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- Welcome once again as MIT Professor Paul Samuelson discusses the current economic scene. This series is produced by Instructional Dynamics Incorporated. Professor Samuelson, the question on everyone's mind is, have we turned the corner yet?

- That is the question on everybody's mind and it's the question that I'm constantly being asked by the press and when I give public lectures, as I did about a week ago, before the American Iron and Steel Institute in New York. It's not, however, I think the most important question that could be asked at this time. And let me explain why. The great guessing game is, is the recession over? And it reminds me of two plays. One was written during the Great Depression by Clifford Odets, a kind of WPA militant activist playwright who had a certain vogue and fame, some 40 years ago. It was called Waiting for Lefty. The gimmick in this play, which gave it a certain amount of popularity and zest, was that the audience is more or less participating. That was more novel in those days than it is today. And the climax of the play comes when Lefty arrives, he's the union negotiator. And he comes to the local union meeting, not from off stage, but right up from the audience. And there's a great cheer, and he says the strike is on, and oh joy, oh joy. Everybody is very happy because now each of us can go out on the picket line. The arrival of Lefty is a very dramatic event, and I wish that the arrival of the end of the recession were itself, one, factually a dramatic event, and two, appraising it for its worth, an important event. Probably the better literary analogy would be a play of Samuel Beckett, avant-garde, Waiting for Godot. Where really, nothing very much happens, and it's a long and tedious wait for those of us who are not connoisseurs of avant-garde literature. Many will think it an extremely dull play. Well I'm afraid that watching the business cycle when you are nearing the troth of the business cycle is a very dull affair. Because almost by definition of what we mean by a lower turning point, by any turning point, you have a very close balance between the forces making for further sliding down in the economy for further recessing in the economy, and the forces making for recovery. So then, more than any other time in the business cycle, except for the upward turning point, the situation is necessarily cloudy. You don't know when Lefty arrives. You don't know when Godot, I should say, arrives, until after the event, because it sneaks up on such soft feet. And necessarily, each expert seems to be disagreeing with his fellow expert, as he counts the strands upward and counts the strands downward. That itself, the fact that we are in a period of cross currents, in which the experts seem to be to the outsider, disagreeing and talking in forked tongues, that itself is a sign perhaps that we are very near the turn, just past it, or just at it. For example, on the very day that I talked at the Grand Ballroom of the Waldorf Astoria with Paul McCracken, former Chairman of Richard Nixon's Council of Economic Advisors, we got in the morning news too, opposing bits of new information. On the one hand, the consumers price index, which had been showing a very cheerful picture, in the early months of this year, showing a very small rise. It was three tenths of a percent in the month of March. Which if you annualize, you get to a little more than three and a half percent annual rate of increase in consumers price index, a consummation devoutly to be hoped for. Well in April, along came the bad news that because primarily of the increase in food prices, the seasonally corrected consumers price index increased by 0.6. That's by six tenths of a percent. Annualized, you have something more like seven and a half percent, which is still better than in the third quarter of last year when we were seeing consumers' prices rising at double digit rates, at 12% and 14%. But still, could be considered to be slightly discouraging.

On the other hand, on that same day, we got a bit of good news, namely, that new orders for durable goods took a, I think it was a 9% leap in that month, which is the greatest leap in that series since 1961. On balance, I think that that little bit of good news was more favorable than the bad news was unfavorable. Because just before I went down to New York, I thought I would consult with one of the private forecasters who is partial to the leading indicators approach. And I asked him what he thought about how near we were to the turn, because I knew that was one of the questions that I would be asked, and I was asked that question. He replied, "Well, most people think we're very near "the turn", he said, "but I'm skeptical, "because the leading indicators, particularly when "you correct them for inflation as you should, "and as official Washington authorities are about "to do", he said, "when you do that, they still "show a slide, and although the lead "of the leading indicators at the lower turning point "is not very great, which is a regrettable fact "about them, still," he said, "I am inclined "to go bide them." It was particularly, I think, durable orders that troubled him, because they did not show a comeback. All the leading indicators are equal, but some are more equal than others, and some, few, of the leading indicators, the experts who watch the entrails of that particular method of forecasting, regard as more important. If you're a monetarist, you'll hardly have an interest in the leading indicators, except to the degree that they tell you that the rate of growth of the money supply is one of the earliest leading indicators. If you follow the stock market closely, you know that the increase in stock prices, which certainly has been giving some kind of a signal, all this year long, is a fairly reliable leading indicator. It doesn't miss very many upturns, however it does give quite a number of false signals. Well, most people who take a more eclectic viewpoint, think of the new orders and average work week as quite important. And so that was a bit of good news. In that same week, we were getting reports from what used to be called purchasing agents, but I guess they're now called purchasing executives, saying that a larger fraction of their brethren were reporting increases in production. It was still a minority, but it was a larger minority than earlier. And all the usual signs when you're near the lower turning point seem to be reflected in the purchasing agent report. Well, to answer the $64 question, I don't know whether history will record that we have already made the turn. I can dismiss it with facetious remarks that the experts used to think it was April Fools Day, that the turn would come, then they thought it was my birthday, May 15th. Well, we're past both those dates, and it's quite possible that history will record that sometime in between those important dates the turn actually came. But it's still too soon for us, swimming in the currents of history as it happens, to be very sure of that. I guess it even money. I would go along with a view that we have just made the turn, but with very slight odds, I'd be willing to wait until the middle of the year, and the more cautious government forecasters having learned their lesson, having been burned by giving out too optimistic reports. They've been protecting their bets by making it the middle of the year. Now, I don't think it's very important for a couple of reasons. First, when Lefty comes and tells you you are gonna go out on strike, that's really only the beginning of the turmoil and the travail. You haven't yet won the strike, and the first week of the strike is an exciting time. Well, in the case of the onset of recovery, the first week of onset of recovery is not an exciting time, and you haven't won anything after the first week, second week, or third week. Because almost by definition of the unfortunate usage, where we use the word recession, which reflects about a quarter of the business cycle, or a little less than half the business cycle, that part of the business cycle which represents the slide. We really use that to represent what the man in the street thinks of, as the... The persistence of depression. Or of mild depression. Well, when the recession ends, the mild depression for which the man in the street thinks it stands, is really at its worst. I've said this once before, but the darkest time is just before the dawn. And the worst situation with respect to unemployment actually comes a little bit after the recovery begins, because until the recovery takes a certain momentum, about equal to the trend rate of growth, of our population, labor force, and productivity, unemployment gets worse. So, even if it were the case that I could confidently say to you, "Yes, the recession is over. "We are now in the recovery", that wouldn't mean that our problems are over. Actually, it would mean, I think, that some of our biggest debates are just ahead of us, because the big debate, the one just ahead of us, which you're going to be taking part in, will come, let's say in the fourth quarter, on the supposition that we are now just rounding the corner into recovery. And if in the fourth quarter, we find that real output is growing as fast as most of the experts think it will, and I'll say a word of caution about their views in a moment. Let's suppose that real output is growing at 6% or 7% in real terms. Then you might say, "How could there be a debate? "Why isn't everybody happy, throwing his cap in the air, "that we're no longer in recession?" Well, the answer is that the unemployment rate will just be edging its way down towards 9% and a little bit below 9%. The unemployment rate will be very slow in coming down towards even 8%, or a little bit below 8%, by the election time 1976. Yes I do mean November 1976. We'll still be talking about unemployment in the high 7% and almost 8%, even if the real output is growing by something like seven or 8%. It will be compounded by a historical pattern which I suppose we can expect to repeat itself. Namely that in the first quarters of vigorous recovery, productivity improvement is at its best. And so, just as productivity improvement was at its worst, was actually a non existent if not negative, as we were sickening and going into the slide. So we might have an increase in manufacturing productivity in the last quarter of this year, or the first quarters of next year, four or 5% per annum. That would not be contrary to the form book. On the contrary, it would be in conformity with what typically historically happens. But of course, that very good news on the side of productivity is bad news, when it comes to the rate at which reading into the unemployed. And so, most Democratic economists will say in this great debate that, what's 7%? As long as we have all this slack in the system, we can afford to grow at an even faster pace. And they will have the election year psychology on their side. On the other hand, those economists, many of them Republican economists, but many also nonpartisan economists in banks and in business, they have been temporarily lulled into a kind of consensus agreement on policy. Namely, that what we need is a sizable deficit. And what we need is a sizable rate of expansion in the money supply. They were lulled into this, I said, but I guess maybe I should say they were terrified into it, by the risks of the falling dominoes in a recession slide. Just as certain profligate rakes forsake their religion, when they're feeling great, when they're feeling lousy, they begin to get religion, what in the East is called rice converts. And so it is with these people. But of course, as the economy begins to get its health back, as it becomes more and more obvious that we're not in for a great depression, we're not in for such agitation throughout the country that the independence of the Federal Reserve will be jeopardized, as perhaps it came close to being by the, what I would regard as the over conservatism of the Arthur Burns Federal Reserve. As soon as that happens, then you will find that Federal Reserve being less frightened of the will of Congress and the will of Main Street. And in Arthur Burns' range of rate of growth of the money supply, from 5% to 7.5%, you will find the Federal Reserve with the courage to begin to try to tilt towards the lower end of the range. So, all the elements are made for a debate whether or not we have reached the turn now or whether or not we reach the turn by the fall, or even into next winter. Now I think it is of some importance that we reach the turn this summer, or in early fall, in terms of how the situation is gonna look during the election period. Because the longer delayed is the turn, in terms of political economics, or economic politics, the less time the economy has to begin its improvement and to accomplish a substantial amount of improvement. I think that from the standpoint of

President Ford's re-election campaign, I'm going on the supposition that he should be taken at his word, that he does seriously intend to run. I think that he is not in such bad shape, because we are still, as I speak, something like 17 months away from the election. And a lot of improvement can take place in 17 months, even though perfectionist Democratic economists will be able to say that there's a lot of room still to go. Well, I've checked with the various experts. No need for me to name their names. And they still are standing pretty firm on their view that the turn comes, if you put it on a monthly basis, some time toward the end of the second quarter. If you put it on a quarterly basis, let's call it mid year, they still are pretty sanguine that by the fourth quarter of the year, real output will be growing at a pace which will be considered healthy by historical standards. Let's say, 6% annual rate in real terms, or better, or more than that. Whether it's better or not, of course, is going to be the subject of the debate at that time. My caution is that these forecasts are almost consistent with the old V bottom story that we were hearing about last fall, when administration economists were just beginning to recognize that we were in a recession. And were putting a comfortable gloss on how we were going to get out of the recession at the middle of this year. It's not precisely a V, because under continuity, you can't literally get a V. But anything like 6% by the fourth quarter in real growth or above is operationally perhaps to be regarded as a V bottom, rather than a W bottom. Now, I want to mention two reasons for caution. They're very simple and very obvious. They are automobiles and housing. Autos, as I talk, have not been rebounding well. And the imports still are a threat. And cutbacks in the production line by the big four in America do seem to be in the cards just ahead of us. Now, it may be that autos will come back strong, before the fourth quarter, and by the fourth quarter, the new models will be on hand. General Motors does have one small new car. And as I understand, that if you can bring people into the showrooms by the bait of a small American car, you often find that American consumers succumb to what it is that they really want, which is a not so small car, and a more comfortable car. So, it could be that General Motors and its rivals will be in the kind of healthy rebound that seems to be implied in most of the forecasts, which involve six and seven, 8% real growth in the fourth quarter. But I think that there is probability room to wonder about that, and we should really have reservations. Similarly, housing is not where many of the consensus experts thought it would be at this time. It has ceased to fall perhaps, but it is not in much of a rebound. If there ever was something that could be described as a U bottom or as an L bottom, it would seem to me that the current housing starts reflect that. Now why? Well, it appears that single dwellings are in better shape than multiple dwellings. And since multiple dwellings, apartment buildings, by people who build them for a profit, or for resale as condominiums, take quite a long time on the drawing boards, it will surprise many of the experts inside the housing industry, if multiple dwellings come back very fast. They'll concede that the inventory of single homes, expensive as they are, may be at long last coming down. They concede that the building permits, which ought to give some kind of indication of how starts are going to behave later, that building permits have taken a favorable turn at the last report. But they've taken a favorable turn from a very unfavorable level, and their new level is still rather disappointing, if you compare it with the present low stabilized housing starts. You may ask, how is it that the sunshine of easier money as reflected by the massive flow of funds into the SNLs, into the savings banks, into the time deposits of commercial banks. How come this has not melted the resistance of housing to rebounding? Well, there are a number of explanations that are given in the trade. First place, an awful lot of the money that's come in has come in, not into certificates, long term certificates, but in to passbook accounts. It looks as if this is very footloose hot money. People who are on the ball and who took their money out of the SNLs and put their money, let's say into much higher yielding liquidity reserve funds, mutual funds that you can draw on at an instant's notice, and in many cases you can draw by check. Those rates, because the Treasury bill rates are down so much and because commercial paper rates are down so much and because CD rates are down so much... The yields of those funds have fallen so much, say from 12% of scarcely a year ago to five or 6% now, that you can do about as well in your local savings bank. But you can't do as well... You can't do better unless you tie your money up for several years, and the people who are smart enough to use these alternative methods of holding liquid balances are probably too smart to count on the interest rate, short term interest rate, staying low here. So if they're transferring the money, and as I worked it out just in recent days, there really is no advantage in transferring your money yet. But if they transfer their money, they transfer their money in passbook accounts, which de facto, whatever the day your regulations can be taken out at short notice. Who wants to put your money somewhere and have to wait 90 days, when the short term market is taking off? And the bankers know this, and they're afraid that they must not put this hot volatile money into 30, 40 year mortar and brick, because they will then be in trouble. The result is that they're tending to use a good deal of this new flow of funds, so it is said throughout the industry, to become more liquid, to repay their borrowings at the Federal Home Loan agency. And also perhaps to buy government securities, which they can sell at an instant's notice. In any case, this flow of funds has not made them itchy, to get it all invested in new housing. And so, although you can perhaps get a better mortgage deal now, or even get a mortgage deal now for the first time in some parts of the country, then you could at an earlier date, it isn't very much different, and you still need a pretty healthy down payment, particularly if it's risky. In the meantime, the cost of a new home, and these are pretty rotten building jobs, if you examine any of them, continues to rise. The median house on the market, which I think very few of the professional and business people who would be listening to my voice now would consider living in, these are 39, $40,000. Seems like a lot, but the increase in the cost of the typical home, and we have time series on that, has in fact not gone up as much as the money income in this age of inflation has of the typical individual who's held his place in the percentage distribution of income. So I ask you, I ask myself, how magnificent can be the upward soaring of the recovery period, if two very important industries, housing and autos, are in only a modest state of enthusiasm in the recovery? And that is why I'm keeping my fingers crossed. I am, at this point, still a little bit more inclined to bet on a lot of U in that bottom, rather than a lot of V. Well, it's a time for waiting, and we'll know more as the passing scene tells us its story.

- If you have any comments or questions for Professor Samuelson, address them to Instructional Dynamics Incorporated, 450 East Ohio Street, Chicago, Illinois, 60611.