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EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
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MEMORANDUM FOR THE PRESIDENT

Subject: Recent Financial Developments

1. An unwelcome upturn in interest rates has taken place in the past few weeks. We have been concerned about this and have made that concern clear to the Fed in confidential friendly conversations. They are not happy about it either, and clearly want to swing rates back down again. We are optimistic that they will take the action needed to put the market back on the right track.

2. After declining for nearly five months, interest rates have risen in February, particularly in the past two weeks.

   - Most rates on securities have risen 1/10 to 1/4 of a percentage point since the lows made in late January or early February. (See attached table.)

   - On the other hand, mortgage rates have provided good news. They declined a tiny bit -- 0.1 to 0.3% -- for the first time in over a year.

3. There are several factors behind the reversal of interest rates on securities.

   - Some bounce back was inevitable, because speculative activity carried rates down faster than the real financial situation warranted.

   - Corporations are planning a record volume of new bond issues for March. They had been waiting for rates to fall and are now lining up for bargains.

   - The Fed has had some technical problems in managing the supply of short-term funds. It has not been stingy in providing reserves, although it should have worked more aggressively to hold rates down.

4. These problems are temporary in nature. Some will linger on for a while, however.

- The heavy new issue calendar and tax payment problems will tend to keep the market fairly tight in March and April.

- It will also take a little time to convince bond buyers that rates are going to resume their downward course.

5. For these reasons, it will take a vigorous policy of easing by the Fed to push rates down again. The Governors sound determined to pursue such a policy.

   - They genuinely regret that the New York Bank's trading operations were not more aggressive in the past two weeks.

   - They have authorized the staff to background the financial press on their true intentions.

   - They all seem to favor giving some signal to show they are still moving toward easier money. But they are not agreed on exactly what move to make. We are hopeful that they will adopt some sort of reduction in reserve requirements next week.

5. Yesterday's market behaved well, with the help of monetary policy.

   - Short rates fell as the Fed brought bills in fair quantities.

   - Bond yields were down a little, mainly because Treasury cash was used to buy bonds to replace special issues in the trust funds (thus reducing outstanding debt).

6. All in all, the last couple of weeks were a setback for the cause of easier money but only a minor one. If the Fed gives some sort of signal of its intentions and keeps on pumping in reserve funds, rates should begin to go down again.

Gardner Ackley

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INTEREST RATES

	December 1965	Peak September 1966	Low Jan.-Feb. 1967	Feb. 24
3 month bills	4.362	5.586 (9/23)	4.486 (2/3)	4.621
3-5 year	4.77	5.83 (9/2)	4.60 (1/30)	4.80
Long term	4.43	4.87 (9/2)	4.34 (1/27)	4.56
New issues Corporate Aa	4.90	6.35 (9/2)	5.22 (2/3)	5.48
New issues Corporate Aaa	4.85	5.98 (9/2)	5.11 (2/10)	5.20
New municipals	3.54	4.24 (9/2)	3.40 (2/3)	3.66
Corporate Aaa	4.68	5.52 (9/9)	4.99 (2/10)	5.05
Municipals	3.56	4.26 (9/2)	3.43 (1/27)	3.68