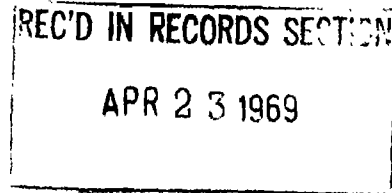




BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551



April 22, 1969

TO: Federal Open Market Committee  
FROM: Mr. Holland

Enclosed for the information of the Committee is a copy  
of a memorandum from Mr. Gramley dated April 8, 1969, and entitled  
"Timing Relationships Between Private Spending and Private Borrowing."

A handwritten signature in cursive script, appearing to read "Robert C. Holland".

Robert C. Holland, Secretary,  
Federal Open Market Committee.

Enclosure

C'D RECORDS SE:

To: Mr. Brill

Date: April 8, 1969.

APR 23 1969

From: Lyle E. Gramley

Subject: ~~Timing Relationships Between~~  
Private Spending and Private  
Borrowing.

The very sharp turnaround in growth rates of monetary aggregates since the fourth quarter of 1968 has not, as yet, been accompanied by a comparable decline in funds raised by private borrowers. Growth in consumer credit has subsided, and flotations of municipal securities have fallen. But business loans at banks have continued to rise rapidly in the first quarter, total corporate security offerings have remained above the 1968 average, and growth in total mortgage credit has yet to show clear signs of moderation--judging from commercial bank data. In view of this, one may well ask whether monetary restraint has yet been achieved, irrespective of what the monetary aggregates show.

The answer to this question depends on the chronology of monetary processes--in particular, the way in which monetary policy temporally record its effects on financial and real variables. Most everyone seems to agree now that the impact of monetary policy actions on spending occurs with a significant lag. Consequently, changes in policy--even though they are evidenced quite promptly in such monetary aggregates as total reserves, the money stock, time deposits, and bank credit--take a long time to influence expenditure and income flows. The timing of the effects of monetary policy on private borrowing, given these lags, depends on whether borrowing decisions are chronologically more closely linked with the initial movements of the monetary aggregates, or with the expenditure effects of policy actions that occur further down the road.

A fully satisfactory answer to this question would require a detailed statistical analysis that attempted to sort out the direct effects of monetary actions and expenditure flows as determinants of borrowing. However, a tentative answer can be provided by simple comparisons of the timing of changes in private investment expenditures and variations in private funds raised. The accompanying charts permit such a comparison. The charts relate private borrowing to private net investment (gross purchases of real assets less estimated capital consumption allowances), since this is the measure of expenditures that seems, from an analytic point of view, most likely to be relevant for external demands for funds.

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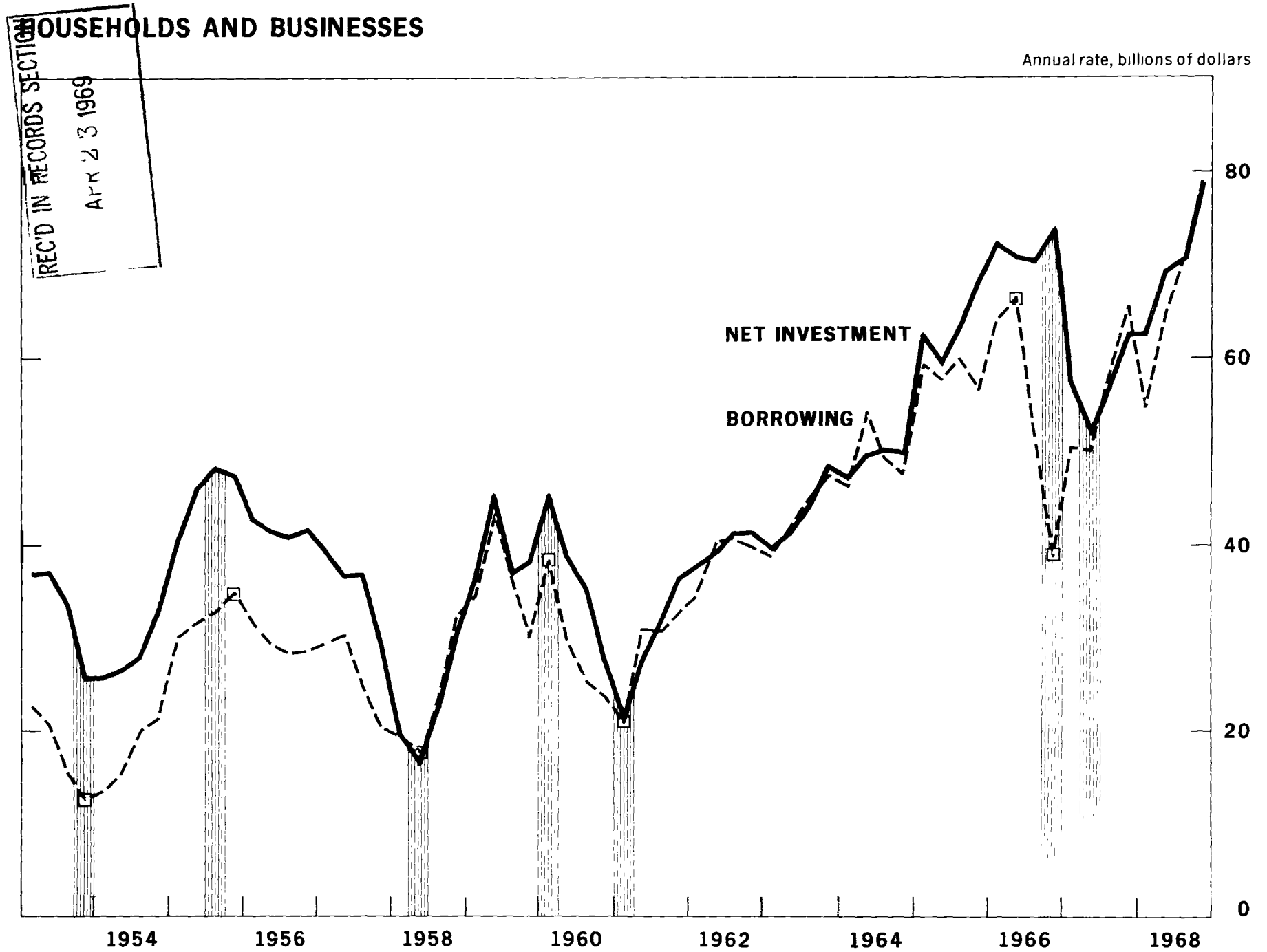
The first chart shows the net investment in real assets by households and businesses together (including households net investment in durable goods), and the amount of borrowing by these two sectors. The timing question can be evaluated generally simply by inspection of the chronological conformance of the two series. However, to facilitate comparisons of cyclical turns, turning points in the two series have been highlighted in the chart. Quarters in which cyclical turning points in net investment seem to have occurred are indicated by vertical shading. The comparable turning points in the borrowing series are shown by a square surrounding the plotted point. Cyclical changes in the rate of borrowing tend to lead, be coincident with, or lag, the cyclical turns in net investment according as the square lies to the left of, is superimposed on, or lies to the right of the vertical shading.

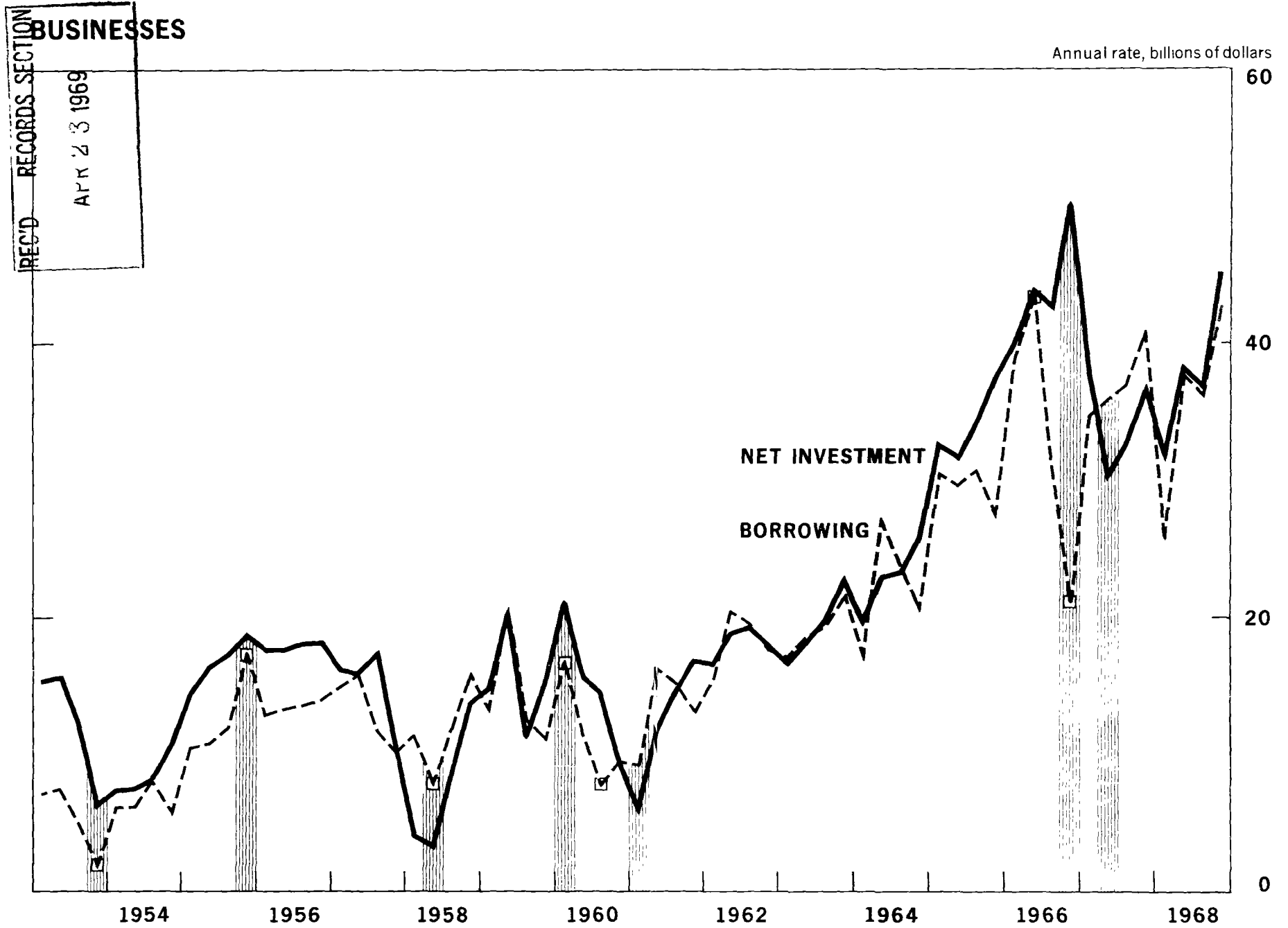
Charts 2 and 3 show the same information for households and business separately, while chart 4 relates business loan growth at banks to the rate of inventory investment. The relation between inventory investment and business loan growth has not been anywhere near as close in recent years as it was earlier. There are probably a variety of reasons for this; certainly one of the more important ones, however, has been the changing pattern of corporate tax payments which has altered the timing of seasonal changes in bank loans.

The message that seems to come through in these charts is that changes in the rate of borrowing do not generally lead changes in the rate of investment spending; the two series are more or less coincidental. There are times--1966 is the clearest case in point--where changes in borrowing appear to have led changes in private net investment, but the lead is not a consistent one over time, and in fact, sometimes cyclical turns in spending have preceded the corresponding turns in borrowing.

It would appear, therefore, that--unless further study were to indicate the contrary--rates of private credit expansion are a rather poor advance indicator of the effects of current policy actions. The volume of private borrowing reflects principally the current stream of expenditures. This does not imply, of course, that private credit expansion cannot be affected by monetary policy, but it does mean that changes in the rate of borrowing induced by policy are likely to show up with about the same lag as induced changes in expenditures.

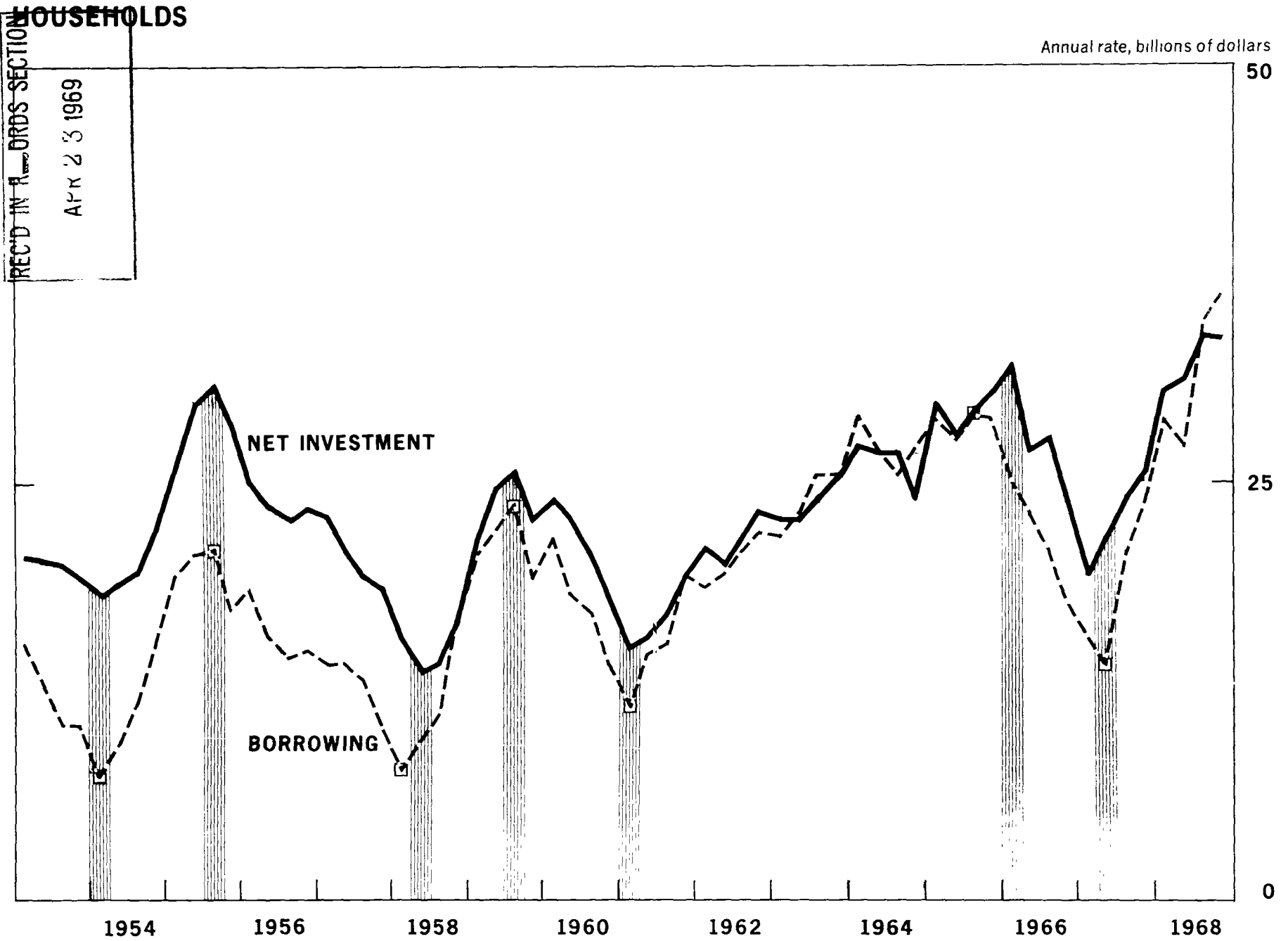
# HOUSEHOLDS AND BUSINESSES





# HOUSEHOLDS

Annual rate, billions of dollars



**BUSINESSES**

REC'D IN RECORDS SECTION  
APR 23 1969

Annual rate, billions of dollars

