

tive mortgage borrowers have only limited borrowing alternatives in securities markets. Since many nonbank financial institutions tend to specialize in residential mortgages, the supply of financing for—and the volume of expenditures on—housing has declined sharply as 1966 has progressed.

Other borrowers—particularly some businesses—who find it difficult to obtain bank credit are able to shift their borrowing to money and capital markets. But such financing is an imperfect substitute for bank loans because of the greater inflexibility, higher interest rates, and transactions costs, as well as the institutional lags, associated with issuance of new stocks and bonds. As in earlier periods of restraint, market financing was made even more costly by the competition of increased liquidation of bank holdings of securities, and in 1966 demands of the Federal Government for funds added to the congestion in some markets.

Still other borrowers who find it difficult to obtain bank credit have only limited alternative sources of financing because they are too small to issue open market paper and securities effectively. Institutional investors in 1966 reduced their financing of firms through private placements, as prior commitments and other drains limited their availability of funds. Trade credit has been relied on heavily by many businesses, but its usefulness is limited largely to inventory financing. Most other sources of financing for these borrowers are quite costly.

Thus, the diversion of funds from claims on banks and other financial institutions by rising market yields has had a pronounced effect on credit markets. The greater cost and limited substitutability of market financing for credit obtained at financial institutions, and the institutional and structural obstacles to a smooth transfer of credit from one type of lender to another, have reduced the total borrowing of the nonfinancial public. Despite the increase in the public's purchases of credit market instruments, businesses, consumers, and State and local governments in the third quarter of 1966 are estimated to have borrowed from all sources at a seasonally adjusted annual rate of about \$60 billion, down 20 per cent from the second-quarter rate; borrowing by nonfinancial businesses was down by almost 40 per cent. While much of the quarter-to-quarter decline in the total funds raised by these sectors reflected increased financing needs in the second quarter because of accelerated tax payments, the rate of total borrowing in the third quarter by each of these sectors dropped below its 1965 rate.