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- Welcome once again as MIT Professor Paul Samuelson discusses the current economic scene. This biweekly series is produced by Instructional Dynamics Incorporated, and was recorded March 24, 1972.

- Today, I'd like to talk about current economic developments as far as the business cycle is concerned. I've jotted down half a dozen different points. I know I won't be able to cover them all in the course of one tape, but let me list them. What's happening to the gross national product? How will we do in the first quarter? What is the outlook for the remaining quarters of the year? In particular, what about the breakdown by different components, any surprises there? That's point number one. Point number two, what are monetary developments? What seemed to be indicated for the future? Point number three, how are prices behaving? Should we be surprised, or is everything about on schedule in connection with phase two and other matters? In fact, I have as point number four, phase two itself. How are the direct controls? Those prices which are most dependent upon the direct controls and wages, what is happening there and what is the meaning of the walk out by the labor members? Fifth point has to do with interest rates. And the sixth point, which I doubt that we'll get to, has to do with, what does this all add up to for general stock market considerations? Now, these points are all interrelated. Some people before they discuss GNP would discuss money, and some people in discussing money in the same breath would discuss interest rates. Still, one thing at a time. First, I would say that as far as the developments of the gross national product, in 1972, as we're coming toward the end of the first quarter, things seem to be pretty much on target, if your projections were those of the shaded down fashionable forecast. In order to make the President's goals, we would have to have in the first quarter of the year something like a 30 billion dollar increase in GNP. Pessimists think that we'll be down in the low 20s, but my reading of the incomplete statistics, and you must remember, that when we end the first quarter, statistically, we are still right in the middle of the first quarter. But my general reading would suggest to me that if I had to make a single guess, I would rather be in the above 25 billion. In other words, between 25 and 30 billion, than in the 20 to 25 billion. Housing starts have been doing very well. Inventory accumulation seems to be beginning. Many people take heart at that. It's a somewhat rueful reflection, that people are very anxious to have inventories begin to boil. I'm not sure that that is a well founded view from the long run, because the faster inventories take off, the sooner you're gonna get into trouble from an over accumulation of inventories. I daresay that commentators in general, who have no personal stake particularly in the November election, are being swept into the election psychology of the year 1972. Well I'll try to resist that psychology, and simply positively state that there is some signs of inventory accumulation. The plant equipment surveys have been very favorable, and we've had a revision upward of the December numbers. So, all the components of the GNP, with the exception of the international, have been fairly favorable. Retail sales, too, have been a little bit on the flat side, but flat is not down, and we shall soon all be alibiing and making allowances for the shortness of the Easter shopping season this year in comparison with next. As far as automobiles are concerned, that Bellwether, each 10 day report has its ups and its downs. But by and large, I think that the noises that are coming out of Detroit are fairly happy noises. So, as far as I can see, in making a guess as to what the money, gross national product, will be in 1972, just take the 1971 number, and don't add 100 billion to it, as the optimists in the fashionable crowd were doing at the end of last year, before the GNP data got revised. But add 90 billion to that, and we are on target, with respect to that particular number. I want to remind you just to orient what 90 billion means. That's a little bit less than 9% for year to year comparison. But it means in terms of the fourth quarter of last year, to the fourth quarter of this year, much more like 95, 97 billion. And so it's an over 9% increase. And all that is compatible with corporate profits after taxes, doing rather nicely in 1972 in comparison with 1971. If we had corporate taxes last year of about 47 billion, why don't we add about 15% to that, and speak of corporate profits after taxes for 1972 of something like 55 billion. Now... What is being assumed about the money supply, in my giving this a particular prospectus? Some people would say that I must have got at this number by already having made an implicit prediction about the money supply. My belief is that the recent increase in the money supply numbers was anticipatable before the fact, and that it's going to continue for some time. Even though from now on out, it is my guess that the open market committee of the Federal Reserve System is going to be issuing noises to itself, which we will learn about 90 days from now, towards holding down the rate of growth of the money supply. A great number of different GNP forecasts which I have seen suggest that in the first half of the year, the money supply... I'll use the ordinary conventional N1 currency and demand deposits. In the first half of the year, it's probably likely to grow something like eight to 9%. And in the last half of the year, is likely to grow something like about 6%, which will average out for the year on the high side, in comparison with say, last year's numbers. And also on the high side, in comparison with what the people who believe in a money supply target as the target, would themselves generally recommend. But I want to remind you that this is an election year, and that the rates which are correct from a long run viewpoint are not likely to be realized in a year that's divisible by four, when everybody has become conscious of how important the economic situation is to the outcome of the election. There's a further point which I will come to when I get to the discussion of interest rates. I believe that the international crisis that I commented on in my very last tape is going to have a direct influence of some importance on the interest rate structure and on the rate of growth of the money supply. Last time, I quoted from that day's newspaper, in which the prominent spokesman for the government out of Washington... I believe I also quoted one Federal Reserve Spokesman. Said they weren't going to pay any attention to the international situation, in any degree, if that jeopardized the recovery domestically. I didn't believe that then. I don't believe that now. And we have had, in the last couple of weeks, definite indications that the government people are becoming more conciliatory, even in their utterances on this matter. It is widely believed, for example, that Dr. Arthur Burns, the chairman of the Federal Reserve, and I may say that he has an importance beyond being the chairman of the Federal Reserve Board, is an importance because he is a skilled economic analyst in his own right worth listening to. But he also has an importance because although we have an independent Federal Reserve system, its independent chairman is a close friend of President Nixon. And I was actually a bit surprised to see in the White House meeting, on the occasion when the President spoke out against George Meany's leaving the Wage Board, that seated around the table, with all the top brass from inside the administration itself, was the independent chairman of the Federal Reserve Board. We've come along way brother, as the popular song says, from the days when Woodrow Wilson would not even invite to a social reception in the White House, a member of the Board of Governors of the Federal Reserve System, for fear that in their innocent merriment, over the fruit punch, they would be jeopardizing the independence of the different branches of government. Well, it is widely rumored. And what's important is not whether the rumor is true, but that it is believed. And of course, it has not been denied that Dr. Burns went to Basel at the Bank for International Settlements. It is not his custom to go to each monthly meeting. Dr. Dewey Danae, board member of the Board of Governors, typically goes to that. Perhaps some rotating other people occasionally go. But in the crisis environment which I described in last week's, last two weeks ago's tape, on the international front, which is not over, I may say, the chairman of the Federal Reserve Board chose to go. And it is said that he told the Europeans that the Federal Reserve was not prepared to preside over the liquidation of the dollar as a stable currency. And it was going to give due consideration to the international situation in everything that it did, which had a bearing upon short term and other interest rates. Well, we have an interconnected system. You can not do something nice about short term interest rates, which will please people abroad, and at the same time, not be doing anything about the rate of growth of the money supply. So I've tried to factor that element into my equation in making my forecast about the money supply. Let me turn now to point three. Some people will consider it especially natural to go from the money supply to prices, because the old fashioned quantity theory of money had to do only with those two magnitudes on the supposition that the other elements in the equation could be considered to be quasi constants. I think there's a lot of merit in that as a long run theory. In the long run, there is a strong tendency for the heat in the room that I'm sitting in, the temperature in this room, to accommodate itself to the temperature outside. It's very much like what some sage has spoken of as the flat tire theory of economics. But it takes an awful long time before the temperature in this room is gonna accommodate itself to the outside temperature. And a lot of us are going to be spending all of our time to keep that from happening. In fact, I don't expect that to happen in my lifetime. It'll be very uncomfortable for me if the temperature in my room accommodates itself to the outer temperature, except when I want it to, which is in the spring and in the autumn. I want it to be cooler in the summer, and there are efficacious ways of ensuring that that's so. Indeed, every tire in the world which is not flat is, if you understood thermodynamics, trying to get flat, and is succeeding. Go away 1000 years from a properly inflated tire, and come back, and you will find a flat tire. We live on the transition. And of course, that's what the trouble is with the old fashioned quantity theory of money. It concentrates upon the long run. It's all very well to do that, if you warn everybody that it is the long run you're talking about. But we live in a succession of contrived short runs. So, the important thing about prices that I must talk about, which you've been reading about in the newspaper, the great disappointment to Washington. Because wholesale prices leaped forward, the cost of living leaped forward. The most it's leaped forward in months, as the commentators say. The prime reason for that, in my judgment, does not have to do with phase two. It has to do with food prices. And it is more closely related to what I've talked about in a couple of tapes. The corn blight. What, you say? The corn blight happened a long time ago. Since then, we've had a bumper corn product, true. But those who understand the mechanics of the corn hog cycle realize that a snake like movement is set into motion by a corn blight. And we are in one phase of that snake like motion. Later on, that bumper corn crop is going to give us cheaper beef, but as the angry housewives say as they storm the meat counter of the supermarket, they can not live in the future. And they're complaining about the high prices now. Well, of course, the whole price level around which this undulation takes place, does have a lot to do with that longer run behind us of what the Federal Reserve was doing all through the 1960s, and what fiscal policy was then, and what fiscal policy is now. It's just that we must, in a fair minded objective, careful and eclectic way, separate out all these different elements. Otherwise, we will be misunderstood, because we will be uttering truths, but one tenth truths. It takes ten tenths of a truth to make the whole truth. Now, I think this increase in the price of food is going to have political repercussions. It can not help but have repercussions upon phase two. And let me turn very briefly to phase two, briefly, because I haven't very much to say about it. The labor members of the AFL CIO have walked off the board. It is interesting that not all five members have. I don't suppose it's surprising that the Teamsters union official remains on the board, because we know that a special relationship has been set up between the Teamsters union and the administration. The wooing of the Teamsters union by the administration has been somewhat successful. I suppose we have to include in this the problem, the parole, of Jimmy Hoffa. But the Teamsters union is a law unto itself. The most reactionary newspaper which we were all reading about in New Hampshire was financed by the Teamsters union. And Mr. Loeb of the Manchester Union leader, who picks on every liberal and radical cause, and every middle of the road person to him looks like a flaming radical, is soft as soft can be on organized labor, particularly where it touches at all upon the interests of the Teamsters. Well, what's more interesting is that the UAW, the United Auto Workers President, Leonard Woodcock, is still on that board. And the fact that two members have stayed gives the administration the opportunity to maneuver. I may say that I do not envy the problem of the administration in this regard, of course from a certain political viewpoint. This strengthens the President, because people get very angry at these rather stereotypes of old old union leaders. Gorge Meany does not have a great sympathetic residence in the bosoms of most of the 200 million odd Americans. I think from the standpoint of maximizing the influence of organized labor that George Meany is probably a detriment. But still, if the President is very tough and utilizes the political advantage he has in being able to denounce in the way that Franklin Roosevelt used to denounce the malefactors of great wealth, the present President can denounce the malefactors of political powerism. But if he does that, he does invite an increase in class warfare in this country. And he causes in the election year, with which he's so much concerned, a great amount of work stoppages, simple strikes. 1972 is a lucky year from the standpoint of strikes. It's a lucky year from the standpoint of how many first year agreements are opening up this year. My recollection is that the amount of strikes taking place now in 1972 is low. But that could change if organized labor as a whole, with some exceptions, goes on the warpath. The rumors that... I was in Washington yesterday, and the rumors that I was hearing had to do with well, maybe, the number of business representatives would be cut down to two from five. And then you'd have two business representatives, two labor representatives. And the effect of this of course would be to maximize the influence of the public members. I must say that the public members have been behaving better, from my viewpoint, of what is required in the public interest. Then either of the other two... You remember the coal agreement, in which the business and the labor people ganged up on the public members, and gave a whopping increase, which almost scuttled the program in its beginning. And then it passed on the hot potato to the price board, to countenance an increase in the price of coal enough to justify that particular settlement. Well, the public members stood out as heroes in my mind on that particular occasion, heroes who lost. And this reshuffling would improve, increase the power of the public members. Nevertheless, because of the bad luck, that the prices that have nothing to do with phase two, food prices primarily, international prices, are misbehaving, is going to put a strain upon phase two and the whole stabilization program. Since I never had very high hopes for phase two, I never thought that we'd realize the President's goals of two to 3% overall price increase in 1972 by the end of the year. I must simply register that things will be a little worse on the price front than I had thought. What about interest rates? Short term interest rates have gone up. I expect them to go up further. I think that every advance in the short term interest rate from now on will put a strain upon the maintenance of steady long term rates, and will make it more difficult for long term rates to continue their gradual easing downward. I've noticed municipal bond long term rates have started to rise already. So, it seems to me that the smart thing is to abet a continuation of the same movement. I don't say it in a drastic and spectacular way. Although, please keep your mind on the international situation that I talked about last time. Because if that international crisis, which I said was quite possible with odds getting towards even odds, were to happen, then you could see something spectacular in the short term interest rate markets. In other words, if any of you out there are out on heavily margins leveraged bond positions based upon the expectation that the general macroeconomic interest rate structure will be going downward, and you'll make a profit on your bonds, then I think you're taking an awful lot of risk upon yourself at this juncture of the business cycle. This does leave me with just a couple of minutes to talk about the general stock market situation. The stock market has risen considerably since last Thanksgiving. That I think was in line with properly discounting the conviction with which one could believe that 1972 was going to be a better year, along the general lines of the fashionable forecast. The improvement in stock market prices is understated by the movement of the much watched Dow Jones Averages. If you've gotta watch some averages, you should watch the Comprehensive New York Stock Exchange Average, plus the American Stock Exchange Average, plus the Over the Counter Average. But if you haven't time for all that, why don't you just watch the 500 Standard and Poor's Comprehensive Index? And if you utilize those indexes, then the Stock Market has gone to a new peak. In other words, it's as if the Dow Average has gone beyond the 1000, which it reached twice, almost reached twice, in the middle 60s and in, around 1968. If the Dow Jones were a representative average, and if you were to wind it up along with stocks generally, it is now over 1000. Now, this can be justified because the profits are still expected to rise. This can be justified because, I'm quoting people in the marketplace, the price earnings ratio is not out of line with what prudent men have thought was the proper price earnings ratio. Nevertheless, there are gonna be some strains upon the advance if you have trouble from abroad. Rising interest rates put a strain upon the stock market. And so, you are left, and I leave you, with where every investor, every speculator, should be left in a well run speculative mark, on the margin of doubt, with the price of stocks having to float in competitive markets in the next few months, to divide the bulls and the bears. I leave to you whether the way those prices float will be upward, sidewards, or downward.

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