

tedious, but I think it is so important to keep the whole credit market picture in mind that it is worth going over this with some care.

On the demand side, the major components are the business sector, the consumer sector, and government.

Businesses borrow to expand their facilities and for working capital, such as to finance inventories.

Consumers borrow chiefly to finance home purchases and for an increasing variety of consumer goods and services—such as cars, vacations, college expenses.

Governments borrow to finance their cash deficits, which arise when the net outpayments from spending and lending programs are not covered by tax and other revenues.

On the supply side, the main sources of credit are the banking system, other financial institutions, and savings generated in the business and consumer sectors. Two of these sources deserve special mention because of their strategic importance.

The banking sector, including the central bank, is a kind of balance wheel which can be permitted or encouraged to supply increasing amounts of credit, or discouraged from so doing by the availability of reserves provided through the central bank.

The other highly strategic sector is the direct supply of credit from individuals. It is strategic because its variations up or down are closely related to net pressures on the markets and on interest rates. Normally, the volume of credit supplied directly by individuals is small. Most individuals place their savings with thrift institutions which, in turn, lend these funds to borrowers. This is known as financial intermediation.

When this individual sector is called on to supply a substantial amount of credit directly, rather than through savings institutions or other intermediaries, it is usually a sign of market pressure. This normally occurs when demand is rising very strongly and borrowers are more interested in getting their money than in the rates that they have to pay for it.

That is what happened in 1966. With credit demands running strong, and supplies limited, interest rates on open market paper kept rising until willing investors could be found—which in many cases involved the withdrawal of funds from thrift institutions and direct investment by individuals in high-rate market paper.

The halt in bank credit growth thrust further demands on individuals. Credit demands had no place else to go, once the banks and other financial intermediaries could not handle any more. Either the demands could be met by the residual sector—individuals—or they could go unmet.

In the process of sorting out the demands that would be met and those that would not be met, interest rates last summer reached the highest levels in several decades.

Starting a little less than a year ago, there was a dramatic turn for the better in the credit markets, reversing some of the forces that had produced earlier strains, but leaving some scars and vivid recollections.

The factors making for a change included the temporary suspension of the investment tax credit, a reduction and rearrangement of Federal demands on the credit markets, holdbacks in Federal spending pro-