

3. MONETARY RESTRAINT

The question of Treasury borrowing needs are closely related to the credit posture of the Federal Reserve System. The view is sometimes expressed that fiscal restraint would lessen the needs for the Federal Reserve to embark upon a policy of credit restraint. Stated another way, failure to reduce the budget deficit would require the Federal Reserve to adopt a more restrictive monetary policy. However, this approach overlooks the market reality that the enormous financing requirements of the U.S. Treasury limit the freedom of the monetary authorities to restrain credit growth, since doing so could jeopardize the success of Treasury refundings or new cash borrowing operations.

During 1967, Federal Reserve policy remained in an easy position which permitted a growth in bank credit by an unprecedented dollar total of \$35 billion. As pointed out in the Council's annual report, total bank credit expanded during the first 11 months of 1967 at an annual rate of 12 percent. This expansion in credit and in the money supply is related, we believe, to the accelerated rise in domestic price levels during the past several months. Continuation of credit expansion at the pace of 1967 would reinforce strong inflationary pressures through excessive additions to available spending power. However, the need to provide for the financing of Treasury securities through the commercial banks has left the Federal Reserves in the awkward position of maintaining relative ease in the face of an oversized Federal deficit. In brief, an unwillingness to adopt fiscal restraint to achieve a lower budget deficit would add to the difficulties of reducing the growth in bank credit. Stated another way, fiscal restraint and a lower deficit would permit the monetary authorities to follow appropriate policies to curb credit-financed demands in the private sector.

In our view, monetary policy should move in gradual steps toward less expansionary policies, to avoid making credit available in such large amounts that demand outruns our capacity to produce, with a resulting rise in price levels. It is well recognized that there is usually a considerable time lag before monetary policy begins to act upon basic economic forces. For this reason, if the Federal Reserve is to be effective in curbing excessive demands later this year, then steps should be taken as soon as possible toward a less expansionary credit policy.

Any discussion of a less easy credit policy usually brings fears of higher interest rates, credit shortages, and a shutting off of residential mortgage finance. But these consequences need not occur if a reduction of the Federal budget deficit lowers the borrowing requirements of the Treasury thus making room for the financing of residential construction, business capital outlays, and other private sector activities.

4. BALANCE-OF-PAYMENTS POLICIES

On January 1, the administration announced a broad program of correctives to improve our balance-of-payments position, including mandatory controls on direct investment abroad, a more stringent program of voluntary controls on financial flows to foreign countries, and proposed curbs on tourist travel outside the Western Hemisphere.