

to be reduced by an increase in the lower end of the anchor unless matters change.

On the other hand, if the economy is weak—if I could accept, for example, the implicit forecast of the Fortune Magazine Roundup which is that the economy is going to be weak for a couple of years—I would not be concerned about the hardening of long-term rates that is taking place right now because what is done can be undone, both by the expectations of the marketplace and by the Federal Reserve, and can be undone prudently.

But the market is not now behaving stupidly. If it believes that in the first quarter of next year there is going to be strong inflationary pressure, then the time is now for that to be recognized in the long-term rate. So the differential mustn't be thought of as an aberration. The market will change its mind as events change.

Mr. WESTON. Let me just say a couple of sentences on that.

By and large, you get this steepness in the yield curve when there are expectations that future interest rates will be higher because the strong demand is on the long term end and not on the short term end.

Conversely, having reached some high level of interest rates, this expectation that interest rates will be still higher in the future begins to subside, and you tend to get then a flattening in the yield curve which provides an expectation which provides a basis for predicting of less pressure and possibly some easing off even in the long rates and a rise in the short rates. However, if you have a long period expectation that money markets are going to be tight and interest rates are going to rise in the long run, then you would certainly have a continuation of a rather sharp yield curve.

Mr. SAMUELSON. To bring the devil right out in the open, if people really think that we are in for a long-term inflationary period where prices, instead of rising for the Consumer Price Index at 1 or 1½ percent, which may not really be a general increase at all, but instead are going to be rising at 3 percent, then you will get built into the interest rate structure an allowance for the change in the value of money and then the *money* rate of interest may look high, but the *real* rate of interest of what is actually earned will not be all that high.

We have seen this in Brazil and Chile and places of chronic inflation. Of course, we are nowhere near to those situations, but probably already there is something in our interest rate structure as an allowance for normal, manageable mixed-economy inflation. That premium could increase.

Mr. WESTON. Right, and I think the implications are that you get expectational effects at that time at the average level. The yield curve would be higher and it would tend to be steeper.

Representative REUSS. I wanted to pursue with Mr. Samuelson what we talked about before, namely, the desirability of the Government's getting hold of additional revenues by loophole plugging in a situation like that prevailing today where we are fairly close to a full employment without inflation, but we are faced with a big deficit.

I think you said, Mr. Samuelson, that while, of course, loophole plugging is a worthy endeavor at any time and you are for it, you don't see any particular desirability of it now because, as you said, if we are at a situation where demand is just about right, close to full employment but not over full, and we are facing a budget deficit, there is no particular advantage in trying to avoid that budget