

Bary Muller
Kathy Dean
United Fidelity

RISK SELECTORS
NOVEMBER 1, 1989

1. APPRECIATE OPPORTUNITY TO ADDRESS RISK SELECTORS
ANNUAL PRESIDENTS' DINNER

A) FEDERAL RESERVE INTERESTED IN DISCUSSING
MATTERS OF ^{Mutual} COMMON CONCERN WITH GROUP SUCH
SUCH AS THIS

B) FEDERAL RESERVE, AS THE CENTRAL BANK, PLAYS
AN IMPORTANT ROLE IN DETERMINING THE
ECONOMIC PERFORMANCE OF OUR ECONOMY AND
FINANCIAL MARKETS.

*and affect decisions of
briefly companies represented heretofore*

2. I WILL COMMENT ^{briefly} ON THE PAST PERFORMANCE OF THE
ECONOMY AND THE OUTLOOK FOR THE PERIOD AHEAD
AS WELL AS WHAT I BELIEVE TO BE THE APPROPRIATE
ROLE FOR MONETARY POLICY. *given the outlook*

3. TODAY--A NOTEWORTHY DATE--THE START OF THE
8TH YEAR OF CONTINUOUS ECONOMIC EXPANSION--
THE LONGEST PEACE TIME EXPANSION IN OUR HISTORY
REAL GROWTH AVERAGE 4.1 PERCENT *dating back to
Nov 1982
over the past 7 yrs.*

A) ADDED 20.4 MILLION NEW JOBS +23 PERCENT

B) INFLATION DECLINED FROM DOUBLE DIGITS TO A
LEVEL BELOW THE CURRENT LEVEL OF 4 TO 5 PERCENT.

*of the late 70s
and early 80s*

- C) NET EXPORTS, AND AS A RESULT THE BALANCE OF OF TRADE, HAS IMPROVED SINCE THE DOLLAR REACHED ITS PEAK AND BEGAN TO DECLINE IN EARLY 1985.
- D) UNEMPLOYMENT HAS DECLINED TO JUST OVER 5 PERCENT AND HAS HELD STEADY FOR SEVERAL QUARTERS.
- E) SOME MODEST IMPROVEMENT IN REDUCING THE BUDGET DEFICIT

4. ALL ANCIENT HISTORY--WHAT HAS HAPPENED RECENTLY?

- A) ECONOMY HAS CONTINUED TO GROW AT A PACE OF 2 TO 3 PERCENT DURING FIRST 3 QUARTERS OF 1989 SOMEWHAT SLOWER THAN IN 1988 (3.40%)
- B) UNEMPLOYMENT CONTINUES AT THE 5.2/5.3 PERCENT LEVEL
- C) THE CORE INFLATION RATE IE:, PRICES LESS FOOD AND ENERGY, HAS HELD STEADY AT THE 4 TO 5 PERCENT LEVEL (IMPLICIT OR FIXED WEIGHT DEFLATOR)
- D) DOLLAR REMAINS STEADY AT THE 140/45 YEN AND 190/95 DM
- E) SOME ACCUMULATING EVIDENCE OF SLOWING IN THE MANUFACTURING SECTOR AS WELL AS IN THE INTEREST SENSITIVE SECTORS SUCH AS HOUSING AND CONSUMER DURABLES INCLUDING FURNITURE AND AUTOS

Best

5. WHAT DOES ALL THIS IMPLY FOR THE PERIOD AHEAD?
DOES THE SLOWING SUGGEST THAT WE ARE HEADING FOR
A RECESSION?
- A) IN MY VIEW, ABSENT SOME UNFORESEEABLE SHOCK
TO THE ECONOMY, WE SHOULD SEE SOMEWHAT SLOWER
GROWTH IN THE 4TH QUARTER AND PERHAPS IN THE
1ST QUARTER OF 1990 FOLLOWED BY A PICKUP IN
ACTIVITY LATER IN YEAR
- B) THE POSSIBILITY OF A RECESSION IN THE NEXT
5 QUARTERS APPEARS TO BE REMOTE ALTHOUGH
I WOULD EXPECT GROWTH TO SLOW TO THE
1 TO 2 PERCENT RANGE OVER THIS PERIOD
- C) GIVEN THIS FORECAST, I WOULD EXPECT THE
INFLATION RATE TO SHOW SOME MODEST IMPROVE-
MENT WITH INTEREST RATES DECLINING VERY LITTLE,
PERHAPS 1/4 TO 1/2 PERCENT OVER THE FORECAST
PERIOD
- Given this outlook,*
6. WHAT IS THE ROLE OF MONETARY POLICY GIVEN THE
LACK OF MEANINGFUL PROGRESS TOWARD THE REDUCTION
OF THE FEDERAL BUDGET DEFICIT?

- Primary*
- A) THE STATED OBJECTIVE OF THE FEDERAL RESERVE IS TO ADOPT THOSE POLICIES WHICH WILL, OVER TIME, ACHIEVE PRICE STABILITY
- B) PRICE STABILITY HAS BEEN DEFINED, FOR THIS PURPOSE, AS HAVING BEEN ACHIEVED WHEN THE EXPECTED LEVEL OF FUTURE PRICES CEASES TO BE A FACTOR IN INDIVIDUAL AND BUSINESS DECISION MAKING
- C) THE FEDERAL RESERVE HAS A RATHER LIMITED ARSENAL OF WEAPONS TO ACHIEVE ITS OBJECTIVES OF PRICE STABILITY NAMELY, THE ABILITY TO CONTROL THE SUPPLY OF BANK RESERVES WHICH IMPACTS THE GROWTH RATE OF THE MONEY SUPPLY AND ULTIMATELY DETERMINES THE LEVEL AND MAKEUP OF NOMINAL GNP TO WIT: HOW MUCH OF NOMINAL GNP IS REPRESENTED BY REAL GROWTH AND HOW MUCH REPRESENTS INFLATION
- D) FROM MY PERSPECTIVE, WE ARE ON COURSE TO ATTAINING A SOFT LANDING. IT WILL REQUIRE A SLOWING OF ECONOMIC GROWTH BELOW OUR NONINFLATIONARY GROWTH POTENTIAL (2 1/2 PERCENT) *wage and* FOR A SUFFICIENT PERIOD TO DAMP PRICE INCREASES AND INFLATIONARY EXPECTATIONS AND THUS ESTABLISH A TREND TOWARD PRICE STABILITY

- E) OUR TASK WOULD BE MEASURABLY EASIER AND
HAVE A HIGHER PROBABILITY OF SUCCESS IF SOME
MEANINGFUL STEPS WERE TO BE TAKEN TO REDUCE THE
FEDERAL BUDGET DEFICIT
- F) CENTRAL BANK CREDIBILITY IS AN IMPORTANT
FACTOR IN ACHIEVING PRICE STABILITY. I HOPE
WE DO NOT HAVE TO USE THAT CREDIBILITY TO
RESCUE OUR ECONOMY BECAUSE OF SOME INACTION
BY THE FISCAL AUTHORITIES. CREDIBILITY IS
A TERRIBLE THING TO WASTE.