FEDERAL RESERVE BANK
OF NEW YORK

MONTHLY REVIEW

JUNE 1959

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Special Supplement:
The Future of the Dollar by Dr. Wilhelm Vocke

Volume 41 **No. 6**

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The Business Situation

The vigorous advance in business activity is continuing on a broad front across the country. The industrial production index rose by two more points in April to reach a record level 18 per cent above the recession low of April 1958, and output and sales apparently expanded further during May. Personal income rose sharply in April to yet another record and, while official figures will not be available for some months, business profits probably are also running at an all-time high.

As during the first quarter of the year, some of the recent gains probably reflect production increases for the purpose of building up inventories, most notably of steel and automobiles. The major part of the advance, however, appears to rest on substantial further increases in the current demand for consumer and capital goods. A more-than-seasonal expansion in sales of new cars and other consumer durables pushed total retail sales higher in April, and automobile and department store sales apparently scored further gains in May. Housing starts have been maintained near peak rates. And with sales and profits booming, business firms have been adding to their investment programs and have stepped up their orders for capital equipment.

Perhaps most encouraging is the substantial improvement in the employment situation over the last two months. From mid-February to mid-April, the seasonally adjusted rate of unemployment fell from 6.1 to 5.3 per cent, and some further drop is suggested by the decline of unemployment insurance claims in subsequent weeks. Much of the reduction, moreover, has occurred among men in the "head-of-family" age brackets, and long-term unemployment also has declined (although it still remains considerably larger than at any time in the postwar period prior to 1958). With the length of the workweek restored to pre-recession levels, the further expansion of factory output was achieved mainly by adding workers rather than by lengthening hours. More jobs have also become available in construction and other outdoor work now that the winter is over. In recent months, moreover, hiring has been stepped up by the trade, finance, and service industries and for "nonproduction" workers in manufacturing. Most of the expansion in private employment over the last few decades has occurred in these occupations, and they are the ones in which employment gains during the upswing have lagged most notably compared with previous business recoveries.

With increased demand for labor, there has also been a more rapid rise in wage rates (partly reflecting an increase in overtime). In the six months following the trough in general business activity in April 1958, average hourly earnings of factory workers increased by less than 1½ per cent. Over the succeeding six months through April 1959, however, these earnings have advanced by more than 4 per cent. Coinciding with the more rapid rise in average pay rates, wage costs per unit of factory output also appear to have turned upward (after tending to decline for more than a year), contributing to the upward pressures on prices. In April, industrial wholesale prices were more than 2 per cent above the year-earlier level (and also the pre-recession level), while retail prices for nonfood items were higher by over 1½ per cent (and by 3½ per cent as compared with the pre-recession level).

During the past year, the rise in prices of nonfood items has been offset by the decline of food prices following two and a half years of uptrend. Now food prices are on the threshold of a seasonal rise, which is likely to result in some increase in the over-all price indexes. Of much more far-reaching significance for the prospects of price stability, however, will be the impact of the settlement ultimately reached in the steel industry, which may determine whether the upward tendency in industrial prices will remain of limited scope or whether it will broaden out into an economy-wide advance.

DEVELOPMENTS IN FOREIGN TRADE

A major exception to the broad upswing in business has been the absence of any recovery in exports. Exports of merchandise (exclusive of military-aid shipments), which at the first-quarter 1957 peak had been running at a seasonally adjusted annual rate of over $20 billion, fell sharply to $16 billion by the first quarter of 1958, and to only about $15 billion in the first four months of 1959 (see Chart I). Over the same two-year period, the exports of the rest of the world also have declined but not nearly so sharply.

It is worth emphasizing, however, that roughly three fourths of the drop in the value of United States exports between the first quarters of 1957 and 1959 has been concentrated in only five commodity groups: cotton, wheat, coal, iron and steel, and petroleum (see Chart II). Even in early 1957, when exports of these five products were at or close to their peaks for recent years, they accounted

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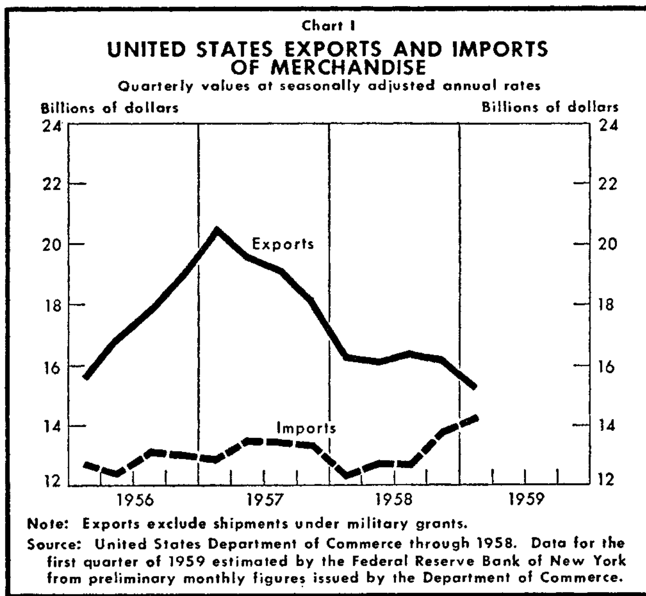
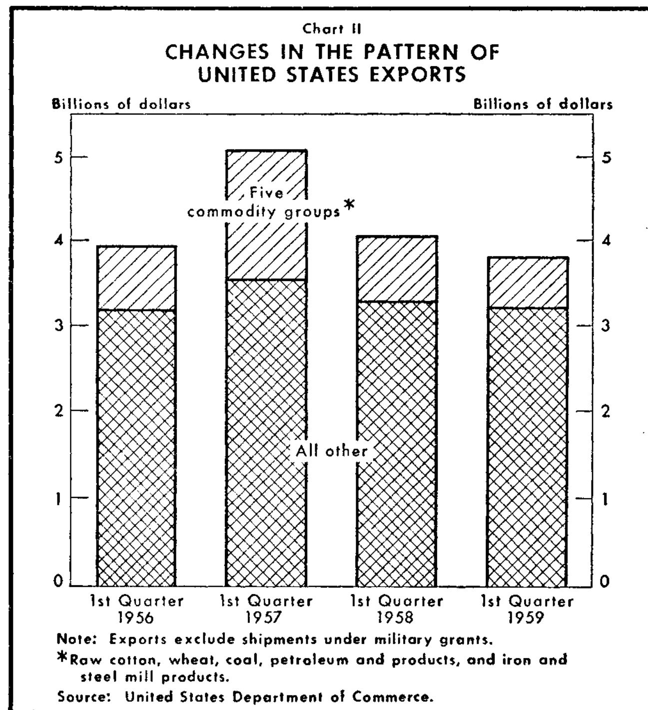


for less than a third of total commercial exports. Furthermore, the 1957 highs were achieved only through a coincidence of temporary influences, among them the Suez crisis and the pronounced business boom abroad which was then approaching its peak. Cotton and wheat exports, for example, which are largely dependent on various Government subsidy programs, were unusually high in early 1957—more than two and one-half times the early 1956 value. The subsequent decline in shipments (about three fourths for cotton and one fourth for wheat) has been chiefly a consequence of Governmental policies, harvest fluctuations, and the world textile recession rather than of market competition. In the case of petroleum and petroleum products, our 1957 exports were inflated because of the temporary closing of the Suez Canal in late 1956, which cut off Europe from its normal sources of petroleum supply. United States exports of petroleum products nearly tripled between early 1956 and 1957, but with the return to more normal conditions they have now fallen even somewhat below the 1956 rate. Finally, as regards coal and steel, foreign demand in 1956 and 1957 was buoyed by the boom in economic activity abroad. In the case of steel, foreign capacity and inventories were substantially expanded during the boom (as was the case in the United States), to the point where supplies abroad have become more nearly sufficient to cover currently prevailing needs.

But, even if much of the drop in United States exports can be explained by special factors, there are no grounds for complacency. Exports of a number of products other than the five noted above—particularly of machinery—also have declined significantly, while there have been few important gains. The sluggish behavior of these other exports may in part be traceable to the foreign exchange difficulties recently experienced by many of the underdeveloped countries (difficulties that in turn are due partly to the fall in the prices of their raw material exports). The fact remains, however, that the manufactured goods exports of several other major industrial nations have been faring better than those of the United States.

To some extent, the misgivings concerning the competitiveness of our finished goods exports are confirmed by the developments in our import trade. While the seasonally adjusted rate of merchandise imports fell about 8 per cent during the 1957-58 recession, most of the drop reflected the fall in world prices of raw materials; in terms of physical volume, imports barely declined at all. Following the upturn in business activity and the recovery of raw material prices, imports increased once more, achieving a new high in the last quarter of 1958 and again in the first quarter of 1959. About a quarter of the increase in imports from their low point, however, reflected a rise in imports of petroleum and petroleum products, partly in anticipation of the restrictions on such imports eventually imposed in early March; since then, oil imports have dropped sharply. The ratio of total imports to gross



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national product in the first quarter of 1959 was about the same as before the recession.

Most significantly, imports of finished goods did not decline during the recession and have expanded appreciably since. This has reflected chiefly the remarkable demand for foreign cars; imports of autos and parts more than tripled between the first quarters of 1957 and 1959. Demand for other imported consumer goods also has been relatively strong. But the behavior of capital goods imports is of particular interest. In the aggregate, these imports are small; in the first quarter of this year, for example, they amounted to perhaps 15 per cent of our capital goods exports and to perhaps 3 per cent of the total domestic market. It is noteworthy, however, that these imports did not decline during the recession despite the sharp drop in domestic outlays on producer goods; indeed, they began to rise in 1958 while capital goods purchases by American business were still falling, and they were some 40 per cent higher in the first quarter of 1959 than in the same periods of 1957 and 1958.

In summary, much of the decline in our exports is attributable to special considerations not directly related to the competitive position of individual products. A number of American products, however, notably capital goods, do appear to have become less competitive in world markets. If this is so, the rapid rise in United States prices for these products (on the domestic market, capital goods prices have risen 20 per cent in the last four years) presumably must carry at least part of the responsibility, although such factors as improved quality and better delivery terms offered by foreign producers have probably also played important roles.

Money Market In May

Member banks were under generally steady reserve pressure during May, as bank loans continued to expand throughout most of the country. On a few occasions the money market developed a relatively easy tone, but for the most part this occurred as a result of temporary accumulations of reserves at the large New York City banks rather than because of an increased supply of reserves in the banking system. Effective May 29, the discount rates of the Federal Reserve Banks of New York, Chicago, Minneapolis, St. Louis, and Dallas were increased to 3½ per cent from 3 per cent. Earlier in the month, on May 15, major commercial banks throughout the country announced an increase to 4½ per cent from 4 per cent in the "prime" loan rate, the borrowing rate for business borrowers with the highest credit rating.

Activity in the Government securities market in May centered in the short-term area, as the Treasury replaced a certificate issue and a special bill issue due on May 15 and raised a small amount of new cash through the issuance of three new securities, all of one year or shorter maturity. The financing operation was unusual, involving an exchange offering of one-year certificates for the maturing certificates, cash redemption of the maturing bills, and the sale of two new special bills for cash. The latter issues were December 1959 tax anticipation bills and April 1960 special bills—the second quarterly issue in the Treasury's new one-year cycle. In the face of prevailing uncertainties regarding the effect of the recent surge in business activity upon interest rates, the market reception of the new offerings was generally restrained. The same influences affected the intermediate and long-term markets and, in limited trading, prices of Treasury notes and bonds declined further over the month, although less sharply than they had in April.

MEMBER BANK RESERVE POSITIONS

Net borrowed reserves averaged $278 million for the four statement weeks ended in May, somewhat larger than the $258 million average for April. Average excess reserves increased from $418 million to $446 million, while average member bank borrowings from the Reserve Banks rose from $676 million to $724 million.

Fluctuations in the weekly average level of net borrowed reserves were quite narrow until the last week. System securities operations, for the most part, replaced bank reserves lost largely through currency drains and gold outflows, which together absorbed nearly $400 million in the four weeks. Total System holdings of Government securities increased by $282 million between April 29 and May 27.

The public's demand for currency remained stronger than might have been expected on the basis of seasonal patterns, reflecting the quickening pace of the business expansion. Outflows of gold continued in May at a faster pace than in April. Float movements were sharp in the last two weeks of the month, but they left reserve positions unaffected over the month as a whole. In the third state-

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Table I

Changes in Factors Tending to Increase or Decrease Member Bank Reserves, May 1959

(In millions of dollars; (+) denotes increase, (—) decrease in excess reserves)

Factor	Daily averages—week ended				Net changes
	May 6	May 13	May 20	May 27	
Operating transactions					
Treasury operations*	+ 15	+ 24	+ 19	— 33	+ 25
Federal Reserve float	— 7	— 98	+ 360	— 215	+ 40
Currency in circulation	— 125	— 136	— 10	+ 42	— 229
Gold and foreign account	— 53	— 24	— 65	— 10	— 152
Other deposits, etc.	— 27	— 26	— 90	+ 5	— 138
Total	— 199	— 258	+ 213	— 210	— 454
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+ 98	+ 234	— 14	— 21	+ 297
Held under repurchase agreements	+ 102	— 32	— 61	— 9	—
Loans, discounts, and advances:					
Member bank borrowings	+ 19	+ 34	+ 144	— 195	+ 2
Other	—	—	—	— 1	— 1
Bankers' acceptances:					
Bought outright	— 1	—	— 1	— 1	— 3
Under repurchase agreements	—	+ 1	— 1	—	—
Total	+ 219	+ 237	+ 66	— 226	+ 296
Total Reserves	+ 20	— 21	+ 279	— 436	— 158
Effect of change in required reserves†	— 25	+ 66	— 118	+ 167	+ 90
Excess reserves†	— 5	+ 45	+ 161	— 269	— 68
Daily average level of member bank:					
Borrowings from Reserve Banks	675	709	853	658	724‡
Excess reserves†	399	444	605	336	446‡
Net borrowed reserves	— 276	— 265	— 248	— 322	— 278‡

Note: Because of rounding, figures do not necessarily add to totals.

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for four weeks ended May 27, 1959.

ment week, the midmonth expansion of float provided the banks with $360 million additional reserves, but this was largely absorbed by the increase in required reserves associated with commercial-bank underwriting purchases of the new Treasury bills, by the expiration of repurchase agreements entered into earlier by this Bank with Government securities dealers, and by other factors.

GOVERNMENT SECURITIES MARKET

Interest rates moved moderately higher during May in virtually all sectors of the Government securities market, extending the sharp April increase. The rate trend reflected continued concern over the implications for credit demands of the recent acceleration in business activity. The midmonth increase in the prime loan rate and the end-of-month increase in the discount rate seem to have been largely discounted by the time they occurred. During the last half of the month, yields on Treasury securities moved lower, offsetting part of their earlier increases. Treasury bill rates, however, rose moderately following the May 29 discount rate increase.

In the uncertain market climate, the Treasury debt operations undertaken in early May to refund some $4.5 billion of securities due on the fifteenth met with a generally unenthusiastic response. Following an over-all financing program announced on April 30 and described in the *Monthly Review* for May, the Treasury redeemed the $2.7 billion of special bills due on May 15 and held two special bill auctions on May 6 and 7, the first for $2.0 billion of 340-day bills dated May 11 and maturing April 15, 1960 and the second for $1.5 billion of 221-day tax anticipation bills dated May 15 and maturing December 22, 1959.

Commercial banks, attracted by the privilege of paying for the new April bills by credits to Treasury Tax and Loan Accounts, exhibited a fairly strong interest in this issue. Tenders received by the Treasury for the $2 billion offering totaled $3.5 billion and resulted in an average issuing rate of 3.835 per cent. In contrast, the December tax anticipation bills auctioned the next day attracted a relatively small bid from investors (payment for this issue by credit to Tax and Loan Accounts was not permitted). The $1.7 billion of tenders barely covered the $1.5 billion offering. The bills were awarded at an average issuing rate of 3.565 per cent, but tenders were accepted at rates as high as 3.655 per cent. At the close of the month, the market rates on the April 15 and December 22 bills were 3.97 per cent and 3.57 per cent, respectively.

The Treasury had included in its April 30 announcement an offering of one-year certificates of indebtedness to mature May 15, 1960 in exchange for the $1.8 billion of 1¼ per cent certificates maturing May 15, but it did not announce terms for the offering until after the results of the bill auctions had become known. Late on May 7 the Treasury announced that the certificates would carry a 4 per cent coupon rate and would be priced at 99.95 per cent of face value to yield 4.05 per cent. The return on the new security was apparently not considered particularly attractive, and the new issue failed to develop a premium above issue price while the books were open. Subscription books were open on May 11 and 12, and the results were made known on May 14. Of the $1,817 million 1¼ per cent certificates of indebtedness outstanding, $1,270 million were exchanged into the new 4 per cent certificates, leaving $547 million (or 30 per cent) to be turned in for cash on May 15.

Market yields on Treasury bills fluctuated irregularly during the month, tending to decline among the short issues and to rise, until late in the period, among the longer issues. The temporary heaviness in the longer end of the list reflected the additional supply of these maturities that had to be digested following the Treasury financing operation. Around midmonth, dealers were called upon to underwrite a sizable portion of the new tax anticipation issue and to take up a residual supply of the new April 15

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special bills being offered in the market by commercial bank subscribers. Meanwhile, the demand which had been anticipated from the reinvestment of the proceeds of the May 15 cash redemptions of the matured special bills and the unexchanged certificates was slow to develop. Eventually this demand gave support to longer bills, as well as to short issues, and a part of the earlier rate increase was reversed. The discount rate change at the end of May touched off further increases in Treasury bill rates, particularly among shorter issues.

Illustrating the divergent trends in the two broad areas of Treasury bill maturities, rates on the three- and six-month bills moved in opposite directions in the regular weekly auctions of May 11 and 18. The three-month bills were awarded at average issuing rates of 2.935 per cent on May 4, of 2.722 per cent on May 11, of 2.869 per cent on May 18, and of 2.878 per cent on May 25, compared with 2.831 per cent on April 27. The six-month bills were awarded at rates of 3.316 per cent, 3.408 per cent, 3.376 per cent, and 3.373 per cent in the respective May auctions, compared with 3.189 per cent on the last April auction date. Market yields on the maturities nearest three months and six months rose by 22 and 27 basis points over the month to 3.08 per cent and 3.45 per cent, respectively.

Trading in Treasury notes and bonds was light throughout the month. Prices of most intermediate and long-term issues moved steadily lower in the first part of the month, reaching new all-time lows immediately following the increase in the prime loan rate, but recovered a part of their losses later in the period. The average yield on long-term Treasury bonds rose from 4.07 per cent on April 30 to 4.08 per cent at the close of May.

OTHER SECURITIES MARKETS

Yields on corporate and municipal bonds moved gradually upward in May in response to the same factors influencing Government securities and to the build-up in the calendar of expected new offerings. On several new issues in which syndicate terminations were reported during the month, yield concessions of as much as 50 basis points were made. Even so, the market remained sluggish, and dealers had difficulty in reducing their large holdings. The average yields on Aaa-rated seasoned corporate bonds rose from 4.30 per cent at the end of April to 4.43 per cent on May 29, while the average yield on similarly rated municipals advanced from 3.18 per cent to 3.31 per cent.

The total volume of new bond financing undertaken in the calendar month fell off from the April total and from that of May 1958 because of a decline in municipal financing. The volume of municipal issues amounted to $500 million in the current month, against $830 million in April and $775 million in the same month last year. Estimated corporate bond offerings for new capital purposes, however, amounted to $345 million in May, compared with $300 million in April and $340 million in May 1958. Investors were generally slow to take up new offerings until the latter part of the period, when a sharply higher pattern of reoffering yields resulted in rapid distribution of new bonds, particularly corporates. For instance, two Aa-quality 30-year utility mortgage bond issues, reoffered to yield 5 per cent or better, were very well received and moved quickly to slight premiums over the reoffering price. On the other hand, a Aa-rated industrial issue of like maturity, reoffered to yield only 4.69 per cent, moved rather slowly. In addition, several large United States Government agency issues were very well received during the month, including $200 million of Federal Home Loan Bank 4⅜ per cent nine-month consolidated notes, $170 million of Federal Intermediate Credit Bank 4½ per cent consolidated collateral trust debentures of approximately the same maturity, and $130 million of Bank for Cooperatives 4¼ per cent six-month debentures, all offered at par.

In the market for short-term debt instruments, several upward rate revisions were made during the month. On May 18, commercial paper dealers raised their rates by ⅛ of 1 per cent, bringing the rate on prime four- to six-month paper to 3⅝ per cent. On May 20 dealers in bankers' acceptances announced a rate increase of the same magnitude, bringing the bid and offered rates on 90-day unindorsed acceptances to 3⅜ per cent and 3¼ per cent, respectively.

COMMERCIAL BANK CREDIT

Total loans at the weekly reporting member banks during the early weeks of May continued to show the vigor which had first become clearly evident in April. In contrast to the relatively sluggish behavior of loans in the first quarter, the $1.6 billion increase during April and the first three weeks of May was well in excess of gains during comparable periods of any recent year. In the corresponding weeks of 1955, for example, when a strong business expansion was under way, loans increased by only about $0.8 billion (see Table II).

Since much of the recent expansion has taken place at nonreporting banks, however, the statistics on weekly reporting banks are not fully indicative of the breadth and strength of the recent loan upsurge. Preliminary data suggest that loans of banks which do not report on a weekly basis increased by about $0.8 billion in April. For all

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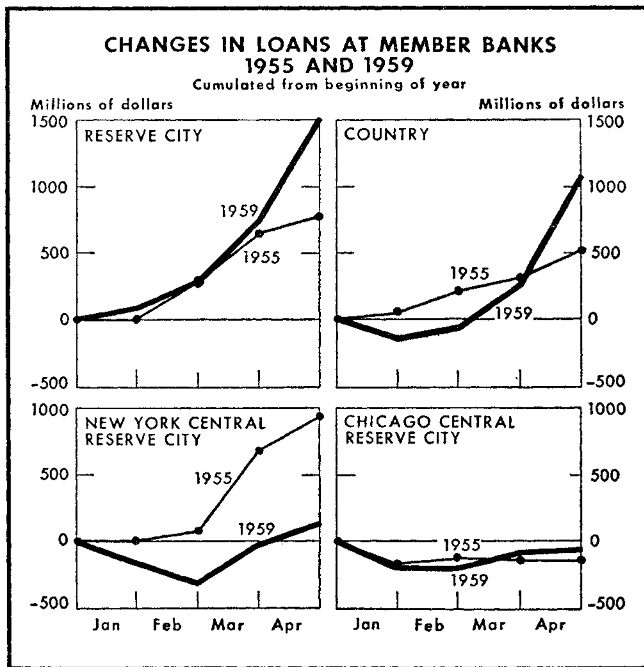

commercial banks combined, the loan expansion in April was $1.7 billion, or more than twice the increase of any April during the last decade. This advance, moreover, was widely distributed among various types of loans, with borrowing by business, consumer, real estate, and miscellaneous groups all exceptionally strong relative to previous years.

Both in the first quarter and in the more recent period, the loan expansion has almost entirely reflected a growth in the portfolios of reserve city and country banks (see chart). Central reserve city banks in New York City and Chicago have not thus far participated in the expansion to any appreciable extent, partly because these banks hold a relatively small proportion of total consumer and real estate loans which have accounted for a good part of the recent loan increase. In addition, heavy repayments this year by public utilities and petroleum firms, which borrow mainly from the larger banks in New York City, have largely offset the expansion of other business loans in which these banks have shared.

Total commercial bank credit increased by an estimated $2.4 billion during April as a result of the $1.7 billion increase in loans and of a $0.7 billion rise in investments. This expansion in bank credit fell short of last year's record increase for April, when credit policy was directed actively toward combating the recession; nevertheless, it still was unusually large by the standard of prior years. However, the April bulge followed a first quarter during which the decline in bank credit, amounting to almost $4 billion, was appreciably greater than seasonal. Government securities were liquidated in substantial volume during this period as bank reserve positions came under persistent, although moderate, pressures. Viewing the year 1959 to date, the change in bank credit thus appears to be broadly in line with a strong and healthy business upswing. But developments in April and early May suggest that the expansion may be approaching a stage where credit demands will press with sharply mounting force against the available supply of loanable funds.

Table II

Changes in Principal Assets of the Weekly Reporting Member Banks

(In millions of dollars)

Assets	Period			
	First Quarter		April—May	
	1955(a)	1959(b)	1955(c)	1959(d)
Loans and investments:				
Loans:				
Commercial and industrial loans	+ 174 }	− 203	+ 44 }	+ 467
Agricultural loans		− 45		+ 37
Securities loans	− 205	− 611	+ 221	+ 382
Real estate loans	+ 298	+ 212	+ 212	+ 253
All other loans (largely consumer)	+ 248	+ 160	+ 353	+ 471
Total loans, adjusted*	+ 468	− 500	+ 815	+ 1,608
Investments:				
U. S. Government securities:				
Treasury bills	−1,257	− 198	− 110	+ 385
Other	−2,760	−2,331	+ 521	− 778
Total	−4,017	−2,529	+ 411	− 393
Other securities	+ 423	+ 86	− 326	+ 10
Total investments	−3,594	−2,443	+ 85	− 383
Total loans, adjusted,* and investments	−3,126	−2,943	+ 900	+ 1,225

* Exclusive of loans to banks and after deduction of valuation reserves; figures for the individual loan classifications are shown gross and may not, therefore, add to the totals shown.
(a) December 29, 1954 to March 30, 1955.
(b) January 1, 1959 to March 25, 1959.
(c) March 30, 1955 to May 25, 1955.
(d) March 25, 1959 to May 20, 1959.

DEBITS AND CLEARINGS STATISTICS

The Board of Governors of the Federal Reserve System has recently published a 156-page booklet entitled *Debits and Clearings Statistics and Their Use,* written by George Garvy, Adviser, Federal Reserve Bank of New York. This booklet is a revised, up-to-date edition of the study originally published in January 1952. Copies are available from the Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington 25, D.C., at $1.00 each.

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International Financial Developments

MONETARY TRENDS AND POLICIES

The upturn in economic activity in the major industrial countries abroad appears to be accelerating. The improvement now extends to a large number of countries, and is broadly distributed among the various economic sectors. Prices have so far remained relatively stable, and unutilized resources at this time are generally larger than in previous recovery periods. In addition, most foreign industrial countries at present hold a fairly comfortable cushion of gold and foreign exchange reserves.

Given this environment, the authorities in these countries (except Canada, as noted below) have generally continued in the past two months to pursue a policy of monetary ease, and in a number of instances have adopted additional measures of credit relaxation.[1] On April 23, the National Bank of Austria reduced its discount rate to 4½ per cent from 5, the first change in the rate since November 1955. On the same day, the Bank of France lowered its discount rate to 4 per cent from 4¼ and also reduced the penalty rates applicable to commercial bank borrowing in excess of an individual institution's discount ceiling. These moves by the Bank of France followed two earlier discount rate reductions in the past eight months and the relaxation of other credit restrictions. The bank's latest measures appear to indicate that a rise in lending activity is regarded as warranted in order to support economic recovery. Meanwhile, the Bank of Greece reduced its rates on most loans to private nonbank borrowers, and in Belgium consumer credit controls were relaxed through an extension of the maximum repayment period.

During the same month the German Federal Bank twice reduced the interest rates at which it sells money market paper, bringing these rates to postwar lows. The bank thus continued its policy of reducing the interest rate differential between German and other financial centers. Other recent measures taken by the German Federal Bank reflect the belief that, at present interest rate levels, further large inflows of foreign funds are unlikely and that the restrictions which had been imposed in May 1957 to discourage speculation in favor of the mark are no longer needed. Thus, the bank abolished, as of April 1, all special reserve requirements against foreign-owned deposits, which had exceeded reserve requirements against domestic deposits and had recently ranged from 10 per cent for savings deposits to 30 per cent for sight deposits; henceforth, the prevailing reserve requirements against domestic deposits are to apply to foreign ones as well. The bank also permitted credit institutions to resume interest payments on foreign deposits and, as of May 1, removed the remaining restrictions on the extension of loans and credits by nonresidents to residents, whether in marks or foreign currencies. Previously, such transactions—which now may also include the acquisition of German money market paper by nonresidents—had been subject to special licensing, and had to have a minimum maturity of five years.

In contrast to the Western European central banks, the Bank of Canada in recent months has once more applied some restraint, reflecting the fact that the current upturn has been somewhat more vigorous in Canada than in Europe. The chartered banks have sold substantial amounts of government securities of all maturities in order to meet the heavy demand for business loans, and interest rates have risen sharply. Following a rise in general business loans of over 10 per cent in the six months through April (see chart), the chartered banks last month agreed among themselves to exercise the utmost care in the granting of credit in order to avoid any significant increase in the over-all credit total.

In most other industrial countries abroad, the expansion of economic activity in recent months has likewise been accompanied (and indeed supported) by an expansion of commercial bank lending. Such lending has, of course, been encouraged by the gradual relaxation of credit restrictions. A particularly sharp rise in bank lending has taken place in the United Kingdom, where the banks during the first ten months following the ending of the "credit squeeze" in July 1958 expanded their loans by 24 per cent to an all-time high. A substantial part of this rise was attributable to an increase in personal loans and in loans to finance the purchase of consumer goods. These categories of credit had been most severely restricted during the period of the "squeeze"; moreover, the buying into finance companies and the introduction of personal loan arrangements by British banks during the second half of last year has tended to give greater scope to loans for consumption purposes.[2]

[1] For developments during January-March, see "International Monetary Developments", *Monthly Review*, February and April 1959.

[2] See "Commercial Banks and Consumer Credit Abroad", *Monthly Review*, January 1959.

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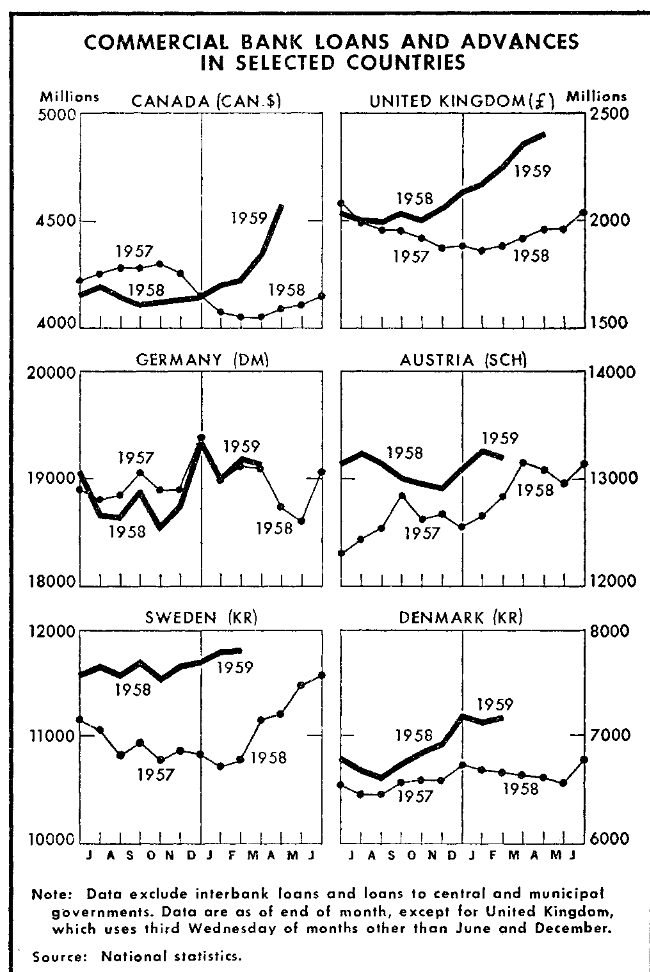

COMMERCIAL BANK LOANS AND ADVANCES IN SELECTED COUNTRIES

Note: Data exclude interbank loans and loans to central and municipal governments. Data are as of end of month, except for United Kingdom, which uses third Wednesday of months other than June and December.

Source: National statistics.

The growth of instalment and consumer credit facilities in other industrial countries also has undoubtedly contributed to the expansion in commercial bank lending in recent months. Following the introduction of personal loan facilities by commercial banks in Denmark, Ireland, the Netherlands, and Sweden late last year, the "big three" West German banks last month also entered this field—an innovation in German banking. The credits to be granted under the new scheme range from DM300 ($71) to DM2,000 ($476), are repayable in six to twenty-four monthly instalments, and are subject to an interest charge of 4.8 per cent on the face amount of the loan. Initial demand for these credits reportedly has been brisk.

EXCHANGE RATES

The New York foreign exchange market developed a mixed pattern during May. Spot sterling, after an initial firming, tended to decline, while the Canadian dollar, following some hesitancy, rose to new 1959 highs toward the month end. Continental currencies maintained a firm undertone, with the Swiss franc recovering its April losses. The Argentine peso continued under pressure, with the quotation reaching new low levels.

Spot sterling, following the announcement of an increase in April of £40 million ($112 million) in British gold and convertible-currency reserves, advanced to $2.8170 in early May. Thereafter, the quotation fluctuated somewhat erratically toward lower levels, reaching $2.8110 in the morning of May 29. This movement largely reflected demand for dollars in London shortly after midmonth, to cover short positions, and offerings of sterling from Continental sources at that time and again at the month end. These factors more than offset good commercial demand for sterling in New York and occasional demand from the Continent. At the market close, on May 29, spot sterling had recovered slightly to $2.8115.

In the forward-sterling market, the discounts on three and six months' deliveries generally narrowed during the month, owing in part to some commercial demand and occasional demand from the Far East. From discounts of 47 and 86 points at the beginning of May, the spreads on three and six months' forward sterling narrowed to 13 and 28, respectively, at the month end.

Securities-sterling quotations, reflecting reduced investor interest in British securities, gradually eased from $2.81½ at the beginning of the month to $2.80⅝ on May 29.

The Canadian dollar, quoted at $\$1.03\frac{59}{64}$ on May 1, declined appreciably when Canadian commercial interests entered the market to fill United States dollar requirements. The quotation touched $1.03½ on May 6, but later recovered substantially, and then settled at about the $\$1.03\frac{25}{32}$ level until shortly after midmonth. Following the placement in the New York market of a new Canadian provincial bond issue and the proposal of an American motor company to acquire outstanding stock of its Canadian subsidiary, the rate for the Canadian dollar moved upward to $1.04¼ on May 26. On May 29 the rate declined to $\$1.03\frac{55}{64}$, in response to general demand for United States dollars by Canadian commercial interests, but closed at $\$1.04\frac{1}{64}$.

The Swiss franc, which had eased to $0.2311½ at the end of April, gradually improved during most of May, reaching $0.2316½ on May 29, the level that had prevailed in early April.

The Argentine peso declined steadily from 79.20 pesos to the dollar (1 peso = $0.01262) at the beginning of May to 89.70 ($0.0114) at the month end.

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Creeping Inflation

Throughout history, wherever people have used money to express the values of goods and services, some form of "inflation" has been a recurring theme. Even though the actual inflations of past generations have, as a rule, either had to be stopped by drastic action or ultimately have destroyed themselves, often with intense human suffering and severe economic loss, there seems to be a tantalizing fascination in the illusion of greater wealth created by rising prices. That lure has led time and again to a search for a new and more promising form of inflationary solution to pressing economic problems. Today, in the United States, the alchemists are at work once more. The new version is called "creeping inflation".

This is not, of course, a single, coherent doctrine. Much of its support comes, in fact, from people who know well the dangers of a cumulative upward price spiral and would oppose anything which they considered to be outright inflation. There are a few, to be sure, who seem to regard sustained price increases as genuinely desirable in order to evoke what they believe will be the maximum of growth in output and employment. But most are simply inclined reluctantly to accept a regular and moderate edging-up of prices year after year, at a rate of no more than 2 or 3 per cent, as merely the least costly way to resolve many of the conflicting claims now being placed upon the American economy.

In the various ways that this general thesis is developed, a paradoxical quirk often appears in the treatment accorded the Federal Reserve System. Both among those who urge and those who reluctantly accept "creeping inflation", there are many who assert their despair of monetary and credit controls, condemning them for such varied shortcomings as being too weak, or harshly punitive, or inequitably discriminatory. And yet those who have confronted the question of how to hold the "creep" of rising prices within the bounds of the 2 or 3 per cent figure invariably mention monetary and credit controls, along with fiscal measures, as the principal means of performing that job. Faced with this ambivalence between mistrust and trust, the Federal Reserve itself might perhaps understandably be puzzled.

This article is an effort to seek clarification, first, by restating briefly some of the various approaches that have been taken by supporters of creeping inflation, and then appraising these in the context of a similarly abbreviated description of the pricing process, savings and investment, "administered" prices and wages, international economic relations, and economic fluctuations and growth.

The appraisal shows that creeping inflation is not merely an innocent vice, a relatively costless or harmless way of relieving tensions. It will lead to much higher rates of interest and a confusing network of "price escalator" arrangements, a distortion and eventual impairment of saving and investment, wider cyclical fluctuations, and a stunting of growth. Moreover, there would be no gains to offset these grave consequences. Over time, creeping inflation would not lessen but would aggravate any threat of unemployment; it would not cushion but would stimulate any abuses that may be associated with "administered" prices or labor's "cost push"; and it would not relieve the kinds of political pressures that may at times interfere with the functioning of a market economy. These serious consequences would not only mean a failure to fulfill the economic potential of the United States, but would also gravely weaken this country's ability to fulfill its responsibilities of leadership in the international economic community and in world affairs.

This single article can only provide a sketch of the analysis underlying these conclusions. In later months, various subjects opened here will be pursued further in separate articles. A supplement to this issue of the *Monthly Review* contains a condensation of one of the most authoritative statements on the subject of creeping inflation—some remarks made recently by Dr. Wilhelm Vocke, former President of the Bank deutscher Länder. That statement and this article, while recognizing that there can never be ideal and final solutions to all of the problems of a changing and growing economy, both conclude that a public policy aimed at reasonable price stability is essential in a modern economy if there is to be sustained expansion of employment and income, for the benefit of everyone.

THE CASE FOR CREEPING INFLATION

Much of the appeal of creeping inflation lies in the ready reconciliation it seems to provide among many of the pressing issues of current concern in the American economy. Is not the acceptance of some form of inflation the only way out, for example, for an economy determined to combat depressions and pursuing sustained maximum employment as a national goal because it will no longer tolerate the conditions under which most of the significant and general price reductions of earlier times occurred? In any event, the argument runs, with so many business concerns able to "administer" prices, and thereby able to reduce output instead of cutting prices when the demand

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FEDERAL RESERVE BANK OF NEW YORK
SUPPLEMENT TO MONTHLY REVIEW, JUNE 1959

THE FUTURE OF THE DOLLAR

By DR. WILHELM VOCKE*
Former President of the Bank deutscher Länder, now the Deutsche Bundesbank, the central bank of the Federal Republic of Germany

You have invited me to discuss with you the problem of the dollar, which is a task that I approach with some hesitation since it concerns, after all, your country. Yet the issues that are involved clearly reach beyond national frontiers and indeed affect the world as a whole. There would be little value in my joining this debate on monetary problems if I thought the world were headed toward another war. But I firmly believe in peace—many years of peace; and I am convinced that the United States can promote peace most effectively not only through the power of its armaments, but through the strength of its financial system as well.

The current debate over the future of the dollar and economic growth has advanced to the stage where the issues are now clearly drawn. The choice is between the path of creeping inflation and that of a strong and stable dollar. A clear decision as to which path is to be taken must be made now in the interest of the business community and the nation, which must know the direction in which the economy is moving and how much trust can be placed in the currency. Things cannot be permitted to drift, creating uncertainty and confusion among long-term investors who must plan ahead and on whose appraisal of the future the economic growth of the country depends.

THE LESSONS OF THE GERMAN EXPERIENCE

Let me first make a few observations on the German monetary experience, from which some fundamental lessons can be drawn. When I assumed office as President of the Bank deutscher Länder ten years ago, monetary conditions in Germany were in a desperate state. Several experts, both German and foreign, with world-wide reputation and extensive experience declared frankly that the Deutsche mark had virtually no prospects of ever becoming a hard currency. That these well-meant opinions proved wrong, as time has shown, is no doubt in part due to a good deal of luck and favorable circumstances. But I, for one, never wavered in my conviction that a monetary policy, consistently and energetically pursued in order to establish and maintain a stable currency, must succeed.

There are perhaps two principal lessons to be learned from the German experience. The first is that currency stability can be achieved and preserved even under the most adverse circumstances. The second, and even more significant, is that a monetary policy, firmly committed to currency stability, not only does not conflict with a high rate of economic growth but indeed is essential to its achievement. Germany's remarkable economic recovery and expansion over the past decade was closely linked to the restoration and preservation of a strong and stable monetary unit.

Obviously, these policies did not escape the test of public opinion. In 1955 the German economy was unmistakably headed toward a dangerous boom. All economic indicators—production, employment, income, exports, and above all wages and prices—were surging upward at a high pitch. Under these conditions prompt and energetic measures by the central bank were called for, in order to keep the economy from losing balance. The steps taken to bridle the inflationary forces proved highly unpopular and were severely criticized by industrialists, government

* Condensation of remarks made in this country by Dr. Vocke on April 13, 1959.

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officials, and the public on the grounds that they would undermine economic growth. As matters turned out, none of the somber predictions came true. On the contrary, as a result of the early effort to defend the Deutsche mark, the economy quickly regained both its equilibrium and the basis for continued expansion in an orderly manner. This experience proves that a central bank must be persistent and unruffled in its pursuit of a determined course of action, and must not shrink from occasionally taking unpopular measures if its obligations and responsibilities to the nation are to be properly fulfilled. In Germany, such monetary measures had to be taken on several occasions in the face of widespread criticism. But now that the economy is vigorously moving forward at a high level of prosperity and on the basis of a stable currency, what were once unpopular policies have now become the object of rather general praise.

The experience in the rest of Western Europe has been much the same. Comprehensive monetary and fiscal measures have helped restore financial stability and have revitalized the economies. The United States may regard the accumulation of gold by these countries with mixed feelings, but the fact remains that the gold had to be earned by productive effort. After years of bitter experience with inflation, Western Europe has now turned to monetary stability. The rejection of policies leading to continual depreciation of the currency was dramatized last December when thirteen European countries took steps to make their currencies fully convertible.

THE "CREEPING INFLATION" THESIS

To a foreigner it seems almost absurd that there should be certain quarters in the United States where inflation is tolerated or even recommended. Surely any price to be paid for inflation must be excessive, considering not only the adverse economic and social effects, but the irretrievable losses in national prestige it may entail. The path of inflation in the United States would not only mean the depreciation and ultimate devaluation of the dollar, but also an acute decline in the moral authority, power, and international stature of the United States. That there are close links binding a nation's prestige to its financial posture is evident from the manner in which the emergence of the Deutsche mark as a sound and stable monetary unit has enhanced the stature of the new western Germany in the family of nations.

The arguments advanced by the advocates of inflation must be earnestly and thoroughly considered. To begin with, the arguments set forth are, above all, political in character. The inflationists purport to show that inflation is an inevitable tide that can be stemmed only at the cost of economic progress. Consequently, they say, the attitude toward inflation must be rendered more flexible, and economic doctrine and policy must be adapted to a new institutional setting instead of plodding along the old rut of a stable currency.

Certainly, the proponents of this thesis by no means favor galloping inflation, but only the mild, creeping kind. In fact, they would for the most part readily admit that even a moderate inflation entails certain evils. Nevertheless, they would argue also that, whatever these evils may be, they are far less serious or significant than the grave political repercussions bound to result from a policy that tolerates an impairment of full employment, however temporary. To the advocates of creeping inflation full employment and monetary stability are incompatible. And, if there exists a choice, the decision would have to be in favor of full employment, for political reasons. Superficially, at least, these arguments may appear more or less plausible, particularly since they rest on political considerations. Yet on closer examination their contradictory nature becomes self-evident.

Let us turn first to full employment. What does it mean and to what degree can it benefit the nation and the economy? If full employment should mean that the labor force is occupied 100 per cent, the law of supply and demand cannot function normally in the labor market, and there exists, in effect, a state of overemployment. Under such conditions, employers can expand output only by outbidding each other for the available work force and by drawing workers away from one another. Labor, in turn, is enabled virtually to dictate its own wages. Such a state of affairs clearly cannot be regarded as the desirable optimum for the nation or the economy, either in its domestic or international aspects.

It is also evident that in a free economy the level of employment cannot be maintained constant to any greater degree than the level of production, consumption, investment, or trade. But, while it may not be possible to eliminate economic fluctuations entirely, the magnitude and duration of the cycles can be at least minimized. In this connection, one ought to bear in mind that, even at fairly high levels of prosperity, it is easier to influence or control the oscillations in employment and business activity than to bridle a cumulative inflation which must eventually lead to the proverbial bust. Nonetheless, the proponents of creeping inflation recommend yielding to overemployment, continually rising wages, and the price-wage spiral, while declaring at the same time that what they envisage

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is merely an inflation that crawls along at the leisurely rate of, say, 2 per cent per annum. Let us examine how this invention will work.

THE CUMULATIVE PROCESS OF INFLATION

The initial phase of inflation has a certain appeal. Rising money income activates the economy like a breath of spring that brings out the blossoms everywhere. Industry invests and production expands; credit volume rises, with borrowers planning to repay loans in depreciated money as inflation progresses. Employment climbs, and for a considerable part of the population the standard of living actually increases as consumption moves up, while the incentives to save wane. All economic indexes surge upward, mutually reinforcing each other, and setting the inflationary spiral in motion. At this stage, and at this stage only, inflation finds many adherents. But this happy state is usually short-lived and lasts only as long as some faith in the currency is still maintained. Even while this phase continues, an increasing segment of the population, dependent on fixed incomes, begins to feel the ruthless grip of the inflationary pressures.

The inflationists have a remedy at hand for the sectors that are squeezed between rising prices and lagging incomes: the escalator clause. This clause, which automatically links wages, salaries, and even some business transactions to the cost-of-living index or gold, was widely used in France, but with results that proved far from encouraging. In fact, the escalator clause is merely an illusion. As long as the depreciation of the currency is minor, the clause is not invoked. And when inflation progresses, it is satisfactory neither to income receivers nor to income payers; meanwhile the government is forced to inflate to an ever greater extent, in order to compensate those groups that remain unsheltered by the index clause. More importantly, however, the escalator clause, in itself, officially discredits the currency and therefore intensifies inflation. Moreover, what it clearly reveals is that, once the currency no longer serves as a stable standard of value, a substitute must be found. Since stability is, after all, essential, the absurdity of abandoning a stable standard of value in the first place becomes patently obvious.

All the various adaptations, compensations, and adjustments to a rising price level may well be bearable as long as inflation remains within narrow limits. But the fact is that inflation is progressive and eventually becomes full-blown. That point is reached when the public begins to lose faith in the currency and the material-value psychosis spreads. The scramble for goods is matched only by the rush into equity investments, while the bond market sags. The damage that inflation inflicts on the market for fixed-interest securities eventually makes it virtually impossible for the government to consolidate its short-term debt. For no one will acquire bonds when the money invested continually shrinks. The inevitable consequence is that the central bank will be asked to absorb the unmarketable public debt, which adds further fuel to the inflationary surge.

The reluctance to hold money or fixed-interest securities finds expression also in the rapid decline in savings. Wasteful consumption and misdirected investments suddenly become rational economic actions, compared with the foolishness of saving money that is rapidly becoming worthless. At this point the reckless spendthrifts and speculators are proved right and amass fortunes, while the honest, conscientious, and weak lose the little they have. As the process continues, customary standards of behavior are swept away and accepted moral attitudes are shattered. Soon everyone flees from the currency and joins in the furious dance of inflation, while the nation is rapidly moving to the brink of disaster.

The succession of events that I have just outlined would probably be considered a gross exaggeration by the proponents of creeping inflation. They would assert that the idea is not to let the inflation get out of hand, but to confine it to a delightful 2 per cent per annum. How is this feat to be accomplished? Obviously, inflation cannot be kept automatically within prescribed limits. There is no stable coefficient of inflation. Once begun, inflation spreads like fire and feeds on itself. Moreover, even if a limited depreciation of the dollar is envisaged, the public will try to protect itself, and by doing so will inevitably accelerate the pace of the price rise. Stability of the rate of inflation is an illusion, for if the public knows there will be a creeping inflation of 2 per cent per annum, then the 2 per cent will be reached not at the end of the year, but at the beginning, and the pressure for inflation will mount.

Since inflation is not self-regulating, by what method would the advocates of creeping inflation confine it to the predetermined limits? One answer is by credit policy, including restrictions on the volume of borrowing and increases in the rediscount rate. But the applications of such measures would be precisely those which the inflationists had sought to avoid in the first place. This means in effect that, while the inflationist would not be prepared to sacrifice full employment to monetary stability, he would nevertheless be disposed to sacrifice it for the sake of keeping the rate of inflation within arbitrary limits. The contradictory nature of the creeping inflation thesis now becomes self-evident.

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We may even go one step further. What is really meant by a 2 per cent rate of inflation? If it refers to the average price level, and not to the prices of individual commodities, say, straw hats or the wages of particular workmen on the bench, then the statisticians may well find that, after they have assembled and averaged the prices of all the separate commodities, the actual rate of inflation has surpassed the stipulated maximum. The consequence might then be the application of an elaborate network of physical controls over individual prices and wages. Adoption of a policy that is defined in terms of hitting a rigid target for average prices greatly increases the chances of detailed regulation to assure its fulfilment. Such economic regimentation would severely shatter the foundations upon which this nation was built and radically alter its way of life. Inflation inevitably breeds economic controls, regimentation, and moral corruption.

THE INTERNATIONAL ASPECT OF INFLATION

Let me now touch briefly on the international aspect of the creeping inflation thesis. During my years as President of the Bank deutscher Länder, that institution accumulated and kept a considerable amount of dollar assets in this country as backing for the Deutsche mark. Other central banks did likewise. And today, foreign central banks alone hold almost $10 billion here as part of their international reserves. These substantial holdings reflect the confidence of the world in the strength and stability of the United States dollar. One should hasten to note, however, that this faith in the dollar is by no means unshakable, and developments affecting its future are closely watched abroad.

There can be little doubt that a green light for creeping inflation would entail grave international repercussions. Acceptance of the doctrine—which to me is virtually unthinkable—would severely undermine the position of the United States dollar and would set in motion forces leading to its rapid replacement by gold as an international standard and store of value. The inevitable result would be a massive withdrawal of foreign dollar balances and heavy gold losses for the United States. Under these circumstances the question of raising the price of gold and hence the devaluation of the dollar would again arise. I have not discussed this issue here; suffice it to say, however, that there are few things that I would regard as more detrimental to the United States and to the world than an increase in the dollar price of gold.

For all the reasons stated, nothing must be permitted to give the world the impression that the stability of the dollar is in doubt. For any action that might signify yielding to the inflation thesis would involve irretrievable losses to the United States and would inflict immeasurable damage to the international monetary mechanism.

CONCLUDING COMMENTS

As a final word I may ask what there is to be gained by setting free the forces of inflation, except a postponement of the unavoidable adjustments that every economy must make sooner or later. It is certainly easier and less painful to curb incipient inflation or moderate the magnitude and duration of economic fluctuations than to tame an inflation that has reached the stage where only drastic deflationary remedies can be administered to restore balance. The measures taken in the United States last year illustrate that recession need not turn into depression and can be short-lived even without turning on the engines of inflation. Inflation essentially means weakness and thus cannot furnish a sound or lasting basis for economic progress. It is the line of least resistance, and not the road to an effective solution of economic problems or to the realization of economic aspirations.

We are living in a critical period in which courageous decisions must be made in order to win the struggle for freedom. This struggle, however, cannot be successfully waged by yielding to the disease of inflation, whether creeping, crawling, or any other kind.

The United States need not fall victim to the grip of inflation if that be the nation's firm will. But any wavering in the determination to preserve the strength and stability of the dollar may lose the battle before it is even begun. I am confident that the underlying beliefs and traditions of this country are strong enough to give unhesitating expression to the will to preserve monetary stability on which much of the power and moral authority of the nation rest.

The words of President Eisenhower and the firm attitude of the Federal Reserve System leave no doubt that the right choice is being made. This should be recognized throughout the world. And, as the spectre of inflation is dispelled, the future of the dollar as the world's best monetary unit continues to be assured. One of the qualities that has rendered this country strong and powerful has been common sense. If common sense is to continue to guide American policies, the stability of the dollar cannot be in doubt.

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for their products declines, what hope can there ever be again for the kind of old-fashioned price competition that formerly resulted in prices moving freely downward as well as up? Not only are a number of business concerns able to "administer" prices in such a way as virtually to exclude price reductions in periods of slow business, but they are said to be readily able to "administer" prices upward when the demand for their product strengthens. Thus able to pass on cost increases in higher prices, they offer only weak resistance to another inflationary pressure supposed to characterize our modern economy. This is the influence of "cost push", most frequently attributed to the ability of labor to obtain increased wages and fringe benefits that exceed productivity gains.

For all of these supposedly new factors in economic life—the quest for full employment, the banishment of depressions, the spread of "administered" prices, and the emergence of "cost push"—creeping inflation seems to offer an accommodating cushion. Moreover, this simple adjustment to the "facts" of modern economic life can be achieved, the creeping inflationists believe, within the framework of the kind of economy which this country wants to maintain, and with which it is identified in the eyes of the world, that is, a market economy. The argument has been made, in fact, that it is only by accepting some inflation that the freedoms essential for a market economy—the freedom of individual choice and free contract—can be assured. For in the face of the strong upward price pressures now present in the economy, the argument runs, a determined effort to prevent average prices from rising would almost necessarily require direct Government intervention in the setting of prices and wages. The only alternative, many seem to feel, would be monetary and fiscal policies so restrictive in their impact on aggregate demand as to generate unemployment and reduce the nation's rate of economic growth below its potential. Yet both domestic needs and the present international position of the United States make this alternative unacceptable.

The various kinds of creeping inflationists all readily concede that they are accepting a steady erosion in the value of the monetary unit, and hence of the savings put aside by a majority of the people in the form of such fixed-denomination assets as savings accounts, life insurance, pension funds, and United States Savings bonds. Some assert, however, that for the "average" person there is a more-than-compensating gain from the greatly increased rise in the real income of the country as a whole to be brought about by the faster growth that is to be expected, and from the reduction of the real burden of mortgage and other debt implied by rising prices. And for those unable to share directly in these offsets, as well as for many who do, there will be the possibility of "indexing" annuities or other kinds of income or assets by inserting "escalator" arrangements in the various contracts, linking them to some index of prices.

On occasion, writers who state a case for creeping inflation as a conscious policy also present an impressive array of statistics. These are used to show that rising prices and rapid growth have occurred together in most of the developed countries much of the time. The inference is then drawn that inflation stimulates growth, and a further conclusion is suggested: that satisfactory sustained growth cannot be attained without sustained inflation. Whether these "demonstrations" are representative, or relevant, or perhaps a form of statistical sleight of hand, may become clearer after the following cross-section analysis of the possible impact of creeping inflation upon the kind of economy that exists today in the United States.

PRICE CHANGES AND EXPECTATIONS

There is, of course, nothing inherently wrong with individual price increases. As long as such price changes reflect the balance of prevailing conditions of supply and demand for a particular product or service, they serve as part of the essential signaling system that directs the allocation of productive resources in a market economy, just as do individual price declines. The great sweeping movements of the entire price structure in the United States, however, have grown out of extraordinary events. The major increases have come with the convulsions of war, and the major declines have usually come with deep depressions. But in between, when the market economy is doing its normal job of allocating resources, with relative changes in different prices stimulating and guiding growth, it should be expected that there will be intervals of several months, or even a year or more, when the net effect of all individual price changes will emerge as a minor increase, or a decrease, in the average of all prices. There will also, as has been true for most of the past year, be periods of continuing sideways movement.

So long as any general and moderate rise in prices just happens, and no one can count with any degree of certainty at any particular time on a continuing rise, businesses and consumers can form their economic judgments in the orderly way that assures the nearest practicable approach, in an imperfect world, to optimum performance of the economy. When there is a roughly even chance, over any short period ahead, that as many individual prices may rise as fall, and that many will not move at all, there is no reason to look outside the zone of one's own competence for possibilities of maximizing earnings or economizing

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on purchases. But if there is definite assurance or a strong presumption that the average of prices will continue to rise indefinitely, even at a rate that seems quite small, everyone sooner or later is tempted—even compelled—to become a gambler. More and more businesses and individuals find it necessary to protect themselves against expected price increases on the products they buy and find it tempting to speculate on expected price increases for the products they sell. In that setting, more and more prices become the objects, in effect, of a betting pool, and perform much less effectively their economic role in a market economy. The cumulative effect of even a small rate of inflation, if it becomes continuous, would indeed be to impair seriously the usefulness of money as a store of value, one of the prime requirements for an acceptable monetary unit—both for domestic commerce and in international trade.

Much of what has been said in support of creeping inflation seems to neglect the critical role of expectations in the spending, saving, and investment processes. All but the most rudimentary decisions as to spending and saving, and all investment, in housing, for example, or plant, or inventory, result from judgments based partly upon expectations of the needs and opportunities that lie ahead. If those expectations include a certainty that the value of the dollar—its purchasing power—will be allowed to drop steadily, then every considered judgment must include an inflation hedge. Judgments may not be made in terms of the values of things as they are, but must be made in the light of what they will be a year or several years ahead. That is, a home purchased today for $10,000 will, if home prices move up only in line with average prices at, say, 3 per cent each year, cost $300 more a year from now, in five years (compounding at the same rate) $1,600 more, in ten (again compounding) $3,400 more, and so on.

Even with public policy aiming at broad price stability there have been some peacetime years since World War II when average prices have risen by several percentage points. But in each such case the price inflation occurred in spite of public policy intentions and there was no firm reason for projecting price inflation of similar magnitude into the future. Yet each time there has been a tendency for a wave of inflationary apprehension to spread through the expectations of savers and investors. The results, while relatively mild because the episodes were rather short, gave a foretaste of the force that changes in expectations might exert if inflation, even of small annual proportions, were to become a virtual certainty. Wage earners, businessmen, retired persons, consumers, savers, and investors have only to consult their own experience during one or another of those episodes to recall evidence, more persuasive than any statistical demonstration, that, when inflationary expectations infect the ordinary day-to-day spending decisions, more and more attention is given to subterfuges and hedges of various kinds, including the hoarding of readily storable goods, in order to find some protection from the probable loss in the value of the dollar. That kind of behavior does not wait for the extremes of recurring inflation and a frantic flight from the currency. It occurs whenever expectations of generally rising prices become widespread.

SAVINGS AND INVESTMENT

THE IMPACT ON SAVINGS

The creeping inflationists generally seem to believe that there need be no decline in the rate of savings from current income with their kind of inflation. Though this view is perhaps subject to question, there will indeed be many individuals who must still continue to save. Upon them—along with all pensioners and others on fixed incomes—the burden of a steady depreciation in the value of each dollar saved will fall heavily and harshly. To the extent they can, however, savers will certainly want to make a decisive shift in the composition of their savings—preferring those forms which offer a prospect of appreciation in value or accretion in yield corresponding to the rate of "creep" intended for the average of all prices. And it is scarcely realistic to expect that the great network of institutional arrangements now mobilizing savings in fixed dollar forms could be completely converted, without loss of effectiveness, to a different form of savings. To the extent that these facilities could not be transformed, some decline in total financial savings over time might well occur.

To minimize such shifts, and their consequences, some of the creeping inflationists have argued for the issuance of bonds with a price escalator attached. Also, they propose that the saver should be offered either upward adjustments of interest rates for conventional savings accounts, or accounts at lower interest rates which would be adjusted in principal amount as the relevant price index rose. There is in all of this, to be sure, a rather frightening prospect of conversions and exchanges for the hundreds of billions of fixed-interest-bearing obligations that are already outstanding. But, even if that combination of problems could be surmounted in some way, the banks and insurance companies and businesses and individuals undertaking new liabilities, variably adjusted to one index or another, would be confronted by other virtually impossible complications.

These complications are not, moreover, mere theoretical conjecture; they have occurred in Finland, for example, where an extensive network of escalators was introduced a few years ago, when a general acquiescence in creeping

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inflation became part of public economic policy. The experiment has already run its course, the Finnish public has been disillusioned, and the apparatus is being gradually dismantled. What happens, as escalator arrangements crisscross the savings mechanism, is that accountants find themselves unable to balance their books unless managements find a way to write up virtually all of their assets (and realized gross income) at least as fast as the relevant price index is increasing. Banks have to require borrowers to escalate upward their liability on loans, or pay interest that includes a surcharge sufficient (after taxes) to compensate for a rate of "creep" of, say, 2 or 3 per cent. No one—borrower, lender, or depositor—can know how much he owes or is owed, nor whether his realizable current assets can meet his rising current liabilities, nor whether he is indeed solvent, from one month to the next under full escalation, even if there were enough electronic computers to go around.

At best, such schemes impose on the economy an enormously complex superstructure of escalator connections, with opportunities for inequity, incongruity, and inefficiency greatly enlarged. And, even if a fully comprehensive, and all-inclusive, mechanism could be contrived, would not the results be only a peculiarly circuitous approach to the same market allocation that would work itself out under conditions of relatively stable prices? The exercise, if fully successful, would only be similar to that of canceling out equal values on both sides of an algebraic equation. At the worst, instead of mere futility, the result might instead be a kind of chaos, leading either to a slow strangulation of the financial mechanism or an acceleration of price increases as lender and borrower attempt to match strides—each trying to offset the gains of the other.

The apparent conclusion is that voluntary saving through the institutional facilities now used by most savers would be discouraged in some degree by a permanent condition of creeping inflation, unless interest rates should rise so high, and other escalator arrangements should be contrived so effectively, that some approximation of the present volume of saving could be achieved. In any event, regardless of whether, or by how much, total saving would be reduced, there would be so many new frictions injected into the system that much of the voluntary saving would probably still seek shelter in the stock market and in the direct purchase of such durable assets as houses and land. A considerable part of total saving would probably, in addition, be "forced" or "involuntary"—a euphemism for the loss of real income suffered by those persons, or those kinds of institutions, which would simply not be able to increase their money incomes as rapidly as prices rise.

REPERCUSSIONS UPON INVESTMENT

In an atmosphere of continually rising wholesale and consumer prices, financial markets would probably take on some of the aspects of a casino and tend to lose their efficiency in directing capital into the most productive uses. At the same time, business concerns or individuals would find it necessary to take into account a new dimension—the certainty of a depreciating dollar—in deciding upon the kinds of physical investment to make, and whether to borrow funds for use in physical investment. The stock markets would probably reflect less and less a consensus of investors' judgments of the long-term growth potential or the soundness of management of a particular corporation, and more and more a guess as to the likelihood that the corporation would be able to hold its own in the price race. In the bond markets, interest rates would tend to rise toward the point at which they could equate, on one side, the advantage to borrowers of financing current investment outlays in a form that could be repaid over the years in depreciated currency with, on the other side, the disadvantage to lenders of placing their funds in investments whose real value would depreciate over time. Although individual adjustments would occur in different ways, and could include arrangements for escalation of the principal amount as an alternative to pushing interest rates up drastically, one over-all result might be a reduced volume of bond financing, which could nonetheless only be carried through at very high cost.

Meanwhile, to the extent that higher interest rates and general escalation of prices and costs fell short of their more or less idealized objectives, there would be strong inducements to businessmen and individuals alike to accelerate their purchases of durable, investment-type goods. If a new machine will be needed six months from now, and the current flow of income permits, buy it today to avoid the price increase. If rents are rising, buy a new home and plan to take a profit on its resale five or ten years in the future. Moreover, to the extent that interest rates do not rise to the point where they fully offset the prospect of rising prices, investors will want to borrow the money to make these purchases. Even an economically submarginal investment becomes desirable if the service or the product it produces will so increase in price as to assure a profit on the investment, particularly if the purchase price of the investment can be repaid in depreciated currency.

Of course, total saving would probably be quite insufficient to provide all of the additional financing sought by all of the individuals and businessmen attempting to make tomorrow's investment outlay today. Potential investment outlays would have to be deferred in those areas of the economy where the return from the sale of the product

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could not be expected to increase so rapidly as the overall price average. What are some of these areas? They include schools, hospitals, and other public service institutions that do not turn out an economic product whose price can readily be escalated. Among them, too, would be many of the institutions and agencies engaged in basic research. And in all likelihood most of the electric utilities and other public utilities concerns, including transportation, would find their prices too slow in adjusting because of the usual lags encountered when prices and rates are regulated by a public body.

In short, both because other prices would rise faster than their own, and because all interest rates would be much higher than they would have to be with prices generally more nearly stable, some of the most important areas for the expansion of this country's basic capital stock of knowledge and facilities would fall behind in the competition for investment resources. The creeping inflationists' answer might then indeed have to be to increase central government regulation of investment flows, perhaps even through direct expansion of Federal investment activities. Even so, school districts, philanthropies, and other public agencies with relatively fixed incomes, or incomes that might lag in adjustment, would probably still be driven to various penny-wise, pound-foolish economies that reduce the efficiency of essential services, undermine the morale of their employees, and justifiably anger the public.

It would seem scarcely conceivable that such an investment mix could result in optimum growth for the economy. The condition of creeping inflation might well stimulate, at least temporarily, a larger numerical total of dollar investment. But neither investment nor the broader goals of economic growth are mere matters of numbers. The *composition* of investment, and of the national product, are always of crucial importance, both for the current satisfaction of the entire community and for the development of a strong base for continuing growth in the future.

THE PROBLEM OF "ADMINISTERED" PRICES AND WAGES

Much of the argument for creeping inflation has been stimulated by the fresh attention given in recent years to what have been called the twin problems of "administered" prices and "cost push" (usually "wage push"). Although it is difficult to define precisely what is meant by "administered" prices, they occur in circumstances in which a few large firms can maintain prices for their products without being closely responsive to short-run changes in supply and demand conditions. The spread of domination by giant firms in some segments of the pricing process has, probably, introduced new elements of rigidity in the price structure. Most observers, including those who accept creeping inflation, would no doubt be most gratified if ways could be found to improve the flexibility of prices through the injection, in one way or another, of more vigorous price competition. But the creeping inflationists, many with regretful resignation, consider such an alternative unrealistic, and look instead for a way of making room, within the entire price structure, for the persistent upward bias in prices that they consider inevitable, so long as important sectors of the economy are dominated by administered pricing techniques. A real question is whether creeping inflation can really be only a palliative, or whether it may not simply provide a stimulant to a further spread of administered pricing, making the fundamental problems eventually much greater.

Along with the widening public concern over administered prices, there is general recognition, too, that the growing strength of labor unions, along with the natural pressures of market demand for labor, have brought about a regular, and at times somewhat arbitrary, pattern of continuing increases in money wages—often without relationship to the change in average productivity that may have occurred during the preceding year or two, or during the current year. Some of the more active proponents of creeping inflation consider continuing increases of money wages quite necessary in order to provide increased sales and profits, and thereby induce businessmen to expand capacity—providing the underpinning for further growth. Many others, however, are less impressed by any need to stimulate purchasing power, and concentrate their attention on the cost aspects of rising wages and labor benefits. While often concerned that such increases may disturb economic balance, they have come to regard them as virtually inevitable, and turn to creeping inflation as a way of accommodating this kind of persistent upward influence upon the price structure. As they see it, the pressure for wage increases from organized labor is so irresistible that public policies which prevented these increases from being reflected in higher average prices would result in unemployment.

Whether support for creeping inflation originates in a resigned acceptance of administered prices or of wage increases which exceed productivity, or whether it rests upon genuine endorsement of high wages and high costs as a deliberate means of inflating the economy to promote maximum growth, the analysis would seem to have been left surprisingly incomplete. It has to be carried one step further. If a slow but steady rate of general inflation were to be tolerated as a form of surrender to the inevitability of price increases in the "administered" price and "organized

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labor" industries, the end result would be the transfer of purchasing power to the workers and management in these industries at the expense of those whose savings are being depreciated or who are unable to increase income in pace with price increases. The proponents of creeping inflation would deny, however, that they intend this type of enforced transfer and would suggest that escalator arrangements be developed in sufficient complexity to prevent the inflation from having an income redistributing effect. Assuming perfect success in this endeavor, the industries and labor groups whose practices make creeping inflation necessary would get the same share in the total national income that they would get at stable prices, if inflation had been prevented.

That kind of amplification points up one of the basic fallacies in the argument for creeping inflation. What reason is there to believe that these industries and labor groups would be more likely to accept a smaller share of the national product in a setting of creeping inflation than they would in a setting of broad price stability? Is it not fully as likely that they would continue to press for even larger amounts, in order to preserve at least the same relative share in the total that their strength, then as now, would lead them to expect. Could there ever be a rate of inflation large enough to disguise and mislead these underlying fundamental forces? If creeping inflation were to be accepted as public policy, therefore, the apparent result would seem to be either social injustice, if escalation were not complete, or a tendency toward a steadily more rapid rate of inflation if attempts at widespread escalation were thoroughly successful. It is also notable, though thus far apparently unnoticed by the creeping inflationists themselves, that one by one the countries which pioneered in escalation—in this case, a "cost-of-living" adjustment factor, beginning with Australia roughly half a century ago—are now abandoning the approach. They find it impairs needed flexibility, both in reflecting technological changes among industries as the years go by and in meeting the shifts of competition, at home and abroad. These lessons may not be conclusive; but they post a precautionary warning against this aspect of creeping inflation, too, at least until there has been much more study of this experience than has yet occurred in this country.

INTERNATIONAL COMPLICATIONS

From the evidence already appearing, as the other developed countries of the world reach the positions of strength toward which the United States has been assisting them since World War II, international competition is becoming significant in the domestic economy of the United States. Deliberate adoption of steady inflation would certainly impair the ability of this country's producers to compete, both in our own markets and abroad, with those other countries who have learned in their own way to combat inflation, and who are strongly committed to maintaining price stability. They would certainly be both shocked and chagrined if it appeared that the United States, after having helped them to surmount the obstacles and dislocation created by inflation, had failed to learn from their own lessons. But they would be quick to take advantage of the competitive advantages ensuing as a steady upward movement of United States prices gradually priced American products out of foreign markets.

One can hardly disregard, moreover, the very serious repercussions that continued inflation would surely have on the United States international financial position, and indeed on this country's stature as a leader of the free world. Apart from its effect on the United States trade balance, a sustained inflation in the United States cannot fail in the long run to undermine confidence in the dollar. Such international repercussions, in combination with the increasing competitive handicaps of American business, might have the effect of strengthening tendencies toward a new economic isolationism. These tendencies might lead to a reduction or elimination of foreign aid and investment, in spite of the compelling considerations of world politics and our international responsibilities calling for a continuation of an aid and investment program. They also would reinforce the pressure that even now is in many instances being mobilized to exclude, by means of tariffs and quotas, imports that are competitive with domestic products. The United States might thus be forced to retreat into a high-cost, "island" economy, while other countries, by pursuing growth in a more well-considered way, were reaping the benefits of international specialization and a gradual removal of internal controls.

ECONOMIC FLUCTUATIONS AND ECONOMIC GROWTH

The certain knowledge of continuing inflation, even at a relatively small percentage rate per year, would as already mentioned discourage the holding of money, or of obligations payable in a fixed amount of money, as a store of value. Anyone lending money would want to stipulate either a very high rate of interest or repayment in "escalated dollars", or some combination of both. The impression has too often gone unchallenged that a creeping inflation would also mean "cheap" money. Quite to the contrary, of course, as expectations of rising prices are assured, interest rates must rise to provide some compensation for the decline in the value of the dollars that would ultimately be repaid. The question is only as to whether

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interest rates or escalated adjustments would just be 2 or 3 percentage points greater than under conditions permitting expectations of reasonable price stability, or whether the rise would be much greater. A companion development to rising interest rates or charges, perhaps particularly by concerns or individuals able directly to invest their own gross savings in this way, would be a tendency toward acceleration in investment outlays on durable or storable products. These probable characteristics of creeping inflation are significant in appraising the likely consequences of a creeping inflation policy for the growth of the economy and for the economy's vulnerability to major economic fluctuations.

In the initial transition period, for perhaps a year or more, it is entirely possible that a creeping inflation would increase the flow of resources into all kinds of investments, as an increasing number of businessmen and individuals employed their available cash (and any credit resources available to them on profitable terms) to accelerate investments in equipment, residences, and other assets that would be more costly if delayed. The income generated by this initial acceleration of expenditures would presumably add to the demands for goods of all sorts. Further investment would thus be called for to supply these demands, and the continuous accelerating tendency of the price outlook, reinforced by expanding product demand, would be most likely to have a further multiplying effect upon investment. Economic activity would blossom in the hothouse atmosphere of assured price inflation, fed by a growing volume of investment expenditures intended to create capacity and accumulate inventories to meet a firmly anticipated demand for goods—sometime in the future. What possible fault can be found with this picture?

It has already been noted that the mix of this investment boom would probably include more and more speculative buying of land, for example, and discriminate against schools and the other kinds of investments that are essential to provide the structure needed to support the steadily advancing technology that is required for long-term growth. In general, over time, basic capital would be allowed to run down as price conditions led to increasing speculation, at the expense of considered evaluation of longer range productive potentialities. But that is not all.

There is always a considerable time interval beween the initial appearance of enlarged demand, which leads producers to plan expanded capacity, and the final appearance of this new capacity. Moreover, there is also a rather persistent and quite understandable tendency in a free market economy for businessmen initiating investment plans to reach beyond presently visible demand to provide for some further expansion. As a consequence, investment projects sometimes bunch together, especially when optimism is running high, and the new wave of productive capacity comes into use before demand is fully ready for it. There is an appearance for a while of "overcapacity", and this often leads to some reduction of further new expansion plans, a reversal in inventory accumulation, and, if there is a spread of pessimistic concern, to some more general business retrenchment. This pattern has been a significant part of the cyclical swings that have occurred since World War II, although each swing has fortunately been kept within a fairly narrow range of fluctuation. With the continuous insertion of another incentive to overreach—the desire to anticipate price increases—there would seem to be an impelling reason to expect that the forces making for both economic booms and recessions would become more pronounced.

The combination of this greater gyration in real investment with the likely speculative boom in the stock market, and the related speculative excesses that result from losing the discipline of a stable standard of value, might create circumstances that would have to be described by a stronger word than "recession". Moreover, economic adjustments, when they occurred, would strike an economy from which the inflation prospect had absorbed any reserve of liquidity. Once a turnaround began, so long as financial markets remained reasonably free, most needs for liquidity would have to be met by selling mortgages, or equities. The effects might well be reminiscent of those more hazardous times before modern economies had developed great markets for providing secondary liquidity in periods of economic unsettlement. The tasks of limiting any thrust toward depression from purely financial factors might then become much more difficult than anything experienced in this country since World War II, while public policy has been aiming for reasonable price stability.

For the long run, therefore, it seems likely that a policy of creeping inflation would widen economic fluctuations. Certainly there is no basis for expecting any narrowing. To be sure, reliance upon growth would probably be cited again as the answer, even by those who might, on reflection, concede the possibility of greater cyclical swings. But what is left now of any stimulus to growth, in view of the prospects already described for saving and investment during creeping inflation?

In its early phases, creeping inflation might stimulate an expansion of investment in tangible assets and other equities, partly in real terms but even more as measured in shrinking dollars. Then, later on, perhaps in a year or two or three, as reliance upon the certainty of rising prices became widespread, a new phase would become clearer—

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that of further and further shifts into the kinds of assets offering the best possibilities for hedging against depreciation in the purchasing power of the dollar. The numerical values of investment, and of income, might still go on rising at impressive rates, although the underlying real structure of balanced productive capacity would have begun to erode. Then ultimately, perhaps after a cyclical downswing, or in a still later phase, the aggregate physical capacity of the economy to produce the goods and services that consumers really want and need might no longer rise at all. By this time, the burdens of maintaining a maze of interrelated escalators, and of diverting effort and materials into providing speculative hedges, would have become so great a drain upon the economy's resources, particularly upon entrepreneurial ingenuity and skill, that it would be difficult indeed even to maintain existing capacity in reasonable balance. Having run its course, creeping inflation would have brought the economy to a state of stagnation, and then, perhaps, creeping paralysis.

CONCLUSIONS AND IMPLICATIONS

In looking back over all that has been suggested so briefly here, many who are already critical of creeping inflation might note the absence of several important considerations. They could suggest that a serious deterioration occurs in the moral character of a nation when its economic life is subjected continually to the strains of rising prices and deterioration in the value of its monetary unit. They could cite many instances in which countries have drifted into an acceptance of some inflation, only to find themselves eventually drawn into a labyrinth of restrictive governmental controls. And they could point, too, to the experience of a number of economies over the past half-century where, despite a multiplication of devious governmental controls, the outcome ultimately was a runaway inflation. They could then, too, elaborate convincingly upon the horrendous effects of that kind of inflation.

All of these criticisms are, of course, perfectly valid. They have, however, been stated so often and so well that they need no repetition. Any critique of creeping inflation should recognize, nonetheless, that all of these greater eventualities—the sapping of moral vitality, the stultifying influence of rigidifying governmental controls, and the collapse that ensues from runaway inflation—are indeed grave prospects that cannot be ignored whenever a modern economy acquiesces in a pattern of inflation.

The lesson of this analysis of creeping inflation, though, does not come from a parade of frightening extremes. It should be enough for a considered evaluation to recognize that, at the least, a consistent acceptance of creeping inflation will end in futility. There is nothing in the nature of the influence exerted by a steady edging upward in prices that can provide a solution to the important problems that are, indeed, quite rightly the center of attention in the American economy. But creeping inflation would not only end in futility. The logic of the analysis and the facts of experience demonstrate that the alleged gains from acceptance of creeping inflation cannot actually materialize. At best, the result is a drastic rise in interest rates as prices mount steadily, while one escalator arrangement after another is superimposed upon those segments of the economy that can practicably make use of such devices. And in the end, with the futility of the escape mechanism fully demonstrated, and as it becomes clear that the hoped-for gains cannot materialize, positively harmful manifestations emerge. Those who can raise prices most readily, or increase wages most effectively, or escalate themselves to a position of neutrality, get more and more of total income, while the unsheltered get less. And, in due course, total real income rises only slowly, if at all. The functioning of a market economy, upon which both the vitality and the growth potential of this country depend, becomes impaired and eventually corrupted.

All along the way, as the panorama of creeping inflation unfolds, the Federal Reserve would probably find itself called upon to attempt a succession of holding actions. Eventually, even greater reliance might actually be placed upon monetary and credit controls than is done today, but because other upward forces of price pressure would also have been condoned and strengthened, the effectiveness of the Federal Reserve would probably be weakened or even nullified. With everyone given a stake in pushing up prices, with credit relationships entangled in escalator clauses, and with interest rates held continuously at very high levels, the scope for flexible variation in monetary and credit policy, and the potentialities for sensitive response to such policy throughout the financial structure and the economy, would soon become narrow and limited.

To be sure, no central bank can be expected to bring about stability in prices and in the economy by its own actions alone. But postwar experience both here and abroad strongly suggests that an effective central bank is one essential part of the governmental apparatus, particularly under any system that aims to avoid direct governmental control over prices and wages. Without attempting to outline the positive contribution that central banking should be able to make, and without touching at all upon the potentialities of such companion instruments as fiscal policy, it should nonetheless be evident that a crippling of the central bank would have serious implications for the implementation of public policy in any market economy.

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The creeping inflationist might still, however, wave all of these grave consequences aside, insisting that the principal problem still remains—that any monetary or fiscal policies strong enough to halt creeping inflation will inevitably create a volume of unemployment so large as to be wholly unacceptable, socially and politically, in a modern society. The persistence and grip of that idea, despite dramatic evidence to the contrary in several European and other countries since the war, is truly remarkable. As a theoretical concept, its appeal must come from the logical simplicity of an "either-or" proposition. There is no evidence to support it in United States experience.

Certainly there is no demonstrated basis for viewing the supposed conflict between price stability and employment, on which the creeping inflationists have fastened so firmly, as inexorable. Even the supposed new influences of administered prices and "cost push" have scarcely been visible long enough to have set in motion the corrective forces which distortions of that kind often produce from inside themselves within a generation, or even less, so long as the force of competition remains at work. And, if competition along old paths may seem for a time to slacken, it will spring up again, so long as public policy gives its determined support, from the influence of new firms, new products or new processes displacing the old, or from the impact of new sellers or buyers abroad.

The issues confronted by the creeping inflationists do not appear to be any different in significance for the current generation from the kinds of issues visualized by the popular economics of "secular stagnation" in the 1930's, or perhaps of "bimetallism" and others even further back. Each of those new theories left behind its grain of truth, as emerging developments pushed aside the base upon which the theory itself had been erected, and there is no doubt that some gain will remain in the articulation of public policy and in the understanding of economic processes, after the creeping inflation thesis has moved on into the archives of economics. But its futility in reaching any of the underlying causes for concern, such as administered prices and wages, and the clearly harmful further consequences that it would also produce, make creeping inflation unacceptable as a basis for public policy.

A limited number of additional copies of Dr. Vocke's remarks on *The Future of the Dollar* and of the article entitled *Creeping Inflation* are available. Requests should be directed to the Publications Division, Federal Reserve Bank of New York, New York 45, N. Y.

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The Federal Funds Market

The Board of Governors of the Federal Reserve System has just published a 120-page booklet entitled *The Federal Funds Market, A Study by a Federal Reserve System Committee.* This study was originally made by a special committee at the request of the Conference of Presidents and the Board of Governors of the Federal Reserve System. Its primary purpose was to obtain information on the structure of the market for Federal funds, the volume of operations, and the use of the market by banks and others—to give a cross-section view of the structure and operation of the market rather than to determine its behavior over a period of time. The study is principally based on data collected in November 1956, and information obtained from interviews with officials of banks and other institutions active in the Federal funds market; it thus throws light on conditions in the Federal funds market during a part of the period of credit restraint that prevailed until the latter part of 1957.

Information developed in the study shows that the Federal funds market has become an important segment of the short-term money market. Since the focus of the study is on fact finding covering a limited period, no attempt has been made to draw broad conclusions concerning the efficiency of the Federal funds market as a means of redistributing the supply of bank reserve funds, the effect of the market on the loan and investment policies of the institutions that use it most frequently, or the implication of Federal funds transactions for credit regulation.

Copies can be obtained from the Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington 25, D. C., at $1.00 each up to ten copies and 85 cents each for ten or more copies in single shipment.

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