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THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

December 2, 1965

MEMORANDUM FOR THE PRESIDENT

Subject: Rebuttal to a Plea for Tighter Money

Paul McCracken, an ex-CEA member under President Eisenhower, recently made a strong plea for higher interest rates, criticizing us for clinging to "always low interest rates" as a "dogma." You asked for our reply.

Sic!

1. Interest rates today are high -- not low -- by historical standards. With the exception of a brief interval in 1959-60 (which was promptly followed by recession), most interest rates are at a 35-year high.

   - The latest Treasury bill auction on Monday again hit another five-year high, 4.115%.

   - Long-Term government bond yields are also at a relative peak, 4.34%.

   - The new Aa corporate bond rate reached 4.79% last week.

2. McCracken is worried about "a disorderly run-up in the domestic economy." But the facts do not justify this diagnosis of the economy's condition today or its prospects for the months ahead.

   - We have been experiencing a remarkable, orderly, steady and well-balanced advance in our national product of a little more than $10 billion a quarter for the past two years.

   - The outlook suggests continuation -- but not an acceleration -- of this well-paced advance, and a maintained noninflationary atmosphere.

   - We have heard warnings time and again in the past two years that the expansion was about to get out of hand. But events have consistently confirmed our confidence in the basic stability of the economy. We remain determined to make policy on the basis of facts and not nightmares.

. The facts tell us that tighter money at this time would merely

-- deprive business of needed legitimate credit,

-- hurt the already sagging housing market, and

-- signal for a slowdown when it is not called for.

3. Nor is tighter money needed for our balance of payments problem.

. The capital outflows that are sensitive to credit conditions are under good control as a result of the Voluntary Program.

. Our one major problem area this year has been direct investment. It would not be curbed by tight money, and it will be trimmed effectively by the new Commerce guidelines for 1966.

4. You have demonstrated in words and action that you recognize the need for flexibility in monetary policy, and are not attached to "dogma."

. As you said in your Economic Report in January:

"Monetary policy must be free of arbitrary restriction. It must be prepared to move quickly

-- if excessive demand should threaten inflation,

-- if an outflow of liquid funds should unexpectedly worsen our balance of payments."

. We remain ready to tighten, if needed. But so far it is not needed and would be harmful to the economy.

Gardner Ackley

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