National Small Business Chamber of Commerce

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Comments by

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INTRODUCTION

I would like to share my impressions on the economy.

But in doing this I want to also describe the deliberative process and structure of the FRS - to provide you a perspective on how current and future issues might be addressed.

PAST IN PERSPECTIVE

To place in perspective the issues that face monetary policy today, it may be worth describing policy steps taken over the past 18 months or so.

.Beginning with December '91, we were faced with an economy obviously stuttering.

.Jobs were not growing unemployment was increasing above 7.5%, investment was sluggish, consumption weak.

.Leverage for both consumers and business was a historical highs.

.Banks were facing a host of problems.

.The one major positive event was that inflation was easing, declining from a neighborhood of 4% to 3%.

.Under these conditions - the prudent action was to continue to ease monetary policy further.

* Discount rate was lowered 1% pt. - FF rate .5% pt. then again in July rates were lowered. And again in September, rates were lowered to 3%, the lowest level in 3 decades.

The effect of these actions clearly helped stimulate economic activity and was what we all wanted.

. GDP grew almost 4% in the third quarter
almost 5% in the fourth quarter.
. Unemployment fell from its peak of 7.7% to 7.2%.

With 1992 ending on such a note, I was reasonably confident that 1993 would be a good year - expecting continued modest growth and progress toward stable prices.

As the year has unfolded, however, the economy's performance has fallen short of expectations.

.First half growth in GDP increased only 1.2% at annual rate. For the year we have lowered our expectations from 3% to below 2.5%.

.Moreover, considerable slack remains in the economy - with slack in most consumer goods - autos being somewhat an exception. Even housing has improved only modestly given the historically low rates. (Denver being a noticeable exception)

.Slack government spending is certainly a drag on the economy especially as it is affecting defense programs. Employment in the defense sector is estimated to have declined by well over 20% since June of 1990.

.Manufacturing has remained noticeably soft with employment in this sector declining continuously during the general recovery period.

.Corporations continue to focus borrowing in long term securities - not banks. Both banks and corporations are focusing on strengthening balance sheets and improving efficiency.

An immediate reaction to all this - is obviously disappointment - perhaps concern and a desire to do something. But to focus only on these statistics is to leave much unsaid -

.BFI is strong - BFI increased 13% AR in the first half. Equip + 17%. And signs in these areas suggest similar growth in the second quarter as well.

.Investment in structures was up almost 2.5% in the first half - ending a long and precipitous slide down.

.Corporate profits appear strong.

.Bank profits and capital levels are up significantly and there were some faint signs of increased business loans at banks.

.Leverage ratios for consumers and businesses have improved - total debt service/Disp. Personal income declined from almost 19% to a more healthy 16%. And thus there is room to borrow, were as two years ago there wasn't.

.The labor markets are showing improvement - employment increased by over $800,000 the first 7 months of the year - unemployment now 7%. I recognize that this does not show the decline in many manufacturing jobs or the increased reliance on temporary help - but still high skilled jobs and service jobs are showing additions as well.

.Long term interest rates have declined 1% pt. - thus further improving cash flow and borrowing opportunities.

The implications from these further data help clarify the picture while we must be mindful of the risks affecting our economy, we have much to be optimistic about.

It also tells me that we have an obligation not to let the latest piece of news - alone - set our course.

Still there are some real uncertainties that remain and must be recognized.

One of these uncertainties is our <u>Trade and Current Account</u> positions.

.Let me first point out that X+M matter a great deal in determining the health of the U.S. economy. While in 1980 they were the equivalent of 16% of GDP. Today they are the equivalent of 25% of GDP and together exceed $1 trillion.

.Moreover, we are the world's largest exporter of goods and services.

.Nevertheless our net merchandise trade deficit remains large, now exceeding $100 b at an annual rate.

.One reason we have not seen improvement recently is that our industrialized trading partners are suffering economic declines "93-"94 - e.g. Germany -2 1/4, 1; Japan 1%, 2 1/4; Canada 2 3/4, 3/14.

.Indeed, our position would be worse if it were not for Pacific Rim, South Am., and Mexico. How these countries do will be extremely important to this country no matter our money policy.

.Most economists expect that Europe and Japan will begin to recover next year and this should improve our trade balance.

.Finally, the outcome of NAFTA and GATT will influence our future as much as money policy, and so a great deal of attention will be focused on these matters in the coming year.

A second uncertainty is Fiscal Policy. We have a fiscal package now which is designed to address our deficit problem. Whether we think good or bad of the new program, ultimately we must address this terribly difficult matter.

Our national savings rate when we include the Fed. Gov. deficit is now only in the neighborhood of 2% of GDP - an incredibly low level.

Unless savings - and as part of this the deficit - is addressed our ability to build our nation's capital stock is weakened - and will affect long term growth and our policy options.

Finally - we have the matter of inflation. One thing that has complicated money policy was the early inflationary signals.

In the first five months of this year, inflation was averaging over 4% AR. So while the economy was hardly growing, inflation was suddenly rising.

Fortunately June-May showed much improved numbers - CPI nearer 3% and PPI nearer 2%.

In this environment money policy has held constant at DIS + FF = 3%.

What all this comes so say is that the U.S. economy is - as we said at the start of this year - expected to grow moderately in 1993 at about 2.5%. Next year this should improve to 3%.

These rates of growth will systematically move us toward greater employment, less unemployment - stable growth a little or modest inflation.

This all leads to the obvious question - what policy will the FR pursue - I can say quite clearly that I view our mission as promoting sustainable long term growth in an environment of stable prices.

.The mission of this institution is to analyze the information, balance the competing forces and aid in the process of pursuing a policy that assures maximum long term growth with stable prices.

.If the FRS does this - it will have done all it can for our national economy. If we pursue growth without regard to the possibility of inflation - we will eventually - as we have seen in the recent past - plunge ourselves into chaotic inflation and lost growth.

.If we pursue stable prices to the exclusion of sustained growth - we can tip our economy into deflation and loss growth as well.

The issues are before us, and I am confident that given good information we can successfully pursue our long term goals of price stability and growth.

Finally, while I cannot speak to what future policy might be, I can take a moment to describe the process and provide insight into how carefully money policy is determined.

.The FRS has been carefully constructed to balance political and private forces in selecting the best policy for all.

.It is a product of the democratic process - and political compromise.

.Following panics of 19th century and 1907, efforts began to establish the 3d central bank of the U.S. This country had not had a central bank since 1836.

.The dominant fear, however, working against its charter was that it would become political, leading to inflation.

.There was as a result a strong group within Congress that insisted that like the first two banks, it be predominantly private. Other political forces believed that it should be apolitical institution.

In the end, the FR came to reflect three critical institutions that brought (1) private sector knowledge and oversight; (2) Public input and oversight, and (3) The merging of these two forces into one to determine money policy.

.Twelve Private reserve banks - each with its own board of directors selecting a CEO for the bank, providing oversight of bank operations, input into discount rate decisions and very importantly providing intelligence on regional economy in the deliberation of national policy. Directors represent a broad cross section of banking, industry, ag, and consumers.

.BOG - Provide general public supervision of Res. Banks, approving discount recommendations of Bd of Directors, and participating in the deliberation of national money policy.

.FOMC - Joint committee of BOG plus 5 of 12 Presidents (who rotate) which in fact determines money policy.

The FOMC is the critical body that determines policy - so let me describe how it works in confronting the matters I've described to you today.

.The BOG dominates the meeting with 7 votes. While only 5 Presidents vote all 12 participate. As the meeting proceeds the Presidents and Governors paint the picture region by region of our economy - some indicating strengths. Others indicating weakness, New Eng. & South Calif.

.Pres. and Gov. go on to review international events and any other factors that are known or thought to be influencing our economy.

.Finally, policy options are outlined and choices made.

It is this combination of private - grass roots - input and public input that provides, I believe over time the best balance in policy.

We have an economy on the mend - all the more so in the context of other economies throughout the world.