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As business executives, many of you have firsthand knowledge 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.

More 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 had a milder impact on the overall economy than had been earlier feared. Of course, those employers 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 is being 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. Since the end of the brief pause in 1976, business activity has again accelerated, led by consumer spending and the homebuilding industry. As sales have picked up, businesses have been able to work off their excess inventories which had accumulated during the pause. And as orders for goods have come more rapidly, production has speeded up, all which translates 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. Moreover, since the trough of the recession two years ago, employment has expanded by more than 5 million persons--a growth of 6.2 per cent in the number of people at work. As a result, a record 89 million Americans are now employed--the largest number in our history. With a large and growing number of people at work, 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 the ultimate impacts of President Carter's energy program. 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 and food items as revealed by recent data. 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. It seems clear to me that the economic developments we are now witnessing, and those which we can reasonably foresee, indicate continued 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 the Federal Reserve has formulated and implemented monetary policy, we have by necessity paid close attention to the growth rates in the monetary aggregates, such as M1, M2, and so forth. Because of this approach to policy, it has become quite fashionable among various groups of so-called "Fed watchers," including a number of financial analysts, to pay extraordinary attention to every little wiggle in the money supply series--even on a weekly basis. The apparent rationale for watching weekly movements in the money supply is that one might detect from these movements what the Fed is going to do. For example, if the money supply jumps up in one week, then the Fed--so the argument goes--will tighten up its policy the following week. Alternatively, if the money supply falls, the Fed is expected to ease its policy the next week.

Earlier this month, for example, the Fed watchers were given some interesting money supply developments to analyze as M1 bulged about \$5 billion in the first week of April. As we discovered, though, this sharp increase in money resulted from some transitory factors: (1) Social Security payments occurred earlier than usual; (2) U. S. Treasury deposits declined sharply--increasing funds in the hands of the public; and (3) an unusually early buildup of

deposit balances by taxpayers looking ahead to April 15. To the extent that these temporary factors contributed to the large early April increases in the money supply, growth rates in May and June should be correspondingly small by the month-to-month yardstick. As a result, money growth rates in the second quarter should be considerably less than is indicated for April.

The point I want to emphasize here is that the "Fed watchers" and particularly those who watch the "Fed watchers" should understand that in conducting monetary policy the Federal Reserve does not try to play "catch up" with weekly changes in the money supply such as the early April bulge. The reason we don't play such a game is that we know the money supply is going to bounce around from week to week by a considerable amount due to technical factors alone. It's going to do that regardless of what actions we take to prevent such movements.

Accordingly, we formulate our monetary policy in a manner that recognizes and allows for the short-run variability of money. Specifically, as some of you may know, we set our short-run, 2-month targets for money in terms of a desired range. And, the ranges we choose often tend to be quite wide. For example, our short-run targeted growth rates for money might vary from 4 to 8 per cent on an annual basis. Such a wide range obviously allows for considerable variation in the week-to-week movements in the money supply. The wide range also ensures that we don't overreact to these short-run movements. In other words, the wide ranges keep us from playing the game of "catch up" with weekly changes in money supply.

You may be asking now: How do we know we have chosen the correct rates of growth for money and credit in the period ahead? In conclusion, let me say that quite obviously, we have no way of knowing for certain we have made the right choice until after the fact. However, we do make an intensive effort to arrive at an intelligent and economically sound decision, and one that is compatible with our national goals of economic growth, full employment, and reasonable price stability.