

debt restructuring and liquidity rebuilding over into 1967. Similarly, a number of tax-exempt borrowers were unable to complete their bond financing in the last half of 1966 because interest rates had moved above the statutory limits they were permitted to pay. This circumstance partly explains the flood of municipal bond issues this year.

A second reason for the large volume of corporate bond financing in 1967 has been the uneasiness and uncertainty created by the policy of the Federal Reserve System adopted in the last half of 1966. The period of extreme strain on the banking system last summer and fall made a number of corporate treasurers aware that a time could come when they would be unable to rely upon their banks for additional lines of credit to finance their activities. Funding of short debt in order to reduce reliance on banks and to free up bank lines became a matter of rather urgent importance.

Last year's credit "crunch" has also had an important impact upon the willingness of lenders to commit funds to long-term obligations. The savings and loan associations and mutual savings banks that suffered heavy attrition in their savings accounts when short-term market rates of interest rose above levels they were able or permitted to pay have been anxious this year to build a stronger liquidity base before aggressively seeking new mortgage commitments. A substantial part of the larger flow of savings into savings and loan associations thus far this year has gone to repay debt at the Federal home loan banks and to add to holdings of short-term Government securities. Life insurance companies that found a surprisingly large proportion of their net funds going into policy loans when market rates of interest rose above the contractual loan rate in their policies have had less new money to commit this year. And commercial banks, in particular, have been reluctant to commit funds to long-term obligations after their experience in 1966. All commercial banks suffered attrition from their savings accounts as savers moved money into higher yielding marketable securities. And the larger banks that had relied upon negotiable certificates of deposit money were particularly hard hit last fall when the Federal Reserve System failed to change its regulation "Q" to permit banks to compete for this money and some \$3 billion of these deposits were lost to other marketable instruments. Throughout the commercial banking system there is a deep awareness of the need to rebuild liquidity in order to protect against a recurrence of last year's events, with the result that the larger flow of savings money into the banks this year has been used for short-term liquidity purposes rather than for long-term credit commitments.

In economic terminology, what we have witnessed has been a sharp upward shift in the liquidity preference functions of both suppliers and users of funds. The inevitable result has been relatively low short rates and unusually high long rates. This is a situation that the ordinary instruments of Federal Reserve policy are not equipped to deal with. Supplying additional reserves to the banking system, lowering the discount rate, and lowering reserve requirements have helped to feed the economy's insistent liquidity needs, but their effect has been almost wholly on the short-term market and only marginally on the long-term market. Recognizing this fact, and partially in recognition of the responsibility they share for the liquidity preference shift, the Federal Reserve System has purchased a sub-