The same speech notes were used for Bucknell University on February 16, 1996, Vanderbilt University on February 21, 1996, and University of Missouri-Columbia on February 29, 1996.

Notes for the above speeches are filed in the University of Missouri-Columbia February 29, 1996, speech folder.

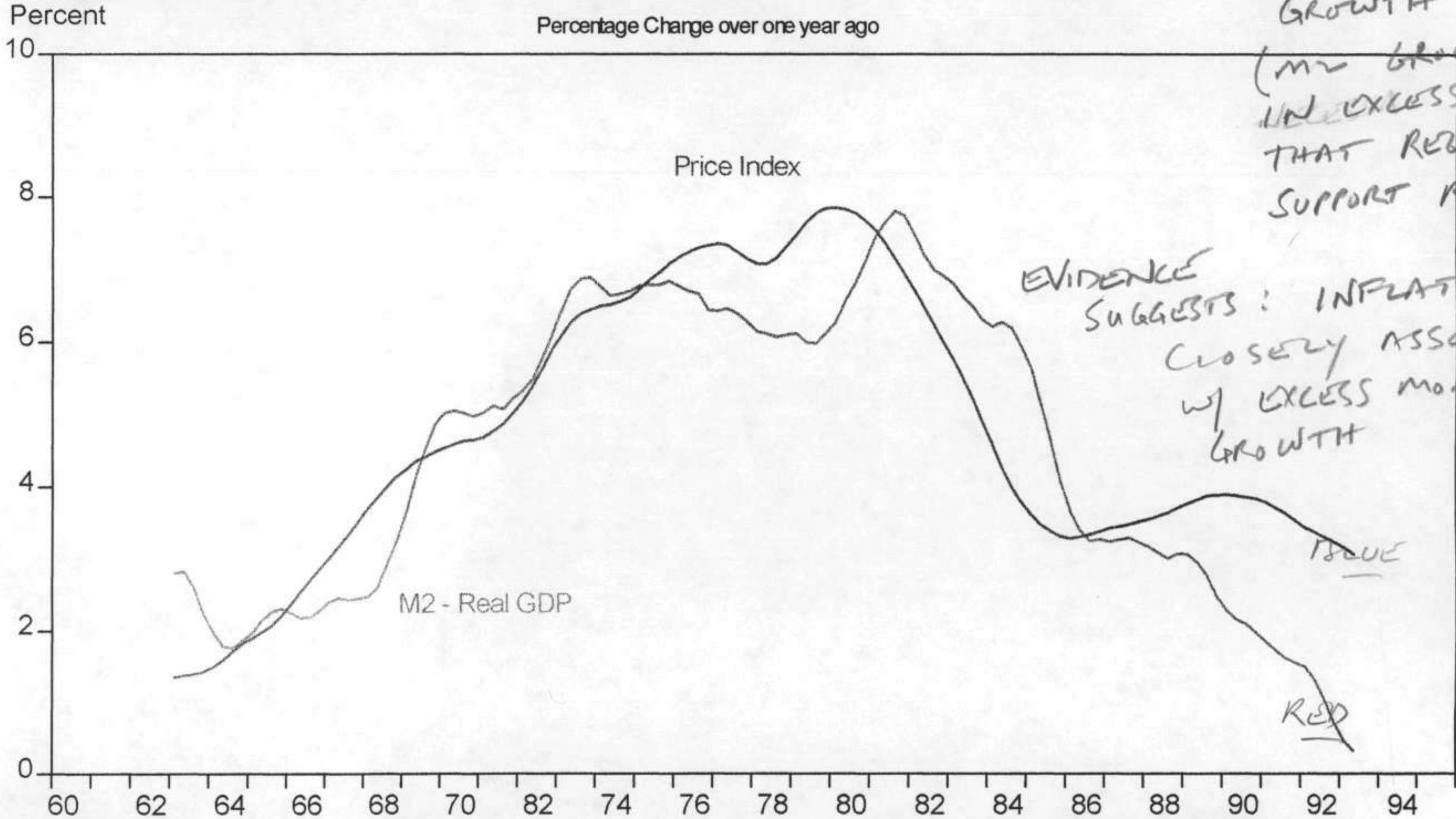
Myth: "Inflation is primarily caused by sudden increases in energy and other raw materials prices, and not by monetary policy."

SOUNDS REASONABLE:

INPUT PRICE GOES UP; OUTPUT PRICE RAISED TO MAINTAIN PROFITS; SIMILAR REACTIONS THROUGOUT SYSTEM; RESULT - INFLATION

M2 and Chain-Weighted Price Index Growth Rates

Quarterly Data, Seasonally Adjusted



HOR — YRS
VER — PCT GROWTH RATE
BL — IMPL GDP DEFLATOR
RD — EXCESSIVE MONEY GROWTH
(M2 GROWTH IN EXCESS OF THAT REQ'D TO SUPPORT REAL GDP)

EVIDENCE SUGGESTS: INFLATION CLOSELY ASSOCIATED W/ EXCESS MONEY GROWTH

AS MONEY GROWTH ROSE IN 60'S + 70'S, INFLATION ACCELER.

AS MONEY GROWTH FELL IN 80'S + 90'S, INFLATION DECELER.

Reality: "Over time, excessive money supply growth is the fundamental cause of inflation."

INFLATION IS EVERYWHERE AND ALWAYS A MINETARY PHENOMENON

INDEED, PRICE SHOCKS OCCUR WHICH HAVE SHORT-TERM IMPACT ON GENERAL PRICE LEVEL

BUT INFLATION CANNOT BE SUSTAINED OVER TIME UNLESS ACCOMMODATED BY MONEY GROWTH

(OIL PRICE SHOCKS IN 70's)

REMIND ABOUT LINKAGE BETWEEN MONETARY POLICY ACTIONS AND MONEY GROWTH, MONEY GROWTH AND INFLATION

Myth: "The Fed is too concerned with inflation, and not concerned enough about unemployment or real growth."

LOGICAL OUTGROWTH OF FED'S LEGISLATED OBJECTIVES:
STABLE PRICES
LOW UNEMPLOYMENT
MAX. SUSTAIN. GROWTH

PERCEIVED TRADEOFF BETWEEN PRICE STABILITY AND UNEMPL, GROWTH

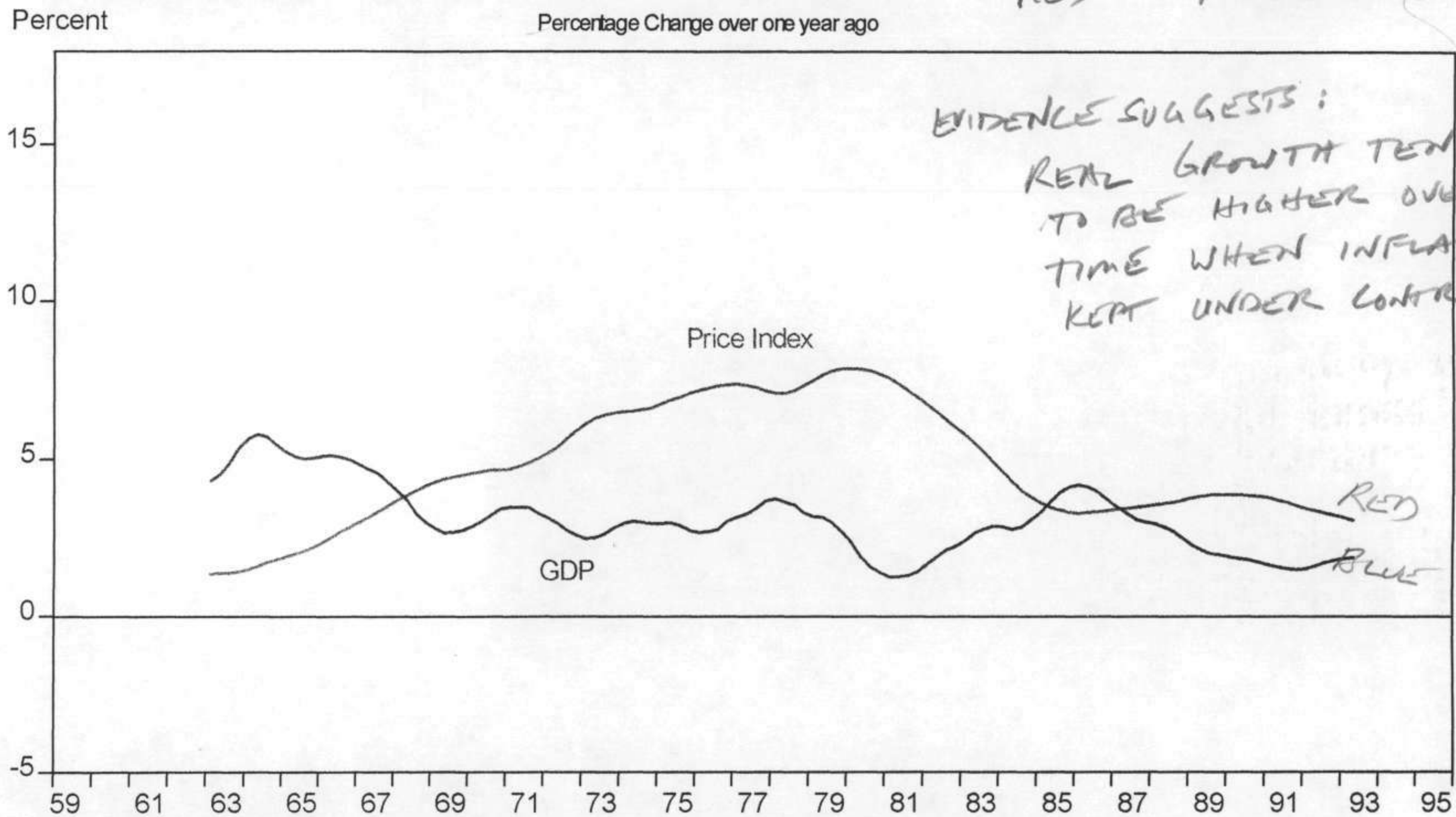
CERTAINLY CANNOT PURSUE RESTRICTIVE POLICY AIMED AT PRICE STABILITY AND BE ENCOURAGING LOW UNEMPL, MAX SUSTAIN GROWTH

IN FACT, RIGHT NOW FED IS BEING ACCUSED OF FIGHTING A NONEXISTENT INFLATION AT EXPENSE OF EMPL, GROWTH

HOR – YRS
VER – PCT GROWTH RATE
BL – REAL GDP
RED – IMPLIC GDP DEFLATOR

Chain-Weighted GDP and Price Index Growth Rates

Quarterly Data, Seasonally Adjusted



EVIDENCE SUGGESTS:
REAL GROWTH TENDS TO BE HIGHER OVER TIME WHEN INFLATION KEPT UNDER CONTROL

AS INFLATION ROSE IN 60's + 70's, REAL GROWTH DECLINED

AS INFLATION FELL IN 80's, REAL GROWTH ROSE

Reality: "The Fed can best support full employment and maximum sustainable growth by pursuing price stability."

KEY INSIGHT: KNOW FED CAN CONTROL INFLATION THROUGH ITS INFLUENCE ON MONEY SUPPLY OVER TIME

ALSO KNOW LOWER INFLATION GENERALLY ASSOC W/ HIGHER GROWTH

ONE WAY FED CAN MEET ITS SEVERAL OBJECTIVES IS BY PURSUING PRICE STABILITY

IN FACT, ONLY WAY; REAL GROWTH DETERMINED BY REAL RESOURCES AND PRODUCTIVITY, NEITHER OF WHICH FED CAN DIRECTLY AFFECT

ASIDE: WHY IS HIGHER INFL ASSOC. W/ LOWER GROWTH?

DISTORTS PRICE SIGNALS (EG., BUILDER)

ADDS TO UNCERTAINTY (E.G, LONG-TERM RATES)

THUS IMPINGES ON SMOOTH FUNCTIONING OF MARKETS, EFFIC USE OF RESOURCES

Myth: "The Fed can reduce unemployment in the short-run by accepting a higher rate of inflation."

EVEN IF NO LONG-TERM TRADEOFF BETWEEN INFLATION AND GROWTH, MAY BE ABLE TO TAKE ADVAN. OF SHORT-TERM TRADEOFF (i.e., IF MONETARY STIMULUS INITIALLY REFLECTED IN HIGHER OUTPUT)

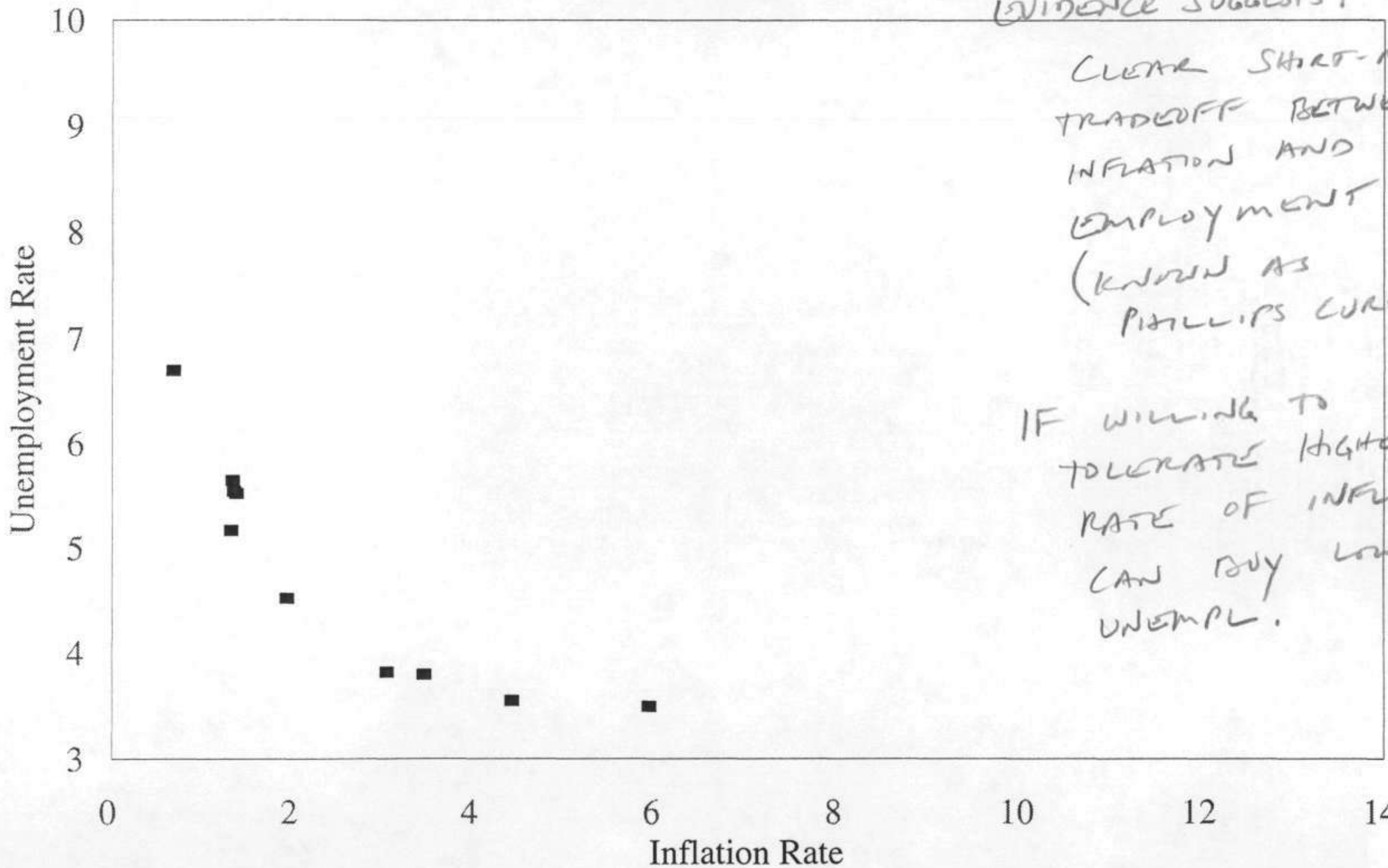
TEMPTING IN CURRENT CIRCUMSTANCES: INFL. APPARENTLY UNDER CONTROL, AND SIGNS ON REAL ECON MIXED

SO WHY NOT RUN SOME INFLATION RISK AND BUY SOME REAL GROWTH, EVEN IF ONLY TEMPORARY?

HOR – INFL RATE
VER – UNEMPL RATE
SQS – EA REPRESENTS A YR IN '60's

Inflation/Unemployment Tradeoff

1960s



EVIDENCE SUGGESTS:

CLEAR SHORT-RUN TRADEOFF BETWEEN INFLATION AND ON EMPLOYMENT (KNOWN AS PHILLIPS CURVE)

IF WILLING TO TOLERATE HIGHER RATE OF INFLATION, CAN BUY LOWER UNEMPL.

9

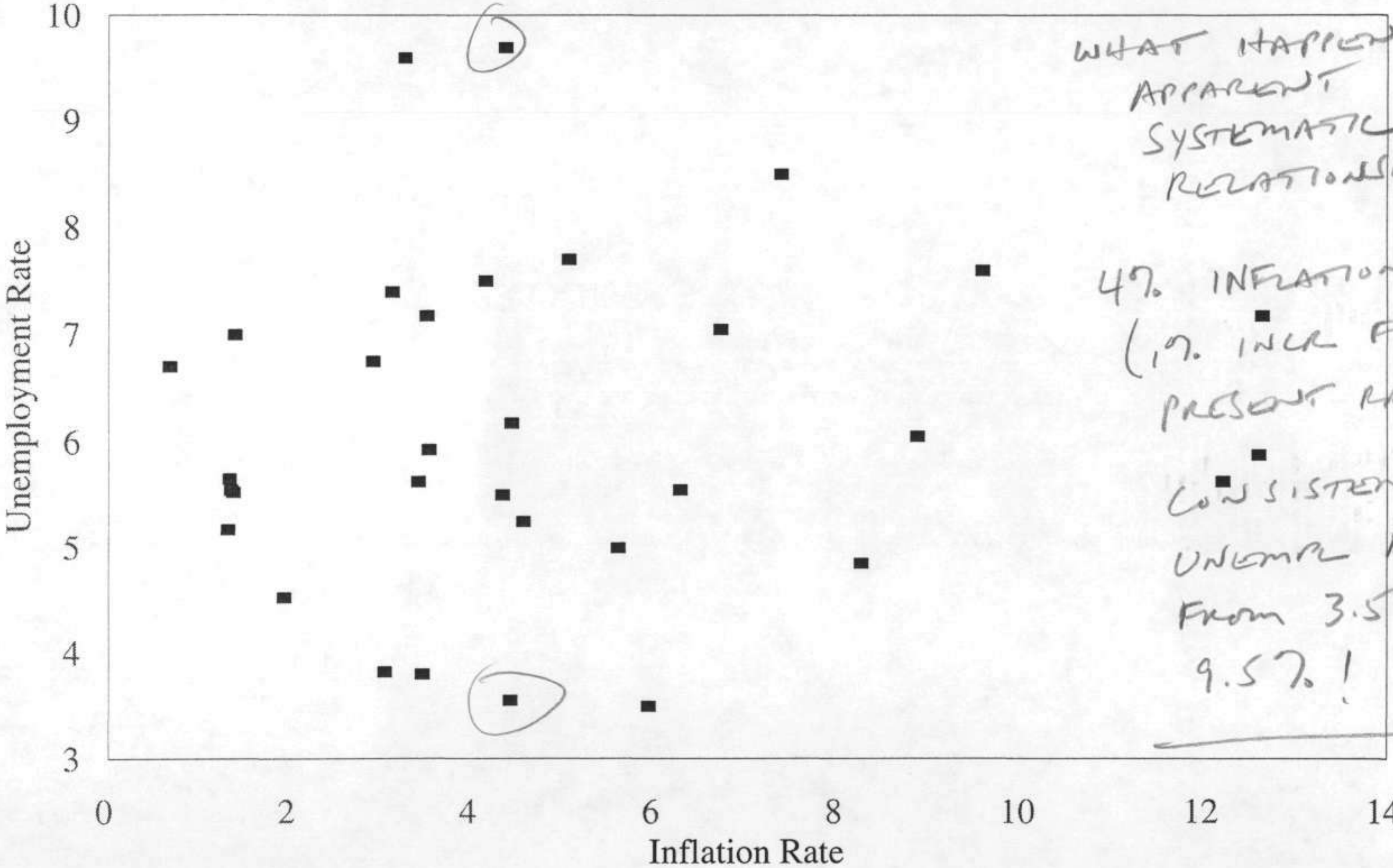
ADD 70's, 80's + 90's

AXES: SAME

SQS: SAME

Inflation/Unemployment Tradeoff

1960-1992



WHAT HAPPENED TO APPARENT SYSTEMATIC RELATIONSHIP?

4% INFLATION (1% INCR FROM PRESENT RATE) CONSISTENT W/ UNEMPL RANGING FROM 3.5% TO 9.5%!

Reality: "There is no persistent trade-off between unemployment and inflation."

SURPRISE BURST OF INFLATION
MIGHT TEMPORARILY RAISE
OUTPUT AND LOWER UNEMPL.
BECAUSE OF UNCERTAINTY SURROUNDING
INCR IN PRICES (CF. BUILDER EXAMPLE)

ONCE REALIZE GENERAL PRICES ~~LEVEL~~ HAS
RISEN, IMPACT VANISHES — HAVEN'T INCR
REAL RESOURCES
OR PRODUCT.

(EASIER TO FOOL PEOPLE IN 60's)

DESPITE LACK OF TRADEOFF, MANY
(INCL. SOME POLICYMAKERS) STILL
ADVOCATE SHORT-TERM FINE TUNING

Myth: "The Fed controls interest rates."

ONE OF MOST COMMON

AFTER MOST RECENT MTG IN
LATE JAN, HOW MANY HEARD OR
READ STATEMENT, "THE FED LOWERED
INT. RATES TODAY?"

FED DOES DIRECTLY INFLUENCE
ONE MARKET RATE –
FED FUNDS RATE

(DEFINE)

HERE WE HAVE RELAT. BETWEEN TWO LONG-TERM MARKET RATES AND FED FUNDS RATE

HOR — YRS

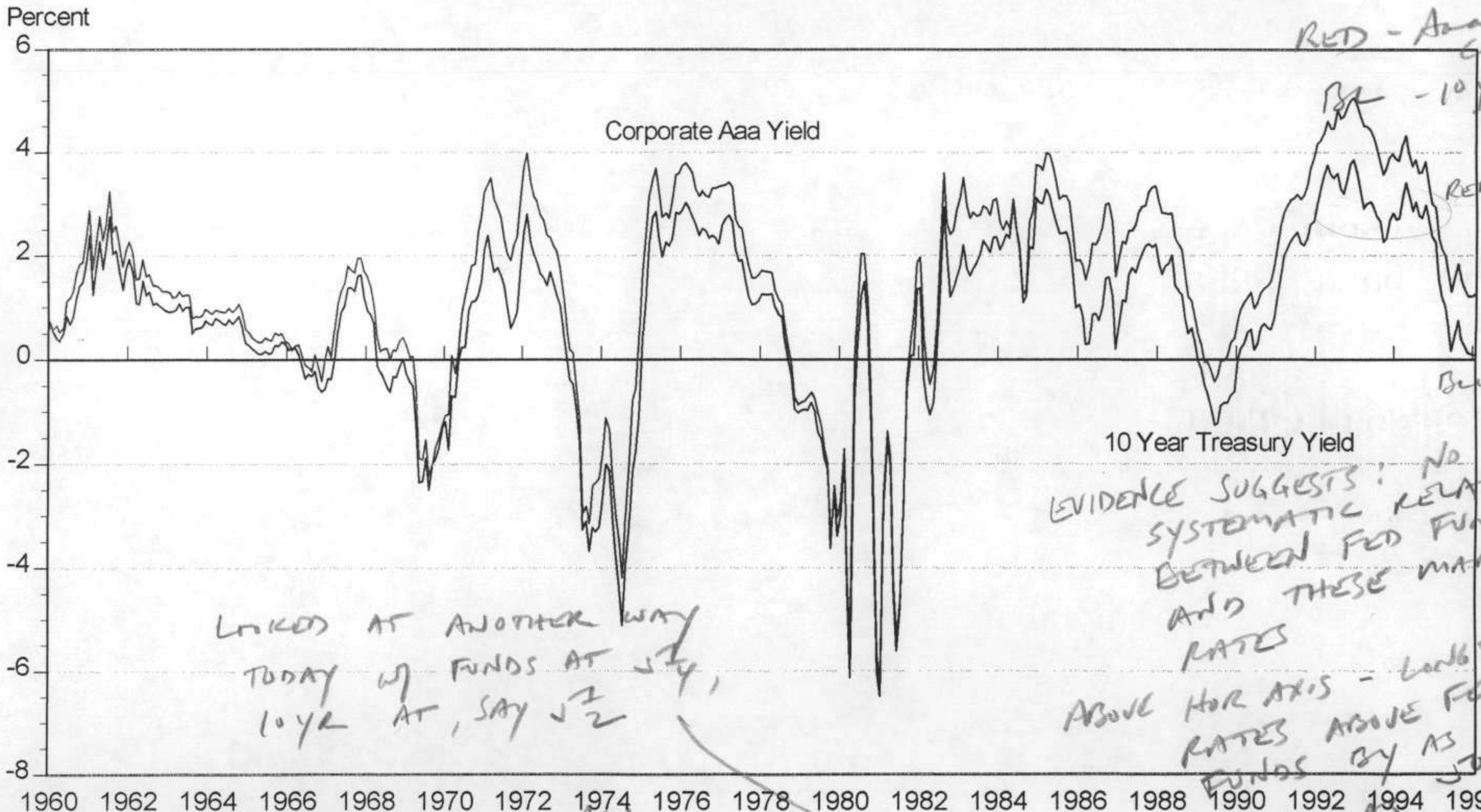
VER — PCT YIELD DIFFER

RED — Aaa CORP

BL — 10 YR TREAS

Differences Between Market Yields and the Federal Funds Rate

January 1960 - January 1996



RED

BLUE

EVIDENCE SUGGESTS: NO SYSTEMATIC RELAT BETWEEN FED FUNDS AND THESE MARKET RATES

ABOVE HOR AXIS — LONG TERM RATES ABOVE FED FUNDS BY AS MUCH AS 500 BP

BELOW — OPPOSITE

LOOKED AT ANOTHER WAY TODAY W/ FUNDS AT 5 1/4, 10 YR AT, SAY 5 1/2

COUPLE OF YRS AGO W/ FUNDS RATE AT ABOUT SAME LEVEL, 10 YR ALMOST 8%

Reality: "The Fed has considerable short-run impact on the federal funds rate, but little direct influence on other market interest rates."

INTEREST RATES SET BY MARKET FORCES OF SUPPLY AND DEMAND

INCLUDE PREMIUM TO ACCOUNT FOR FUTURE INFLATION EXPECT. AND UNCERTAINTY ABOUT THAT EST.

PREMIUM CAN BE QUITE LARGE IN LONGER-TERM RATES

Myth: "The Fed's anti-inflation policy keeps interest rates high."

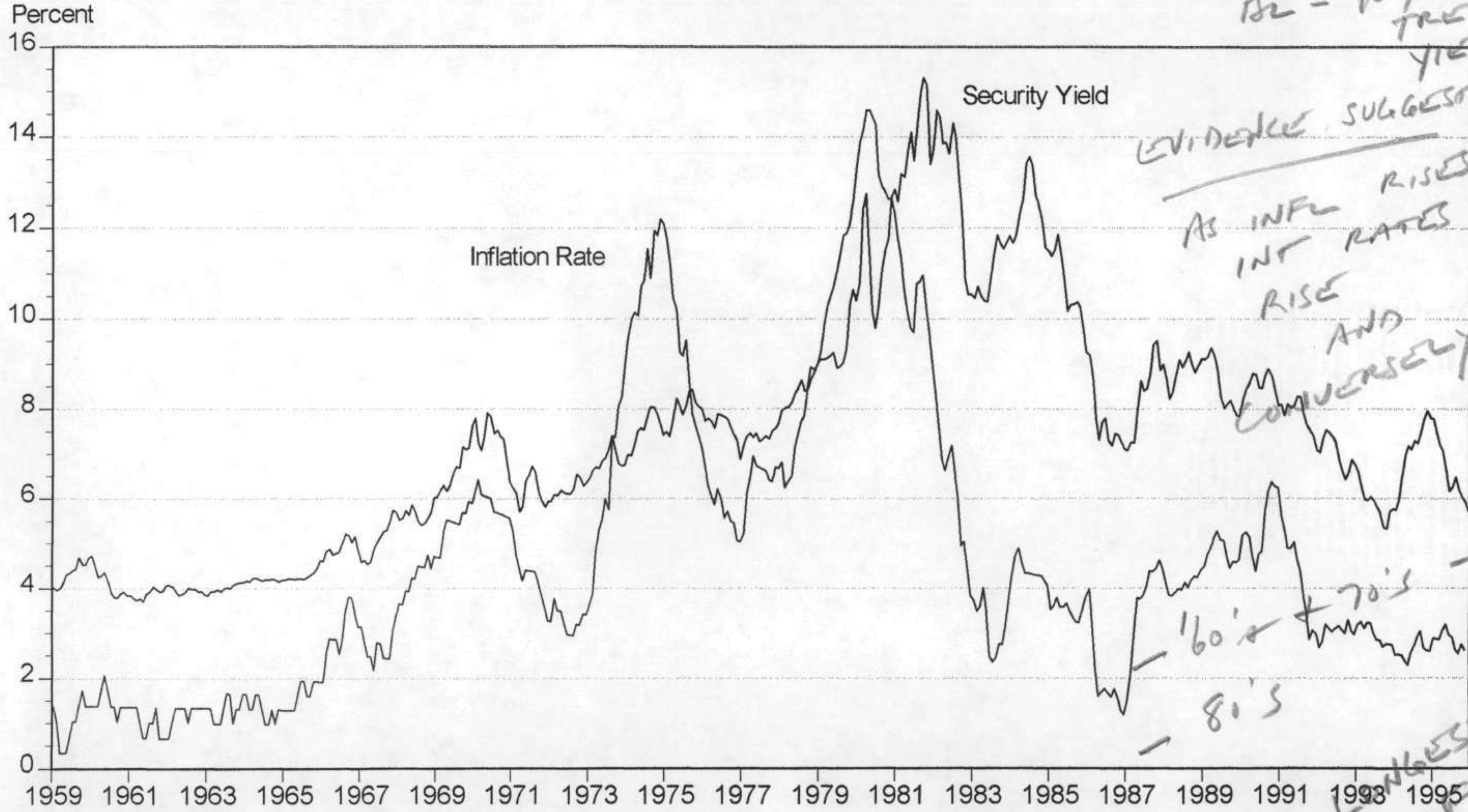
FOLLOWS FROM PREVIOUS MYTH

IF RESTRICTING RESERVE AVAILABILITY TO CONTAIN INFL PRESSURES OR REDUCE INFL., FED FUNDS RATE MIGHT RISE

THIS, SO THE STORY GOES, CAUSES ALL INT RATES TO RISE

HOR - YRS
VER - PERCENT
RD - INFL RATE
BL - 10 YR TREAS YIELD

Ten Year Government Security Yield and Year-Over-Year CPI Inflation
January 1959 - December 1995



EVIDENCE SUGGESTS!
AS INFL RISES, INT RATES RISE AND CONVERSELY

BLUE

RED

- '60's + 70's -

- 80's -

- 90's LONGEST PERIOD OF LOW, RELATIVELY STABLE INFL SINCE LATE 50's/EARLY 60's

LOWEST 10 YR TREAS YIELDS SINCE LATE 60's

Reality: "Interest rates are generally lower when inflation is low."

SMALLER INFLATION PREMIUM

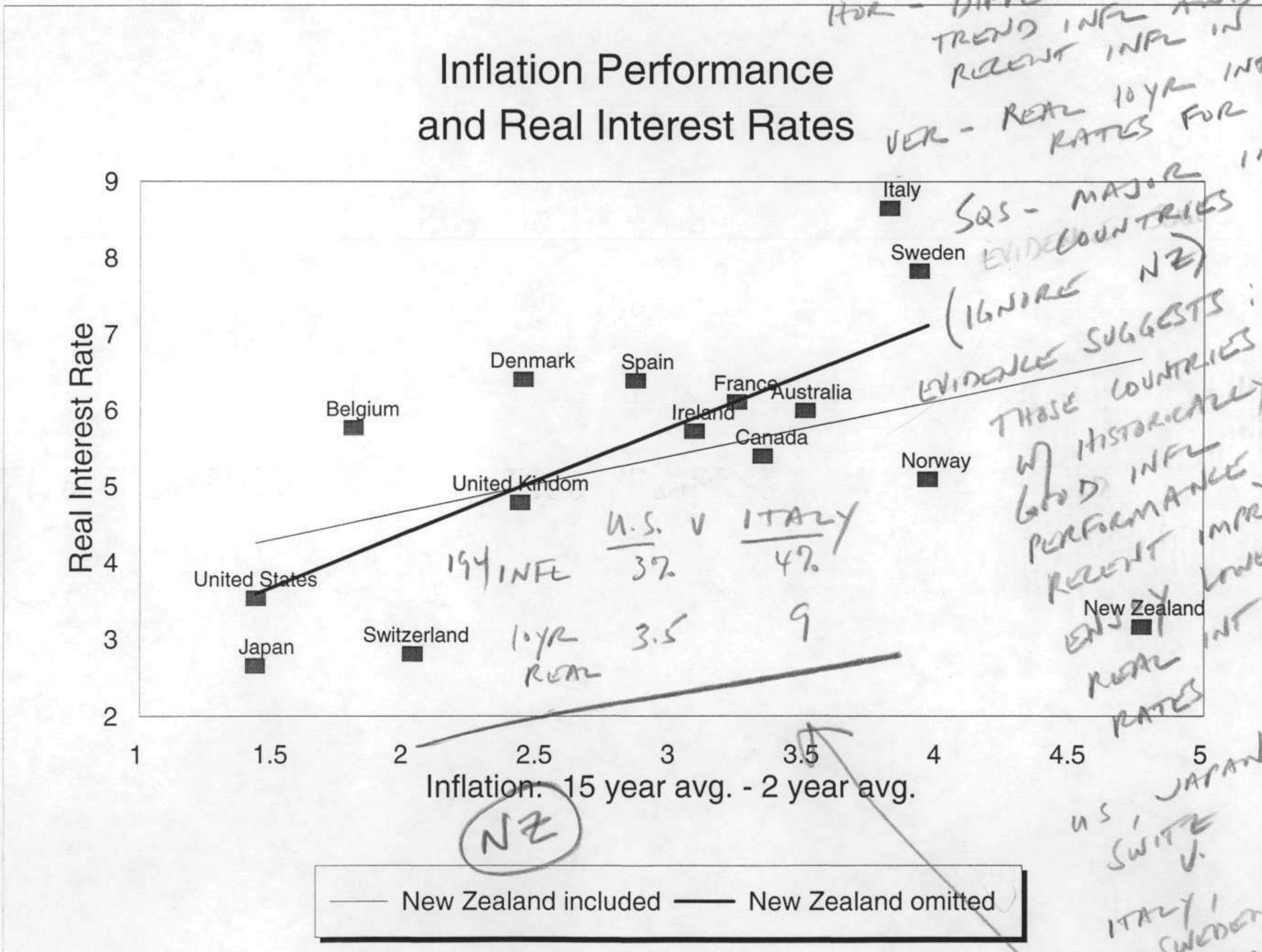
Myth: "Once controlled, inflation has no lasting consequences."

SO WHAT IF ENGAGE IN SHORT RUN FINE TUNING AND INFLATION MOVES HIGHER?
SIMPLY BRING BACK DOWN LATER
CENTRAL BANKERS ARE UNNECESSARILY PREOCCUPIED W/ INFLATION

RELAT. BETWEEN INFL PERFORM + REAL INT RATES

HOR - DIFFERENCE BETWEEN TREND INFL AND RECENT INFL IN PCT PTS

VER - REAL 10 YR INT RATES FOR 1994 IND



SQS - MAJOR IND COUNTRIES (IGNORE NZ)

	U.S.	v	ITALY
94 INFL	3%		4%
10YR REAL	3.5		9

NZ

EVIDENCE SUGGESTS: THOSE COUNTRIES W/ HISTORICALLY GOOD INFL PERFORMANCE (LITTLE RECENT IMPR) ENJOY LOWER REAL INT RATES

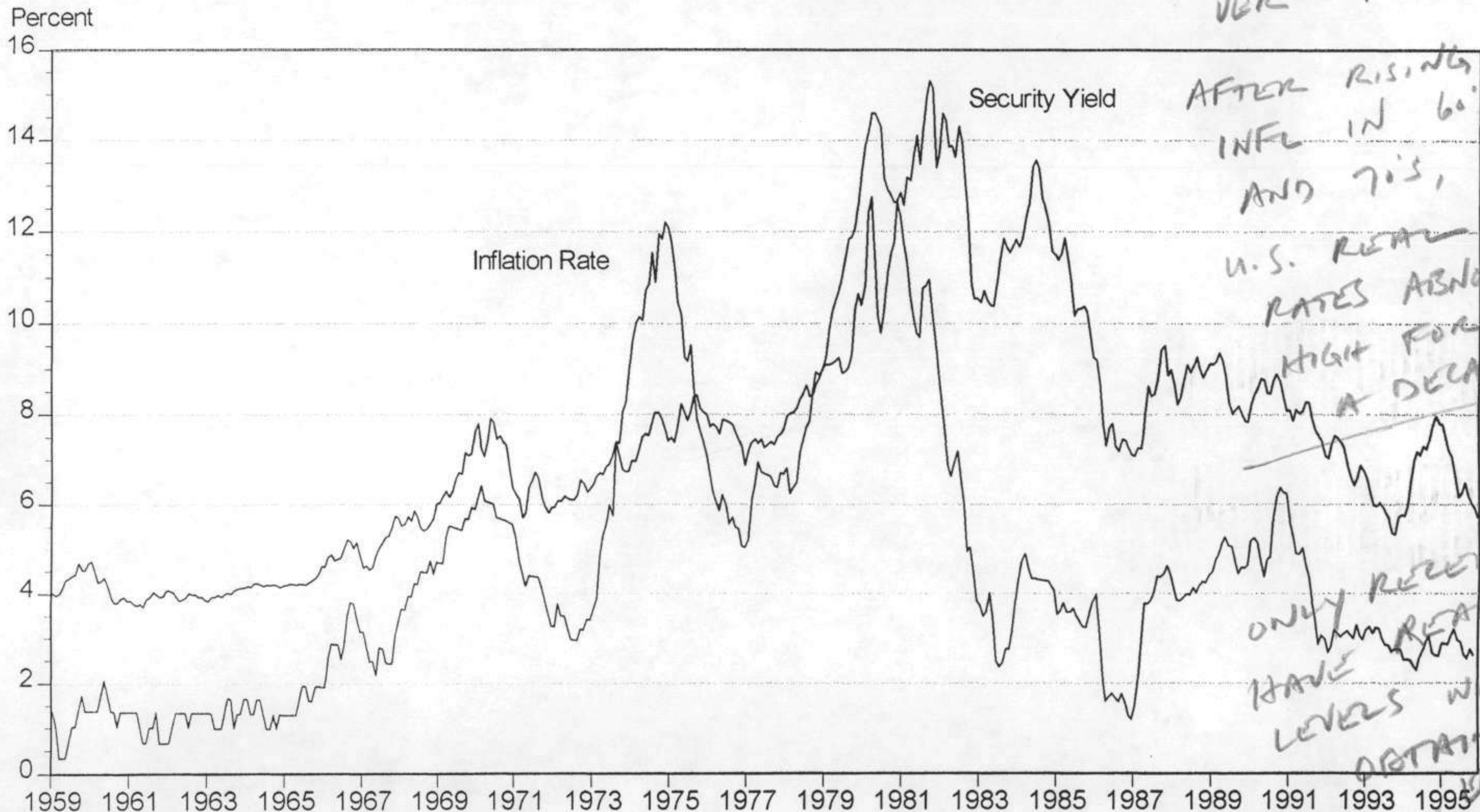
US, JAPAN, SWITZ V. ITALY, SWEDEN, AUST.

SAW EARLIER

Ten Year Government Security Yield and Year-Over-Year CPI Inflation

January 1959 - December 1995

HR - YRS
VER - PERCENT



AFTER RISING INFL IN 60's AND 70's, U.S. REAL RATES ABNORM HIGH FOR A DECADE

BUT ONLY RECENTLY HAVE REACHED LEVELS WHICH OBTAINED IN EARLY 60's

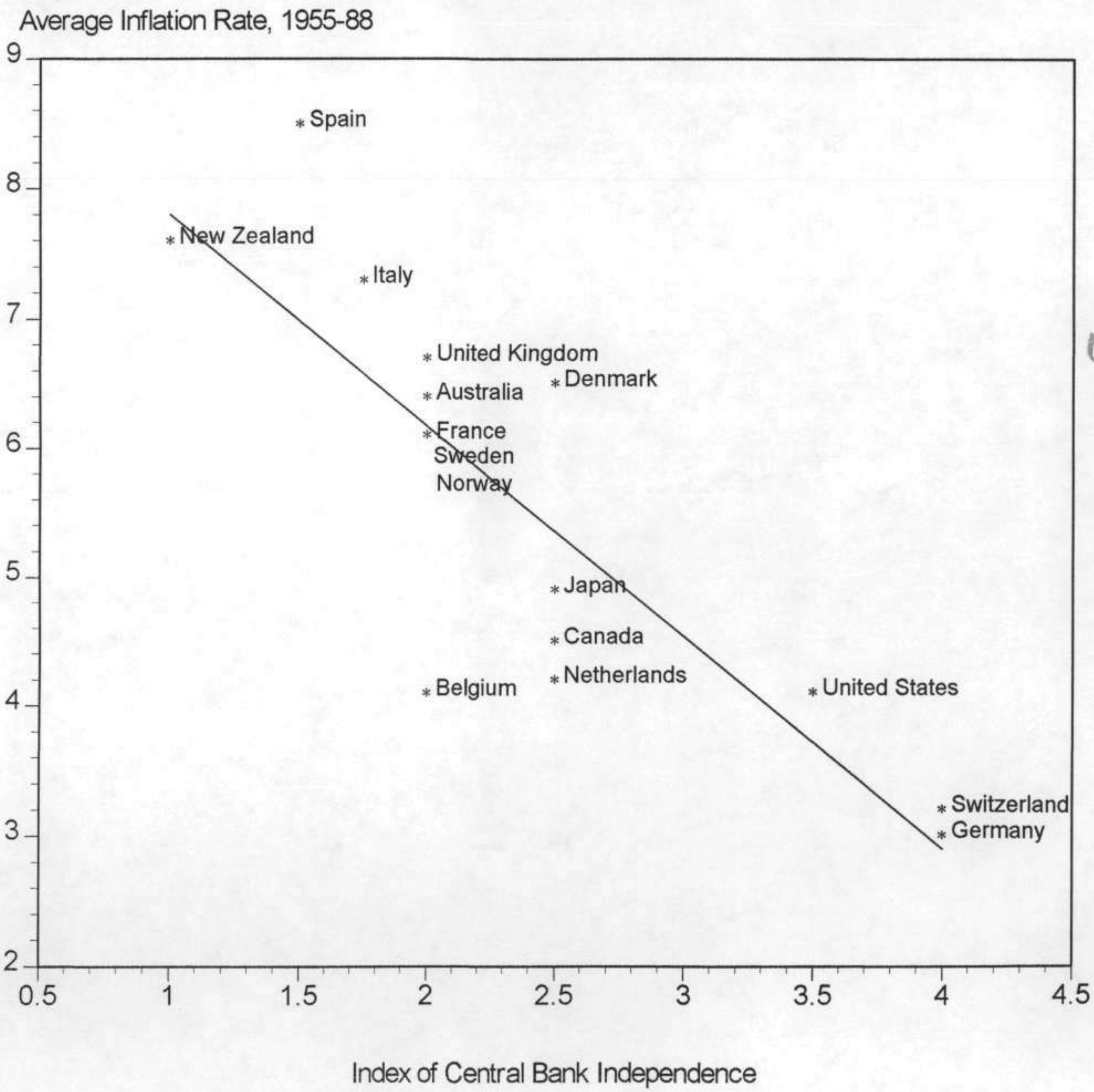
Reality: "Once lost, it takes time to regain the credibility of an anti-inflation monetary policy. The mere possibility of higher inflation can raise the real cost of borrowing."

ENOUGH SAID!

Myth: "The Fed has too much independence."

FED CRITICIZED FOR BEING TOO INDEPENDENT – "ELECTED OFFICIALS SHOULD HAVE MORE CONTROL"

Inflation and Central Bank Independence



HOR: INDEX OF INDEPEND FROM ALLESINA/ SUMMERS

VER: AVG INFL RATE 55-88

EVIDENCE SUGGESTS: THOSE COUNTRIES W/ MOST INDEPEN. CENTRAL BANKS HAVE LOWEST TREND INFL RATES

(ALSO GRTST CREDIBILITY)

Reality: "Inflation is lower in countries with independent central banks."

REMEMBER: LOWER INFLATION ASSOCIATED W/ HIGHER REAL GROWTH

Myth: "The Fed should be more accountable for its actions."

FOLLOWS FROM PREVIOUS MYTH

TOO INDEPENDENT -- NEEDS TO BE HELD MORE ACCOUNTABLE

USED AS AN EXCUSE TO PUT SHORT-TERM POLITICAL PRESSURE ON FED, INTERFERE W/ DELIBER. PROCESS (E.G., HEARINGS IN EARLY 90'S)

Reality: "The Fed should be more accountable for its actions."

REALITY IS, I AGREE!

WAY TO ACHIEVE IS BY GIVING FED CLEAR, ACHIEV. OBJECTIVE AND THEN JUDGE PERFORMANCE AGST

(COMPARE TO EMPLOYER/EMPLOYEE RELAT)

BUT PROBLEM W/ CURRENT OBJECT — HELD ACCOUNT FOR THINGS CANNOT DIRECTLY INFLUENCE

ONLY OBJECT THAT MAKES SENSE IS PRICE STABILITY OBJECT

(MACK BILL)

A politically-independent central bank, with a clear mandate to focus on price stability as its sole objective, will produce the monetary policy that can best promote full employment output growth.