PRESS CONFERENCE

With

G. William Miller

Chairman, Board of Governors of the Federal Reserve System

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MILLER PRESS CONFERENCE

Mr. Balles. Some of you, I'm sure, were here last June for Chairman Miller's last San Francisco press converence, held in conjunction with a major address that he gave to the Bay Area Council. We're delighted to have you back, Mr. Chairman, and I think the floor is open.

Mr. Miller. Thank you, John. I do not have a prepared statement, and so I'll just open it up to your questions.

Question. Mr. Miller, much is being said these days about what we can do to try to control inflation. Although the Administration says that it is being controlled, it seems that the paychecks and so forth are actually not keeping pace with the inflation. What can the Federal Reserve do about this?

Answer. Well, the Federal Reserve's responsibility in the anti-inflation fight is restricted to monetary policy, which affects money and credit and thus is very much related to the whole problem of inflation. In order to look at the probabilities of wringing inflation out of our economy, we need to know something about how it came about. The inflation we are now experiencing in the decade of the 1970's is higher than we've ever experienced in peacetime. But the origin of the inflation goes back a dozen years. It started with the policies dealing with Vietnam, and the fact that we did not at that time feel that we could or should tax the American people to pay the bill. So we started off with building inflationary forces, and over the decade of the 70's we've been trying in various ways to cope with those forces. What will be necessary to bring inflation down towards zero, where it should be, is a multi-year -- five, six, seven year -- campaign against inflation. With that campaign, we not only have to take care of the transitory aspects, but also uproot the embedded

features of inflation which have become so structural that it's going to take a consistent and prolonged warfare to eradicate them.

Question. What's being done about eliminating and cutting down government spending?

Answer. There are a number of policies that are important in order to control inflation. One is fiscal policy, which has to do with Federal spending and taxing. Here, one of the aspects of inflationary pressure has been the build-up of large Federal deficits over a number of years, the cumulative amount of which is quite large. During the decade of the 70's we'll double our Federal debt. In other words, in ten years we'll double the debt which had been accumulated over two hundred years of the republic. Obviously that scale of accumulated Federal debt creates substantial pressures on our financial system. The financing of that Federal debt competes with the capital needs of the private sector, where the creation of jobs through investment is essential if we're going to accomplish our economic goals. So the important thing is to continue to bring the Federal deficit down to zero -- and more than that, to reduce the level of Federal expenditures in relation to the total economy from the recent 22-percent figure to something like 20 percent of GNP. That would transfer $60 or $70 billion over time back to the private sector, where the cumulative effect of individual and business spending decisions will be far more effective and do more long-term good for the economy.

Question. Various political solutions to this problem are being suggested. One is limiting taxes, the other is limiting spending. Can you comment on which of these two is more effective, or are both needed in the long-run to contain inflation and stabilize the economy?

Answer. In order to accomplish the fundamental purpose, we've got to limit Federal spending to not more than 20 percent of Gross National Product, and that can be accomplished by continuing the present trend over the next couple of years. Once you've limited spending, and have an objective of a balanced full-employment budget, then obviously you have to limit taxes accordingly. As you keep Federal spending lower in relation to the total economy, you need to tax less in order to cover it. In that way, you get a dividend back to the private sector. So it's very important to recognize that on the spending side, we must have discipline, and once we have exercised that discipline we can cut taxes commensurate to the cut in spending. It would be very dangerous to cut our taxes and just increase the Federal deficit without cutting spending.

Question. It's said that any bureaucracy can probably defeat any president by just holding the line and doing nothing. Are you running into a lot of resistance in trying to cut spending? Can it really be done?

Answer. Let me declare my colors. I'm from the central bank, which in the United States is called the Federal Reserve System. Its responsibility in this area is of course monetary policy -- the regulation of money and credit in the banking system. So when we talk about fiscal policies, we're talking about policies that belong to the Administration and Congress, but which are important to the Federal Reserve because we need to have help in dealing with monetary policy issues. If the fight against inflation were left to monetary policy alone, it would be necessary for us to put a terrible crunch on the economy to wring out inflation. By getting parallel discipline on the fiscal side, it very much helps us on the monetary side. Of course, decisions on spending and taxing belong to the President and Congress and not to the Federal

Reserve. But it is important that we express our views on these questions because they relate to the posture of monetary policy, to the growth of money and credit, which is extremely important if we are to wring out inflation. We must have monetary discipline, but that discipline will be more effective and work through the economy with less hardship if it's coupled with fiscal discipline.

Question. The present plans for raising the prime rate and other interest rates seem to be taking money out of the pockets of consumers and adding to inflation. Is this successful or not?

Answer. Well, I don't think I can respond to plans to increase those kinds of costs. The prime rate is set by banks in a marketplace dealing with the supply and demand of a commodity, money, which is like any other commodity such as wheat or corn. It is true that the Federal Reserve's posture in fighting inflation has been to restrain the growth of money and credit, and that makes it scarcer and tends to make short-term costs higher. But, without that restraint, there would be an excessive flood of money in the economy -- and the demand for goods and service would accelerate, and the inflation would accelerate, and interest rates would accelerate further, and the penalty would be even greater. So trying to restrain the monetary aggregates and the growth of credit does cause some short-term rates to go up. Let me tell you a couple of things about that, however. Number one, long-term interest rates have not gone up as much as short-term rates, because long-term rates are based upon the evaluation over a longer period of time of what may happen to inflation. At the moment, there are higher rates in the long-term capital markets, but those rates have increased much less than short-term rates. The short-term market is where the battle is being

waged to try to dampen the forces of inflation. But interest rates are made up of two components. One is inflation. If you lend me $100 at the beginning of the year, and if inflation is 8 percent during that year, you need $108 back at the end of the year to have the same purchasing power you had before. If you've got 8-percent interest, and there is an 8-percent inflation, you would receive zero real interest. So that's one component of interest. The other component is real interest, how much more do you have to pay to return the same purchasing power.

Question. If we keep going at the present rate, are we going to be in for a recession or depression?

Answer: Well, we certainly are not going to be in for a depression. That's just not in the cards; there's nothing in our economy that would suggest that. We have a well-balanced economy. Our activities in the process of fighting inflation -- discipline on the fiscal side, incomes policies, efforts to defend the dollar, and monetary restraints -- all have the objective of dampening down the economy so it doesn't bubble up too strong. And as you dampen an economy, there is a risk that it might slow too much and go into a recession. It's my judgment that we're not going to have a recession in 1979. I have said previously that our policies are so dedicated to fighting inflation that we'll have to take the risk that there might be a recession, but it's not our purpose or desire, nor is it likely. It's not likely now because the economy is well-balanced and consumer spending is supported by increasing employment; the number of jobs in our economy has risen by 7 1/2 million in the last two years, and this has created new purchasing power. Along with that, we've continued to have a very well-balanced inventory position, so that we don't have an

overhang of unsold inventory that would require an adjustment of production lines. We've had housing maintained at a fairly decent level -- its decline this year should be only moderate. Business spending will not be particularly bullish, but will be maintained at a level pace. And so we have a very balanced condition overall.

Question. If we could back up for just a second, what is your best guess as to where we are right now on the interest cycle? Are rates about to break and go down, or are they going to climb some more?

Answer. Well, the interest-rate cycle will be determined by the confluence of all the policies I mentioned, and the degree to which the dampening of the economy translates itself into a reduction in demand for money and credit. We have been endeavoring to pursue a policy which would create a dampening, and would therefore make it unnecessary to have greater restraint that would drive interest rates higher. None of us can tell when the peak in rates may come. Last June when I was here, I said that the 1978 peak in interest rates would come in 1978, and they did. And the 1979 peak in interest rates will come in 1979, which of course is no answer to your question.

Question. Do you feel we're on the threshold of the peak now or in the next few weeks?

Answer. No, I can't say that. I think we must be prepared to take whatever monetary and fiscal action is necessary to restrain inflationary forces. We can't predict exogenous events -- can't predict what will happen to oil supplies in the world or what will happen to crops, so I

don't think anyone should try to predict interest rates. I've never predicted interest rates. My answer is not meant to be facetious; it's meant merely to illustrate that I think we would be unwise to have a fixation on interest rates. We should look at the underlying effect of rates on the economy. I'm very interested in getting more people to understand the objectives of our monetary policy, including our interest-rate objective. The objective of monetary policy has been, number one, to restrain the growth of money and credit in order to dampen real activity in the economy to a sustainable level. Second, the policy has been to bring this about smoothly, with the restraint being put on steadily and smoothly, and not with some disruption to the economy. So there has been a steady application of the pressure. And third, there has been an effort to bring about this restraint, not only smoothly, but also in a balanced way, so that we don't throw too much of the burden on any one sector of the economy. This has been accomplished as I mentioned. And a fourth objective has been to dampen the level of output and real activity in the economy, but not to recessionary levels. We see a strategy of maintaining slower rates of growth for longer periods of time, rather than a strategy of up and down, which is so disruptive to an economy and so distressing to most Americans.

Question. Do you feel that Congress will pass a bill this year to resolve the attrition in the Federal Reserve System?

Answer. We're very hopeful about the reintroduced monetary-improvement legislation, which was initiated last year and which Congress addressed but could not complete because of the time limits on the last session.

We're very hopeful that this legislation will develop into a sound package to improve the relation between the central bank and the banking and depository institutions, and thus improve our capacity to deal with monetary policy. There are two objectives of that legislation. One is to improve the conditions of fair competition among depository institutions, so that we have a strong competitive equality among such institutions. The second is to improve the capacity of the Federal Reserve to exercise monetary policy. That is accomplished by assuring that adequate coverage of deposits in the United States is subject to central-bank reserve requirements, so that the predictability of monetary policy will be greater -- and therefore the probability of action coming out in the way we desire will be greater, with less sloppiness and less room for error.

Question. Do you really feel that universal reserve requirements have a chance, in view of all the opposition to it?

Answer. Let's look at the constituencies who are affected. It seems to me the purpose of this legislation has been to put forward some far-reaching yet very fair proposals, and then to assess the legitimate concerns of those affected and to try to accommodate those concerns. This isn't some preconceived idea that is being rammed down somebody's throat. The democratic process involves taking the real issues that affect the economy and making sure that they have been talked through and debated. This is not a question of us just trying to accomplish something without considering how it affects various institutions. Member banks certainly should support this move because it would lessen their burden, lessen the tax that applies only to member banks through reserve requirements, and make them more able

to compete with other depository institutions. Nonmember banks would benefit because we would stabilize the environment for competition between banks and non-banks and near-banks, and this means with some established ground rules that the environment would be more equitable -- that non-member banks would have a more certain future. Smaller banks and smaller thrift institutions would be benefitted because they would have access to the central bank and yet be exempted to a large degree on deposits up to a substantial level. So they would have the benefit of the backup of the central bank -- its services and its discount window -- without the burden of reserves. Thrift institutions would benefit, in my opinion, because reserve requirements would affect only their transactions accounts, which means you lessen the tension as thrifts seek new asset powers. If they're subject to the same ground rules, then we're likely to see those powers develop in a more orderly fashion that if they have a preferred position. The Federal Reserve benefits because we gain better monetary control. The U.S. Treasury is a beneficiary, because if we do not take such action, Treasury revenues are going to drop off. It seems to me that everyone is going to be able to benefit. So I think we'll find that there will be a growing consensus, and an understanding of how this works, and a resolution of those areas of difficulty which need to be examined to see if there's any particular part of this that could be improved in some way.

Question. What message do you bring from Washington to the middle-income wage earner who can no longer buy a car every couple of years, who can't afford a home, and who gets a raise and yet brings home less pay?

Answer. I bring to every American the message that inflation is a clear and present danger -- it threatens the economic well-being of those Americans and of every other American. The disease has come upon us because of long-term conditions, yet whatever short-term adjustments and sacrifices each of us will have to make will be worth it. We must wring out inflation. That is the only way to assure the prospects for growth in real income and for the maintenance of real values -- the opportunity for middle America to go back to the period where they've experienced annual improvements in real income. If we do not wring out inflation, there will be no hope of that. Every American family, therefore, ought to enlist in the war against inflation, ought to be willing to be more austere in their personal choices of spending, be willing to forego some items in order to dampen the pressures of demand, and be willing to take substitutes for products that are escalating too much in price. We ought to become better disciplined in our families in order to contribute in a massive way to the discipline that is essential. The reward for that is price stability, full employment, a sound dollar, and a return to periods when we will have annual improvements in real income.

Question. What sort of an inflation rate do you find acceptable?

Answer. Zero.

Question. Do you really think that's possible?

Answer. I certainly do. Between 1961 and 1965, for about five years, this country had the longest period in the post-World War II era of peacetime economic expansion. That whole era was characterized by virtual price stability. The annual increase in prices -- that is the inflation

rate -- was on the order of 1 percent, but that was virtually zero because the quality of goods was changing enough to account for the 1 percent. In that period, we had a remarkable expansion of business fixed investment, which produced a remarkable period of productivity gain and which made it possible for all families to achieve annual real increases in income. Therefore, since prices weren't going up, we experienced perhaps one of the most congenial times we've seen with real progress. Now there's no real reason we cannot return to that. We must do it by exercising discipline in the fiscal area and the monetary area. We must all put our support behind incomes policies -- the wage and price moderation the President has called upon business and labor to implement. We must be willing to really address ourselves to productivity. Our productivity has fallen way behind other nations. Our capital investment has fallen behind other nations. We must incentivize that in order to get capital flowing back. That produces both the jobs and the lowering of costs that would break this vicious cycle of wages chasing prices and prices chasing wages. We must defend the dollar because a weak dollar introduces inflation, and we must promote our exports to close our trade gap. We must be more serious about energy conservation. Here we have OPEC increasing prices this year. The price by the end of this year will be 14 1/2 percent over what it was in December. I do not detect anywhere the kind of response that I think Americans ought to make. We ought to cut down by 15 percent the gasoline we individually use this year. And I can tell you that in any family I know, that can be done with a little caution without interrupting the

standard of living at all. We waste that much just by not being careful. And if we would begin to take seriously these issues and respond individually and collectively, the cumulative effect would be fantastic.

Question. How quickly, under the slow and steady pressure that you talk about -- and assuming that you can keep it all in balance and not go into recession -- how quickly do you think we can get back to roughly a zero inflation rate?

Answer. Well, when you come to the top of an inflation cycle, and start down the slope of the other side, your rate of change downward is slow. So we'll start off with slow reductions of inflation, of 3/4 percent a year perhaps. But it will take five years minimum -- and depending on how hard we work at it, perhaps longer -- in order to bring inflation down to the 3-percent range. And at that point, of course, I think the momentum of reducing inflation will carry us on down to something approaching the zero rate. We won't be able to measure it when you get down below 2 percent, because changes of mixed individual desires and kinds of products will make it difficult to see whether we're really changing prices or changing our standard of living. But that's a time table that we've got to realize, which means that our character, our will, our seriousness, our determination, our unity as a nation is going to be tested. That's why I talk about this being equivalent to war, and talk about marshalling our weapons. We've got to be willing to stay with this program as a nation -- not as monetary authorities, not as Congress, not as President, but all of those plus every American -- we've got to stay willing to fight this dread disease for this

period of time. Now it's not that hard, because this year we should see some progress, and that should give us encouragement -- and in two or three years I think we will see enough progress that we will no longer be so distressed and we'll be well on our way to a solution. But we've got to stay with it for five, six, seven years.

Question. Is Emmett Rice going to be appointed Governor?

Answer. I don't know, that's up to the President.

Question. Is he being considered?

Answer. There are a large number of people being considered, and I read in the newspapers that he's being considered. I'm sure the White House has a hundred names under consideration.

Question. What do you see as the impact of the Iranian oil situation on inflation?

Answer. Well, the reduction of the Iranian source of supply is quite serious, because that nation was a large producer and exporter of oil. The impact is greater for some other nations than for the United States -- but it affects the worldwide supply, and the availability of oil affects price. So it just accelerates the need for us to be more vigorous in our determination to reduce our dependence on imported oil. It makes it more urgent that we look at every way to conserve our uses of energy. It makes it urgent that we create a climate for developing more indigenous sources of energy. Now a lot has happened since the oil embargo in 1973. In industry, there has been quite a bit of progress in reducing the amount of

energy per unit of output. Up until 1973, energy was so small a part of cost in most industries -- except of course in aluminum, some chemicals and a few other areas -- that most industries did not pay too much attention to the problem. We built an industrial system which consumed far more energy per unit of output than other nations because we had abundant and inexpensive energy. But industry since 1973 has achieved an improvement of some 25-30 percent in its energy use per unit of output. We haven't had a commensurate improvement in households -- in weatherization of homes or conservation -- nor in public buildings or commercial buildings. Nor have we reduced our energy needs per mile of transportation. But all those things are coming. Still, we've got to really make this more of a critical issue if we are to offset the effects of the oil shortage.

Question. If you get down to a 2-percent or zero inflation rate, what would this do to unemployment? And will the Democratic Congress stand for a rise in unemployment?

Answer. Well, the prospects for full employment are much greater with low inflation. The period I cited in the 60's of course was a period of very low unemployment. There's just no question that when you have high inflation you have instability, you have uncertainty, and businesses are very reluctant to invest, and consequently you have problems of job creation. And with high inflation you have more of a probability of cyclical behavior. There is a recessionary bias that comes from excess inflation as behavioral patterns of spending and investment are upset, and this creates unemployment. The best way to assure full employment is

to have a stable economy with low inflation, where businesses would be willing to invest because they can predict their costs in relation to their markets. In fact, we cannot achieve full employment without low inflation. The attitude before was that those goals were somehow competing. But there's no way that we can achieve anyone of our economic goals unless we achieve all of them. Our primary economic goals, at the bottom line, are full employment, price stability, and a sound dollar. And you can't have any one without the others.

Question. If fiscal policy doesn't regain a balanced budget, would that call for a constitutional convention?

Answer. Well, I think the objective of discipline in fiscal policy is very important. I think that behind that call for a convention is a sincere concern about the growth of these federal deficits. But I would suggest that the Constitution is the basic charter and framework for our nation, and it seems to be inappropriate to use it as the basis for imposing a discipline upon our political and economic system which we should impose through our governmental process. As I mentioned, this is the only decade in over two hundred years of this nation where we've had high inflation in peacetime. Do we know why it exists? Why don't we just get about the business of taking care of it rather than running to our Constitution to do something instead? We don't know what the future will bring, and a constitutional amendment creates an inflexibility for future generations in responding to problems we don't know about. I think what we need is for every Congress and every elected official to be disciplined every year, and not create some limitation that could affect the future. We might come to

a period in the world where there were disruptions again. We saw this in the 1930's. And I would hate to see it happen that we can't handle those problems because of some such limitation.

Question. Are you considering making any changes in the new money-market certificates?

Answer. At the moment, I know of no pending changes. I think we're open-minded and will continue to look at the situation. The money-market certificates have performed a useful service, making it possible for the intermediaries (banks and thrift institutions) to provide funds for the housing industry and to avoid the massive disintermediation that took place in 1973-74. Since that has been successful, we would be reluctant to interfere and have more regulatory restraint on market flexibility. Some of the thrifts are concerned that their profits may be squeezed as more of their deposits shift into this form, and as their costs of money grow, and also as market restraints or legal restraints affect their mortgage rates. But so far, I think the system is adjusting itself, and at the moment I think the best thing is to let the managements of those institutions make up their own minds. After all, the authorizations for these certificates do not require that they be offered at the maximum price, or that they be compounded or that they be offered at all. So maybe it's time for all of us to get more used to managing our own affairs and less used to having the government manage them for us. I'd like to see the market system work a little more before we consider any changes.

Question. Can you foresee any circumstance that might bring about mandatory price controls and wage controls in the near future?

Answer. I really do not. I think they're ineffective and inequitable. They won't work, and I would be opposed to them under any circumstances that I can see.

Question. What are you forecasting in the way of recession, which is of such great concern right now?

Answer. Well, the economy is well-balanced. It is slowing down, as we had hoped that it would, so that it would dampen the forces of inflation. But the present circumstances of the economy do not indicate an impending recession in 1979. The various disciplines of fiscal and monetary policy, and the other actions to fight inflation, have somewhat dampened the economy, which is necessary to help bring down inflation. And those restraints on the economy have a risk of a reaction into a recessionary mode. But at the moment there is no such indication. The economy is well-balanced, and there are no clouds on the horizon that would indicate a recession. We do expect slower growth rates, but still not negative growth.

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