

year when such credit should have been available. The rollover of the excessive debt and new cash borrowings in a period of rising short-term rates added to the costs of savings and loan associations and restricted their ability to acquire mortgages. The liquidity breakdown is well explained in "A Study of Mortgage Credit" prepared last year at the request of the Subcommittee on Housing and Urban Affairs of the Senate Committee on Banking and Currency.

So the depressed housing market of 1966 had some legacies from earlier years which made the situation worse than it might otherwise have been. I offer this analysis because I believe that monetary policy, while at fault, may have been excessively condemned.

The implication that monetary policy succeeded in slowing down the pace of economic expansion only by causing a sharp decline in homebuilding and other areas of construction is an oversimplification. Monetary policy has a much more pervasive influence. The effects of a sharp slowdown or a cessation of the growth of money supply can be found in consumer spending and the demand for financial assets—stocks and bonds—as well as plant and equipment outlays. In any event, monetary policy has been generally credited with the moderation of the rate of economic expansion in the first half of 1967.

THE CONTRARY BEHAVIOR OF INTEREST RATES IN 1967

Many economists have long held that monetary policy influences the economy primarily through interest rates. In other words, rising interest rates gradually deter economic growth and falling interest rates encourage it. It is generally believed that the Federal Reserve can readily control the level of interest rates by adjusting the supply of credit. In 1967—and not for the first time—these views were disproved. The Federal Reserve became increasingly expansive, yet interest rates rose higher and higher. Moreover, the rise in interest rates did not harm business conditions; instead economic expansion speeded up in the course of the year. One important lesson we should learn from this is that monetary authorities do not have as much control over interest rates as they once assumed.

Expectations of borrowers and lenders play an important role in changing the structure of interest rates. In the spring of 1967, even after the Federal Reserve reduced the discount rate from $4\frac{1}{2}$ to 4 percent, long-term rates continued the rise that began in late February. In the course of the year some rates reached the highest levels since the Civil War.

The rising volume of new corporate issues in the first half of 1967 was not unusual. In recessions—and the first half of last year has been tagged a minirecession—corporate treasurers generally seek to strengthen their debt structures. However, in the past, long-term interest rates have continued to edge lower despite the enlarged volume of new capital issues.

I would suggest that the sudden, unusual acceleration in the volume of new capital issues in the second quarter of 1967 was not so much a legacy of 1966 as it was the expectation of extraordinarily large Government financing requirements in the second half of last year and in 1968.

The original budget figures released by the administration in Janu-