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THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

March 11, 1966

MEMORANDUM FOR THE PRESIDENT


Subject: Prime Rate Increase

1. At your suggestion, I have talked with Governors Maisel, Brimmer, and Robertson about the matter of your commenting on the prime rate increase. On further reflection I decided not to approach Governor Mitchell. I asked each of them if they would be willing to give you their advice, through me, on a purely personal and unofficial basis.
2. The strong preference of all three was that you make no comment. I then outlined the type of comments which Joe Fowler and I had drafted for Bill Moyers to use in response to a question regarding your reaction to the increase. Brimmer saw no great harm in such a statement, but only if it were done in Fowler's name or mine rather than yours. The other two felt that such a statement would do no good, and might interfere with broader objectives of improved Fed-Administration coordination, and better cooperation by the banks with your programs.
3. All of them felt that monetary policy has now gone as far as it should go in the direction of restriction. As I understand it, this is also the present view of Chairman Martin. Both Brimmer and Maisel volunteered the observation that further restraint on the economy is necessary but that it should come from fiscal policy.
4. Maisel pointed out that the present very strong demand for loans by prime rate customers of the banks, and the preference that the banks always give to prime rate customers, was depriving small business, housing, and consumers of their fair share of the restricted credit availability. Thus, a prime rate increase -- which might discourage some prime rate customers -- could helpfully divert a larger share of credit to the less preferred customers, putting more of the burden of credit restraint on the large corporate borrowers. He pointed out that smaller borrowers are paying rates that are already at or close to the usury ceilings of many States. They might actually pay no more, but receive fuller accommodation.

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5. Although Robertson preferred no statement, he suggested that, if a statement were made it should attempt to encourage the expectation that this is the end of the road. For example: "Much of the pressure on the banks has apparently reflected the anticipation of higher interest rates. Now that the prime rate has been raised, this unhealthy pressure can be expected to terminate."
6. It was also observed that a prime rate of 5-1/2% is about in line with the level of other interest rates. A prime rate 1% above the discount rate has in the past been considered normal.
7. As to the question of what "good" tight money has done up to this point, the only evidence referred to was the fairly substantial postponement of bond issues by State and local authorities and some corporations. One recent tabulation shows postponements in the past few weeks adding up to \$1/2 billion. It should be noted, however, that postponement of financing does not necessarily mean postponement of spending. In many cases it merely means reliance on short-term financing, while awaiting more favorable bond market conditions.
8. Negative free reserves in the past week reached an average of \$220 million. This means that growth of credit is being sharply restricted -- as compared with what would have happened if the Fed were supplying reserves freely. To the extent that spending for goods and services depends on credit, this must mean that spending is restrained and inflationary pressures thereby limited. Of course, when the supply of credit is restricted, a rise in its price is almost inescapable.
9. My own recommendation is that a Moyers' statement is the most you should do.


Gardner Ackley