Informal Opening Remarks by Paul A. Volcker,
Chairman, Board of Governors of the Federal Reserve System,
at the Twentieth Meeting of Governors of Central Banks
of the American Continent — Boston, May 2, 1983

On behalf of the Federal Reserve System I am pleased to welcome you to Boston and I am honored to assume the chair of the Twentieth Meeting of Central Bank Governors of the American Continent. I appreciate the kind words by General Manager Pachano.

This is a timely meeting. Recent economic developments in the countries represented here today underscore the importance of the world economy and the international financial system of what happens in the Western Hemisphere.

The agenda for this meeting covers a wide range of issues affecting our economies — exchange rates, capital flows, interest rates, international debt, international liquidity. Our discussions will help us gain a better appreciation of the impact that developments in our respective economies could have on others. No economy is immune to the influences outside its borders. These meetings provide a good opportunity to reflect on how to deal and cope with these forces.

The issues that will be discussed during these meetings need to be viewed in the context of the performance of the world economy. The performance of the U.S. economy plays a leading role in developments worldwide. Latest data on housing activity, retail sales, inventories and industrial production in the United States confirm that recovery is taking hold. U.S. price performance since mid-1981 has been better than anticipated, with current inflation rates in the 4-5 percent range. Moderation of wage increases in recent quarters, together with advances in productivity, provide a base for a further slowing in unit labor costs and continued favorable price trends. Ample oil supplies will also help price performance.

We have come a long way in setting the stage for non-inflationary expansion in which unemployment will decline and workers again can enjoy lasting increases in real income. This process needs to be nurtured with care and discipline, involving sound monetary and fiscal policies. But we are not yet home free. Expectations have adjusted downward less than actual inflation, and this is one reason for high real interest rates.

The objective of U.S. monetary policy at this juncture is to provide an environment of enough liquidity to meet the needs of recovery while avoiding excesses that would reignite inflationary pressures. We all would benefit from a sustained recovery rather than a sharp rebound that runs the risk of impairing favorable price prospects and undermining the sustainability of the recovery.

The conduct of monetary policy at this time is complicated by difficulties in interpreting the behavior of our monetary aggregates. We are in the midst of a period of considerable institutional change in our financial system that is distorting conventional relationships between money and credit growth, on the one hand, and economic activity and inflation, on the other. As a result, the performance of the monetary aggregates provides an incomplete, and at times, confusing, guide to the stance of monetary policy.

U.S. interest rates have receded significantly over the past year, but interest rates remain high, particularly in real terms. Many observers are perplexed by the persistence of high interest rates, especially for longer-term securities, where Federal Reserve actions can have only limited influence. Despite impressive gains in reducing inflation, current interest rate levels appear to reflect a lack of confidence in financial markets about the prospects for the United States maintaining a low-inflation economy. Erosion of market confidence to a large extent is attributable to burgeoning budgetary deficits that are being projected for the United States into the indefinite future. Moreover, prospective budget deficits pose a strong potential for a clash between the need to finance the deficit and rising financial requirements for business investment and housing that are crucial to a healthy recovery. This is not just a problem for the future. The perception that there is a structural imbalance between our public spending programs and our government revenue base affects conditions in financial markets today.

It is tempting to suggest that the budget problem and its consequences for the performance of the economy and interest rate levels could be solved by a more accommodative monetary policy. Excessive money and credit creation to meet the needs of the Government would only risk adding to the uncertainty about future inflation and interest rates, and the hard-fought gains in the battle again inflation would be jeopardized.

Success in reducing the structural budgetary deficits and the restructuring of public expenditures and revenues would provide a better environment for the conduct of monetary policy. Recent experience of a number of countries in Latin America, in taking decisive actions to curb excessive public sector deficits, could serve as a useful lesson for the United States. The stabilization programs adopted by some Latin American countries in recent months demonstrates that it is possible to muster the political will to address the problems of serious fiscal imbalances.

It is widely recognized that large budget deficits in the United States are creating problems at home and abroad. The U.S. Congress and the Administration are working on this problem. I am cautiously optimistic that progress will be made.

Other countries have been attempting to deal with some of the same basic problems that we have been facing — a decade of inflation, subnormal economic performance, and unemployment levels unprecedented in postwar period. Stubborn inflationary pressures that arose in nearly all countries cannot be attributed to oil alone. There was a broad consensus that policies needed to be directed toward restoring stability.

While wide divergences remain among individual countries, striking progress has been made generally in achieving lower rates of inflation. But, at the same time, growth has essentially stopped, with real GNP in major foreign industrial countries showing no significant change on average last year. For most developing countries, there was abrupt and substantial deceleration from the growth rates of recent years, from above 5 percent in the 1970s to slightly above 1 percent last year. In Latin America, growth was negative in 1982, after many years of annual growth rates that averaged about 5-6 percent.

Current indicators in a number of industrial countries abroad point to the beginning of a recovery. This, combined with the recovery in the United States, will contribute to an improvement in the economic climate, which is so important for the prospects of developing countries.

During this period of economic difficulties there has been a substantial risk of countries turning toward protectionism in an attempt to insulate their own industries. That approach would be self-defeating. As protectionist measures spread from one country to another, gains from reduced imports would be offset by closed export markets. Protectionist measures work directly against the competition necessary to restrain inflation. In the United States, as elsewhere, compromises have been made with protectionist pressures. We can take some satisfaction that a liberal trading order has not broken down over all.

The vulnerability of the United States to weakness in international trade was conclusively illustrated by events in 1982. The slowdown in business activity abroad, combined with a surge in the strength of the dollar relative to other currencies, has sharply curtailed our export opportunities. U.S. export volume dropped about 15 percent from the fourth quarter of 1981 to the fourth quarter of 1982, considerably greater than the declines experienced by other industrial countries. While imports have also declined, the change was small. As a result, the decline in real U.S. exports of goods and services over the recession period has accounted for a major portion of the total decline in U.S. GNP. In contrast to earlier periods of U.S. recession, when our trade balance generally improved, thus tending to offset other areas of weakness, the export sector has been one of the major depressing influences on the U.S. economy. Our current account has moved into large deficit, and the external sector is likely to remain a source of weakness for some time.

The United States over time has become more exposed to external influences. The destination of U.S. exports has also been shifting increasingly toward markets in the less developed, non-industrial countries. Over the past 10 years, the share of these countries in our total exports has risen from less than 30 percent to about 37 percent. The health of the international economy and our trading position are today highly important to our recovery and prosperity. The point is emphasized all the more by the sharply deteriorated financial position of several large developing countries that are heavily indebted to commercial banks and other institutions in the industrialized world.

The international debt situation will certainly be a focus of discussion during these meetings. I, therefore, will only touch briefly on this issue in these opening remarks. For several years, a number of large developing countries had been increasing their foreign debts at a pace that could not be sustained indefinitely, either from the standpoint of the rising debt service burden on the borrower or of the gradually increasing exposure relative to assets and capital of the lending banks. For a time, the heavy borrowing helped to sustain rapid internal growth in much of the developing world, but increasingly the need for adjustment to reduce internal pressures and balance of payments deficits became apparent. The slowdown in world growth helped expose the increasingly precarious position of borrowers as prices of commodity exports fell, markets for manufactured goods weakened, and higher real interest rates increased their debt servicing requirements. But it would be misleading to attribute the source of borrowing countries' financial difficulties solely to external influences. Internal factors, including in the areas of public sector deficits and wage and interest rate rigidities, have contributed to the debt difficulties of many developing countries.

Without action to deal with the international debt problem, the consequences could be harsh, not only for the borrowing countries but for their trading partners and for all countries dependent upon a smoothly functioning financial system. In a spirit of cooperation, vigorous efforts are underway to deal with these problems. Management of that situation has required, and will continue to require, active cooperation of borrowing countries, commercial banks, central banks and treasuries of leading countries and international financial institutions.

The improvement in activity that is emerging in industrial countries will make an important contribution to a lasting solution to the indebtedness problem of many developing countries. Further progress in easing financial strains of many countries facing debt-servicing difficulties also can be expected from lower interest rates and from lower oil prices. In the final analysis, however, the economic problems facing both the developing and industrial economies will require following through with the major adjustment programs that many of us have adopted.

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ADDRESS OFFICIAL CORRESPONDENCE TO THE BOARD

Volcker, P.A.

August 10, 1983

Mr. Juan Manuel Rodriguez
Head, Information Department
Centro de Estudios Monetarios Latinoamericanos
Durango 54
Mexico 7, D.F. MEXICO

Dear Juan Manuel:

Enclosed is a reconstructed version of Chairman Volcker's opening remarks at the Boston meetings in May. As I indicated to you, I am somewhat uneasy of having it appear in print, since his delivered remarks differed at times from the prepared outline, and the tape that was supposed to allow me to prepare a more precise text was inaudible. However, since Chairman Volcker acceded to your request to have his remarks appear in print and gave you the adjusted text version and since most of those who attended will not have a record of his delivered remarks, I see no serious harm using the attached version. You may want to add a footnote to the effect that this is an unofficial and not a verbatim text of Chairman Volcker's remarks.

Please send me a copy of the published version.

My schedule unfortunately prevents me from joining Governor Gramley and Yves Maroni in Caracas this September, but I look forward to subsequent meetings.

Best wishes for a successful and smooth-functioning meeting in Venezuela.

Best regards.

Sincerely,

Charles

FOR FILES
Charles J. Siegman

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Enclosure.

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