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Opinion  
April 15, 1948.

### Credit Policy

1. Increased military expenditures and tax reduction have created a new situation with respect to the coordinated program of credit restraint and debt management which we have been pursuing in order to restrain further expansion of bank credit.

2. There are various estimates of 1948-49 fiscal year results. With the possible exception of Congressional committee estimates the figures of receipts and expenditures are not very far apart. A great deal now depends, of course, on how rapidly increased appropriations for defense are translated into actual expenditures. President Truman in letter to Speaker Martin indicated 1.7 billion additional expenditures in fiscal '49.

3. By means of the transfer of 3 billions for ERP from the 1948 budget to the 1949 budget a bookkeeping surplus of about 1.5 billion can be shown in 1949. From the standpoint of credit policy, however, the important figure is the cash surplus which is estimated at 1 to 2 billions, barring business recession (and consequent decline in Treasury receipts), or greater increase in military expenditures than is now requested.

4. This amount is probably no more than enough to take care of voluntary redemptions of maturing securities, leaving nothing for redemption of securities held by Federal Reserve Banks. In fact, during the first half of fiscal year 1949 (second half of calendar year 1948) Treasury may well be a temporary borrower.

This means that existing program of credit control, based on Treasury redemption of Federal Reserve held securities, will not be in working order much longer. War loan calls of about 450 million (additional) in April, 1,050 million in May, and 1,700 million in June will not be sufficient to offset Treasury payments to market.

5. It is uncertain, of course, whether inflationary pressures will persist strongly during second half of this calendar year, and it is still debatable what and how much should be done to try to curb such pressures by monetary action. It has seemed likely that there would be a falling off in business capital expenditures during the latter half of 1948 and first half of 1949. If Government expenditures do not pick up rapidly, it is conceivable that their inflationary effect might be offset by this decline in private capital expenditures. There are other elements in our economy -- i.e., supply of some goods overtaking demand and prospect of better world crops -- which will also mean a relaxation of inflationary pressures. On the other hand, tax reduction will be a sustaining influence on the demand side, ERP expenditures will help to maintain foreign demand, and a third round of wage increases is tending to aggravate the situation.

6. In the field of fiscal policy, debt management, and credit policy, if we are still faced with the necessity of resisting inflationary pressures, the choice (as put by the President's Council of Economic Advisers) is whether to try to cut down personal consumption, private or public investment, military expenditures, or other Government services.

Although there should be room for some paring of previously planned military expenditures now having a lower order of priority, it is unlikely that much will be accomplished. Similarly, in the field of other Federal Government expenditures, the prospect for substantial economies is doubtful and State and municipal investment expenditures are not under control. As suggested above, a gradual decline in private capital expenditures seems likely, unless the contemplated effects of increased military spending are exaggerated and pressure for private capital expenditures again increases, which might then require allocations of materials rather than credit controls.

By means of action in the monetary and credit field we can attempt to prevent or restrain a further expansion of purchasing power based on bank credit, but we can't do much, if anything, about purchasing power already in existence, unless we want to take measures so drastic as to risk a serious over-all decline in production and employment.

7. Nevertheless, with fiscal policy inhibited and debt management reduced in scope, monetary policy may be able to play a relatively more important role than in the recent past when it has been pretty completely dependent upon Treasury surpluses. If there is a decrease in the demand for private capital funds the pressure on long term rates which asserted itself last fall will be relieved. Maintenance of the 2 1/2 per cent long term rate on Government securities should not then require us to put large sums into the market. Meanwhile, we could proceed further with increases in short term rates, so as to encourage the banks to use whatever reserve funds come into their possession (through gold imports, return flow of currency, our purchases of long bonds, Treasury expenditures, or otherwise) to purchase short governments from us, or we might even take affirmative action by pressing sales of short governments from our portfolio.

8. This program would involve permitting bill rates and rates on outstanding certificates to begin to move up in the near future, issuing a 1 1/4 per cent 1 year certificate to refund the June maturities, increasing the discount rate, adjusting the scale of rates on tax savings notes, adjusting support prices on short governments other than bills and certificates and probably eventually getting rid of the pegs on obligations with maturities up to 5 years. Consideration should also again be given to permitting the 2 1/4's of 59-62 to decline slightly below par, to bring them into line with the rest of the market and to begin the process of getting rid of the

par bogey which, in any case, was never meant to apply to all issues of Government securities but mainly to the longest term 2 1/2 per cent bonds.

9. Whether further action (or further powers) will be necessary or desirable during the second half of 1948 depends on the future course of business, credit, and the budget. Presently the total money supply is down about \$4 billion from the peak of mid-December 1947, and the experience table for the next three months indicates no considerable change is to be expected in this quarter.

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# YIELDS OF TAXABLE TREASURY BONDS

