

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

September 20, 1965

The third statutory meeting of the Federal Advisory Council for 1965 was convened in the Board Room of The Madison, Washington, D.C. on September 20, 1965, at 9:30 A.M.

Present:

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| Lawrence H. Martin | District No. 1 |
| James S. Rockefeller, Alternate | District No. 2 |
| William L. Day | District No. 3 |
| L. A. Stoner | District No. 4 |
| John F. Watlington, Jr. | District No. 5 |
| Sam M. Fleming | District No. 6 |
| Edward B. Smith | District No. 7 |
| James P. Hickok | District No. 8 |
| John A. Moorhead | District No. 9 |
| Roger D. Knight, Jr. | District No. 10 |
| James W. Aston | District No. 11 |
| Ransom M. Cook | District No. 12 |
| Herbert V. Prochnow | Secretary |
| William J. Korsvik | Assistant Secretary |

Absent:

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| William H. Moore | District No. 2 |
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On motion duly made and seconded, the mimeographed notes of the meeting held on May 17-18, 1965, copies of which had been sent previously to the members of the Council, were approved.

A complete list of the items on the Agenda for the meeting and the conclusions of the Council are to be found in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council*, which follows on pages 23, 24, 25 and 26 of these minutes.

The meeting adjourned at 12:20 P.M.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

September 20, 1965

At 2:30 P.M., the Federal Advisory Council convened in the Board Room of the Federal Reserve Building, Washington, D.C.

Present: Mr. John A. Moorhead, President; Messrs. Lawrence H. Martin, James S. Rockefeller, Alternate for Mr. William H. Moore; Messrs. William L. Day, L. A. Stoner, John F. Watlington, Jr., Sam M. Fleming, Edward B. Smith, James P. Hickok, Roger D. Knight, Jr., James W. Aston and Ransom M. Cook.

Absent: Mr. William H. Moore.

Members of the Board staff, Division of Research and Statistics, discussed domestic and international economic conditions. Messrs. Albert R. Koch, Associate Director, J. Charles Partee, Adviser, and Kenneth B. Williams, Adviser, participated.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

September 20, 1965

At 8:10 P.M., the Federal Advisory Council reconvened in the Board Room of The Madison, Washington, D.C.

Present: Mr. John A. Moorhead, President; Messrs. Lawrence H. Martin, James S. Rockefeller, Alternate for Mr. William H. Moore; Messrs. William L. Day, L. A. Stoner, John F. Watlington, Jr., Sam M. Fleming, Edward B. Smith, James P. Hickok, Roger D. Knight, Jr., James W. Aston, Ransom M. Cook, Herbert V. Prochnow, Secretary, and William J. Korsvik, Assistant Secretary.

Absent: Mr. William H. Moore.

The Council reviewed its conclusions regarding the items on the Agenda and sent to the office of the Secretary of the Board of Governors the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council*, which follows on pages 23, 24, 25 and 26, listing the Agenda items with the conclusions reached by the Council. The *Memorandum* was delivered to the Federal Reserve Building at 9:45 P.M. on September 20, 1965.

The meeting adjourned at 9:10 P.M.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS

FROM THE

FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON SEPTEMBER 21, 1965

1. Economic conditions and prospects.
 - A. How does the Council appraise prospects for the U.S. economy during the remainder of the current year? Have recent developments in steel had any significant effect on the Council's view as to the general outlook?

The Council believes that the level of business will rise further during the remainder of the current year. There is a widespread feeling of optimism among businessmen and investors. The rise in business, however, may be moderated slightly by the liquidation of steel inventories accumulated earlier in the year in anticipation of a strike in that industry.

Recent developments in steel have not had any significant effect on the Council's view as to the general outlook except that it has eliminated one uncertainty.

- B. Are Council members aware of any substantial revisions in business inventory policies as a result of changing expectations – reflecting the Vietnam hostilities or other current developments? Have significant revisions been observed in capital expenditure or other business plans?

Except in certain retail lines, the members of the Council are not aware of any substantial revisions in business inventory policies as a result of changing expectations. However, the step-up in military operations in Vietnam and the expansion in defense spending, even though modest to date, have resulted in the general expectation that the uptrend in business would continue, presumably because federal spending would rise further. As a consequence, the liquidation of steel inventories, for example, may be spread over a longer period. The members of the Council have observed significant upward revisions in capital expenditures and other business plans.

- C. How strong does the Council judge pressures to be on businesses from the demand or cost sides to raise prices?

Steadily rising wage and material costs and a continued high demand are both exerting pressure on business management to raise prices.

- D. How does the Council appraise the current status of the bond markets? What trends does it foresee over the rest of the year in interest rates on corporate, municipal, and Government securities, and in the differentials among these rates?

The recent behavior of the bond market is an indication of the continued strengthening of the interest rate structure. The extraordinarily strong demand for bank loans, together with the increased requirements for funds to finance the capital expansion program of business, has exerted an upward pressure on rates despite a continued expansion in the flow of personal savings and corporate cash.

As a consequence, the yields on corporate and government securities are higher than at any time in the past four years and the spread between government bonds and corporate obligations has widened. Yields on municipal obligations are approaching the peak levels of recent years. Despite the rise in yields that has taken place to date, the members of the Council anticipate some further upward pressure on the rate structure and the maintenance or widening of the present spread in yields. Because of the current high volume of bank loan demand, it is probable that the demand of banks for government and municipal obligations will lessen.

2. Banking developments.

- A. What is the Council's appraisal of the factors underlying the more rapid increases in both savings deposits and time C.D.'s that have occurred since midyear?

The increase in savings deposits that has occurred since midyear varies from district to district, reflecting in part changes in interest paid on these balances. The more rapid increases in time C.D.'s are the result largely of the more aggressive bidding for C.D. funds by major commercial banks who have been offering higher rates to obtain funds to meet the borrowing demand.

- B. Does the Council expect business demands for bank credit this fall to be substantially in excess of usual seasonal needs? Does it anticipate any firming of bank interest rates or other lending terms and conditions?

Most members of the Council anticipate business demands for bank credit this fall will be somewhat in excess of the usual seasonal needs. The strength and persistence of the loan demand of banks combined with the somewhat tighter reserve position is exerting upward pressure on interest rates and lending terms and conditions.

- C. What are the prospects for further bank issuance of capital notes and debentures during the remainder of this year and next year?

The very rapid expansion in bank assets that has occurred in recent years, and particularly this year, has tightened the reserve position of most banks. In addition, the capital ratio and the risk asset ratio of some banks have become less favorable. These developments, together with the fact that prevailing rates on C.D.'s are very close to the Regulation Q ceiling, are factors which are likely to result in the additional issuance of capital notes and debentures during the remainder of this year and in 1966.

- D. What are the Council's expectations with regard to near-term developments in the Federal funds market, with respect to both the extent of participation in this market by medium and smaller-size banks and likely rate levels relative to the discount rate?

The Council believes that the rates in the federal funds market are likely to stay above the current discount rate because of the reluctance of borrowing directly from the Federal Reserve. In these circumstances, an increasing number of medium and smaller size banks are likely to participate in the federal funds market.

3. Balance of payments.

- A. How does the Council appraise the results of the voluntary foreign credit restraint effort to date? In particular, does it appear that the priorities for export financing and for the less developed countries are being reasonably met?

The results of the voluntary foreign credit restraint efforts seem to have been helpful to date, although the large domestic loan demand and the pressure on reserves also have been of assistance in redressing the deficit in the balance of payments. Priorities for export financing and for the less developed countries apparently are being reasonably well met.

- B. What changes does the Council anticipate in the volume of U.S. bank lending to foreigners over the rest of the year?

Since most banks are near the 105 per cent ceiling, the volume of U.S. bank lending to foreigners probably will not rise significantly over the rest of the year.

- C. As the Council appraises the balance of payments outlook, what does it believe would be the best course of Government action in this area in 1966?

Although the voluntary program has been helpful in restraining the outflow of capital, the fundamental adjustments required to balance our international payments have not been made. The present program tends to restrict the movement of goods and capital, and as such may be harmful to the long-term development of the economy. If the program is continued, the ceiling should be raised.

As the Council has indicated in the past, a comprehensive plan is required which would include such factors as the following:

- 1) a further reduction in U.S. economic and military aid overseas;
- 2) a curtailment of defense expenditures in Europe;
- 3) an easing of barriers tending to discourage the repatriation of earnings overseas;

- 4) a narrowing of the differences between domestic and foreign interest rates;
 - 5) a continuation and expansion of the program to encourage exports; and
 - 6) a continuation of efforts to keep wages and other costs within productivity gains.
4. What are the Council's views on monetary and credit policy under current circumstances?

The Council is concerned with the increasing evidence of the development of inflationary pressures, the continued strong demand for bank loans with the reliance on C.D.'s to meet this demand, and the underlying difficulties with the balance of payments. Consequently, we believe the Board should be prepared to move in the direction of further restraint including a tightening of reserves and an increase in the discount rate.

MINUTES OF JOINT CONFERENCE OF THE FEDERAL ADVISORY COUNCIL
AND THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

September 21, 1965

At 10:30 A.M., a joint conference of the Federal Advisory Council and the Board of Governors of the Federal Reserve System was held in the Board Room of the Federal Reserve Building, Washington, D.C.

Present: Members of the Board of Governors of the Federal Reserve System:

Chairman Wm. McC. Martin, Jr.; Vice Chairman C. Canby Balderston; Governors J. L. Robertson, Chas. N. Shepardson, J. Dewey Daane and Sherman J. Maisel; also Mr. Merritt Sherman, Secretary, and Mr. Kenneth A. Kenyon, Assistant Secretary, of the Board of Governors.

Present: Members of the Federal Advisory Council:

Mr. John A. Moorhead, President; Messrs. Lawrence H. Martin, James S. Rockefeller, Alternate for Mr. William H. Moore; Messrs. William L. Day, L.A. Stoner, John F. Watlington, Jr., Sam M. Fleming, Edward B. Smith, James P. Hickok, Roger D. Knight, Jr., James W. Aston, Ransom M. Cook, Herbert V. Prochnow, Secretary, and William J. Korsvik, Assistant Secretary.

Absent: Mr. William H. Moore.

President Moorhead read the first item on the Agenda, and the conclusions of the Council as given in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council* as printed on pages 23, 24, 25 and 26 of these minutes.

In a discussion which followed several members emphasized that there was evidence that businessmen were stepping up their capital spending plans and requesting additional bank credit to finance the programs. Furthermore, many corporations that heretofore had been able to finance their expansion programs out of retained earnings and depreciation charges were now obliged to borrow heavily from commercial banks for the first time in many years. As a consequence of these increased loan demands, it was reported that some banks are beginning to allocate funds and to turn down some would-be borrowers.

President Moorhead then read the second item and the Council's conclusions.

In the discussion on short-term notes, Chairman Martin observed that the Board had the authority to classify short-term notes as deposits. Upon further query, the Chairman stated that the Board probably also had the authority to classify long-term capital notes as deposits.

In commenting on credit conditions, Governor Maisel stated that the basic question really was whether the Council felt the banks were lending too much money. Should the supply of money be increased, he asked, or should the demand be dampened? Several members expressed doubt that all of the loans being sought were necessary for the ongoing of the economy.

The President of the Council read the third item on the Agenda and the Council's response. In the discussion which followed, Governor Robertson stated that the response of the bankers to the voluntary foreign credit restraint effort had been superb. He added that he felt the program would have to be continued in 1966.

The fourth item on the Agenda and the Council's reply were then read by President Moorhead.

In response to a query from Chairman Martin, several members of the Council indicated that a further tightening of reserves should be accompanied by an increase in the discount rate.

In answer to a question from Governor Daane, President Moorhead said he thought most bankers envisioned a slight firming in reserve availability and perhaps a one-half of one per cent increase in the discount rate.

The meeting adjourned at 12:30 P.M.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

NOTE: This transcript of the Secretary's notes is not to be regarded as complete or necessarily entirely accurate. The transcript is for the sole use of the members of the Federal Advisory Council. The concise official minutes for the entire year are printed and distributed later.

H.V.P.
W.J.K.

The Secretary's notes of the meeting of the Federal Advisory Council on September 20, 1965, at 9:30 A.M. in the Board Room of The Madison, Washington, D. C. All members of the Federal Advisory Council were present except Mr. William H. Moore. Mr. James S. Rockefeller, Chairman, First National City Bank, New York, New York, attended as Alternate for Mr. Moore.

The Council approved the Secretary's notes for the meeting of May 17-18, 1965.

ITEM I

ECONOMIC CONDITIONS AND PROSPECTS.

- A. HOW DOES THE COUNCIL APPRAISE PROSPECTS FOR THE U. S. ECONOMY DURING THE REMAINDER OF THE CURRENT YEAR? HAVE RECENT DEVELOPMENTS IN STEEL HAD ANY SIGNIFICANT EFFECT ON THE COUNCIL'S VIEWS AS TO THE GENERAL OUTLOOK?
- B. ARE COUNCIL MEMBERS AWARE OF ANY SUBSTANTIAL REVISIONS IN BUSINESS INVENTORY POLICIES AS A RESULT OF CHANGING EXPECTATIONS-- REFLECTING THE VIETNAM HOSTILITIES OR OTHER CURRENT DEVELOPMENTS? HAVE SIGNIFICANT REVISIONS BEEN OBSERVED IN CAPITAL EXPENDITURE OR OTHER BUSINESS PLANS?
- C. HOW STRONG DOES THE COUNCIL JUDGE PRESSURES TO BE ON BUSINESSES FROM THE DEMAND OR COST SIDES TO RAISE PRICES?
- D. HOW DOES THE COUNCIL APPRAISE THE CURRENT STATUS OF THE BOND MARKETS? WHAT TRENDS DOES IT FORESEE OVER THE REST OF THE YEAR IN INTEREST RATES ON CORPORATE, MUNICIPAL, AND GOVERNMENT SECURITIES, AND IN THE DIFFERENTIALS AMONG THESE RATES?

President Moorhead read Item I and invited members of the Council to comment. An extended discussion followed. There was general agreement that business will be very strong for the rest of the year. The members also reported a widespread feeling of optimism among businessmen and investors. While several mentioned the liquidation of steel inventories, it was felt that these would have only a slight impact on the level of business since the upward push of business was so strong.

Recent developments in steel have not had any significant effect on the Council's views as to the general outlook other than that it eliminated one uncertainty.

Except in certain retail lines, the members of the Council are not aware of any substantial revisions in business inventory policies. Several acknowledged, however, that the step-up in military operations in Vietnam and the expansion in defense spending may have the effect

of spreading the liquidation of steel inventories over a longer period. Several members felt that the change in business expectations had caused businessmen to revise upward their capital spending plans. There was wide agreement that rising wage and material costs and a continued high demand are exerting pressure on business managements to raise prices.

The recent behavior of the bond market is an indication of the continued strengthening of the interest rate structure. The extraordinarily strong demand for bank loans, together with increased requirements for funds to finance the capital expansion program of business, have exerted an upward pressure on rates despite a continued expansion in the flow of personal savings and corporate cash. As a consequence, yields on fixed income obligations are near record highs. Despite the rise in yields that has taken place to date, most members of the Council anticipate some further upward pressure on the rate structure and the maintenance or further widening of the present spread in yields. Because of the high volume of bank loan demand, it is probable that the demand of banks for government and municipal obligations will lessen.

ITEM II

BANKING DEVELOPMENTS.

- A. WHAT IS THE COUNCIL'S APPRAISAL OF THE FACTORS UNDERLYING THE MORE RAPID INCREASES IN BOTH SAVINGS DEPOSITS AND TIME C/D's THAT HAVE OCCURRED SINCE MIDYEAR?
- B. DOES THE COUNCIL EXPECT BUSINESS DEMANDS FOR BANK CREDIT THIS FALL TO BE SUBSTANTIALLY IN EXCESS OF USUAL SEASONAL NEEDS? DOES IT ANTICIPATE ANY FIRING OF BANK INTEREST RATES OR OTHER LENDING TERMS AND CONDITIONS?
- C. WHAT ARE THE PROSPECTS FOR FURTHER BANK ISSUANCE OF CAPITAL NOTES AND DEBENTURES DURING THE REMAINDER OF THIS YEAR AND NEXT YEAR?
- D. WHAT ARE THE COUNCIL'S EXPECTATIONS WITH REGARD TO NEAR-TERM DEVELOPMENTS IN THE FEDERAL FUNDS MARKET, WITH RESPECT TO BOTH THE EXTENT OF PARTICIPATION IN THIS MARKET BY MEDIUM- AND SMALLER-SIZE BANKS AND LIKELY RATE LEVELS RELATIVE TO THE DISCOUNT RATE?

President Moorhead read Item II and invited comments from members of the Council. The discussion disclosed that the increase in savings deposits since midyear varied from district to district and presumably reflected in part at least changes in interest paid on these balances. Most members thought the more rapid increase in time C/D's was a result largely of the more aggressive bidding for C/D funds by major commercial banks who have been offering higher rates to obtain funds to meet the borrowing demand.

Most members of the Council anticipate business demands for bank credit this fall will be in excess of usual seasonal needs. The strength of loan demand and the tighter reserve positions is causing bank managements to raise interest rates on loans to other than prime borrowers. Many bankers also are attempting to strengthen other lend-

ing terms and conditions. There was wide agreement that there are a number of forces operating in the economy which are likely to result in the additional issuance of capital notes and debentures during the remainder of this year and in 1966.

In a discussion on the reserve position of banks, several members described recent experiences at the discount window. Because of these and the general reluctance to borrow directly from the Federal Reserve, the rates in the federal funds market are likely to stay above the current discount rate. In these circumstances an increasing number of medium- and smaller-size banks are likely to participate.

ITEM III

BALANCE OF PAYMENTS

- A. HOW DOES THE COUNCIL APPRAISE THE RESULTS OF THE VOLUNTARY FOREIGN CREDIT RESTRAINT EFFORT TO DATE? IN PARTICULAR, DOES IT APPEAR THAT THE PRIORITIES FOR EXPORT FINANCING AND FOR THE LESS DEVELOPED COUNTRIES ARE BEING REASONABLY MET?
 - B. WHAT CHANGES DOES THE COUNCIL ANTICIPATE IN THE VOLUME OF U. S. BANK LENDING TO FOREIGNERS OVER THE REST OF THE YEAR?
 - C. AS THE COUNCIL APPRAISES THE BALANCE OF PAYMENTS OUTLOOK, WHAT DOES IT BELIEVE WOULD BE THE BEST COURSE OF GOVERNMENT ACTION IN THIS AREA IN 1966?
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President Moorhead then read Item III. In the discussion which followed the Council concluded that the results of the voluntary foreign credit restraint effort to date seem to have been helpful. However, the large domestic loan demand and the pressure on reserves also have been of assistance in this regard. Apparently priorities for export financing and for the less developed countries are being reasonably well met. The members of the Council do not anticipate any significant rise in bank lending to foreigners in the remaining months of the year. While acknowledging that the voluntary program has been helpful, it may be harmful to the long-run development of the economy. If the program is continued, however, the ceiling should be raised.

As the fundamental adjustments required to balance our international payments have not been made, the Council again urged consideration of a comprehensive program which would include the following factors:

- 1) a further reduction in U. S. economic and military aid overseas;
- 2) a curtailment of defense expenditures in Europe;
- 3) an easing of barriers tending to discourage the repatriation of earnings overseas;
- 4) a narrowing of the differences between domestic and foreign interest rates;
- 5) a continuation and expansion of the program to encourage exports; and
- 6) a continuation of efforts to keep wages and other costs within productivity gains.

ITEM IV

WHAT ARE THE COUNCIL'S VIEWS ON MONETARY AND CREDIT POLICY UNDER CURRENT CIRCUMSTANCES?

President Moorhead read Item IV. Despite the previous discussion on this topic earlier in the day, there was additional comment at this time. The members of the Council expressed concern with the increasing evidence of a development of inflationary pressures, the continued strong demand for bank loans with the reliance on C/D's to meet this demand, and the underlying difficulties with the balance of payments. Consequently, there was some feeling among the members that the Board should move in the direction of further restraint. Presumably this would include a tightening of reserves and an increase in the discount rate.

The meeting adjourned at 12:20 P.M.

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... BOARD BOOK ...
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THE COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING, WASHINGTON, D. C., AT 2:30 P.M., ON SEPTEMBER 20, 1965. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MR. MOORE. MR. JAMES S. ROCKEFELLER, CHAIRMAN, FIRST NATIONAL CITY BANK, NEW YORK, NEW YORK, ATTENDED AS ALTERNATE FOR MR. MOORE.

Members of the Board staff, Division of Research and Statistics, discussed domestic and international economic conditions. Messrs. Albert R. Koch, Associate Director, J. Charles Partee, Adviser, and Kenneth B. Williams, Adviser, participated.

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THE COUNCIL RECONVENED AT 8:10 P.M. ON SEPTEMBER 20, 1965, IN THE BOARD ROOM OF THE MADISON. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MR. MOORE. MR. JAMES S. ROCKEFELLER, CHAIRMAN, FIRST NATIONAL CITY BANK, NEW YORK, NEW YORK, ATTENDED AS ALTERNATE FOR MR. MOORE.

The Council prepared and approved the attached Confidential Memorandum to be sent to the Board of Governors relative to the Agenda for the joint meeting of the Council and the Board on September 21, 1965. The Memorandum was delivered to the Federal Reserve Building at 9:45 P.M. on September 20, 1965.

The meeting adjourned at 9:10 P.M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON SEPTEMBER 21, 1965

1. Economic conditions and prospects.

- A. How does the Council appraise prospects for the U.S. economy during the remainder of the current year? Have recent developments in steel had any significant effect on the Council's view as to the general outlook?

The Council believes that the level of business will rise further during the remainder of the current year. There is a widespread feeling of optimism among businessmen and investors. The rise in business, however, may be moderated slightly by the liquidation of steel inventories accumulated earlier in the year in anticipation of a strike in that industry.

Recent developments in steel have not had any significant effect on the Council's view as to the general outlook except that it has eliminated one uncertainty.

- B. Are Council members aware of any substantial revisions in business inventory policies as a result of changing expectations--reflecting the Vietnam hostilities or other current developments? Have significant revisions been observed in capital expenditure or other business plans?

Except in certain retail lines, the members of the Council are not aware of any substantial revisions in business inventory policies as a result of changing expectations. However, the step-up in military operations in Vietnam and the expansion in defense spending, even though modest to date, have resulted in the general expectation that the uptrend in business would continue, presumably because federal spending would rise further. As a consequence, the liquidation of steel inventories, for example, may be spread over a longer period. The members of the Council have observed significant upward revisions in capital expenditures and other business plans.

- C. How strong does the Council judge pressures to be on businesses from the demand or cost sides to raise prices?

Steadily rising wage and material costs and a continued high demand are both exerting pressure on business management to raise prices.

- D. How does the Council appraise the current status of the bond markets? What trends does it foresee over the rest of the year in interest rates on corporate, municipal, and Government securities, and in the differentials among these rates?

The recent behavior of the bond market is an indication of the continued strengthening of the interest rate structure. The extraordinarily strong demand for bank loans, together with the increased requirements for funds to finance the capital expansion program of business, has exerted an upward pressure on rates despite a continued expansion in the flow of personal savings and corporate cash.

As a consequence, the yields on corporate and government securities are higher than at any time in the past four years and the spread between government bonds and corporate obligations has widened. Yields on municipal obligations are approaching the peak levels of recent years. Despite the rise in yields that has taken place to date, the members of the Council anticipate some further upward pressure on the rate structure and the maintenance or widening of the present spread in yields. Because of the current high volume of bank loan demand, it is probable that the demand of banks for government and municipal obligations will lessen.

2. Banking developments.

- A. What is the Council's appraisal of the factors underlying the more rapid increases in both savings deposits and time C.D.'s that have occurred since midyear?

The increase in savings deposits that has occurred since midyear varies from district to district, reflecting in part changes in interest paid on these balances. The more rapid increases in time C.D.'s are the result largely of the more aggressive bidding for C.D. funds by major commercial banks who have been offering higher rates to obtain funds to meet the borrowing demand.

- B. Does the Council expect business demands for bank credit this fall to be substantially in excess of usual seasonal needs? Does it anticipate any firming of bank interest rates or other lending terms and conditions?

Most members of the Council anticipate business demands for bank credit this fall will be somewhat in excess of the usual seasonal needs. The strength and persistence of the loan demand of banks combined with the somewhat tighter reserve position is exerting upward pressure on interest rates and lending terms and conditions.

- C. What are the prospects for further bank issuance of capital notes and debentures during the remainder of this year and next year?

The very rapid expansion in bank assets that has occurred in recent years, and particularly this year, has tightened the reserve position of most banks. In addition, the capital ratio and the risk asset ratio of some banks have become less favorable. These developments, together with the fact that prevailing rates on C.D.'s are very close to the Regulation Q ceiling, are factors which are likely to result in the additional issuance of capital notes and debentures during the remainder of this year and in 1966.

- D. What are the Council's expectations with regard to near-term developments in the Federal funds market, with respect to both the extent of participation in this market by medium- and smaller-size banks and likely rate levels relative to the discount rate?

The Council believes that the rates in the federal funds market are likely to stay above the current discount rate because of the reluctance of borrowing directly from the Federal Reserve. In these circumstances, an increasing number of medium and smaller size banks are likely to participate in the federal funds market.

3. Balance of payments.

- A. How does the Council appraise the results of the voluntary foreign credit restraint effort to date? In particular, does it appear that the priorities for export financing and for the less developed countries are being reasonably met?

The results of the voluntary foreign credit restraint efforts seem to have been helpful to date, although the large domestic loan demand and the pressure on reserves also have been of assistance in redressing the deficit in the balance of payments. Priorities for export financing and for the less developed countries apparently are being reasonably well met.

- B. What changes does the Council anticipate in the volume of U.S. bank lending to foreigners over the rest of the year?

Since most banks are near the 105 per cent ceiling, the volume of U.S. bank lending to foreigners probably will not rise significantly over the rest of the year.

- C. As the Council appraises the balance of payments outlook, what does it believe would be the best course of Government action in this area in 1966?

Although the voluntary program has been helpful in restraining the outflow of capital, the fundamental adjustments required to balance our international payments have not been made. The present program tends to restrict the movement of goods and capital, and as such may be harmful to the long-term development of the economy. If the program is continued, the ceiling should be raised.

As the Council has indicated in the past, a comprehensive plan is required which would include such factors as the following:

- 1) a further reduction in U.S. economic and military aid overseas;
 - 2) a curtailment of defense expenditures in Europe;
 - 3) an easing of barriers tending to discourage the repatriation of earnings overseas;
 - 4) a narrowing of the differences between domestic and foreign interest rates;
 - 5) a continuation and expansion of the program to encourage exports; and
 - 6) a continuation of efforts to keep wages and other costs within productivity gains.
4. What are the Council's views on monetary and credit policy under current circumstances?

The Council is concerned with the increasing evidence of the development of inflationary pressures, the continued strong demand for bank loans with the reliance on C.D.'s to meet this demand, and the underlying difficulties with the balance of payments. Consequently, we believe the Board should be prepared to move in the direction of further restraint including a tightening of reserves and an increase in the discount rate.

ON SEPTEMBER 21, 1965, AT 10:30 A.M., THE FEDERAL ADVISORY COUNCIL HELD A JOINT MEETING WITH THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM IN THE FEDERAL RESERVE BUILDING, WASHINGTON, D. C. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MR. MOORE, MR. JAMES S. ROCKEFELLER, CHAIRMAN, FIRST NATIONAL CITY BANK, NEW YORK, NEW YORK, ATTENDED AS ALTERNATE FOR MR. MOORE.

THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: CHAIRMAN MARTIN, VICE CHAIRMAN BALDERSTON, GOVERNORS ROBERTSON, SHEPARDSON, DAANE AND MAISEL. MR. SHERMAN, SECRETARY, AND MR. KENYON, ASSISTANT SECRETARY, OF THE BOARD OF GOVERNORS ALSO WERE PRESENT.

The minutes of the joint meeting are being prepared in the office of the Secretary of the Board of Governors of the Federal Reserve System. Their content will be compared with the notes of the Secretary of the Council. Assuming they are in substantial agreement, they will be reproduced and distributed to the members of the Council.

The meeting adjourned at 12:30 P.M.

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The next meeting of the Council will be November 15-16, 1965.

- 1. HOW DOES THE BOARD OF GOVERNORS FEEL ABOUT THE COUNCIL'S RECOMMENDATIONS?
- 2. WHAT ARE THE BOARD'S VIEWS ON THE COUNCIL'S RECOMMENDATIONS ON THE CAPACITY OF THE FEDERAL RESERVE BANKS?
- 3. HOW DOES THE BOARD OF GOVERNORS FEEL ABOUT THE COUNCIL'S RECOMMENDATIONS ON THE NEED FOR A FEDERAL RESERVE BANK IN ST. LOUISIS?
- 4. HOW DOES THE BOARD OF GOVERNORS FEEL ABOUT THE COUNCIL'S RECOMMENDATIONS ON THE NEED FOR A FEDERAL RESERVE BANK IN ST. LOUISIS?
- 5. HOW DOES THE BOARD OF GOVERNORS FEEL ABOUT THE COUNCIL'S RECOMMENDATIONS ON THE NEED FOR A FEDERAL RESERVE BANK IN ST. LOUISIS?