

In the years immediately prior to 1966, businesses in the aggregate had little need to concern themselves with their liquidity positions or with the availability of bank loans or other sources of funds to meet their credit needs. Partly as a consequence of this, additions to liquid asset holdings were relatively modest. Thus, increases in liquid asset holdings of nonfinancial corporations were less than \$1 billion in each of the years 1964 and 1965.

Businesses entered the period of accelerated tax payments, therefore, with little preparation for meeting a heavy excess of tax payments over accruals. For nonfinancial corporations, payments exceeded accruing liabilities by about \$2 billion in the second quarter of 1966 and by about \$5 billion in the second quarter of 1967. With credit markets taut during a large part of this period, liquid asset holdings were run down by nearly \$3 billion in the year ended in mid-1967, in reflection of the heavy needs for funds for accelerated payments of taxes and other purposes.

Many businesses, consequently, took the opportunity afforded by more ample credit availability in 1967 to do something about their liquidity positions. Corporate long-term security issues began to rise rapidly in reflection of these increased liquidity demands during the spring of 1967, and they remained at exceptionally high levels until late in the year. Observers close to financial markets reported that an unusual increase in liquidity preference was responsible. The demand for money had thus risen for reasons not associated with intentions to spend for goods and services. This is the kind of increase in demand for money which monetary policy can meet, by permitting an increase in the supply, without inflationary consequences.

The behavior of interest rates during the latter half of 1967 provided the confirmation needed that this interpretation was on the right track. Interest rates on longer term securities had begun rising in the spring months in response to the rapidly growing supply of corporate long term borrowing. Short-term rates, however, continued to decline until shortly before midyear. After midyear, however, interest rates began to rise drastically across the range of maturities, and the increases were much too rapid to be explained by the effects of rising incomes and economic activity generating increased demands for credit. They were reflecting increased demands for quick assets to restore balance sheet liquidity—demands that were not being fully satisfied by the rate of growth in money and time deposits permitted by monetary policy. It seems evident that monetary policy was much less expansive in 1967 than the high rate of monetary growth, taken by itself, might seem to imply.

Nevertheless, had it been known that timely fiscal restraint was not going to be forthcoming, monetary policy would have been less expansive over the summer and fall of 1967, in order to achieve a posture more consistent with a return to price stability. Earlier adoption of a program of monetary restraint would have been difficult, in light of the turbulent state of domestic and international financial markets but it would not have been impossible. Such a program was not adopted earlier, I believe, largely because those of us responsible for making monetary decisions found it almost inconceivable that this Nation would once again, following the painful experience of 1966, choose to rely exclusively on monetary policy to moderate the growth in