

5/5/80

THE SAME OLD PROBLEM - A NEW PROSPECTIVE

I. ACKNOWLEDGE INTRODUCTION - SOME 5 WEEKS SINCE INVITED TO ADDRESS THIS GATHERING - SEVERAL IMPORTANT DEVELOPMENTS HAVE OCCURRED IN THE RECENT PAST.

FROM MY VANTAGE POINT - THESE DEVELOPMENTS COME ABOUT OR HAVE GROWN OUT OF THE ONE ~~GENERAL~~ PROBLEM FACING OUR NATION - THE HIGH RATE OF PRICE INFLATION. THESE DEVELOPMENTS INCLUDE:

1. THE FEDERAL RESERVE ANTI-INFLATION POLICIES INCLUDING THE CREDIT RESTRAINT PROGRAM ANNOUNCED MARCH 14th, 1980 - AND -

2. FISCAL RESTRAINT AND A BALANCED FEDERAL BUDGET

3. DEPOSITORY INSTITUTIONS DEREGULATION AND MONETARY CONTROL ACT OF 1980.

*Passage of the*

*talk of*

*/and that-*

*signed by the president on 11 March 31, 1980*

II. RECOGNIZING THAT YOUR INTEREST AND RESPONSIBILITIES INCLUDE PROVIDING ADVICE AND DIRECTION TO YOUR BANKING AND OTHER FINANCIAL CLIENTS, I HAVE CHOSEN TO DIRECT MY BRIEF FORMAL REMARKS TO THE ECONOMIC ENVIRONMENT WITHIN WHICH YOUR CLIENTS MAY BE CONDUCTING THEIR BUSINESS IN THE PERIOD AHEAD AND LEAVING TO THE QUESTION AND ANSWER SESSION SPECIFIC COMMENTS ON THE IMPACT OF THE CREDIT RESTRAINT PROGRAM AND DEREGULATION AND MONETARY CONTROL ACT.

*Remarks to the*

*I would like to address my "Some Old Problem - ~~but from~~ a new perspective"*

*that we have seen recently*

WE ALL KNOW THAT ~~THESE~~ <sup>the</sup> RECORD INTEREST RATES ARE DUE LARGELY TO THE NATION'S INFLATION. <sup>pro. problems. advisors</sup> AS BANKERS YOU NEED NO LENGTHY RECITATION OF INFLATION STATISTICS: WHETHER YOU CHOOSE TO FOLLOW

THE CONSUMER PRICE INDEX'S CLIMB FROM 9 PER CENT IN 1978 ANNUAL *to nearly 13% in 1979; to the current 18% ANNUAL* RATE--OR IF YOU PREFER THE SLIGHTLY LESS PAINFUL NUMBERS OF THE

GNP DEFLATOR--THE FACTS ARE AGONIZINGLY CLEAR. INFLATION HAS EXTRACTED A SEVERE PRICE FROM OUR NATION. AND THE INFLATION CURES

WHICH ARE CALLED FOR WILL LIKELY BRING ADDITIONAL DISTRESS DURING THE PERIOD OF ADJUSTMENT WHICH LIES AHEAD.

*The Question arises--*

WHY DO WE HAVE THIS INFLATION? WHAT CAN WE DO ABOUT IT?

*Any reasonable analysis suggests that--*

~~IN MY JUDGEMENT~~, THE INFLATIONARY ENVIRONMENT OF THE 1970'S-- AND ITS UNWANTED LEGACY IN THE 1980'S--HAS A NUMBER OF ROOTS. THE "GUNS AND BUTTER" POLICY PURSUED DURING THE VIETNAM WAR IS SURELY A CAUSE, AND SO IS THE SHARP INCREASE IN ENERGY PRICES SINCE THE MID-1970'S. ANOTHER CONTRIBUTOR IS THE DETERIORATION IN THE ECONOMY'S PRODUCTIVITY IN THE 1970'S--WHICH PROBABLY FLOWS FROM

CHANGES IN THE LABOR FORCE, A SLOWER PACE OF CAPITAL INVESTMENT, AND EXCESSIVE GOVERNMENTAL REGULATION. MONOPOLY ELEMENTS IN LABOR AND PRODUCT MARKETS ALSO CONTRIBUTE TO INFLATIONARY PRESSURES BY REDUCING THE RESPONSIVENESS OF CERTAIN PRICES AND WAGES TO MARKET FORCES.

MOST IMPORTANTLY, IT SEEMS TO ME, THE INFLATIONARY FIRES HAVE ALSO BEEN STOKED ~~CONSIDERABLY~~ BY THE DEFICIT SPENDING OF THE FEDERAL GOVERNMENT ACCOMPANIED BY RAPID GROWTH IN THE SUPPLY OF MONEY AND CREDIT. AS YOU ALL KNOW, DEFICIT SPENDING AND RAPID MONEY GROWTH LEAD TO DEMAND IN THE ECONOMY THAT IS NOT MET BY THE ECONOMY'S CAPACITY TO SUPPLY GOODS AND SERVICES--AND THAT <sup>Triggers</sup> ~~INITIATES~~ INFLATIONARY <sup>Pressures.</sup>

ADD TO ALL THESE FACTORS SOMETHING WE CALL INFLATIONARY EXPECTATIONS. <sup>AS</sup> ~~THE~~ BUSINESSMEN AND WORKERS BEGIN TO EXPECT INFLATION TO CONTINUE, THEY BASE PRICE AND WAGE DECISIONS ON THE BELIEF THAT INCREASES ARE NEEDED TO OFFSET THE INFLATION THEY WILL EXPERIENCE, AND THE INFLATION<sup>ary</sup> PROCESS BECOMES FIRMLY ANCHORED IN THE ECONOMY.

TO SUMMARIZE MY VIEW, I BELIEVE THE MOST IMPORTANT CAUSES OF INFLATION HAVE BEEN DEFICIT SPENDING BY THE FEDERAL GOVERNMENT ACCOMPANIED BY RAPID MONETARY GROWTH, ALTHOUGH THE OTHER FACTORS-- PARTICULARLY RAPIDLY RISING ENERGY COSTS IN THE 1970'S--HAVE CERTAINLY PLAYED <sup>major</sup> A ROLE.

THIS SHORT REVIEW OF INFLATION AND ITS CAUSES TAKES CARE OF PART OF THE IDEAS SUGGESTED IN THE TITLE OF MY REMARKS. BUT THERE IS ANOTHER ASPECT OF THE "SAME OLD PROBLEM." AS BANKERS <sup>advisors</sup> AND CONCERNED CITIZENS, YOU ARE AWARE THAT MOST DISCUSSIONS OF INFLATION ALSO INCORPORATE SOME MORE OR LESS STANDARD PROPOSALS OF POLICIES NEEDED TO COMBAT INFLATION. UNDOUBTEDLY YOU ARE FAMILIAR WITH A GENERALLY ACCEPTED ANTI-INFLATION PROGRAM, WHICH IS, INDEED, A GOOD ONE. IT USUALLY INCLUDES:

- A BALANCED FEDERAL BUDGET
- MODERATE GROWTH IN MONEY AND CREDIT TO SUPPORT MODERATE, SUSTAINABLE, ECONOMIC EXPANSION

- ENERGY POLICIES THAT ENCOURAGE BOTH PRODUCTION AND CONSERVATION OF ENERGY TO REDUCE OUR DEPENDENCE ON OPEC.

*and*

TAX POLICIES OR OTHER ACTIONS THAT WILL STIMULATE INVESTMENT AND BRING ABOUT IMPROVEMENTS IN PRODUCTIVITY

MOST OF YOU WOULD AGREE, I THINK, THAT IMMEDIATE IMPLEMENTATION OF THOSE POLICIES WOULD CONTRIBUTE TO A DIMINISHED RATE OF INFLATION AND THE BUILDING OF A BASE FOR SUSTAINABLE, LONGER-TERM ECONOMIC GROWTH. UNFORTUNATELY, THOSE SOUND ANTI-INFLATION SOLUTIONS STILL REST IN THE "SAME OLD PROBLEM" CATEGORY BECAUSE THEY ARE MOSTLY STILL UNFINISHED BUSINESS. UP TO NOW, ~~YOU AND I~~ <sup>we</sup> HAVE SEEN LITTLE EVIDENCE THAT OUR NATION IS WILLING TO MOVE EFFECTIVELY <sup>*in taking those steps necessary*</sup> TO CURB INFLATION. A NOTABLE EXCEPTION, OF COURSE, IS <sup>a</sup> MORE RESTRICTIVE MONETARY POLICY AND THE MORE RECENT FEDERAL RESERVE ACTIONS DESIGNED TO RESTRAIN CREDIT GROWTH.

AS A NATION, WE DO KNOW WHAT POLICIES ARE REQUIRED, BUT WE  
GENERALLY HAVE BEEN UNWILLING TO TAKE THE MEDICINE THAT MIGHT  
PERMANENTLY SLOW INFLATION., WE DON'T LIKE THE THOUGHT THAT A  
STRAIGHTFORWARD ATTACK ON INFLATION AND ITS CAUSES MAY RESULT IN  
a LESS BUOYANT ECONOMIC GROWTH AND A SLOWER RISE IN OUR STANDARD OF  
LIVING. "

DOES OUR HESITANCY TO MEET INFLATION HEAD ON ) MEAN THAT WE ARE  
DESTINED ALWAYS TO SUFFER PERIODS OF DEVASTATING INFLATION COUNT-  
ERED BY EPISODES OF EQUALLY DAMAGING RECESSION AND UNEMPLOYMENT?  
IS SUCH AN UNWELCOME CYCLE / INEVITABLE?

I DON'T THINK SO. IN FACT, I DETECT THAT THE WIND HAS CHANG-  
ED, BRINGING US <sup>a</sup> BETTER <sup>set of</sup> ECONOMIC POLICY TOOLS / AND / MORE DETERMINA-  
TION FOR A FRESH ASSAULT ON INFLATION. AS A RESULT, MOREOVER, I  
BELIEVE THERE IS INDEED A NEW PERSPECTIVE TO GO ALONG WITH THAT  
SAME OLD PROBLEM. THIS NEW PERSPECTIVE IS CHARACTERIZED BY WHAT I  
SEE AS A REAL OPPORTUNITY FOR US IN 1980 TO IMPROVE OR ENHANCE OUR  
PUBLIC ECONOMIC POLICIES--AND TO DO SO--WITH THE GROWING SUPPORT OF  
THE GENERAL PUBLIC.

*I would like to*

*the 1980's*

~~LET'S~~ EXAMINE MORE CLOSELY THIS OPPORTUNITY OF 1980'S--THE ONE WE MUST GRASP DECISIVELY. IT SEEMS TO ME THAT THIS OPPORTUNITY HAS THREE KEY ELEMENTS WHICH MUST BE FULLY EXPLOITED. THESE ELEMENTS ARE (1) IMPROVED MONETARY POLICY, (2) A MORE DETERMINED ANTI-INFLATIONARY FISCAL POLICY, AND (3) THE AWARENESS AND EVEN ANGER OF A PUBLIC STUNNED BY INFLATION.

AS FOR IMPROVEMENTS IN THE ANTI-INFLATIONARY CAPABILITIES OF MONETARY POLICY, YOU ALL KNOW THAT THE FEDERAL RESERVE'S "SATURDAY NIGHT SPECIAL" OF OCTOBER 6 HERALDED A RENEWED ATTACK ON INFLATIONARY EXCESSES, BRINGING INCREASES IN THE DISCOUNT RATE AND IN CERTAIN RESERVE REQUIREMENTS. ON THAT SAME DATE, WE ANNOUNCED A CHANGE IN OUR MONETARY POLICY OPERATING PROCEDURES. THESE NEW PROCEDURES PLACE MORE EMPAHSIS ON BANK RESERVES IN ACHIEVING THE DESIRED ~~CONTROLLING~~ MONEY AND growth LESS EMPHASIS ON INTEREST RATES. A RESULT OF THIS NEW EMPHASIS ON RESERVES IS THAT INTEREST RATES WILL BE ALLOWED TO VARY ALONG WITH THE DEMAND FOR MONEY AND CREDIT. IT'S CLEAR THAT THIS NEW PROCE-

DURE HAS CONTRIBUTED TO THE SHARP INCREASE IN SHORT-TERM INTEREST RATES IN RECENT MONTHS. BUT IT'S ALSO CLEAR THAT OUR NEW PROCEDURE HAS CONTRIBUTED TO THE FEDERAL RESERVE'S SUCCESS IN MODERATING MONEY GROWTH SINCE OCTOBER. IN MY JUDGMENT THE FEDERAL RESERVE HAS BEGUN TO EFFECTIVELY EXPLOIT THIS OPPORTUNITY FOR IMPROVED MONETARY CONTROL.

ANOTHER WAY ~~THROUGH~~ WHICH THE FEDERAL RESERVE WILL HELP BLUNT INFLATIONARY FORCES IN 1980 LIES IN OUR INTENTION TO ADMINISTER THE SPECIAL CREDIT RESTRAINT PROGRAM WITH A FIRM HAND. AS YOU ~~WELL~~ KNOW, THE RESTRAINT PACKAGE INCORPORATES A 6 TO 9 PER CENT RANGE IN BANK LOAN GROWTH IN 1980 AND INCLUDES OTHER FORMS OF RESTRAINT ON BANK LENDING. THE PROGRAM DOES NOT INTEND TO DISCOURAGE A REASONABLE FLOW OF CREDIT TO SMALL BUSINESSES, AGRICULTURE, AND THE HOMEBUILDING INDUSTRY. ALTHOUGH THE CREDIT RESTRAINT PROGRAM IS INTENDED AS <sup>only</sup> A TEMPORARY <sup>MEASURE</sup> ~~ACTION~~, IT UNDOUBTEDLY WILL REINFORCE THE MORE RESTRICTIVE FEDERAL RESERVE POLICIES INITIATED IN OCTOBER AND OTHER SUBSEQUENT STEPS.

ADDITIONAL POTENTIAL FOR THE FEDERAL RESERVE TO IMPROVE ITS FIRM ANTI-INFLATIONARY STANCE WILL BEGIN TO COME ON STREAM THIS YEAR AS A RESULT OF THE PRESIDENT'S SIGNING OF THE DEPOSITORY INSTITUTIONS DEREGULATION AND MONETARY CONTROL ACT OF 1980. WE IN THE FEDERAL RESERVE PARTICULARLY APPLAUD THE RESPONSIBLE SUPPORT OF FINANCIAL INSTITUTIONS WHICH LED CONGRESS TO CREATE THIS PACKAGE. NOT ONLY WILL THIS LEGISLATION PROVIDE MORE EQUITABLE TREATMENT OF FINANCIAL INSTITUTIONS AND ENHANCE COMPETITION AMONG THEM, BUT IT SHOULD LEAD TO <sup>a</sup> ~~THE~~ FURTHER IMPROVEMENT IN THE FEDERAL RESERVE'S ABILITY TO ~~CONDUCT~~ <sup>formulate and implement</sup> MONETARY POLICY. SINCE UNDER THIS NEW LAW / RESERVE REQUIREMENTS WILL BE UNIFORMLY APPLIED TO ALL DEPOSITORY INSTITUTIONS OF LIKE SIZE, / MONETARY POLICY WILL HAVE A <sup>more</sup> DIRECT IMPACT ON A WIDER RANGE OF FINANCIAL INSTITUTIONS. THE BROADER IMPACT WILL INCREASE THE EFFECTIVENESS OF MONETARY POLICY AT CRUCIAL TIMES SUCH AS THESE, WHILE SPREADING THE BURDEN OF RESERVE REQUIREMENTS MORE EQUITABLY THROUGH THE NATION'S FINANCIAL SYSTEM.

*I CAN*

FROM MY PERSPECTIVE AS A FEDERAL RESERVE POLICYMAKER, ~~LET ME~~  
ASSURE YOU THAT WE WELCOME THE POTENTIAL OF THESE IMPROVEMENTS IN  
OUR POLICY CAPABILITIES. *I intend to* ~~I WILL~~ URGE THEIR APPLICATION FIRMLY,  
BUT WISELY, TO BOLSTER THE FIGHT TO WRING INFLATION FROM OUR ECON-  
OMY. IF OUR RESOLVE REMAINS STRONG, I HAVE NO DOUBT THAT THESE  
POLICIES WILL MAKE A MATERIAL CONTRIBUTION IN THE BATTLE AGAINST  
INFLATION.

BUT WE ALL KNOW THAT MONETARY POLICY ALONE CANNOT HALT INFLA-  
TION. OTHER PUBLIC POLICY TOOLS MUST BE BROUGHT INTO THE FRAY.  
THIS BRINGS ME TO THE SECOND MAJOR OPPORTUNITY I SEE TO COMBAT  
INFLATION IN 1980, THE USE OF THE FEDERAL GOVERNMENT'S FISCAL  
POLICIES. THE PUBLICLY STATED INTENTIONS OF THE ADMINISTRATION  
AND CONGRESS TO BALANCE THE 1981 BUDGET SHOULD BE APPLAUDED AND  
ENCOURAGED BY ALL ~~OF US~~ WHO ARE CONCERNED ABOUT THE INFLATIONARY

PRESSURES WHICH HAVE RESULTED FROM THE DEFICIT FEDERAL SPENDING IN  
19 OF THE LAST 20 YEARS. FURTHER, MANY OF US WOULD URGE FEDERAL  
SPENDING CUTS IN THE CURRENT FISCAL YEAR, AS WELL AS THE ESTAB-  
LISHMENT OF A <sup>Clear</sup> POSITIVE COMMITMENT FOR FUTURE FEDERAL BUDGETARY  
DISCIPLINE. SUCH AN APPROACH / COUPLED WITH THE CONSISTENT,  
CREDIBLE MONETARY POLICY TO BE PUT FORTH BY THE FEDERAL RESERVE,  
WOULD CLEARLY SIGNAL PROGRESS IN RETARDING INFLATION GROWTH.

NONE OF US ARE SO NAIVE TO BELIEVE THAT STRINGENT MONETARY  
POLICIES AND RESTRICTIVE FISCAL POLICIES CAN EXPECT TO SUCCEED  
AGAINST INFLATION UNLESS THERE IS A BROAD BASE OF PUBLIC SUPPORT  
FOR SUCH POLICIES. THEREIN LIES THE THIRD MAJOR OPPORTUNITY FOR  
ANTI-INFLATION PROGRESS IN 1980--DRAWING ON THE <sup>Present Level</sup> ~~IMPACTS~~ OF PUBLIC  
AWARENESS OF THE SEVERE IMPACTS AND PENALTIES OF INFLATION.

SCARY HEADLINES ABOUT THE PRIME RATE AND THE CPI MAY MAKE US WINCE  
IN PAIN, BUT AFTER THE WINCE / COMES THE ~~SCARY~~ EYE-OPENING REALITY  
OF INFLATION.



TO THE STABILITY WHICH WILL BRING RENEWED PROSPERITY AND GROWTH TO  
OUR <sup>Republic.</sup> ~~ECONOMY.~~

BUT WHAT IF WE DON'T GRASP THESE OPPORTUNITIES OF 1980? WHAT

IF WE AGAIN FAIL TO ACT DECISIVELY AGAINST INFLATION? WE HAVE NO

*other good*

CHOICE. IN MY JUDGEMENT, FAILURE TO TAKE FIRM, COORDINATED ACTION

NOW CAN ONLY LEAD TO A FURTHER SPEED-UP IN INFLATION. IN SHORT,

DEALING WITH 15 OR 18 PER CENT INFLATION NOW IS FAR LESS PAINFUL

*would be*

THAN <sup>n</sup>THE CURE REQUIRED FOR 25 OR 30 PER CENT INFLATION THE NEXT

TIME AROUND.

IF YOU AGREE WITH ME THAT THE OPPORTUNITIES ARE HERE--THAT

THE TIME IS INDEED RIGHT TO MOVE FIRMLY AGAINST INFLATION, <sup>to take decisive action</sup> / <sup>urge</sup> ~~CON-~~ <sup>I would</sup> ~~your~~

TINUED <sup>to</sup> YOUR SUPPORT OF THE FEDERAL RESERVE POLICIES AND PROGRAMS

DESIGNED TO FIGHT INFLATION. / CONTINUE YOUR SUPPORT / <sup>For and demand</sup> ~~as~~ RESPONSIBLE

FISCAL POLICY. IN PARTICULAR--GIVEN THE MOOD OF THE NATION IN

THIS ELECTION YEAR, WHEN THE BANNER OF FISCAL CONSERVATISM COULD

WELL BECOME A RALLYING POINT--<sup>I would urge you</sup> SUPPORT CANDIDATES WHOSE RECORDS AND  
<sub>OF Those</sub> STATEMENTS STAND FOR ECONOMIC REASON.

WHAT ELSE CAN BE DONE? WORK MORE INTENSIVELY TO ASSURE THAT  
<sup>, Banker and other,</sup> YOUR CUSTOMERS ~~AND ASSOCIATES~~ UNDERSTAND THE ULTIMATE GOALS OF  
PUBLIC ECONOMIC POLICIES. HELP THEM TO COMPREHEND THAT FUTURE  
BUSINESS CYCLES MAY WELL LOOK <sup>Quite than past cycles -</sup> DIFFERENT THAT SLOWER ECONOMIC  
GROWTH MAY WELL BE A PERMANENT FACT OF BUSINESS LIFE IN COMING  
YEARS. ~~[ ABOVE ALL, CONTINUE TO BE LEADERS AS WELL AS LENDERS.~~  
~~( WITH YOUR HELP, WE WILL SUCCEED. )~~

IN CONCLUSION, LET ME ASSURE YOU THAT THE FEDERAL RESERVE  
NEEDS AND APPRECIATES YOUR SUPPORT. WE NEED SUPPORT NOW AS THE  
ANTI-INFLATION FIGHT HEATS UP. WE <sup>Certainly</sup> ~~MAY~~ WELL NEED IT LATER DURING  
THE INEVITABLE BUSINESS DOWNTURN WHICH ACCOMPANIES OUR SEARCH FOR  
LONG-RUN ECONOMIC STABILITY, ESPECIALLY IF OUR APPROPRIATE BUT  
UNPOPULAR POLICIES COME UNDER FIRE. IF WE CAN HOLD FIRM, WE CAN  
LOOK FORWARD WITH YOU TO A TIME PERHAPS WHEN RAPID INFLATION AND  
SERIOUS ECONOMIC INSTABILITY WILL BE ONLY UNPLEASANT MEMORIES.