REVIEW and OUTLOOK

Liquidity, Inflation and the Fed

The Federal Reserve Board's suspension of interest-rate ceilings on certain large time deposits is a sensible, indeed overdue, move in itself. That it was triggered by the immediate corporate "liquidity crisis," highlighted by Penn Central's troubles, in no way mars its longer-range wisdom.

For the past couple of years bankers have chafed under the ceilings. Their result has been that increasingly banks have been bypassed and corporations have borrowed and loaned funds between themselves and through brokers.

The banks will now be able to offer enough interest to attract deposits from corporations with cash in amounts beyond their immediate needs. That money has been flowing into commercial paper, or short-term unsecured notes, in growing volume because interest rates in that market were higher than those the banks could pay for deposits. Now, says one banker, it will be good to "get back into the banking business."

True, the Federal Reserve's action was less than sweeping. Suspended are the ceilings of 6.25% interest on 30- to 59-day deposits and 6.5% on 60- to 89-day maturities. It applies only to certificates of deposits and other single-maturity time deposits in denominations of $100,000 or more. Various other ceilings remain—for the time being, anyway.

Still, in terms of the concern over the liquidity problem (a concern which heavily fueled the 18-point decline in the Dow Jones industrial average on Tuesday), the move is cleverly calculated.

For one thing, the maturity range of one to three months hits the area of the largest volume of money market investment and the greatest competitiveness for funds. For another, the limitation to certificates of $100,000 and more should mean that it will not add to the housing industry's problems. That is, there should be little impact on savings and loan associations, which are major mortgage lenders but which serve mainly small savers. Incidentally, the ceilings were first clamped on partly in the hope of keeping banks from bidding funds away from the S&Ls and savings banks.

Most important, the Fed's move, while providing more liquidity to banks, will be doing so in what should prove to be a non-inflationary way. It's more desirable, as some bankers point out, than a big expansion of the money supply, which would almost certainly be inflationary. In the words of the Board, it won't "interfere with the continuing objective of curbing inflation."

Continuing the attack on inflation is vital not only for the health of the economy and for the sake of all the citizens plagued by years of rising prices. It is involved in the current liquidity difficulties as well. For, as these columns have observed before, inflationary Federal monetary and fiscal policies under the Kennedy and Johnson Administrations have helped propel a number of companies into their present troubles.

There was an excess in the money supply, which in turn led to a psychology of an illusory perpertual prosperity; the combination caused various corporations to be less careful in their management than they should have been. The rapid, haphazard growth of certain of the conglomerates is only an egregious example. In today's changed conditions, careful management is more essential than ever, and no one can afford a resumption of inflation with its attendant easy-come psychology.

We think it is an exaggeration to call the liquidity problem a "crisis," at least in the manner that some people are carrying on about it, but the fact that trouble exists is manifest. For the purpose of easing that trouble, the Federal Reserve's action seems sophisticated and skillfully pinpointed.

But it should be a beginning not an end of the matter. In due course the deposit interest-rate ceilings should all be eliminated. The fewer of these artificial impediments, the better the chance for regaining a sounder economic base.