NEWS RELEASE

FEDERAL RESERVE BANK of PHILADELPHIA

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YEAR-END STATEMENT

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The course of the economy in 1974 is about as uncertain as at any time in recent memory, but one thing is clear: various parts of the economy will behave quite differently and this will call for highly selective public policy. 1974 will not be a time for a flood of liquidity to stave off rising unemployment or a meat-ax approach to fighting inflation.

Some elements of uncertainty, such as whether or when the Arabs will increase the flow of oil, are obvious. More subtle is how consumers and businessmen respond to the various shortages that will exist. How much will they substitute one kind of spending for another? Will the family, unable to go on a skiing trip in Vermont, make more frequent trips around the corner to McDonald's? Nobody really knows; we have never before faced this kind of shortage economy in peacetime. If there is a great deal of substitution, the impact of shortages will be less and the pace of economic growth may not decline much. If there is not much substitution, the economy could register a recession that could be considerably more than a statistical phenomenon.

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The likelihood of at least a "statistical recession" now seems high. The first half of 1974 probably will consist of two quarters of decline in real GNP. Unemployment will be rising, perhaps to around 6% by year-end. At the same time, prices are certain to increase at a faster clip than seemed likely only a few weeks ago.

Within these broad parameters, however, the behavior of parts of the economy and parts of the country will vary--from automobile production toward the depressed end of the scale to capital spending at the other, and from resorts which will be inaccessible by automobile to areas which produce goods in short supply.

How should policymakers deal with such a prospect? Obviously, policies must be flexible. Government spending must be adaptable to conditions in specific areas. Federally financed projects in hard-hit areas of the country can limit the rise in unemployment for those localities, for example. Taxes can help to siphon off excess profits in some industries favored by rapid price increases. A variety of fiscal incentives can be used to stimulate energy production and discourage energy consumption. Price and wage controls can remain where needed and be phased out where not.

The Federal Reserve can do little to differentiate among sectors of the economy, but it can help in the overall by avoiding policies that aggravate either recession or inflation. Clearly, this is a hazardous line to tread: too much money put into the economy could send prices zooming; too few funds could turn a "shortage recession" into a "demand-deficient" downturn. Here again, policies must be flexible. Contingency planning is essential, but 1974 will be a year in which policymakers will find themselves, of necessity, going much of the time by the seat of their pants.

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