The Economy in Perspective

Hear ye, hear ye, hear ye ... Ladies and gentlemen of the jury, the question before us is a simple one: Do overabundant money and credit creation threaten the U.S. economy with accelerating inflation and below-par performance? You have heard me present the prosecution's argument, and you have heard the case of Ms. Rose Glass, counsel for the defense. You have also weighed a great quantity of evidence and listened to expert witnesses for both sides. Just a few minutes ago, Ms. Glass summarized the defense position. Now, before you withdraw for final deliberations, I would like to review the prosecution's case.

Certain facts are not in dispute. The U.S. economy has been expanding continuously since 1991, and, far from slowing, its growth rate has accelerated in each of the last two years. Capacity utilization rates seem high throughout the economy. The nation's unemployment rate, which stood at nearly 8 percent early in this business cycle, has fallen steadily and has registered less than 5 percent for the last nine months. Add to these excellent conditions the facts that the producer price level held steady last year and consumer prices increased less than 2 percent.

Now, ladies and gentlemen, Ms. Rose Glass would have you believe that the U.S. economy has achieved price stability and that resisting an upsurge of inflation is inadvisable today because inflation is already so low. This is where she and I part company. Many people think that inflation is whatever the Consumer Price Index records as the rate of price change from one year to the next. But, as I have shown you, inflation is a decline in the purchasing power of money that results from a *persistent* increase in the general level of prices. Last year's 1¾ percent CPI increase and the even better performance so far this year are lower than the rates that prevailed during most of this economic expansion, and, I maintain, lower than those we will see going forward.

I have laid out our evidence that inflation's underlying rate easily surpasses 2 percent. For example, last year's CPI excluding food and energy expanded 2¼ percent, and the median CPI—an even better measure of core inflation—grew 2¾ percent. These core measures averaged between 2¾ percent and 3 percent over the last five years, suggesting that the economy's recent inflation performance has not moved off this trend. Energy prices on average have barely risen for six years.

We know that inflation is a monetary phenomenon which escalates when the amount of money supplied exceeds the demand. Ms. Glass' experts have told you that there is no positive way to determine when too much money has been created, but that is irrelevant. You are not required to know beyond any doubt, but only to judge whether there is a preponderance of evidence. On this score, I have presented some compelling facts. Since 1959, the U.S. economy has had four distinct periods of persistently accelerating inflation. Before each of these episodes, it enjoyed two years of strong output and employment growth. In addition, the growth rate of the monetary base rose steadily over the four years prior to each inflationary run-up, especially during the six to 12 months just before inflation began to accelerate.

And what do we see today? Most money measures have been accelerating during the past few years, with annualized growth rates early this year reaching 8 percent for the monetary base and M2—and hitting 12 percent for M3. Even 3 percent inflation is unlikely to be sustainable unless these money growth rates slow down.

Financial markets are providing lavish credit to private borrowers. Mortgage debt outstanding has increased nearly 25 percent in just four years. Short-term bank financing, combined with nonfinancial issuance of commercial paper, soared last year and is still accelerating. Corporations are also raising large sums through bond issuance and equity sales.

Make no mistake, ladies and gentlemen of the jury; excess money and credit creation are serious threats to our economy and must not go unchecked. In the last four episodes, painful economic adjustments had to be made when inflation and inflation expectations accelerated rapidly. Inflation distorts economic decisions, and the greater the distortions, the more costly the correction. I therefore ask you to make the only responsible decision and return a guilty verdict—before the Rose Glasses of our society color our economic judgment.