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Statement by

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Chairman, Board of Governors of the Federal Reserve System

before the

Joint Economic Committee

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I appreciate the opportunity to appear before this Committee today. As you know, the Federal Reserve submitted its semi-annual monetary policy report to the Congress earlier this week, copies of which have been distributed to you. That report describes in detail our plans for monetary policy, including the Federal Reserve's objectives for the growth of money and credit. I have also testified before the House and Senate Banking Committees the last two days and have distributed copies of my formal statement to you. My prepared remarks this morning, therefore, will be brief and confined to more general considerations of monetary policy within the context of recent and prospective economic and financial developments.

The basic policy objective of the Federal Reserve continues to be to contribute to sustained economic expansion in a context of greater price stability. In setting the target ranges for the various monetary and credit aggregates, the Federal Open Market Committee at its meeting last week had to be alert both to the need for economic growth and to the danger of renewed inflationary pressures. Consistent with these objectives and the current economic situation, the FOMC essentially reaffirmed the tentative ranges for the monetary and credit aggregates for 1984 established last July. The ranges call for growth rates that are 1/2 to 1 percentage point below those set for 1983.*

The ranges for 1984 envisage that relationships between monetary and credit growth and economic activity and inflation --

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*The new target ranges are set out in Table I attached, against the background of last year's targets.

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the "velocity" of money -- will broadly follow past trends and cyclical developments after the unusual behavior of 1982 and early 1983. Most of the special influences that depressed velocity in late 1982 and early 1983 appear to be behind us, and the evidence over the past half year has become more (but not entirely) in line with longer-run experience. This judgment about the fundamental relationship between money and economic performance will, of course, be reviewed constantly in the months ahead, and our evaluation will reflect all of the available evidence about production, employment, prices, and domestic and international financial markets.

Consistent with the monetary ranges established for this year, the members of the FOMC generally felt that the economy would grow at a more moderate -- and potentially more sustainable -- pace of 4 to 4-3/4 percent during 1984 and into 1985. The gains in output are expected to generate a further expansion of new job opportunities and the unemployment rate is expected to decline to the area of 7-1/2 to 7-3/4 percent by year's end. After remarkably good progress in 1982 and 1983, price increases are expected to be a little larger on average, essentially as a result of cyclical factors and special circumstances -- including the effects of bad weather and the large hike in payroll taxes earlier this year.

The prospect of further good economic gains in 1984 comes on the heels of a far better than anticipated performance in 1983. Real gross national product rose 6 percent over the four quarters

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of the year, well above earlier projections, and the unemployment rate was cut by 2-1/2 percentage points. At the same time, most broad measures of prices and wages recorded further progress toward lower inflation. With employment expanding, productivity improving, and inflation moderating, the real income of the average worker rose.

As we move into 1984, there are strong reasons for believing the economic gains of the past year can be extended. The latest reports on employment, income, and production, showing further gains around the turn of the year, are consistent with that view, as are indices of consumer and business confidence at high levels. Much more fundamentally, the progress against inflation, the evidence of increased productivity, the sense of greater discipline and restraint, and a recovery in profits all, in my opinion, go a long way toward setting the stage for a long period of greater prosperity.

We all realize a year of strong recovery -- hard on the heels of a severe recession -- has left unemployment still far too high, with some 9 million still out of work. To some degree, the rapid progress toward price stabilization has reflected "one time" or cyclical influences. More time must pass before we can claim success or take satisfaction that we have restored prosperity or assured stability. And, we need to recognize, and deal effectively, with some obvious hazards and risks that jeopardize the good prospects for 1984 and beyond.

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Those prospects rest in good part on whether interest rates, and conditions in credit markets more generally, can support the housing and investment we need, whether we can restore better balance in our international accounts, and whether, in the meantime, we can count on the inflows of capital from abroad upon which we have become dependent.

Over time, success in those areas is dependent upon the expectation and the reality that we can build on the progress toward price stability. Monetary policy must contribute to that goal -- disciplined growth in the money supply is a critical ingredient. But there are also factors outside the control of monetary policy that bear importantly on the question.

As you know, we are faced with two deficits: the structural deficit in our Federal budget and the deficit in our external accounts -- both at unprecedented levels and getting worse. Those twin deficits have multiple causes, but they are not unrelated. Left unattended, each, rather than improving, will tend to cumulate on itself. Sooner or later, the financing of those deficits will expose us to financial risks that could undercut all that has been achieved in recent years with so much effort and so much pain.

Large budget deficits, currently and prospectively, are a burden on credit markets and absorb historically unprecedented fractions of our domestic savings. That is one reason interest rates today are far higher than is healthy from the

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standpoint of balanced growth domestically. Those interest rates have been moderated as a result of a growing capital flow from abroad, stimulated by a variety of causes; in effect, net capital inflows have been used, directly or indirectly, to help meet the government's financing requirements. But those growing capital inflows, which have tended to appreciate the dollar relative to other currencies, are also inextricably related to a large and growing deficit in our trade accounts. In both our financial and our trading interests, we simply can't afford to become addicted to drawing on increasing amounts of foreign savings to supplement our limited domestic savings simply because the Federal Government is drawing so heavily on that savings pool. The longer they last, the more difficult it is to cope with these internal and external deficits because interest costs compound on themselves.

I believe we now have a rare opportunity to set in train a long period of growth and stability. A decade that began with accelerating inflation and prolonged recession can end with renewed confidence and strength. But that happy vision will not be achieved by resting on our oars -- by sitting back and drifting with the tide. It will require a continuing sense of discipline by business and labor, and emphasis on competition and productivity. It will require the demonstration by those of us responsible for public policy that our twin deficits can be brought under control and that inflation will not again get the upper hand.

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We can and should be gratified by the progress that has been made, and by the many positive signs in the outlook. We have time -- time to influence markets constructively, time to demonstrate that we are in control of our own financial and economic destiny. But to wait would be to multiply the risks, to increase the hazards to full recovery, to jeopardize what has been achieved.

That is why I hope that you in the Congress, together with the Administration, can find the consensus required to begin reducing the budget deficit, and to restore confidence that, over time, the structural deficit can be closed. Right now, no other action appears so promising and so important in terms of seizing, and capitalizing upon, the immense opportunities before us. Certainly, that would make it easier for monetary policy to play its own essential role.

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Table I

Federal Reserve
Objectives for Money and Credit Growth in 1984[1]

	New ranges for 1984 (%)	Tentative ranges for 1984 set in July 1983 (%)	Ranges for 1983 established in July 1983 (%)
M2	6 to 9	6-1/2 to 9-1/2	7 to 10[2]
M3	6 to 9	6 to 9	6-1/2 to 9-1/2
M1	4 to 8	4 to 8	5 to 9[3]
Domestic Nonfincial Sector Debt	8 to 11	8 to 11	8-1/2 to 11-1/2

1. Ranges apply to periods from fourth quarter to fourth quarter, except as specified.
2. Range applies to period from February-March 1983 to fourth quarter of 1983.
3. Range applies to period from second quarter of 1983 to fourth quarter of 1983.

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