FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 72-18
January 28, 1972

TO THE CHIEF EXECUTIVE OFFICER:

Dear Sir:

The President's Committee on Interest and Dividends on January 19, 1972, announced a program for voluntary restraint of interest rates. The Committee has requested that I send to you for your information a copy of the Statement describing that program.

The Committee notes that interest rates in money and capital markets have declined substantially over the past 15 months. Rates on borrowings by households, such as home mortgage, automobile, and personal loans have followed market rates with a considerable lag and have fluctuated in a much narrower range. The Committee adds that it expects lenders to be aggressive in passing on promptly to the borrower the benefits of reduced costs of funds available in the credit markets.

It is in the interest of the nation generally and of financial institutions particularly that the Committee's voluntary program succeed. I urge that you do everything you possibly can to insure that it does succeed.

Yours very truly,

P. E. Coldwell

President

COMMITTEE ON INTEREST AND DIVIDENDS

Statement on Interest Rate Program

Since inauguration of the President's stabilization program in mid-August, interest rates in money and capital markets have declined substantially. This decline represents a reversal of the uptrend that had prevailed during the spring and early summer, when inflationary expectations were having a renewed impact on interest rate levels. On balance over the past 15 months, long-term rates have dropped about 1-1/2 percentage points while short-term rates have declined by up to 3 percentage points.

Market rates typically fluctuate widely. They are established from day to day through a highly competitive process in which many knowledgeable market participants are bidding against each other on an impersonal basis. The rate on short-term commercial paper, for instance, fell from a high of 9 percent in the spring of 1970 to a low of 4 percent a year later. It subsequently rose to almost 6 percent in August of 1971, and has since declined to 4 percent.

Rates on seasoned long-term corporate bonds of high grade, another "market" instrument, fluctuated from 8.60 percent in 1970 to 7.06 percent in early 1971. This rate is currently about 7.20 percent. Yields on seasoned municipal securities fluctuated even more widely--from a high of 7.12 percent in 1970 to a low of 4.97 percent in October, and were about unchanged from that level in mid-January.

Since last summer a substantial part of the inflation premium has been wrung out of the interest rate structure. Continued progress in reducing the premium depends on the further reduction of inflationary expectations. While the Committee is mindful that market conditions may change as business expands and demands for funds increase, the Committee expects the President's program will succeed in further moderating inflationary expectations in the months ahead.

Interest rates on borrowings by households, such as on home mortgages, automobiles, and personal loans, are less sensitive than market rates to changes in underlying conditions. They have tended to move in the same direction as rates on open market instruments of comparable maturity. But these movements generally have followed market rate fluctuations with a considerable lag and have fluctuated within a much narrower range. In part, this sluggishness reflects the heavy cost of administering such loans.

Since late 1970, home mortgage rates have declined by 3/4 to 1-1/2 percentage points, with a significant part of the decline occurring since August 1971. In recent months a number of lending institutions have announced reductions in consumer loan rates. The Committee on Interest and Dividends expects lenders to be aggressive in passing on promptly to the borrower the benefits of reduced costs of funds available in the credit markets. The Committee will maintain close surveillance of these markets and will discuss developments with lenders as circumstances warrant. All lenders should be mindful of the probable repercussions of their rate actions on other aspects of the stabilization program.

On August 19, 1971, Secretary of the Treasury John B. Connally, in a communication to financial institutions, urged lenders to do what they can to keep interest rates low. On October 20 the Committee on Interest and Dividends announced that it expected all lenders to assemble and maintain records of their rates for various types of loans made since August 15, 1971. For purposes of its statistical and surveillance program, the Committee is in the process of obtaining interest rate information on a sample basis from banks, savings institutions, finance companies, and mortgage companies. Results of these various interest rate surveys will be reported to the Cost of Living Council and to the public as they become available.

January 19, 1972