1972: PESSIMISM AMID OPTIMISM

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before

THE PHILADELPHIA JAYCEES

at the

"First Thursday Luncheon"

John Wanamaker's Mirador Room

July 6, 1972 - 12:00 Noon

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As we stand at the halfway mark in 1972, it is now clear that the economy is on a strong upward path, that sales and profits are improving vigorously, jobs are becoming more plentiful, and paychecks are getting fatter. Yet, despite these optimistic signs, for many -- including businessmen -- there is still an underlying sense of concern and even pessimism in some quarters about the economic road we're on and where it is leading us. Pessimism amid optimism -- this is the paradox I'd like to explore with you briefly today.

Outlook for growth

First, the case for optimism: So far this year, GNP has grown in real terms (that is, after allowing for price changes) at an annual rate of about 6 percent. This is a healthy rate of expansion and reflects the fact that, after a shallow recession and an unusually drawn-out recovery, the economy is now beginning to pick up steam and show the characteristics of upturn that are more typical of past recovery periods.

In the second half of the year, real GNP is likely to grow still more rapidly, most likely in the 7 to 8 percent range. Supporting this overall vigor will be the strength in several important sectors of the economy.

Housing starts will be high at an annual rate of well over 2 million units. Building activity has been exceptionally strong for some time and it would be unrealistic to expect it to improve further. But the fact that it will stay high is a bullish sign.

Businessmen are planning to step up their investment in plant and equipment at a vigorous rate. During the second half they will be spending at a rate 10 to 15 percent above a year ago. So far they have been conservative about adding to inventories, and what they will do in the rest of the year is something economists have been debating. Some observers say businessmen are waiting for consumers to become more enthusiastic about spending. Some say businessmen have learned, with the help of computers, to get by with lower inventories. To my knowledge, however, no one is saying that businessmen are really afraid the recovery will peter out. In any case, they will be adding some to inventories and this will be a plus.

State and local governments will be spending more, and their plans should be strengthened by prospects for revenue sharing. The Administration has announced that it will be spending more for defense. The President has just approved stepping up Social Security payments; and since Social Security taxes are not scheduled to go up until January 1973, this will put additional money into the consumer's pocketbook.

The consumer himself will be spending at fairly high rates. For example, he has been buying new domestic cars recently at the rapid rate of over 9 million units a year, and this should continue. He has cut his savings rate from over 8 percent last year to about 7 percent so far this year. Just what he will do in the rest of the year is debatable. But even if the consumer continues to save at relatively high rates, the fact that he will have a considerably larger income to spend should mean still more dollars in the hands of retailers.

All in all, when you add up the individual parts of the economy, the obvious conclusion is that we re in a period of rapid expansion. And

judging from the trend of leading indicators, the expansion should last a while. In addition, with any luck at all, we should soon begin to see a turnaround in our balance of trade -- with exports rising faster than imports. The result then for 1972 will be more prosperity in general, and for you in particular substantially higher profits.

Why the pessimism?

Why, then, do so many people feel uneasy and at times pessimistic about the economy? When I say they are pessimistic, of course, I'm stating a judgment that can be hard to prove. There are statistics about how consumers feel. One survey indicates that although consumer sentiment has improved since last year it is still considerably below what it has been for most of the past decade. The attitude of businessmen is harder to pin down, but from meetings we have been having recently with leading executives it is clear that businessmen have many worries that are offsetting the more favorable outlook for sales and profits.

For a moment, let us speculate on some of the possible reasons why consumers and businessmen hold this bearish attitude amid so many bullish signs.

1. One possibility is that attitudes just haven't caught up with the improving statistics. Having gone through some rather upsetting experiences in recent years, people may have something of a credibility gap. They may simply find it hard to believe that things are really getting better or will remain better for long. If this is true, attitudes should be much better at the end of 1972 than at midyear. And I think there is something to this line of reasoning.

But I also believe there is more at work than just lags.

2. An obvious concern is inflation -- both now and beyond 1972. Although the public gave the wage-price freeze remarkable support, there is much skeptism around about the equity and success of controls. Unfortunately, available statistics do not provide convincing assurance that controls have been anything more than marginally successful. On the one hand, consumer prices have shown marked improvement in recent months, but on the other hand wholesale prices are doing about as poorly as before the freeze -- and this does not auger well for retail prices in the months ahead. In addition, economics aside, the housewife's concern about rising food prices isn't tempered much by the thought that farm voters would be unhappy at more extensive controls on meat. Looking further down the road, many businessmen are worried about the heavy calendar of labor negotiations coming up in 1973 and what this will mean for costs. So, a major cause of lingering anxiety is the fear that inflation may only be taking a short snooze rather than a long nap.

3. Unemployment is another concern. In spite of the improving economy, it is still high and, in spite of further improvement to come, it will not decline as much as anybody would like. More and more questions are being raised as to whether the only answer is to step up efforts to train, educate, and employ directly (by some kind of Government

work program) those who are out of work, especially the disadvantaged. Discouragement about progress in getting unemployment down has unquestionably contributed to the prevailing pessimism, particularly among blacks and teenagers.

4. The fiscal situation is still another factor. Economists and government officials have done a commendable job at trying to convince the public that large federal deficits are good for the economy during periods of recession. But the other side of this same coin also says that large federal deficits are bad for an economy with a full head of steam. In other words, as the economy expands during the next year, the federal deficit should be reduced. In reality, however, the deficit is likely to be substantially larger than during the past year. This kind of perversity in fiscal management is most unsettling to large segments of the business and financial community.

5. International economic problems undoubtedly are also a concern to some. Although I doubt if the average person any longer cares very much what happens to gold, he undoubtedly interprets devaluation of the dollar as a sign of weakness. Of more concern to many businessmen, however, is how to compete with foreign producers. In 1964, the United States had a trade surplus of $8 1/2 billion; at latest count we had a deficit of over $6 billion -- a negative swing of almost $15 billion in less than a decade. Furthermore, most businessmen realize that there will be no quick or easy

solutions to the problem of improving the U.S. competitive position in the world economy or restoring stability to the international monetary system. Dollar devaluation will help, improving productivity will help, rising costs overseas will help; but improvement will still not be dramatic.

Well, I'm sure you could all add other items of concern, (we haven't, for example, touched upon the problem of ecology, drugs, crime, etc.), but those I've mentioned -- inflation, unemployment, fiscal policy, and foreign competition -- seem to me to be the most important ones contributing to current anxiety and pessimism.

Federal Reserve policy

In this environment, let me say a word about where the Federal Reserve fits in. The Fed has a difficult job in any case. It is trying to provide enough stimulus to keep the economy on a recovery path and to help reduce unemployment, and at the same time exercise sufficient moderation to discourage inflationary pressures. After all, a fundamental fact of economics is that controls on prices and wages cannot resist the inflationary pull of an excessive supply of money in the economy. So, in balancing these conflicting objectives and at the same time bearing in mind problems on the international economic front, the Fed has been pursuing a policy of moderation.

Hardly anyone, of course, is against moderation in principle, but achieving moderation in practice is not always easy. It seems to me that we are entering one of those periods when the Fed will have to try especially hard to keep a moderate rein on monetary expansion. In the months ahead, when moderation will be particularly appropriate because of an increasing

federal deficit, the temptation for the Fed could well be to step up the flow of money and credit to the economy. The reason is that, as the economy continues to gain strength, credit demands from business and the consumer, plus heavy Treasury borrowing, will likely put additional upward pressure on short term interest rates, and rising interest rates are unpopular. The law of supply and demand tells us that the only way to hold down short term rates would be to increase the supply of money and credit to the economy. But experience tells us that if we try to hold down short-term rates in these circumstances that a new round of inflation would likely follow, and ironically the threat of more inflation would itself drive interest rates higher than they otherwise would be. For only a naïve lender would not adjust upward the rate of interest he charges in the face of a new round of inflation. He would need an inflation premium to protect his principal. So, it seems to me that moderation on the part of the Federal Reserve is so important to the longer-run health of the economy that if rising short-term rates is the only way we can maintain moderation in the months ahead, we'll just have to bite the bullet and take whatever flack may come our way.

Conclusions

Let me sum up by saying that the optimism stemming from the business recovery is well-founded. We are in a strong

cyclical upturn that shows signs of still more vigor. But in contrast to this cyclical optimism, we are still left with an underlying concern -- and in some cases pessimism -- about the fundamental and longer-run problems of inflation, structural unemployment, foreign competition, and the prospects for controlling government expenditures.

I believe that we do have the ability and imagination to deal with these fundamental and longer-term problems. I believe that the optimism that now characterizes the cyclical recovery can lay the foundation for a new secular optimism. But it will take some hard thinking and determination, not only in Washington, but also in business and labor and elsewhere. A year ago we had pessimism amid pessimism, now we have pessimism amid optimism, and there is no good reason why we can't have optimism amid optimism.

DPE:7/5/72