to all of us, especially at the moment, is the one in which bank loan demand is vigorous and, at existing interest rate levels, this component of total bank credit alone is tending to expand by more than the growth being allowed by current monetary policy in the demand deposit component of the money supply. In other words, the adjustment process in case of a "squeeze."

Initially, as I said, banks respond to a "shortfall" in total reserves by liquidating readily salable investments. On some occasions, a substantial increase in loans can be accommodated through this process with no other major balance sheet changes or disturbance to financial markets. For example, from 1948 to 1951, total loans increased at an average annual rate of 11 percent, while the money supply grew at an average rate of only 2 percent. In this period, banks' U.S. government security holdings declined at a 3-percent rate.

On other occasions banks have accommodated loan demand by moving more aggressively to attract savings and other time deposits.

In 1964–65 the money stock went up at a 4.2-percent average rate, while total loans increased at 13½-percent rate. On still other occasions, in the squeeze—or crunch if you like—of late 1966, for example, the impact on loan expansion was quick and direct, the rate of loan expansion was brought practically to a halt. It was six-tenths of 1 percent from October to November.

I cite this historical experience simply to illustrate the fact that bank response to a lesser rate of monetary expansion than would accommodate current loan demand varies.

It depends, of course, on the condition banks are in at the outset, on their ability and freedom to attract funds from the market and from other institutions, and on the strength and structure of the loand demand that confronts them.

In the present circumstances, I think it is fair to say that the adjustment process is likely to involve some of all the ingredients in the historical examples I have cited. Banks undoubtedly acquired some liquid investments, over and above the bare minimum, during 1967. They can, and undoubtedly will, accommodate some loan demand in excess of the presently permitted rate of monetary expansion by selling liquid investments. They have some ability and freedom to compete more aggressively for time deposits and at least until very recent weeks they have managed to keep total time deposits rising. That they will continue to be able to do this is open to question. Banks are obviously also moving to moderate loan expansion—or at least to produce lower rate of expansion than would otherwise prevail—by more restrictive lending policies.

Clearly, all these things tend to push interest rates up. In order to sell portfolio investments to nonbank investors, banks must offer them at attractive prices—or higher yields. To attract time deposit money they must pay more and to discourage borrowing they must charge more.

And to the extent they succeed they will undoubtedly push some borrowers into other markets—rather than out of the market completely—and increase credit demand, and rates, in those markets.

How these effects permeate financial markets and the economy is another story for another witness. But perhaps I have said enough to suggest to you why I believe that focusing just on the rate of growth