

people with some degree of expertise who claim that the budget deficit is likely to be as high as \$20 billion or \$29 billion.

Be that as it may, how is any such deficit as \$13.5 billion to be financed and what is this likely to do on interest rates?

Mr. ACKLEY. May I ask my colleague, Mr. Duesenberry, to comment on that question?

Mr. DUSENBERRY. Senator, there will, of course, be a substantial increase in Treasury financing in the second half. Of course, it is normal for there to be a substantial amount of Treasury financing in the second half of the year because of the seasonal movements in revenues.

I should emphasize the fact that in the first half of this year, while there have been no problems of Treasury issues of securities, corporations have sold a very large volume of Treasury securities in making the extra tax payments which were required by last year's changes in the tax law. When we compare the second half of 1967 with the first half, the total strain on the Government bond market—taking account of tax collections as well as of security issues—will not increase as much as appears from the increase in the volume of security issues by the Treasury.

We pointed out in our statement that of course it will be necessary for commercial banks to purchase some securities, whether Treasury securities or other securities doesn't matter, in this market. That will require two things: First, the Federal Reserve System should provide the reserve base which would be required for an expansion of bank assets; and, second, the climate in the security market should be favorable enough in terms of expectations about future interest rates and future Federal Reserve policy to encourage banks and other investors to buy securities in the maturities that are coming on the market.

A lot of our problem in the last few months has been the expectation that rates would rise. This resulted in borrowers' seeking to protect themselves against a future rise in interest rates by borrowing long now, while lenders tried to play the opposite game of avoiding long term commitments until rates had risen. It is essential that we should have a fiscal outlook and a general economic outlook which encourage people to believe that the Federal Reserve will continue to supply reserves and that there won't be a reversion to tight money. We believe it will be possible to balance the flows in the security markets if those conditions are satisfied.

Senator JORDAN. Do you anticipate a lower interest rate, the same interest rate, or a higher interest rate?

Mr. DUSENBERRY. Given the appropriate tax action, we would expect that long-term interest rates would begin to decline. Now it is always a slow process to work long-term interest rates down once they have risen, simply because it requires a change in people's expectations about the future.

On the other side, there should be some pressure on short rates partly because they have been artificially depressed by the desire of people to get liquid assets recently and partly because the Treasury securities which will be forthcoming will have to be at maturities which are toward the short end since the Treasury cannot issue any very-long-term securities. That would put some upward pressure on the shortest maturity rates.