the entire economy.

In reviewing the overall national economic outlook for 1977, I would like to say at the outset that I believe 1977 will be a good year for business activity, absent some unforeseen outside shocks such as a severe drought, another oil embargo, or similar event. After the brief pause in 1976, we saw business activity begin to accelerate again late in the year, led by consumer spending and the homebuilding industry. As sales picked up, businesses were able to work off their excess inventories which had accumulated during the pause. And as orders for goods came more rapidly, production speeded up, all which translated into a higher demand for labor. For example, in the last 6 months, 1.7 million additional persons have been added to the ranks of the employed. As a result, a record 89 million Americans are now at work--the largest number in our history. With a large and growing number of people employed, personal incomes have continued to rise at a steady pace. Consumers and businessmen appear to be optimistic. Both have money to spend and they are spending it. Furthermore, there appears to be ample credit available at rather modest rates to finance the purchases of goods and services by consumers, as well as for expansion by businessmen, who are encouraged by a growing consumer confidence.

In my opinion, a major contribution to that growing consumer confidence is the slowing of the rate of price inflation and a corresponding reduction in the public's inflationary expectations. The current inflation rate--in the 5 to 6 per cent range--continues to be encouraging, particularly in view of the unsettling double digit inflation which we experienced during 1974 and into 1975. But there are some unknowns on the horizon--the major one being President Carter's energy program to be announced next week. Most observers agree that the program undoubtedly will result in higher energy costs, which will affect every consumer directly or indirectly.

In addition, inflationary developments already have shown up in the prices of certain basic raw materials as revealed by the most recent wholesale price index and for some food items. Despite these inflationary signals, I still believe that the rate of price inflation can be held in the 5 to 6 per cent range well into 1978. However, it seems to me that further progress in reducing the rate below 5 per cent may be dealt a serious blow by the energy and other related price increases we might reasonably anticipate.

But even with some of these negative factors, I continue to believe that most sectors of our economy appear bullish for 1977 and into 1978. Housing is strong because demand is high and mortgage money is available. Business spending for inventories is likely to rise in coming months to rebuild depleted inventory levels--thus reflecting the expected continued strength in consumer spending. Businessmen also are likely to spend at a higher rate for capital projects. As you know, business capital spending has been sluggish throughout the current recovery, but it is expected to be much stronger in upcoming quarters--especially if the sharp increase in orders for capital goods recorded in recent months is an accurate indicator.

On the demand side of the economy, one particularly difficult sector to judge is the foreign exports market. Most of the major economies of the world have recovered more slowly than has ours from the deep recession and foreign buyers are not in a position to buy

U. S. products aggressively, nor will they be in the near future. Further, most of the large food producing nations have reported good crop years and as a result we can expect somewhat less stimulation from export demand for our agricultural products in the coming months.

Overall, it seems clear to me that the economic developments we are now witnessing, and those which we can reasonably foresee, indicate a continued moderate business expansion in the period ahead. Let me add further that the stable financial conditions which have characterized the recovery and expansion so far with an accompanying decrease in the rate of price inflation will continue to be a major goal of Federal Reserve monetary policy in the period ahead.

The relative financial stability which we have enjoyed during most of the economic recovery is largely the result of the Federal Reserve's monetary policy. This policy has been designed to promote conditions which will foster a substantial expansion in economic activity while, at the same time, guarding against any rekindling of inflationary pressures. In implementing this policy, the Federal Reserve has sought and achieved moderate rates of growth in the money supply. To illustrate, starting at the trough of the recession in the spring of 1975, the most familiar measure of the money supply (M1) has grown at a rate of about 5.6 per cent. This level of money growth has been quite adequate to finance the large gain in the volume of output and employment that we have experienced.

At the same time, by holding firm to its moderate course--despite pressures from various sources to boost money growth more rapidly--the Federal Reserve has helped to dampen inflationary expectations of our business and consuming public. In short, by refusing to create more money than appeared reasonably needed to fuel and encourage the economic recovery, the Federal Reserve has contributed to a strengthened confidence at home and abroad in the present and future value of the dollar.

In this environment, interest rates have not risen as would have been expected in a normal recovery period and, in fact, almost all market rates are lower now than they were

at the beginning of the expansion period. With money in ample supply and its cost relatively low and stable, prospects for continuation of the expansion are in my judgment enhanced. As noted earlier, credit is available for housing, for consumer expenditures on autos and other goods, and for business spending on inventories and new plant and equipment. Moreover, the stable and less inflationary environment has permitted financial institutions, including banks and savings and loans, business corporations--and even households--to rebuild badly needed liquidity.

As I have noted earlier, overall, I am optimistic that the sound growth evident in most sectors of the economy--combined with the favorable financial environment--augur well for business in 1977 and into 1978. However, beyond the next year or so, I must temper my optimism because of a concern about some fundamental and structural problems present in our economy for which answers must be found. My concern is increased by some of the solutions now being considered at the Washington level.

One major problem is unemployment. The existence of a pool of unemployed labor resources in our economy is to be sure an economic problem, but perhaps more important--it poses a serious social problem. Unfortunately, it seems to me that much of the current public rhetoric concerning unemployment obscures some of the more basic issues.

As a nation, we cannot long tolerate a situation where more than 7 million persons are unable to find work--as reflected by the latest unemployment data. The rate of unemployment continues to hover above 7 per cent overall. On the positive side, we should not lose sight of the fact that the current rate is well below the 9 per cent rate reached in 1975. This improvement in the employment statistics which has occurred in the last year or so is even more impressive when you consider the continued rapid growth in the nation's labor force, which adds new entrants or reentrants into the labor market every week--workers who also must be absorbed into the economy's mainstream. Furthermore, a close analysis of the structure of the unemployment figures yields some instructive insights into the problem.

For example, as a statistical category, breadwinners who are heads of household experienced an unemployment rate of 4.6 per cent in March--high by historical standards to be sure--but better than a point below the 1975 average rate, and well below the 7.3 per cent overall unemployment rate. At the other end of the spectrum, the category of workers 16-19 years old suffered an unemployment rate of 18.8 per cent in March. The rate for minority workers was 12.7 per cent and for part-time workers, the rate was more than 11 per cent. It is apparent that the younger, unskilled workers are bearing the brunt of the current labor market imbalances.

What then should we expect from this kind of structural unemployment? Unfortunately, so long as young workers enter the labor force without the skills needed to compete for and hold productive jobs, and so long as union rules and the minimum wage laws remain unchanged, then we probably should not expect to see any rapid reduction in unemployment in those groups which include the young and minorities. Many authorities are now recommending public service jobs or government programs designed to upgrade the skills among these structurally unemployed workers to prepare them for the kinds of jobs available in an increasingly sophisticated and expanding economy. While such programs are being proposed in the President's current fiscal stimulus package--and I applaud their underlying goals--I personally would prefer programs which would provide an incentive to private industry to solve this type of structural unemployment.

On the other hand, for experienced full-time workers, the outlook should be much brighter as the economy continues to expand. For these workers, it is to be expected that job opportunities will continue to develop and that unemployment data affecting them will again begin to reflect the more traditional patterns.

The public perception of unemployment is one of the major reasons that policymakers are often tempted--and in fact now are planning--to add the stimulus of more Government

spending to boost the rate of growth of the economy and hopefully solve these problems.

However, because the economy does appear to be on a clear and positive growth path, I hope the Administration and Congress give serious consideration to the longer range impact of the proposed stimulus programs. I say this primarily because of my concern that we must continue to make progress in reducing the rate of inflation to minimize the harsh penalties that inflation extracts from everyone in the nation, including the unemployed. In my judgment, fiscal policy programs which do not take account of their potential inflationary impacts may do serious longer-range harm to the stable, moderate-growth environment that we seek.

Many Americans now realize the cause-and-effect relationship between the persistent large Federal deficits and inflation over the past 15 years. While there obviously have been many complex and interrelated factors involved in the nation's past inflationary experiences, I believe that the continuing pattern of large Federal deficits (spending in excess of revenues) has contributed significantly to the decline in public confidence about our economic stability.

Because of diminished public confidence which results from these persistent Federal deficits--which have been running in the range of 50 to 80 billion per year--and their inflationary results, many observers--myself included--are concerned about the size and shape of the fiscal stimulus package now being considered in Washington. This program as announced was intended to include the \$50 rebate as a major feature, although recent reports indicate some growing congressional resistance to the rebates program.

There is considerable concern in Congress about how the Federal Reserve will react when and if the stimulus package is implemented--that is, will we act to offset some of the impact by restraining the growth rates of the money supply or will we be willing to tolerate the higher growth rates which undoubtedly would occur. Chairman Burns offered some assurance during Congressional testimony recently when he said that the rebate program would temporarily add to the rates of growth of the money supply in the second and perhaps into

the third quarter, but he noted that the fiscal stimulus goals of the Carter Administration--as presently outlined--could likely be accommodated within the Federal Reserve's long-range monetary growth targets. I agree that the fiscal actions planned for 1977 can be accommodated by the Federal Reserve particularly in view of two important facts: namely--the nation's industries are now operating at only about 80 per cent of our plant capacity and, further, that Federal expenditures currently are running about 9 to 10 billion dollars below expectations. However, you should not be surprised to see a more rapid growth of the money supply for some short time if the rebates are indeed distributed to consumers.

My optimism about 1977 does not, however, lessen my concern about the need for a good balance between the stimulus programs and our efforts in the longer term fight to control inflation. While many of us see little economic justification for additional fiscal stimulus at this time, we also are aware of the realities of the political world. While some of the planned stimulus programs probably would not be harmful in the short run, the important question is where is that line between moderate stimulation and the kind that will renew strong inflation pressures? In my view, the timing of the impact of the stimulus is critical, particularly as we look toward 1978. For example, if the economy moves ahead strongly this year as we anticipate and then is stimulated again in 1978, as planned, via new spending or additional tax cuts to the tune of an additional 15 to 17 billion dollars--which would surely result in another large Federal deficit--isn't there a danger that pressures could mount on our capital markets and renew inflationary expectations?

Yes, that danger is real. Large Federal deficits mean Federal borrowing and lots of it. Those of you who watch financial developments noted, I'm sure, the rise in interest rates earlier this year which was attributed solely to the fears about the size and shape of President Carter's fiscal package. While it certainly does not appear that the Administration's fiscal plans would cause any serious "crowding out" of private borrowers in financial markets in

the near future, it does appear that enlargement of the projected Federal deficit and resulting deficit-induced borrowing of this year and particularly in fiscal 1978 would, indeed, put pressure on the markets. Such developments will undoubtedly contribute to higher interest rates--if those rates have not already moved upwards as a result of inflationary expectations or from just the normal increase in credit demands from the private sector. Of course, until we get a clearer picture of the intentions of the Administration and Congress, it is difficult to make any precise judgments about the ultimate economic and financial impacts.

If I have stressed a longer-run perspective about our economic situation today, it is with good reason. I believe economic policymakers have a unique opportunity in 1977 to adopt policies which will tend to build public confidence in the future of our national economic health. If this confidence can be strengthened through the promotion of moderate--but sound--economic growth and if we can resist the temptation to apply a quick fix through massive government spending programs to solve fundamental economic problems, then I believe the future is indeed bright for some years ahead.

In conclusion, let me state my belief that wider public understanding of economic problems can contribute to creating an environment in which those problems may be solved realistically. I also believe that events such as this press luncheon perform a valuable service by providing the forum for rational discussion of our problems and their solutions. I sincerely hope this opportunity for interchange between bankers and the news media will be a permanent fixture in New Mexico. For you members of the media, let me assure you that the Federal Reserve--the nation's central bank--is open and ready to help you with the facts you need to communicate economic understanding to the public. We hope you'll call on us whenever you need our assistance.