

**STATEMENT OF TILFORD C. GAINES, VICE PRESIDENT, FIRST
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Mr. GAINES. Thank you, Mr. Chairman.

The outlook for the financial markets in the last half of 1967 is not at all encouraging. Most rates of interest probably will be subject to unremitting upward pressure, and there may be insufficient credit available to service all of the demands upon the market.

This forecast of continuing credit strain rests upon relatively optimistic assumptions, optimistic, that is, for financial markets. It is assumed that the acceleration in economic activity in the next 6 months will be moderate, yielding a gross national product for the year of only \$779 billion. It is assumed that the deficit in the administrative budget will be of the order of \$14 billion, much lower than some figures that have been mentioned. And it is assumed that the Federal Reserve System will continue its present policy of making abundant reserves available to the banking system. If any or a combination of these assumptions should be wrong, it is likely that the error will be in the direction of underestimating the pressures on the credit markets.

Developments in the financial markets during the first half of 1967 have involved a paradox that is without precedent in our modern history. In spite of a progressively easier Federal Reserve policy that has supported a 5.4 percent growth rate in the money supply and 12.8 percent in total bank credit, and in spite of the stagnant performance of the economy, interest rates on long-term investments have risen virtually to last summer's historically high levels. Before attempting to appraise the outlook for the remainder of the year, it is first necessary to explain this paradox and to appraise its significance for the months ahead.

The simple explanation for the present high level of long-term interest rates is that the demands upon the long-term capital market have been excessive relative to the available supply of long-term funds. In the first 6 months of this year, publicly offered corporate bond issues will total \$7.7 billion as compared with \$3.7 billion in the same period last year. Private placements are somewhat lower this year, but the total of public and private placements will be approximately \$11 billion against last year's \$8.4 billion—and 1966 was an alltime record year for corporate bond flotations. Tax-exempt State and local bonds sold so far this year total \$7.6 billion, substantially more than last year's \$6 billion, and 1966 was also a record year for municipal bond sales. Mortgage lending, the other principal user of long-term funds, has not been as large this year as in earlier years, but the shortfall in this area has not been sufficient to offset the excess demands on the bond markets.

There are two related reasons for the huge volume of bond financing this year. First, during the period of rapid business expansion between 1961 and 1965, as corporations committed ever larger amounts of money for plant and equipment, inventories, receivables, and other purposes, there was not a proportionate increase in long-term financing. Corporations relied on bank credit and available internal liquidity to finance a larger and larger part of their outlays. Corporations began funding their debt during 1966, but the demoralized market conditions that developed after midyear forced part of the