

too likely that the Treasury will be able to do more than a nominal amount of financing in this maturity area.

The tables which accompany this statement provide greater detail on the outlook for financial flows during 1967. (See pp. 53-55.) In conclusion, I would like to suggest some implications of the financial outlook for the balance of this year as I have outlined it.

First, the volume of Treasury financing in short-term obligations in the next few months will almost surely drive all short-term interest rates significantly higher. The low level of Treasury bill rates in recent months has been due partly to the economy's drive for liquidity and partly to the fact that the U.S. Treasury and the Government agencies have, on balance, been retiring short-term debt. If the steadily large supply of new short-term Government securities is accompanied by an improvement in automobile and other durable goods sales, leading to an accelerated increase in finance company paper outstanding, and if commercial bank loan demand should expand faster than anticipated, leading to an increased supply of certificates of deposit in the market, the projected increase in short-term interest rates could be quite substantial.

A corollary of this short-term interest rate outlook is the possibility that these market rates might rise to a point that would induce a flow of savings funds out of the financial institutions—disintermediation—similar to that which occurred last year. Were this to happen, the financial outlook for the balance of this year would be extremely troublesome. However, so long as the Federal Reserve discount rate remains at 4 percent, it should serve to anchor short-term bill yields at a level no higher than $4\frac{1}{2}$ percent, with yields on other instruments scaled up from that level to perhaps a maximum of $5\frac{1}{4}$ to $5\frac{1}{2}$ percent on U.S. Government agencies and commercial paper, a range of rates that should not result in substantial withdrawals from the savings intermediaries. Still, given the potential volume of short-term financing in the next 6 months, at least some concern over the prospect of renewed disintermediation is justified.

Another conclusion implicit in my analysis is that the pressure of borrowing demand upon the bond markets will probably prevent any significant decline in long-term interest rates from present historically high levels. The demand for capital funds is so intense that further interest-rate increases from present levels are a possibility, but it seems more likely that the extraordinarily high rates now prevailing will tend to discourage some borrowing and thus prevent long-term interest rates from rising much above present levels. In this connection, a good deal will depend upon the policies followed by the Federal Reserve System. A program of steady—and I underscore “steady”—week-by-week purchases of long-term Government securities by the Federal Reserve would be most useful in stabilizing the long-term market and, if offset by sales of Treasury bills, would have no inflationary effect upon money supply or commercial bank credit.

Also, my analysis and the supporting tables suggest that loanable long-term funds will not be available to finance a major recovery in residential construction. My estimates suggest that the net growth in mortgage credit this year may be of the order of \$20 billion, approximately equal to last year and consistent with a total of housing starts