EXECUTIVE

THE WHITE HOUSE
WASHINGTON

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FG 11-3
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Joe Califano -

Look at this.
I agree with Okun. Have Okun talk to Fowler and see if he and Martin agree.

Okun wants a decline in "net borrowed reserves"

LBJ:mr
7/16/68
1:30pm

JUL 1
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THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

r - 16|68
9:30

July 15, 1968

MEMORANDUM FOR THE PRESIDENT

Subject: Financial Conditions and Policy

1. Interest rates have shown a disappointingly small movement since the tax bill was passed.

- Financial markets were moving ahead nicely while the bill was progressing toward final enactment. But since then, they have stalled.

- Rates actually rose a bit in the last week of June. But they have come down again most recently. Investors are becoming aware of how much the fiscal package will cut Treasury financing needs. But they are waiting for a signal from the Fed.

- As shown in the table, most rates are still well above the year's lows of January-February, although well below the high point of late May.

	Jan-Feb 1968 Low	May 21-24 High	June 21 (post tax bill)	July 12
Treasury issues				
3 month bills	4.82	5.90	5.20	5.38
3-5 year issues	5.43	6.17	5.56	5.53
Long-term bonds	5.08	5.54	5.12	5.10
New corporate bonds				
Aaa-rated	6.18	6.83	6.67	6.56
Aa-rated	6.50	7.09	7.00	7.04
Long-term municipal bonds	4.16	4.71	4.43	4.36

3. The thrift institutions suffered heavy deposit outflows in late June and early July, as depositors took advantage of high yields on securities and the booming stock market.

 . Savings and loan associations and large mutual savings banks in New York City had net losses during this period totaling $1.5 billion

 -- double the outflow of a year ago,

 -- about three-fourths as large as during the liquidity "crisis" of mid-1966.

 . There are some points on the brighter side

 -- the thrift institutions started with good liquidity positions and are not badly squeezed by the outflow;

 -- many who had feared even greater losses are now expressing considerable relief and confidence that the worst is over;

 -- we are thus assured that homebuilding will not be collapsing as it was in 1966.

 . But we want and need good gains in homebuilding for the end of 1968 and the first half of 1969. And we won't get them unless interest rates on securities start coming down soon.

 . Warren Smith has called a meeting of the housing credit committee for Wednesday. The group consists of representatives from Treasury, Budget, HUD, Fed, FNMA, VA, and FHLBB. They will see whether any administrative actions can be taken to support housing.

4. Against this background of recent developments, the Federal Reserve Open Market Committee will be meeting tomorrow. It will be their first meeting since the tax bill was passed.

 . Most members of the Committee share our disappointment that interest rates have stopped falling.

- Most also recognize that, if they wait for really hard evidence that the economy has cooled off, their easing may be too late.

- But many fear that any overt monetary easing might offset the big boost to world confidence in the dollar brought by the tax bill. They also fear that a drastic easing would be viewed as undoing the anti-inflationary effect of fiscal restraint.

- The Fed is thus split. We have made our views clear in frank discussions with the Board.

- We do not expect the Fed to make a big move toward ease right now -- such as a cut in the discount rate. But we hope they will adopt some relaxation in open market operations -- enough to bring a visible decline in "net borrowed reserves" of the commercial banks and in the interest rate at which "Federal funds" are traded among the banks.

Arthur M. Okun