

REMARKS BY

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I am under no illusions as to why people who belong to the Bond Club would come out to hear what a person from the Fed has to say. I would like nothing better than to tell you what the rate on AAA Corporates is going to be at 11 a.m. next December 15. Since I can't-- because I obviously don't know and just as obviously couldn't say if I did--let me probe around the subject for a few minutes. I want to look first at some forces which will be at work in the short-run--say, the next 6-9 months. Then I'd like to speculate in a very general way on developments in the rest of the 70's.

Short-run outlook

So far as the short-run is concerned, let me join the bottoming out crowd. I have some very distinguished company in that crowd--including the President--and feel quite comfortable there.

Evidence is accumulating convincingly. The new leading indicators are up two months in a row and dramatically so in April. The number of jobs is actually increasing after a half year of decline. The drop in industrial production slowed almost to zero at last reading and an upturn is probably now underway. Retail sales other than autos are showing considerable strength in part from tax rebates. The decline in housing seems to have ended. Inventory liquidation still has a way to go but is well along.

The obvious question on which there is still some difference of view is how fast the recovery will be. My guess is still that it will be slow to moderate. Housing will not recover with its usual vigor because of the large backlog of unsold housing and many families find the cost of housing beyond their financial reach. Consumer spending, while likely to improve still further, doesn't appear on a boom course; consumers are less pessimistic, but they aren't happy enough to go on a spending binge. Businessmen are going to remain cautious about spending large sums on new plant and equipment with all the excess capacity they have.

All this means that on the bad side unemployment will stay disappointingly high, but on the good side there should be continued progress against inflation. By the end of the year unemployment will probably still be around 9 per cent, not all that far from where it is now. The price deflator will likely be rising at about 5 per cent, well below the double digit dimensions of last year.

At some point in the recovery, short-term rates will tend to rise. You recognize, of course, that I'm not giving you any inside dope when I say this. In the light of historical experience, it simply would be most unusual in a recovery period for this not to happen. Long-term rates are harder to foresee and I'll come back to them in a minute.

The difficult question is how fast and how far short-term rates will rise. There is some basis for arguing that the increase may be slow and moderate. For one reason, as I've said, the economy seems likely to

recover only sluggishly. This will, I believe, make room for a substantial amount of Treasury financing; the arguments against "crowding out" look better all the time. And finally, to the extent that improvement in the inflation prospect influences short-term rates, this should tend to hold down whatever increase lies ahead.

Longer-run outlook

Now let's focus on the next several years, roughly the rest of the 70's. Let me sketch very broadly a picture that might prevail and throw out a proposition for you to consider.

The proposition is that the kind of environment we face in the next few years may well be something like that of the early 1960's -- after the recession of 1960-61 and before escalation of the Vietnam war. This environment would rule out two alternative possibilities. One is the boom-bust possibility, the idea that rapid expansion in 1976 will follow the recovery, leading to double-digit inflation again in 1977 and another recession in 1978. The other possibility is a period of sustained prosperity without much inflation. The early-1960's scenario is somewhere in between and would call for anemic growth with continued high unemployment, but relatively stable prices--at least well below sky-high rates of last year.

Without pressing the point too hard, let me develop a few aspects of this possibility. In the early 60's, after two back-to-back recessions, actual GNP was substantially below potential. Now we are again at a point, as the result of the single worst recession since the 1930's, where there

is a large gap between what we could produce and what we are producing. It took about a half decade to close the gap of the early 1960's and my proposition is that it will likely take several years to get back to full potential in the late 1970's.

The main reason is that forces in the private economy are likely to be less than vigorous. Perhaps basic is the attitude of the consumer. Looking ahead, consumer attitudes must improve because they are now so very low. But they may not go very high in the next few years. If jobs continue to be hard to come by, consumers are likely to remain insecure. With inflation more under control and the economy expanding, real incomes will be rising faster than in recent months; but with the economy operating at less than potential, incomes may tend to rise slowly and family budgets will still be tight. Moreover, we have to make the adjustment from a cheap energy era to an expensive energy era. Not only will this put a crimp in the comforts of life, it will hit the basics as well. Food, housing, and transportation will likely take a larger share of family incomes, thus reversing a trend of many years in which the proportion of incomes going for basics--like food--has declined.

All this ties in with the possibility that the next few years may see the beginning of changes in life styles that so many futurists predict for us. These changes would have us moving from the goods-oriented life style of the past few decades to one that emphasizes the non-material and quality aspects of life. Perhaps this new life-style will make us all feel better in the end, but the transition from one to the other could be tough.

It won't be easy for some to step down from an Impala to a Nova and from large, mechanized houses to smaller, more spartan dwellings. Those who were led to believe in the 50's and the 60's that rapid economic growth is the key to a rising and more equitable living standard may find their rising expectations frustrated.

The businessman's attitude in part will reflect that of the consumer. Certainly, with about as much excess capacity as after the 1960-61 recession, there should be little enthusiasm for investing heavily in new plant and equipment. Much of the investment that does occur will likely be for pollution control rather than improvement and expansion of production. At the same time, the businessman may enjoy something of a repetition of a pleasant phenomenon of the early 60's. During that period, with productivity rising faster than wages, labor costs per unit of output actually declined for several years. This undoubtedly contributed heavily to the fact that wholesale prices experienced a long sustained period of stability back then. The businessman could face a world of mixed blessings in the coming years as well--inadequate demand and excess capacity but relative stability of costs.

If you are willing to accept for the moment the general proposition I am suggesting, let's go one step further to examine some implications for capital markets. In the kind of economy I've described demands for funds should not be pressing very hard on supplies--at least as far as the private economy is concerned. New issues by corporations remained fairly modest for several years after the 1960-61 recession and could again this time. The same goes for bank loans to business. If consumers are fairly restrained in their purchases of durables, demand for consumer credit may be moderate as well.

In the public sector, on the other hand, the Federal Government, I would guess, will be running a substantial deficit as long as unemployment stays high and, therefore, will be a persistent visitor in the credit market. State and local governments are less certain. But with their revenue outlook less than buoyant and continued pressures on expenditures, state and local governments will also be frequent tappers of credit.

On the whole though, all this suggests relatively moderate demands for funds. Combined with favorable experience on the inflation front, it could mean more stability for long-term rates than many now expect. Perhaps the experience of the early 60's is too much to hope for. The prime rate stayed absolutely constant for five years. Market rates on corporates, municipals and governments were remarkably stable.

I'm not making a prediction that the same will happen in the rest of the 70's, and I have left out many "on the other hands." But it is a possibility you might think about because it just might be what's in the cards.