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THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

November 24, 1964

MEMORANDUM FOR THE PRESIDENT

Subject: The Impact of the Discount Rate Increase on our Prosperity

Summary:

The immediate increases in interest rates resulting from the rise in our discount rate have been about as small as we could have hoped for.

But any increases are unwelcome. The tasks of sustaining brisk expansion and pursuing full employment have become a little tougher -- and they were difficult already.

This shift in monetary policy for international reasons increases the importance of expansionary fiscal measures.

1. After Bill Martin's excellent and unprecedented press conference, interest rates on Treasury securities rose less today than might have been feared:

   - New 3-month Treasury bills yielded 3.81%, up .19 from last Friday. Sizable purchases by the Fed helped hold down the yield.

   - A new one-year bill yielded 4.07%, .28 above last month.

   - Long-term Treasury bond yields have risen .04 to .06 since Friday and now average about 4.15%.

2. Even these small increases in interest rates have some significance.

   - Short-term Treasury rates have not been this high since early 1960, though bond yields remain a shade below their 1964 peaks in April and October.

   - With Treasuries now more attractive, and discounting more expensive, banks will tighten up somewhat on business loans. The extent of the tightening will depend on the Fed's readiness to supply bank reserves.

- Reports in the press this morning indicate that commercial bankers are eager to raise the costs of business loans, although competition may prevent them from moving very far.

3. The small shift in monetary policy will not convert prosperity into recession. But, if it has to stick, the higher discount rate will cost us production and jobs in 1965. We do not know the exact size of these costs, and even a year from now we won't be able to measure them accurately. Some academic studies suggest that losses for 1965 could run as high as $1 billion in GNP and 100,000 jobs.

4. This would be as large as the gains in some of our key job-creation programs: 100,000 people received training under MDTA projects in 1963; about 100,000 jobs a year are provided directly and indirectly by Accelerated Public Works.

5. You will soon have the results of the latest Treasury-BOB-CEA "Troika" review, completed last week. It indicates our concern about the dangers of rising unemployment in the second half of 1965 and points to the need for additional fiscal stimulus.

6. Now, in view of the latest international monetary developments, it is clear that

   -- we would not be free to ease money in the event of an economic slowdown; and

   -- the importance of stimulative fiscal measures is increased, since we need to offset the effects of somewhat higher interest rates.

7. We can provide that greater stimulus through some combination of

   -- a larger or earlier excise tax cut,

   -- somewhat larger increases in direct Federal spending, or

   -- expanded grants-in-aid to States and cities.

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