

period and point to the slowing of real growth in output late in 1966 and on through the first half of 1967 as confirmation of their point of view. I would not question that some of the restrictive effects on spending of earlier tight monetary policies were still being recorded in the first half of 1967—although it may be noted that outlays for residential construction began to rise as early as the first quarter of that year. What I would question is the contention that the inventory adjustment of early 1967 was entirely, or even primarily, caused by tight money in 1966.

The undesired buildup of inventories that occurred in the last quarter of 1966 reflected mainly the inability of business to foresee the slowdown in final sales that resulted when consumers began to exercise more cautious buying attitudes. Personal consumption expenditures had been rising at a rate of about \$8 to \$9 billion per quarter in the year ended with the third quarter of 1966—and so far as anyone knew at that time, they might well have continued to do so. But consumer buying slowed materially in the fourth quarter, as a major increase occurred in the personal savings rate, and consumers continued to exercise caution in their buying habits throughout 1967. At best, this behavior of consumers can be contributed only in small measure to tight money in the summer and fall months of 1966. Many other factors were undoubtedly of fundamental importance—including a reaction to the rapid income growth and the buildup of stocks of durable assets in the immediately preceding years, resistance to rising prices, and the general uncertainties emanating from our involvement in Vietnam.

But whatever its origin, the economic slowdown of early 1967 did require compensating adjustments in monetary policy to keep the economy from slipping into recessionary conditions. Fortunately, the inventory correction of early 1967 was anticipated in time to take the initial steps toward monetary ease in the fall of 1966, and this helped to bolster residential construction through the first half of 1967. With fiscal policy also turning expansive and helping to bolster final sales substantially during the first half of 1967, excess inventories were worked off relatively quickly, and by July industrial production had begun to turn up again.

The pickup in business activity after midyear 1967 was foreseen by a number of forecasters, including our own staff at the Federal Reserve Board. Why, then, did monetary policy not take earlier and more decisive steps to reduce the rate of expansion in the money stock and in bank credit during the latter half of the year? There are two parts to the answer to that question.

First, the high rate of expansion in the money stock during the final 6 months of last year greatly overstates the actual degree of monetary ease promoted by monetary policy. What it represented was the supplying of funds through monetary policy to permit the satisfaction of a sharp increase in liquidity preference on the part of non-financial corporations. Their desires to rebuild liquid asset holdings stemmed only in part from the experience with tight credit policies in 1966. Of more fundamental importance were the trends in corporate liquid asset management over the previous several years, together with the heavy toll on corporate liquidity resulting from the acceleration of tax payments that began in 1966.