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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. This program was recorded March 27th.

- Well the oil boycott is now over, spring is almost arriving in much of the country. This would seem to be a very good time to take a quick look around to try to decide exactly what's happening to the American economy. I think if you asked the typical non-economist where we now stand, most people will reply that they think our economy is in terrible shape. The housewife finds her food bills soaring. Each month she finds her utility bills are rising, mostly of course due to the energy creeps upward in price despite that brave talk of congressional rollback of prices. The unemployment rate is going up, particularly the rate which many of us think counts most, the rate for full time employees, for example, the married man series. Arthur Burns at the Federal Reserve has hinted darkly at two digit Latin American inflation and indeed since consumer's prices this very quarter are probably rising at about an 11% annual rate, who can deny the possibility of that. I attended a meeting in Florida of top operating heads of America's largest corporations, and I must say they seemed as shaken in their confidence as the man in the street. Bill Moyers told a story there on one of the panels that came almost too close to home. He was told by one of his Wall Street friends I feel more optimist than ever about the market. Then how come you look so worried, Moyers asked. I'm worried because I'm afraid that my optimism may be wrong, was the answer. Well we all seem to be rather like the young cowboy who comes to with a lasso in his hands and doesn't know whether he's lost a horse or found a rope. To document this qualitative malaise I'm looking at the performance of certain volatile leading indicators. I don't mean leading indicators of business activity, but indicators of speculative sentiment. This is a list that is sent to me kindly by somebody from Moors & Cabot, New York Stock Exchange brokerage firm. And I'm just looking at what's happened to things like the price of silver since January 1st. This is January 1st to March 22nd. So it's essentially the first quarter of the year. Well, the price of silver has risen 69.9%, that's 70%. That's obviously not a measure of the demand by Polaroid for film silver, or by newlyweds for presents, that's a infectious carryover from the increase in the speculative price of gold. In fact the price of gold has risen 58.3%. The stock market generally, although you wouldn't guess this if you talked to all of your friends down at the club, has been working its way upward. If you take an indicator of stocks across the board, not blue-chips, say the Value Line industrials, I think that's 1500 stocks, and it's actually a biased downward index but it's an index of the lesser known stocks, that rose 12% in the first quarter. Ominously, or brightly, the American Stock Exchange has been outperforming the New York Stock Exchange. The AMEX index has risen by 9.4%. The over-the-counter market, and particularly the blue-chips there that are quoted on the computer, the NASDAQ industrials have gone up 7.1%. All this while the Dow Jones average, the industrials, the thing people watch most, which tends to be blue-chips, has gone up 3.2%. Well you may ask what's happened to the market really because as you know the Standard & Poors 500 Index is a much better indicator of what whole market is doing. And that, surprisingly enough, has lagged behind, it has hardly changed at all, it's minus .1% since the beginning of the year. Actually then we could say qualitatively that there's been an increase in speculative interest in the market as against that solid, stolid, bourgeois blue-chip interest in the market. As a matter of fact, the first tier stocks, the ones that the Morgan Trust Apartment, First National City Trust Apartments hold, the Avons, the Polaroids, the Xeroxes, the IBMs, they have been, not been outperforming the market as was the case a few years back. They have actually been underperforming the market. Well, that's the gloomy picture if you canvas the non-experts. What's the story if you look at what the various experts are thinking. Well first, let me stick my neck out and say that I suspect a good case can be made that the mini recession that we've been in, call it a recession, call it a bear recession, that it's within six to eight weeks of its bottom. And really from the standpoint of next year at this time it won't matter much if I'm wrong about a Memorial Day trough, provided it actually does come to pass, by Labor Day. And I know of only one serious forecaster, who has real output declining throughout the whole year. Well, on the basis of the hypothesis I've just put before you, it seems to me we don't have to be so very surprised about what's been happening in the money market. What you've had there is an increase in the prime rate. Increased more than once. Whereas a number of people had expected it would continue to decline. You've begun to have a firming up in the long term interest rate structure, corporate bond rates, even though many of the model builders showed a decline in those rates into the middle of the year, until the trough was well at hand, and maybe even well established in people's minds. If we're within a few months of the bottom then the firming up of business loan demand which has taken place and which has been part of this process of tightening up of the market, seems to me to be in line with it. And so on the basis of this hypothesis, which of course may be wrong, it seems to be less and less likely that we'll see those substantial drops in short term interest rates that many model builders, perhaps most model builders, had written into their mid-year figures. What will the first quarter numbers show when they become available in a few weeks' time? Concretely, I would guess that the first quarter numbers will show that real output has been declining at at least a 3% annual rate or more, even perhaps 4%. The overall GNP price deflator has been horrendously behaving, it's been rising at a 9% or bigger rate. I almost said better rate. Bigger is of course not better. This means that consumer's prices have been rising presumably at a more than 10% rate and the wholesale price increase is something which you have to go into the second octave of 10 digit figures to represent for the first quarter. There's been a slight delay in the rise in the overall unemployment rate, I think it's still 5.2% at the last numbers, but such a delay is not out of line with past experience particularly following upon a very rapid earlier month to month decline. And the best bet is still for unemployment to crawl up above the five and a half percent rate several months after the actual trough of the mini recession is reached. Some first quarter profit figures are going to look bad but some of the oil companies' first quarter profit figures are going to come in embarrassingly high, embarrassingly high in political terms. There are going to be also across the board horrendous inventory profits. Very hard to know how to appraise these in realistic terms, but we're having an increase in prices over unit costs that is hard to match in experience for a long long time. More than that an awful lot of businessmen feel that they still have a catch up period on price increases due them as the high raw material prices begin to work their way through the system. About the only prices that have been a little bit on the weak side have been the prices of beef. You have an anomaly there. Because the price of grain is very high compared to the price of beef, the price of beef goes lower still as cattlemen find they can't afford to feed up as many livestock and so they bring those livestock for slaughtering to the market, which results in a temporary glut on the market. It's too bad that people can't all go to their freezers and store that because otherwise you'll just get a beef buying binge. See the price has to drop to whatever it takes to clear the market, and as a matter of fact, what we've come to expect in our present populous democracy has now come to pass that the conservative Nixon administration has just announced that it's about to buy up some of the surplus beef. Alas, not for storage to alleviate the drought of beef which may be coming up many months later, when we'll begin to miss all these prematurely slaughtered cattle, but rather to use it in the food lunch programs. Old people's programs, perhaps. Now, nobody can be against more protein for deserving and needy school children, but that is a consideration that could have been said all along and a short run program in which those children get more protein for a short period of time isn't going to really do much about the long term situation. I've given the overall likely first quarter numbers, what about its quantitative and qualitative breakdown? Well of course as expected, housing has been weak, and that has subtracted something over the fourth quarter real numbers. Autos of course have been weak. And a new element, in all probability, inventories were considerably weaker, several billion dollars weaker than that swollen figure in the fourth quarter, much of which represented unwanted large automobile model inventory. Now I know you can get in an argument on this, Dr. Sommers of the Conference Board just recently has expressed the opinion that although he can't prove it by the figures, those figures are misleading. They are distorted by the inflation that's going on, and that there in fact is an inventory accumulation building up which he regards as ominous for the duration of the recession. But I had a new interesting post oil boycott forecast from Chase Econometrics, Dr. Michael Evans with his pretty good recent batting average, and he believes that the inventory accumulation is down several billion dollars in the first quarter from that it was in the fourth quarter. I imagine there's gonna be a tremendous statistical discrepancy in all GNP numbers this quarter. And when you think of the ambiguity that's involved and the adjustments that have to be made to inventory valuation profits, you'll realize that the figures are more than usually noisy, more than usually subject to later revision. Consumer's goods other than housing, non-durables for example, in real terms have just about held up, which means that they're up in money terms only by the amount of the increase in prices. Another weak spot has been in our current export surplus because of course that expensive oil has now come home to roost in the form of bills and you have to chop off some billions of dollars from the very nice net export surplus that was building up in the last quarters of 1973. This is an item we have to begin to get used to because what you're getting of course is that a larger fraction of the western European dollar and also a somewhat larger fraction of the American dollar is now going to buy resources in the Mideast and is being deflected away, unless we curtail our savings, from what dollars would otherwise have been spent upon, manpower in the United States, upon the output of plants in the United States and in western Europe. Still, nevertheless, fixed investments does show up as a bright spot. The demand for it is strong and even though the firms are not getting the plant and equipment spending done as optimistically as they had projected in their intentions, this is presumably due to shortages in supply. We want to be forward looking. What can one expect in the second quarter on the basis of this pattern. Well, it seems to me that the majority of the experts think the second quarter will be about flat. A little bit up or a little bit down, but if you look more carefully among those experts I think you'll find a little more down than up as we are approaching the second quarter itself. So my guess is that you'll pick up most of the guesses if you assume that the second quarter real GNP will do considerably less bad than the first quarter. Let's say it will be somewhere between minus 1% annual rate of decline to plus a half percent or so of annual rate of increase in real output. Flat to down would be a fair enough way of describing that. If so, I believe that that's quite consistent with the trough coming sometime in the next six to 10 weeks, even possibly before the middle of the second quarter itself. With respect to the price increase, the experts are divided but I think the preponderance of the experts expect that the rate of price increase generally will not be as bad as it was in the first quarter. Wholesale prices will not rise as much, staple prices will not rise as much. The Consumer Price Index will probably not rise as much, and slowest of all to come down from the horrendous first quarter numbers, is likely to be the implicit overall price deflator which I remind you has a lot of services in it, has a lot of government employees in it. Has a lot of wage items in it. But even that I do not find among responsible forecasters, I don't find an expectation that that will be in the two digits that, be above 10%, but rather shading downward from whatever the first quarter number shows. If that first quarter would have shown 9% then you can take something off for the second quarter. That means that the money GNP is going to increase at about, well about the amount of the price rise that's shown. Something like let's say 8%, which would be a rebound for the money nominal GNP from the first quarter numbers, which if you add together the nine-odd percent of prices, and the algebraic minus three and a half, 4% of real output gets you down to about a 6% rate of increase. Now, is this bottoming out consistent with the overall appraisal of demand? That to me is the most important question. I should say demand and supply because supply considerations are important. But some people would want to sharpen up the question and ask whether it's consistent with Federal Reserve policy, whether it's consistent with the monetarists view of what's happening. And I'm not a card-carrying pure member of the monetarist school, but I think I understand the analysis which members of that school use, and there it would seem to me that there is nothing in the tenets of monetarism or in the facts of the money supply which would be inconsistent with the hypothesis that I have laid before you. For one thing, there is a subset of the monetarists who think that the money supply numbers which one ought to watch if one can only watch one set of numbers, ought to be the broader definition of the money supply, M2 so called, which is the currency plus checkable demand deposits, plus adjusted time deposits that bear interest. And there according to the view say of my colleague Professor Milton Friedman, the best bet is that the velocity of circulation of M2 is trendless. It may meander a bit. All relationships in economics are subject to a certain amount of jitter and noise, but he doesn't see any better behavior equation than to assume that that velocity is constant. Well, as I look at the latest numbers on past M2 rate of growth, and those are the numbers that I should be looking at if you believe that what happens in the middle of the year is determined by what happened to the money supply three months earlier, six months earlier, nine months earlier, and 12 months earlier, then as I look at those numbers they will support a rate of increase of money GNP, of order of magnitude of 10% because that's what the rate of growth of the money supply has been doing since say last Labor Day. Or going back to the middle of last year, there's a 9% increase in the M2 money supply during that time. And I think that if we try to project just a quarter ahead or so the guessing seems to me to be that the M2, the rate of growth of the money supply will not fall short of those numbers, and even if it did it would be too late for it to have much of effects by the middle of the year, so it wouldn't affect very much. I think the timing of the trough, of the business cycle upturn. Now, how important is the end of the oil boycott? We live in an age of instant analysis, the age of the computer. In a few microseconds you can change your input into the, well I guess in a few hours you can change your input into the computer and in a few microseconds you can get a new run of the output. And I was amused at the precision of modern forecasting because I received a flash announcement from the Wharton school model on how much of a difference the end of the boycott would make compared to my previous, I think it was March 1st, estimate. It was like the flash headlines of newspaper extras that we used to have, or I suppose the more appropriate image in the modern time would be the quick news on radio, the first thing that tells you that an atomic bomb has exploded or that peace has broken out. Well, it turned out to make only one eighth of one percent difference in the real output for the whole of the four quarters of 1974, according to the Wharton way of analyzing. Now, you might say that this suggests that the Wharton analysts think that the oil boycott has no importance, but I don't think that's quite the proper interpretation that I can put on it. What it means is that they must have been pretty good in projecting the most likely ending of the oil boycott in their previous estimates in order that only so small an adjustment needed to be made. Let me say this however, I regard the ending of the oil boycott as extremely important. Because even if you were pretty canny and had given as your best point estimate an ending pretty much the way it actually happened, the confidence with which you can hold that opinion was certainly enormously increased by the fact of the boycott. And I say this taking into account the fact that it's supposed to be just for two or three months, it's supposed to be just a look-see affair, subject to a reopening of the boycott in June, toward the middle of the year. I believe though that that's always a possibility. Every contract these days is renegotiable, is open, and that's particularly true as the large oil companies have been finding, and as the American and western European consumer has been finding, about contracts made in the Middle East. It's almost a rule that if you make a contract with a government that contract can be unilaterally broken. Not by you, but by the government. And the Mideast governments are no exception in this regard. And so they certainly could end the boycott at any time but what we know from the internal dynamics of the deliberations is that there's some division among the OPEC countries. The Shah of Iran, there's only one way to describe it, he's just greedy for immediately higher sums of money. The Syrians are militantly in favor of shutting off the oil in order to put pressure on Israel. The Saudi Arabians are the important ones, they have the oil. I don't mean that Kuwait doesn't have a lot of oil, it does, but the real swing marginal supply, and they've got a lot more in the ground that hasn't yet been exploited, comes from Saudi Arabia. With them in the cartel, it may hold at almost any posted price. With them out of the cartel, no posted price is safe. And the Saudi Arabian government, from King Faisal down through his oil negotiators, have taken a view that the posted price is if anything too high. And that it would not be in the interests of Saudi Arabia to contribute towards a world depression. And contribute toward strengthening of the Soviet Union in the Mideast and communism at the expense of the American influence in the Mideast and the non-communist, and I suppose Moslem way of life. So, the oil boycott I believe is important. Now, it's not important in the way that you might have thought if you looked at the forecasts of last December 1st. What was a growth recession, what was to be a growth recession, seems to have been converted into at least a bear mini recession by the energy crisis. This has not shown itself however by a shortage in BTUs. If it were that then once the BTUs come back, well you could have even a V bottom. We have pretty much cut down, by let's say two and a half million barrels a day of oil use out of 18 million barrels, at home. By lower thermostats, by less recreational and discretionary automobile driving. There have been some shortages of energy related feed stuffs in industry. But I think most of those cannot fairly be attributed to the OPEC monopoly solely, or the boycott. They are probably more closely related to the way the price controls were misbehaving anyway and creating particular markets and spot shortages. And it'll take time for that situation to change. I may say since my time is running short that it looks as I'm not speaking, more and more likely that on April 30, the guts of price controls will in fact be ended. I heard down in Florida, Mr. Woodcock, the head of the United Auto Workers union give the most eloquent and reasoned argument against price and wage controls, which he has been against all along. I think his arguments would have really done well coming from a University of Chicago economist, and coming from a Detroit trade union leader I think they carried a certain extra amount of force. Well, what is the big open question that I end my discussion with today? I think the big open question is with respect to how prices are gonna be behaving at the end of the year and how prices are going to be behaving a year from now and in the middle of next year.

Because although most of the model builders show a considerable decline by the end of this year, you have to remember that coming back from one fire, from one recession, we're really on our way to the next conflagration, which is the next period of expansion. And there does exist a minority of economists who are more worried that the recession will come to an end within six to 10 weeks, than they are worried that it won't come to an end. They regard this as ominous for the future of the rate of inflation. Well, more of this later.

- If you have any comments or questions for Professor Samuelson, address them to Instructional Dynamics Incorporated. 166 E. Superior Street, Chicago, Illinois, 60611.