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Discount Administration (September 1 Letter) —— 1966-1968 (1 of 2)

1

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GOVERNOR BRIMMER

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For Information Only

CONFIDENTIAL (FR)

March 4, 1968

B

TO: Board of Governors

SUBJECT: Implementation of Discount Administration

FROM: Division of Examinations

B6f. There is attached a memorandum which summarizes the various matters discussed during the conference call with discount officers on February 28, 1968.

Attachment.

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CONFIDENTIAL (FR)

TO: Division of Examinations SUBJECT: Conference Call on

FROM: Priscilla Ormsby Discount Administration

Another in the series of conference calls to discuss discount administration was held on Wednesday, February 28, 1968, among representatives of the Board staff and the discount officers of the twelve Reserve Banks. The Board staff was represented by Mr. Holland, Mr. Leavitt, Mr. Axilrod, Mr. Bernard, Mr. Baker and Miss Ormsby.

The increased discounting activity reported by some Districts on the January 10 call had become more widespread in recent weeks, and most Districts reported a pick-up in the level of borrowing. This was now attributed in most cases to the somewhat tighter monetary conditions and resultant increase in the Federal funds rate, currently averaging about 1/4 to 3/8 of a percentage point above the 4-1/2 per cent discount rate. This was clearly seen in the case of a downtown St. Louis bank, typically a fairly heavy buyer in the funds market, which had temporarily reduced its funds purchases by approximately 50 per cent and made up the difference by borrowing at the discount window. Some of the increased borrowing was also seen as resulting from seasonal pressures.

While increases in borrowing were numerous, not all Districts were involved. Discounting activity was still fairly light in the Dallas District and had actually decreased in the Philadelphia District. However, banks in the Eleventh District were net purchasers of Federal funds and, in a development of possible significance, the country banks in the

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Third District, long recognized as unusually heavy net sellers of funds, had apparently changed their practice in this regard. Funds purchases by these banks had increased and sales had declined, so that, while they were still net sellers, this margin had been rather substantially reduced. No ready explanation for this change more specific than the developing tightness of general monetary conditions was available to Reserve Bank officials, although it was suggested that some banks might be using their excess funds to buy Treasury bills.

Scattered instances of administrative contacts with extended borrowers were reported through the System, but in general the increased borrowing was apparently being done by a changing sample of short-term borrowers. Thus System pressure on borrowing banks to adjust was not now contributing in any significant way to the tightening of money and credit conditions, nor was it expected to do so in the immediate future.

In the Second District one of the major money market banks had been at the discount window several times recently for relatively large amounts, and the prospective withdrawal of that bank from the window might have some effect on the money market. However, the bank had a good borrowing record and had not yet approached the threshold of administrative contact in its current borrowing span. It was also noted that this bank was running a comparatively light basic deficit in its reserve position, and the effect of its repayment of borrowing on the market was therefore likely to be less prounounced than that which might result if it were more heavily over-invested.

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Seven of the twelve Reserve Banks reported recent instances of borrowings by a number of member banks which had previously been strangers to the discount window. Both country and reserve city banks were included in this group, although the majority seemed to be country banks, and the date of their last borrowing ranged from October of 1966, in the case of a First District reserve city bank, back as far as the 1930's in some other cases. It was suggested that this development might reflect some change in member bank attitudes toward the discount window, but it was felt this was probably not the case, since there was currently a clear incentive to borrow resulting from the relatively high Federal funds rate and the shortage of funds in that market.

Mr. Holland repeated a suggestion first made during the conference call of April 14, 1967. This was for the establishment of a reporting system whereby the Reserve Banks would submit weekly a breakdown of borrowing activity based on whether or not administrative pressure to adjust was being exerted (or was about to be exerted) on the borrowing banks. Such information would be useful to the Trading Desk and to the staff of the Federal Open Market Committee, since the response of the banking system -- and therefore of overall bank credit and money market trends -- to a given level of borrowing was not invariant, but depended on a number of factors including where in their borrowing spans the banks were (i.e., how subject to the pressure of administrative discipline). In response to questions, Mr. Holland suggested that informational contacts were of no concern for this purpose and that Reserve

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Banks should therefore report only contacts where some degree of pressure to adjust was actually exerted on the subject bank.

While such pressure on an individual small bank was not significant for the money market, Mr. Holland noted that in a period of high borrowing the aggregate amount of adjustment undertaken by all contacted country banks could reach a level of real importance for market conditions and it therefore would probably be unwise to limit the reporting system to the larger banks. It was seen as important that the amount of information requested be held to a minimum, however, and a compromise was suggested which would call for six numbers from most Districts and eight from New York. This compromise would employ the breakdown already used in the Federal funds reporting system: 8 major money market banks; 30 other money market banks; all other reserve city banks; and all country banks. For each of these categories the Reserve Bank would report each Wednesday the average dollar amount of borrowing in the reserve computation period just ending by banks currently subject to administrative pressure to repay and the amount by banks which would become subject to such pressure if their borrowing continued into the next reserve period. Mr. Holland agreed to prepare a memorandum outlining this proposal and distribute it to the discount officers for comment.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date November 9, 1966.

To Governor Brimmer

From Merritt Sherman

St. Louis was among the four banks that proposed an increase in the discount rate on July 14, 1966. Each of the four banks (New York, Cleveland, St. Louis, and Chicago) proposed an increase from 4-1/2 to 5 per cent; St. Louis gave no statement of reasons for the action.

Attached is a copy of the Board's letter of July 16 stating reasons why the Board did not approve a rate increase. Also attached is the copy of the New York Bank's letter of July 14 stating the basis of the directors' action, as well as a copy of their letter of July 22 commenting on the Board's letter of July 16. Previously (on July 6) Mr. Hayes had sent Governor Robertson a confidential memorandum of notes on possible discount rate action, a copy of which was furnished to you on July 7.

Also attached is a copy of the Philadelphia Bank's letter of September 2 regarding subsequent action taken by that Bank on the discount rate, as well as a copy of a telegram from the Minneapolis Bank dated August 19 presenting reasons for action taken at that time by Minneapolis directors.

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BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

DATE 9/12/67

TO Gerri

FROM *Andrew F. Brimmer*

Please put in file on "Discount Administration".

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

September 8, 1967.

TO: Governor Brimmer

FROM: Robert C. Holland

In connection with his assignment to review the September 1 letter experience for the purposes of the discount study (see attached prospectus), Dave Melnicoff is trying to talk to each of the Governors involved. He has already talked to Governors Mitchell, Maisel and Robertson, and would like to arrange to talk to you at the first opportunity.

He asked me to see if your schedule permitted you to see him any time next Monday, September 11--if so, he could jump on the train and run down. If that isn't workable, he may check with your secretary on Tuesday in the hopes of finding some open time at a later date. I would guess he would take about a half-hour of your time.

Attachment

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April 19, 1967

FUNDAMENTAL REAPPRAISAL OF THE DISCOUNT MECHANISM

TO: The Steering Committee

FROM: The Secretariat

SUBJECT: Project #29 Analysis of the "September 1 letter" and its program of coordination of Discount Administration with other aspects of Federal Reserve Policy

The purpose of this paper will be a close retrospective analysis of the temporary modification of the discount mechanism, announced in the letter of September 1, 1966 -- its impact on the banking and business community, its effectiveness in achieving System objectives, and its implications for change in the future. For some years, the discount mechanism had been used as a passive "safety valve" for pressures generated by other policy instruments. The September 1 Program represented an attempt to utilize the discount mechanism as a more active tool that, in coordination with other monetary actions, could alter the extent and distribution of monetary restraint.

The stated aims of the September 1 Program were subject to varying interpretation in the banking community. Within the System itself there has been some question about the Program's success in attaining its objectives; and, in fact, the actual course of events during September and October was different from expectations. The paper will attempt, with hindsight, to explore the extent to which the deviations from expectations were the result of independent events in business and banking, active opposition to the Program, failures of communications, or a misconception of the nature of current problems and their origins.

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The September 1 Program was invoked under the "exceptional circumstances" and "sound credit" sections -- 201.0(d) and (e) -- of Regulation A. To this extent it could be said that the Program was within the scope of prevailing "rules of the game." Those sections, however, had recently been rather narrowly construed -- paragraph (d), to apply as a response to circumstances beyond the control of particular banks or of the banking system, and paragraph (e), as a negative constraint available in extreme cases involving individual institutions. The "purpose of the credit" and its effect on "sound credit conditions" referred to in paragraph (e) were often looked upon as quaint holdovers from the real bills doctrine. In broadening the meaning of these sections, the Program indicated a concern with structural and institutional factors in the monetary system. This paper will not be aimed at judging the basic validity of that concern on the part of the Federal Reserve System; but it will try to weigh the efficacy of the September 1 letter technique, recognizing that such efficacy is partly dependent upon the degree of acceptance of the underlying objectives.

The September 1 Program anticipated a considerable administrative burden on the Federal Reserve Banks and their discount officers. The mechanisms conceived and finally adopted to cope with problems of administration should be appraised not primarily, as it turned out, for their effectiveness in administering the Program, but for the possibilities they suggest for use in the future. Similar considerations would apply also to the Program's implications for coordination and cooperation between the discount window and the supervisory and open market functions of the System.

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For Information Only

CONFIDENTIAL (FR) September 25, 1967

TO: Board of Governors SUBJECT: Implementation of Discount Administration

FROM: Division of Examinations

There is attached a memorandum which summarizes the various matters discussed during the conference call with discount officers on September 14, 1967.

Attachment.

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CONFIDENTIAL (FR)

September 18, 1967

TO: Division of Examinations

FROM: Priscilla Ormsby

SUBJECT: Conference Call on Discount Administration.

Another in the present series of conference calls to discuss discount administration was held on Thursday, September 14, 1967, among representatives of the Board staff and the discount officers of the twelve Reserve Banks. The Board staff was represented by Mr. Holland, Mr. F. Solomon, Mr. Leavitt, Mr. J.C. Smith, Mr. Sundberg, and Miss Ormsby.

Without exception, discounting activity was reported as having continued extremely light through the summer. Borrowing by country banks in the Kansas City District was showing some seasonal increase, but was still significantly below the typical level for this period. However, both the Kansas City and Chicago Banks foresaw a possibility of increased country bank borrowing, as a result of the large grain crops which were expected to be harvested.

Mr. Holland reported that analysis prior to the September 12th meeting of the Federal Open Market Committee had pointed up the possibility of some tightening of the market atmosphere during September. This forecast was based largely on technical factors, including the September 15th corporate tax date and the probable end-of-month Treasury financing; but it could result in Federal funds being less readily available from time to time and some of the adjustment needs currently being filled through this source could rebound to the discount window.

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In some Districts, business loan demand had increased, but remained below bankers' expectations. Mr. Berge (Boston) suggested that this might be the result of efforts to sharpen up internal financing operations on the part of corporations fearing a repeat of the 1966 credit squeeze. Mr. Leonard (St. Louis) reported that corporate treasurers in the Eighth District had characterized much of the borrowing that was occurring as anticipatory, since current liquidity positions were more than adequate.

The only area reported as experiencing any strong credit demand was the northwest sector of the Twelfth District, around Tacoma, Washington. Both business and mortgage loan demands were strong in this rapidly developing area. In those few other instances where business loans had increased significantly over 1966, deposits had increased at a greater pace and banks were enjoying easier liquidity positions. Banks in most Districts still expected a stronger increase in business loan demand during the fall.

With many banks holding excess liquidity, Federal funds were readily available, as noted above, typically at rates very close to the discount rate. Bank demand for Government and municipal securities was relatively strong, and Mr. Berge (Boston) reported that the prevailing rate pattern was leading a number of the small banks in the First District to buy Treasury bills in preference to selling funds.

Maximum rates being posted on negotiable certificates of deposit ranged from 5-1/8 to 5-3/8 per cent. New York banks were reported to be offering the ceiling rate of 5-1/2 per cent in isolated cases. In the

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Chicago District the rate had reached 5-1/2 per cent for a time in August, but was now back to about 5-1/4 per cent. Mr. Cowan (Dallas) reported that few of the Eleventh District banks were selling C.D.'s with maturities in excess of six months.

Mr. Moffatt (Chicago) reported that a correspondent bank in the Seventh District had been asked by its country bank customers to provide lines of credit. This suggested that these smaller banks expected funds to be less plentiful later in the fall and were unsure of the availability of discount window accommodation. There had even been a hint that these banks feared the possible issuance of another "September 1 letter". The correspondent bank had refused these requests and planned to continue providing credit in the normal manner.

Funds were reported as being plentiful in the mortgage market, and the rates on mortgages were steady to slightly higher. Savings and loan institutions and mutual savings banks, like commercial banks, continued to attract ample funds and were extremely liquid in general. Mr. Merritt (San Francisco) reported that savings and loan institutions in the Twelfth District fell into two categories: those that were not borrowing from the FHLB and those that seemed to remain chronically illiquid regardless of the prevailing monetary atmosphere.

Chairman Martin and President Hayes of the New York Bank had both testified earlier in the day before the House Ways and Means Committee on the 10 per cent surtax proposed by President Johnson, and Mr. Holland reported that they had both predicted sharp increases in interest rates in the absence

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of a tax increase. The Committee had appeared to be generally opposed to such an increase and still favored spending cuts as an alternative or at least a quid pro quo for a tax measure.

Also Governor Robertson had testified before the House Banking and Currency Committee on the proposed extension of the 1966 law enabling the Federal Reserve to impose differentiated ceilings on C.D. rates on the basis of face amount (the same law gave the FDIC and FHLBB the authority to impose interest rate ceilings on mutual savings banks and savings and loan institutions and permitted open market operations in securities issued by agencies of the Federal Government). There seemed to be little doubt as to the passage of this extension, but a rider had been added to the bill calling for GAO audit of the Federal Reserve. This same rider had also been added to the "eligible paper bill".

The Committee members seemingly remained generally opposed to GAO auditing of the System, but not with the same solidity as had been apparent in the past. There was discussion of a possible compromise which might enable the GAO to "add up the numbers" but avoid the loss of System independence which seemed likely to accompany acceptance of standards GAO auditing procedures. The Administration was also opposed to the auditing proposal, but less firmly than was the System.

It was expected that the rider would be dropped from the interest rate bill, but several Committee members (i.e., Chairman Patman and Congressman Annunzio) were continuing to push strongly for the proposal. Therefore it was expected that it would be retained on the eligible paper bill or might be introduced as a separate bill.

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Several Districts reported new applications for or grainting of V-loans as scattered defense financing needs continued to appear. However, in at least two Districts V-loans had been paid off, one after having been carried for fifteen years.

Mr. Euans (Kansas City) reported that the reserve city banks in the Tenth District which had shown up in the records as a continuous borrower for some time had actually been out of debt and had bben listed as the result of a computer error.

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Credit Rationing in an Inflationary Situation*

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*Prepared by Stanley J. Sigel

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April 25, 1966

Credit Rationing in an Inflationary Situation*

The anti-inflationary role that monetary policy is now playing has raised many questions relating to credit rationing. The purpose of this memorandum is to discuss some of the general issues involved in order to provide perspective and background for more specific and operational discussions.

Summary

The memorandum centers around three major questions related to a possible policy role for credit restraint or rationing -- what are the objectives of credit rationing in the current situation; is credit rationing likely to be successful in meeting these objectives; and, given the objectives, what should be the criteria established for the rationing. The applicability of previous experience with credit rationing to the current situation is also briefly considered.

A major objective seen for the policy encouragement of rationing in the current situation is the limitation of the interest rate increases that might otherwise ensue with the pursuit of an effective anti-inflationary monetary policy. Credit rationing can undoubtedly bring about a significant limitation in interest rate increases for particular assets or particular groups of assets. It can probably also achieve some limitation in the increase in average rates for the whole range of financial instruments. How significant the limitation for average rates would be would depend on the particular rationing

*Prepared by Stanley J. Sigel.

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scheme adopted and on the relative interest rate responses to changing availability of funds of the various credit instruments. For the limiting of average rate increases, there is a possibility that credit rationing might not, by itself, be sufficient.

Another major objective for which credit rationing could be effective in the current situation is to help limit the expansion of credit in circumstances where the monetary authorities feel that it would be unwise to restrict credit solely by direct monetary policy actions.

If credit rationing is to be encouraged as a policy matter, it may be necessary to provide a set of criteria for guidance in carrying it out. In the current situation, criteria primarily in terms of the impact of various credit uses on the immediate inflationary situation would seem to be more appropriate than criteria based primarily on a distinction between productive and nonproductive uses of credit.

The general objectives of credit rationing in the present situation are quite different from the purposes of the general credit restraint program at the time of Korea and the more limited present program in connection with foreign lending. The experience under those two programs thus has limited applicability to the present situation.

What is meant by credit rationing

Credit rationing, taken at its most general, covers all means and criteria other than interest rates for allocating credit. A situation in which interest rates were the sole allocative factor and in which there was no rationing would be one in which

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lenders made no distinction at all among borrowers except on the basis of their willingness to pay the rates, the degree of risk and the costs of handling their business; in which everyone could borrow all he wanted at the going rate of interest adjusted for differences in degree of risk and handling costs; in which, if total credit demanded at a given rate differed from the amount available, interest rates would move promptly and flexibly until the response of borrowers to the rate change was such as to match the demand to the supply.

This, of course, never describes the actual credit situation. A significant part of the allocation of credit is usually performed on a rationing basis rather than on a price basis. Lenders, as a matter of practice, are seldom willing or able to lend to all comers on an equal footing, letting price alone determine who gets the limited supply. Such considerations as portfolio balance, liquidity needs, customer relations and preferences, community relations, supervisory agency attitudes, and expectations of various kinds also enter in. Moreover, situations may arise, particularly where adverse expectations are set up, in which the raising of rates within practical or legal limits would not succeed in dampening the demand for credit sufficiently to keep it within the amount available. In such situations, rationing takes on a larger role.

The continuing presence of credit rationing that arises out of normal financial operations forms the background but not the focus of the current interest in credit rationing. The questions raised in the

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present economic context have more of a policy orientation -- should the monetary authorities take steps to encourage or enforce rationing over and above what might have occurred in any case, at what purposes should the additional rationing aim, what form should it take, and what should the criteria be.

The prospective situation and credit rationing

What are the major elements of the prospective situation that seem to have been the occasion for the current discussion of possible policy roles for credit rationing? The economy faces a potentially inflationary situation where for some time the brunt of providing the needed restraint is likely to fall on monetary policy, even if an ultimate decision is made to increase taxes. Interest rates have already risen significantly. The added restraints that may be needed could, in face of the strength of demand for credit, produce still higher rates and potentially undesirable developments in the structure of relationships among various types of financial institutions and among different credit markets.

It is in this context that concern is mounting about the effects of leaving exclusively to the market mechanism the determination of the relative weights to be given to price and nonprice factors in allocating credit. Attention has been directed toward the possibility of introducing, as a policy matter, further nonprice elements in credit markets, of urging restraint and rationing different from or greater than that which would result from market processes alone.

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Various objectives of credit rationing

In discussions of the possible need for further credit rationing, a variety of different objectives have been enphasized or implied. While these various purposes may to some extent overlap -- and they are not always differentiated in discussion -- the form and function of credit restraint could be quite different depending on which objectives are being sought or which are given priority. The major types of objectives to be discussed here can be summarized as follows:

(a) To moderate the rise in the general level of interest rates that is likely to occur in a situation where monetary policy is succeeding in keeping down the total availability of credit.

(b) To influence the distribution of credit within an otherwise adequate total in order to keep down particular interest rates (e.g., on U.S. Government securities) or groups of rates (e.g., on long-term securities).

(c) To help limit the extension of total credit in a situation where monetary policy is not or can not be sufficiently restrictive to keep the potential expansion in credit down to noninflationary levels.

(d) To promote the flow of credit to certain uses (e.g., "productive uses" or specific uses deemed essential by overriding military or political considerations) or away from certain uses (e.g., "unproductive credit," foreign loans, uses creating specific inflationary pressures). Attention to specific uses may arise as an incidental outgrowth of pursuit of other objectives as well as being desired for its own sake.

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The concern about high interest rates

One major reason for some of the increased interest in credit rationing as an element in monetary management is a fear that the degree of monetary tightness necessary to contain the inflationary pressures of the coming years, particularly in the absence of a tax increase, may result in undesirably large increases in interest rates. Concern centers around such factors as (a) the ability of financial markets to perform adequately in an environment of steeply rising rates and extreme uncertainty; (b) the threat of rising rates to the stability of some financial institutions and to the relationships among various types of institutions as rate competition feeds on itself; (c) the dangers of building into financial relationships levels of interest rates that may prove to be quite temporary, leaving some borrowers saddled with peak rates and some lenders facing impaired flexibility; (d) the creation of expectations that can produce cumulative effects; (e) the distortions caused by institutional inflexibilities in the rate structure, such as the usury laws and the legal limit on Government bond rates; (f) the complications that may arise in Treasury financing operations; (g) restrictions on future Federal Reserve maneuverability as banks acquire high-cost deposit liabilities; and (h) questions of equity with respect to asset values, costs, and income flows.

If, for these or other reasons, the desirability of limiting the rise in interest rates is accepted, what role can credit restraint or rationing play in achieving such a limitation in a situation where

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total credit availability is adequately restricted by monetary action? The problems involved in keeping rates down and the role of credit rationing in this depend on whether the focus of concern is on rates for the whole range of credit instruments (i.e., loans and securities, short-term and long-term), for a class of credit instruments (e.g., long-term securities), or for a single type of security (e.g., Federal securities). Let us consider first the broadest case.

The role of credit rationing in limiting increases over the whole range of interest rates. Rationing and interest rates are alternative means of allocating credit. It is thus natural to try to keep down the average level of interest rates by a system of credit rationing, without resorting to guidelines or other means of guidance with respect to the rates themselves. With total credit adequately determined through other mechanisms, the rationing of credit among different claimants on the basis of some administratively-suggested set of criteria would tend to produce a different structure of rates, and would probably in many cases serve to limit the increase in average interest rates. . . How significant this limitation would be in any specific situation would depend on the particular rationing scheme adopted and on the relative elasticities and institutional rigidities for the various rates.

A rationing system may eliminate whole classes of loans or borrowers or, less drastically, it may set quotas or otherwise favor some categories over others. In either case, there would seem to be little question that the rationing would limit the increase in rates in the

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favored categories. It might also so reduce the total market for credit that the total permitted expansion of credit could take place at average rates of interest significantly below what they would otherwise have been.

The situation in which there would be the best chance for credit rationing by itself to temper the average increase in interest rates is one where the rationing, whether by design or inadvertently, favors those parts of the portfolio where the elasticity of interest rates is high over those where it is low. (This may not always be an available path to the goal, since in some cases the pattern of credit flows set with reference to relative elasticities may be undesirable on other grounds.) If interest rates in the excluded or less favored types of borrowing are not particularly sensitive to a reduction in the supply of credit available for them, any limiting of rate increases in the favored categories would tend to be a net gain.

A note of caution is needed, however. Credit rationing may not necessarily in all cases be sufficient, by itself, to provide a significant limitation to the upward movement of average rates. If the restraints were imposed, say, only on commercial banks, some of the excluded credit demands might be able to shift to other sources. If these other lenders shifted away from credit uses favored in the rationing scheme in order to accommodate the excluded categories, some of the pressure might be shifted back to the banks where it would show up in the form of increased demand in the favored categories.

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This suggests that a system of restraints would have a greater chance for success if it covered nonbank financial institutions as well as commercial banks. The flexibility of the financial mechanism and its great ingenuity in quickly adapting itself to new situations and pressures can be expected to act in the direction of frustrating the purposes of guidelines applied solely to banks.

Even where the rationing scheme did cover all institutional lenders, however, or where the excluded borrowers (or types of loans) did not have ready access to other financial institutions, analogous shifting of some of the pressures into other forms might take place. For example, some of the excluded borrowers might be able to rework their financial arrangements so as to bring some of their credit demands within the favored categories; some excluded borrowers might get credit extensions from their suppliers or customers whose credit demands did come within the favored categories; some excluded borrowers might be able to sell to the lenders financial assets that did come under the favored categories.

These processes of shifting, to the extent that they occurred, would themselves have some effect on interest rates. The "other" lenders are unlikely to shift portfolio composition except under the incentive of higher rates offered by the borrowers put at a disadvantage by the rationing scheme. Similarly sales of financial assets by such borrowers will tend to keep up pressure on these market rates.

Even without this kind of shifting, the pressures of demand in the unfavored categories of borrowing are likely to be such that

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interest rates on these forms of credit could be expected to rise at least somewhat more rapidly than they would have in the absence of the rationing. This would have the effect of offsetting to some extent the limitation on rate increases achieved in the favored categories.

Even in the most favorable case where the division between favored and unfavored is -- either deliberately or fortuitously -- on the basis of relative elasticity of interest rates, some offsetting may occur. Thus if the elasticity of interest rates is low in the unfavored categories because of a nonprice allocating mechanism -- i.e., the lenders, for one reason or another, do not usually move the rate in response to demand pressures -- rather than because of a high interest-elasticity of demand for credit, the mounting pressures of demand in the nonfavored areas may lead the lenders to exploit the situation by resorting to a greater than usual use of interest rates as an allocative mechanism in these areas. As a consequence, even in this case, there is a possibility that there is some offset to the limitation of rates in the favored categories.

These various offsets and shifting of credit demand pressures are not likely to be of sufficient magnitude to change the general conclusion that a system of credit rationing operating within an adequately restricted total credit expansion could probably achieve a significant limitation in the rise in average interest rates. But it is not a sure thing and cannot be relied on absolutely. There is a chance that, to achieve the desired limitation, credit rationing by itself would

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not be enough and would have to be supplemented by a system of restraint or guidance in terms of the interest rates themselves.

The adoption of such a supplementary program calling for restraint on interest rates themselves would itself change, to some extent, the nature of the credit rationing. With rates lower than they otherwise would have been, there is a larger amount of would-be borrowing at the going rate to be cut out of the market and thus there is more rationing and probably a different allocation of credit. Limitations of this kind on interest rate movements would undoubtedly lead to increased emphasis on long-run customer relationships, closer attention to compensatory balance considerations, etc.

Paradoxically, such limitations might also lead to closer attention to short-run profitability. To the extent that nonprice rationing had already been playing a considerable role in portfolio practice, the relative rates charged to various customers or for various types of loans would not have represented a complete profit maximization, at least in the short-run. In this circumstance, any administrative guidance or limitation on the freedom of rates to move might very well result in a shift toward those assets that are relatively profitable.

Both of these factors -- a shift toward more profitable asset classes (i.e., a shift away from nonprice to price considerations), and, within each asset class, a greater stress put on nonprice considerations -- are likely to bear with different weight on various loan and customer categories, resulting in a different composition of credit. Since there is no reason to suppose that the results of these

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shifts in the pattern of lending would automatically accord with what may be considered to be the economy's needs, there is a possibility that the guidance on rates that was adopted as a needed supplement to the credit rationing would in turn require a still further strengthening of the credit rationing system itself.

Limiting the rise in interest rates on a single asset or a single group of assets. The preceding discussion has taken the objective to be the limiting of increases in average interest rates for the whole range of financial assets. The objective of the credit rationing, however, might be the narrower one of limiting the rise in a particular group of rates -- say on marketable public issues of the U.S. Treasury, or on all long-term securities as a group. Here, as has already been implied in the previous discussion, the picture is somewhat clearer than for the general case and the chances of success better.

Credit rationing in the form, say, of a compulsory secondary reserve, which could be applied to nonbank institutions as well as to banks, could certainly result in Treasury rates that were below what they would otherwise have been. Rationing in favor of Government issues, or securities in general, in order to keep their rates down does not, of course, have to take the direct form of requiring or encouraging purchases of these securities. The emphasis can, instead, be put on encouraging rationing or restraint with respect to the rest of the portfolio -- i.e., with respect to loans. With the total of credit determined, restraints on loan expansion can provide a greater market

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for securities, or prevent the liquidation of securities that might otherwise occur as banks respond to loan demand pressures.

Even where the focus is on a given rate or group of rates, there may still be some concern about what happens to other rates or to average rates. In some discussions of limiting particular rates through rationing, however, there does often seem to be an implied belief that these other rates will not move, are not important, or will not be noticed. But, as discussed above, with the total of credit given, other classes of assets might show an accompanying increase in rates greater than what would have occurred otherwise, the extent of this depending on the relative elasticities and institutional rigidities for the various rates.

Patterns of credit use as the objective. The objective sought in credit rationing within a given total of credit expansion may be the channeling of credit into, or away from, specific uses rather than a limitation on increases in interest rates. In any given situation, there is probably a mixture of the two objectives. The keeping down of rates is often so linked in discussion with the fostering or discouraging of certain credit demands that it is difficult to be sure which is the end and which is the means. For example, in calls for restraints on bank loans, it is not always clear whether the intended purpose of such restraint has to do with interest rates on Government and other securities or with the feeling of a positive need to limit bank loans per se.

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However, the two general objectives -- rates and patterns of credit use -- are not necessarily linked together operationally. It is possible to conceive of keeping interest rates down without changing in a predetermined fashion the allocation of credit; and, conversely, it is possible to conceive of changing the allocation of credit without achieving a predetermined level or structure of interest rates. Since different ways of going about the rationing may yield different combinations of rates and credit flow results, it is important to be clear on what is really wanted from the rationing -- to keep interest rates below what they would have been; to make the channeling of credit different from what it would have been; or both.

Credit restraint as a determinant of total credit

The situation examined so far has been one in which credit restraint and rationing had the objective of limiting rate increases and influencing the composition of borrowing within a suitable total volume of credit expansion determined by the customary policy procedures of the monetary authorities.

Current discussion on credit restraint and rationing, however, is often in terms that suggest a different situation and a different objective for credit restraint. This other situation is one in which the monetary authorities have not, by their own actions (i.e., other than calling for restraint), limited the creation of reserves to the amounts called for by the economic situation but have instead permitted conditions in which the amount of total credit that banks and other financial

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institutions could grant is greater than the amount that is deemed appropriate. Consequently, restraint is asked of financial institutions in order to keep the total of credit extended within appropriate limits, which is less than the lenders could provide if they so chose and would provide if they acted in their usual fashion.

What are the circumstances under which this role would be given to "restraint," in which the monetary authorities would refrain from themselves limiting reserves to the proper amount? It might conceivably come about where the monetary authorities felt

(a) that to tighten credit sufficiently to eliminate the excessive lending potential would by itself result in too sharp interest rate increases; or

(b) that Federal Reserve support of Treasury operations precluded an adequately restrictive policy; or

(c) that an adequately restrictive policy would so demoralize and disrupt the financial markets as not to be worth the risk; or

(d) that a sufficiently restrictive policy would put a disproportionate and inequitable burden of adjustment on the commercial banks; or

(e) that they could not adequately control total credit through usual procedures and therefore wanted other means of influencing the total.

The restraint expected of the banks in this type of situation can be interpreted in two ways, depending on the nature of monetary

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policy operations. In one view, the monetary authorities can be considered to take actions, in order to limit interest rate increases, that actually create more reserves than are deemed generally appropriate. In this case, the restraint asked of the banks, in order to prevent overexpansion of credit, is to carry more excess reserves than price and other economic considerations might otherwise lead then to and thus to lend less than they might otherwise do with that amount of reserves.

Such a restraint program would be a kind of voluntary increase in reserve requirements. The impact of this kind of restraint would differ, however, from that produced by an increase in reserve requirements, mainly because of distribution differences. The distribution of direct impact of an increase in reserve requirements would depend on the distribution of excess reserves and of deposits among member banks; the distribution of direct impact of a restraint program would depend on the nature of the guidelines set down and the distribution of assets among the lending institutions covered. The direct impact of a change in reserve requirements would be only on member banks, whereas the immediate burden of a restraint program could be spread to all commercial banks or to the entire range of financial institutions.

In the second view, where the Federal Reserve is considered to be responding to market pressures in the provision of total reserves (in the short run, in any case), the restraint asked of banks is not in relation to reserves but in relation to the demands for credit put upon them. They are asked to restrict their lending in order to minimize the market pressures that would result in the creation of more reserves -- reserves that the Federal Reserve would allow to be created if so

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pressed because of a desire to limit the increase in interest rates. The restraint in this case does not lead to larger excess reserves but rather to smaller total reserves than would have come about without the restraint.

The two views of the meaning of credit restraint as a means of limiting total credit flows probably do not yield precisely the same impact on interest rates. This difference will not be dealt with here in considering what might be the impact on rates of this kind of restraint on total credit flows.

In dealing with the question of impact on interest rates, it is necessary to specify with what other situation the comparison is being made. Thus comparison might be made with the situation where no restraint or rationing was put on credit and where the Federal Reserve created or allowed to be created more reserves and more lending than the economic situation called for. As compared with this situation with its excessive credit extensions, a system of restraint simply on the total of credit each institution could extend would almost certainly produce higher interest rates.

On the other hand, when compared to the situation where monetary policy had been adequately restrictive (and assuming that the total credit set for the economy in the rationing system is approximately what the monetary authorities consider to be the appropriate amount), this kind of restraint would probably result in lower interest rates. How much lower would depend not only on the fact of restraint on total lending but also on how lenders set about allocating credit among those

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making demands on them. Assume the total amount of credit expansion under the restraint program to be the same as what would have been produced under a directly restrictive monetary policy. If banks in their relations with their customers resort to the same combinations of price and nonprice allocation in the former case as they would have in the latter case, the effect that restraint on total credit expansion by itself would have in limiting the rise in interest rates below what would occur under a directly restrictive policy would be minimized. If the restraint on total credit, however, is accompanied by restraint or rationing programs directed toward lending institutions' relations with their customers and toward the composition of their portfolio, the impact on interest rates could be substantial. (The qualifications mentioned in the earlier discussion and the consequent possibility that such credit rationing programs might have to be supplemented by guidance on the rates themselves would also apply here.)

Restraints in relation to interest rates on deposits. A restraint program directed at total credit could also have substantial effects in limiting interest rate increases through its impact on the rates that financial institutions pay on funds deposited with them. Where restraints are put on the total credit expansion of financial institutions, there is less incentive for the lenders to engage in aggressive com petitive bidding up of deposit rates. Thus, to the extent that competitive driving up of deposit rates may result in a spreading circle of higher interest rates in important segments of the

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money markets, restraint on total credit expansion may have an important influence on limiting interest rate increases generally.

In addition to the restraints working indirectly in this way on deposit rates, there may also be a role for restraints directly aimed at these rates. Such a policy of direct restraint on competitive bidding for deposits would not necessarily change total credit expansion, assuming that the Federal Reserve makes adjustments in reserve availability that are called for by differences in reserve requirements for different types of deposits and for deposits at different types of institutions. But it undoubtedly would change the institutional location of deposits. The change in deposit distribution can in turn affect the distribution of credit among borrowers and types of instruments to the extent that portfolio practices of the various financial institutions affected are significantly different and inflexible. Such a change in the pattern of total credit may or may not be consistent with the aims or needs of the rest of the anti-inflationary program.

Criteria for credit guidelines

There are various circumstances in which it might be desirable to include in the restraint program a specific structure of guidelines or of criteria with respect to the rationing of credit. This may come about as a major element of the program where there are specific and compelling reasons to channel credit one way rather than another. It may also come about as an incidental, but important, part of a more general approach, where the credit guidelines are wanted not for their

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own sake but because without them it might be more difficult to push forward or keep control of the main policy of restraint.

The discussion so far has made no reference to the various criteria that might be behind the guidelines for allocating credit. The spelling out of specific guidelines may turn out to be an important part of the program, particularly if it is found that general exhortations for restraint unaccompanied by guidelines that are carefully geared to what is needed bring forth responses inappropriate to the given situation.

Inflationary impact as a criterion for rationing. The current discussion of rationing arises from a need to contain a threatening inflation without bringing about levels and rates of change of interest rates that are considered excessive. In this circumstance, a reasonable set of criteria for credit rationing would be one directly addressed to the problem at hand, that is, one in terms of the impact of various credit uses on the immediate inflationary situation.

Such a system of criteria based on inflationary impact would have several elements. Some of the criteria would have to do with discouraging loans that finance expenditures hitting in areas that are particularly likely to lead to price rises. Consumer and business loans to finance purchases of goods that were in ample supply would not be discouraged, but consumer and business loans that financed demands for goods in tight supply would be discouraged.

Another element of such a general system of criteria would be to favor those business loans where there was a fairly immediate payoff

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in increased production or the maintenance of present production lines. Conversely, those business loans that put demand on present resources but lead to increased capacity only some years hence would not be favored. Inventory loans would thus be favored if there were no bottlenecks in the production of the goods in question, but discouraged if the goods were in short supply; favored if such loans contributed to maintaining or increasing the present pace of a production line, but discouraged if they contributed to the speculative holding of goods off the market or if they were in connection with work-in-process not due on the market for some time or the piling up of materials to be used in constructing a plant not due to come into production for some time.

Since a major objective of the credit rationing in the present context is to limit increases in interest rates, another group of specific criteria arising from the emphasis on strategic inflationary impact would be addressed to impact on interest rates. Loans whose ultimate effect was to lower interest rates would, other things being equal, be favored over those whose ultimate effect was the opposite. For example, loans to purchase stocks would be favored or discouraged depending on whether they are deemed to have such an effect on stock prices, on expectations, and indirectly on trading on debt securities as to lead to downward or upward pressures on bond yields. This factor in the guidelines for security loans would, of course, be additional to those stemming from considerations of whether such loans contributed to stock market behavior that was desirable or undesirable in itself in terms of effects on

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inflationary pressures and to those in terms of the use of the proceeds of the securities sold by means of such loans.

Thus under a system of criteria based on immediate inflationary impact, some uses of credit would be positively encouraged, some would be positively discouraged. Any that were neutral with respect to major inflationary effect would not be discouraged simply because they were not "productive." For example, so-called takeover loans, usually regarded as of low social priority in a situation like the present, would be discouraged under this system of criteria only if they had a definite deleterious effect in the developing inflationary situation.

Difficulties in "inflationary impact" as a criterion. Several problems arise in attempting to use inflationary impact as the principle for drawing up criteria for credit rationing. There is a question of time horizons. How immediate is the immediate impact in improving the inflationary situation? It clearly covers a business loan that will lead to increased production in a week or a month, but how about 3 months or 6 months or a year? The answer to this obviously depends in part on how long the inflationary crisis is expected to last, but it also depends on when other anti-inflationary policies can be expected to take over from rationing.

Moreover, the inflationary impact of specific extensions of credit, even within relatively short time horizons, may not be obvious in all cases. This is partly a matter of the complexity of the industrial system. Even assuming that we knew the immediate impact of each credit extension on purchase of goods, the setting up of workable criteria

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might also require an extensive knowledge of such things as the short-run aspects of the structure of interindustry relations, industrial capacities, cost and supply elasticities, possibilities of substitution of materials, manpower availabilities, etc.

Also, the possibility would arise that in many cases the criteria would have to be applied on an individual loan basis rather than in terms of broad classes of loans and securities. For example, in the case of inventory loans, a specific evaluation of each company's production process might be implied.

The operational need for information is even greater when we drop the assumption of a simple and easily known connection between each loan and the resulting immediate impact on the real economy. The fluidity and flexibility of the financial markets and the high degree of substitutability that exists in them raises serious problems in applying any system of criteria that is in terms of the ultimate use of the proceeds of the loan. For example, in the case of security loans, the application of the criteria might require us to know where these funds were to go and what they were ultimately to finance and what might be their effects on the structure and level of rates and yields. Even if we had exact knowledge after the event -- which we don't -- of the paths of impact through several transactions, it would not be of much help since the decision on whether the loan fits the criteria must be made before it starts on its rounds.

Moreover, the various financial markets are far from being watertight compartments. In evaluating what specific effect the borrowing

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is likely to have on the borrower's actions, it cannot be assumed that a given source of funds can necessarily be identified with a specific use, regardless of the form of the loan application or of the security. This is, of course, an ever-present problem in evaluating financial flows, but in a situation where access to credit is determined by given criteria, some increase can be expected in the divergence between the "good" and the "real" reasons for borrowing. Attempts to ration credit simply with reference to the nature of the borrower or the type of loan or the stated purpose of the loan may lead to great uncertainties as to the actual impact of such general guidelines. To insure that the criteria are effective, pressures might arise to extend the guidelines and to make them detailed in terms of lenders, borrowers, and methods of raising money. A burdensome and detailed searching into, and behind, the actions of individual lenders and borrowers might then be implied by this.

On the other hand, the fact of some loopholes and slippages, while disturbing perhaps from the point of view of equity or esthetics, does not necessarily imply the need for a more stringent detailed system. A more pragmatic attitude can be taken and the loopholes ignored, particularly if there are enough clear-cut cases of sufficient magnitude to produce a large and effective impact, in the desired direction, through a relatively simple system of guidelines and relatively relaxed enforcement procedures.

If, however, for reasons of effectiveness or equity, the rationing system is deemed to require a detailed and comprehensive system of guidelines and standards and a detailed examination and surveillance

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of individual lenders, borrowers, and loans, then the costs and burdens of this must be compared with the severity of the problem. The present and developing situation, while requiring serious attention and action, would not appear to be so desperate, either with respect to inflationary pressures or the pattern of resource use, as to warrant the burdens and costs that a detailed and comprehensive restraint program would entail. In these circumstances, it would appear more in keeping with the requirements of the economic situation to concentrate on an approach that worked on the totals of credit and on permissible interest rate movements and that allowed the market to determine its own allocation within that total, with perhaps some isolated guidelines for a few very specific purposes.

"Productive uses" of credit as a criterion for rationing. In the preceding discussion of "inflationary impact," some extensions of credit that were favored could be described as being "productive uses." On the other hand, some of the credit to be discouraged under the criterion of inflationary impact also was of this kind. "Productive use," as such, is clearly not a proxy for "inflationary impact."

In much of the discussion about credit rationing, however, "productive use" appears as a major, if not the sole, criterion for rationing credit. Discussions of "productive use" as a criterion are often confused by the frequent use of the term in a circular sense without any specific and independent operational meaning but simply to repeat or reinforce the call for restraint in favor of "good" uses of credit as opposed to "bad" uses, otherwise unspecified.

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However, even where the phrase has quite specific conceptual and operational content, it does not provide a suitable criterion for determining the proper amount of total bank credit (as has been demonstrated time and again in the centuries-old analytic battle over the real-bills doctrine, to which "productive use" is not unrelated). Conceivably, it may be more useful and pertinent when it comes to the allocation of a total determined by other factors. In circumstances like the present, this does not seem to be the case. Where used with any substantive meaning, the criterion of "productive use" may yield, in fact, quite wrong allocations of credit in short-run inflationary situations in which aggregate demand is too high.

For example, the situation may be one in which the bulging of investment expenditures is one of the dangerous inflationary factors, in which the industries producing investment goods are one of the serious bottlenecks and an important part of additional investment outlays is likely to be dissipated in higher prices, and in which the investment outlays being encouraged will not bear fruit in increased production for some time -- perhaps several years. In such a situation, a principle that encourages investment expenditures can hardly be viewed as an obviously useful criterion for allocating credit in a short-run anti-inflationary program.

At best, a system of criteria for credit rationing based in "productive use" is basically oriented to long-run problems of economic development rather than to short-run problems of inflation. Yet even

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assuming that we want to take the longer-run perspective, is it clear that enough is known about the processes and requirements of long-run balanced economic development and growth to be able to specify the truly productive uses of credit and to be able to establish workable criteria in terms of productive uses? In any case, even if we had the requisite knowledge, and leaving aside the question of consistency with the basic political and social environment, such a set of criteria would in general have little relevance to the problems of credit rationing as a short-term aid in containing inflation.

Other criteria. There are a variety of other criteria for channeling credit that might be considered. Only two will be mentioned here -- specific military needs and considerations of equity.

In some circumstances, the setting of guidelines or criteria may have as its object the channeling of credit into specific uses that are determined by the patterns of production needed for some overriding national purpose, such as to support a program of specific military outlays and specific military-supporting production. The Korean credit restraint program was to some extent of this nature. As will be discussed in the next section, such a principle of credit rationing does not seem applicable to the present situation. It is, of course, always possible to conceive of changed circumstances in which this would be a valid and necessary principle of rationing.

If interest rates are held down below market-determined levels and if less reliance is put on price as an allocating factor, problems

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of discrimination and favoritism, always present to some extent, probably become more acute. There may be some pressure to devise a system of rationing specifically geared to minimize this. There are great difficulties in establishing a set of workable criteria or procedures to accomplish this that would not at the same time create still other problems of equity and hinder the ability of the financial system to make necessary adjustments to the changing credit needs of the economy. It would probably be better to deal with this class of problems by general urging of caution and restraint on the institutional lenders, by ad hoc treatment of individual cases, or even by setting up special credit facilities, rather than by attempting to specify a structure of guidelines.

Previous voluntary credit restraint programs

There have been two major recent examples in this country of attempts to achieve a desired credit pattern through organized voluntary credit restraint programs with specific criteria and guidelines -- the general program at the time of the Korean war and the more limited present program in connection with lending abroad. The circumstances within which these programs were adopted and the purposes they were intended to serve differ substantially from those at present. Except perhaps in an administrative sense, the experience under those two programs has little applicability to the present situation, though for quite different reasons in the two cases. Whatever the success enjoyed by the two previous programs, the same approaches would almost certainly be less satisfactory in the present circumstances.

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The foreign lending program. In the case of the present voluntary credit restraint program for foreign lending, there is a definite operational goal with respect to a narrow range of assets. The program is one of rationing in an attempt to prevent the amount of lending that might otherwise have occurred in response to interest rate differentials. There is also an attempt, with the interest equalization tax, to deal directly with some types of rates, or rather with differentials between foreign and domestic rates. The program shares the present concern with achieving certain portfolio results without resorting to the kinds of interest rate increases that might alternatively achieve these results. But the foreign credit program affects only a small portion of the total portfolio and lending, whereas a program for the present situation would involve a much broader range of assets and rates. This difference in scope is a basic one in the use of rationing.

Moreover, the goals of the foreign program are relatively simple and straightforward -- a fairly specific reduction in the rate of foreign lending -- with a corresponding relative simplicity in the criteria and operations. In the present case, the concern with an incipient general inflationary situation implies goals, criteria, and operations with many more dimensions and complexities. For these reasons, the applicability of the foreign loan restraint program to the present situation is minimal.

The Korean program. The voluntary credit restraint program of the Korean period, in contrast to the foreign program, did affect a whole range of credit flows. To that extent it is more comparable to

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present needs. Here, too, however, the underlying circumstances and the roles to be played by rationing are so different as to make the Korean experience inapplicable to the situation now developing.

During the Korean period, the economy was on much more of a war-footing than is likely to be the case this year. National defense expenditures were 10 per cent of GNP in 1951 and 13 per cent in 1952 as compared to 7-1/2 per cent for 1965 and projected for 1966. Moreover, the rise in military expenditures was more rapid in the earlier period both in dollar amounts and as a per cent of GNP. In the years preceding 1951, national defense outlays were running about 5 per cent of GNP, substantially below the following years. By contrast, in the years preceding 1966, the ratio was as high or higher than in 1966. The dollar amount of defense outlays more than tripled from 1950 to 1952, whereas from 1965 to 1966 the projected increase is only 10 per cent. Even if estimates of defense outlays are revised upward substantially, the contrast with the Korean period will remain.

The Korean situation thus included abrupt changes in the structure of production and in the pattern of use of real resources. In these circumstances, the voluntary credit program had a role to play in facilitating the shift of resources. Fairly definite criteria could be set that could be related to specific production and investment goals that could themselves be related to fairly specific, and overriding, needs of the country.

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The situation now is quite different. The problem now is more one of a general containment of inflationary pressures in the private economy rather than the sharp curtailment of certain types of private spending to aid in the shifting of physical resources into specific patterns needed for the military effort. The kind of program that was developed then would seem to be inappropriate for the more general and less severe economic tasks facing us now.

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Attach to memo circulated 8/10/66 containing other copies of original letters regarding discount window.

8/17 dww

Governor Brimmer

**FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.**

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Mr Sherman
Mr Holland
Mr F. Solomon

FEDERAL RESERVE BANK OF CHICAGO

OFFICE OF THE PRESIDENT

August 15, 1966

Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Gentlemen:

This is in response to your letter dated July 19 wherein you indicated it would be helpful if the Presidents and Discount Officers of all Federal Reserve Banks would review carefully the administration of their discount windows.

With the waning of "reluctance to borrow" on the part of member banks, the fuller investment of their funds, increased pledges of their investment securities to an ever enlarging group of preferred public depositors and an intensified squeeze on the net earnings of some banks, we believe Regulation A, in its present form, is being put to a severe test. We do, however, agree that this is not an appropriate time to change the provisions of the Regulation, either formally or informally.

We have discounted notes for many "first-time" borrowers during recent months, and have noted their approach to the discount window was not accompanied by fear or reluctance to borrow. Their reasons for borrowing appeared appropriate, and their unwillingness to seek higher costing federal funds or CD's economically wise.

Many banks are encountering increasing difficulty adjusting for sudden withdrawals of funds, especially when the amounts are large. With banks being more fully invested, a number have been forced to the window repeatedly for this uncontrollable reason rather than by choice or design.

In numerous cattle feeding areas seasonal peak periods of credit demand are giving way to steady demands at higher levels. This is a phenomenon not contemplated by the agriculturally slanted discount (nine months) provisions of the law and

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regulation. Also, today, the manufacturing lead time in many industries greatly exceeds the 90-day discount provision.

In the past six months we have had to visit with a number of banks concerning inappropriate use of our discount window. This has included borrowing to purchase from brokers and carry high yielding loans secured by convertible bond collateral and selling high priced federal funds while indebted to us.

Many bankers have been cautioned that they cannot avail themselves of every attractive investment opportunity that comes their way unless they already have available loanable funds. In a few areas banks have attempted to improve their public images by increasing their real estate mortgage lending as savings and loan associations curtailed theirs, with the hope they could lay off the loans acquired with big city correspondents and insurance companies. Their expectations for relief proved unrealistic and some troublesome and costly asset adjustments resulted.

By and large, we believe Seventh District member bankers have a fairly good understanding of what constitutes appropriate use of the discount window and we have been surprised that we have not had more borrowing requests.

Fall loan demands of member banks are expected to be quite heavy, and with the present low discount rate structure we expect to experience administrative difficulties in assuring ourselves that all borrowings are appropriate.

We have no further comments at this time other than the belief that, as stated above, any policy changes in the administration of the discount windows should await completion of the Reappraisal of the Discount Mechanism.

Sincerely,

Charles J. Scanlon

Charles J. Scanlon

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Federal Reserve Bank of St. Louis

Add to the copies of the original letters distributed August 11, 1966, regarding the discount window.

8/1✓

Governor Brimmer

**FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.**

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Federal Reserve Bank of St. Louis

Mr. Sherman
Mr Holland
Mr F. Solomon

FEDERAL RESERVE BANK
OF ATLANTA
ATLANTA, GEORGIA 30303

OFFICE OF
PRESIDENT

August 9, 1966

Mr. Merritt Sherman, Secretary
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Dear Mr. Sherman:

I have reviewed with considerable interest your letter of July 19 regarding reasonable uniformity of administration of the discount window consistent with current objectives of monetary policy.

While we have had some expansion in the number of borrowing banks, attributable specifically to country banks, our administrative policies are generally consistent with those set forth in your letter. We have experienced the expansion of credit and the shift of demand out of the larger financial areas into smaller banks.

So far as we are able to determine, there have been no instances of banks deliberately using Federal Reserve credit to profit from the rate differential in the Funds market. However, there have been some few instances of banks selling funds while indebted to us at the window occasioned by unexpected deposits late in the day, demands made by correspondent banks too late to adjust and for other similar reasons. We have communicated with all banks in the District and advised that such practice was not an appropriate use of Federal Reserve credit.

Sincerely yours,

Harold T. Patterson

Harold T. Patterson
President

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Federal Reserve Bank of St. Louis

8/22 pm

Governor Brimmer

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

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Federal Reserve Bank of St. Louis

Mr. Sherman
Mr Holland
Mr F. Solomon

FEDERAL RESERVE BANK
OF ATLANTA
ATLANTA, GEORGIA 30303

OFFICE OF
PRESIDENT

August 19, 1966

CONFIDENTIAL (F.R.)

Mr. Merritt Sherman, Secretary
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Dear Mr. Sherman:

This is in response to the Board's letter dated August 15, 1966 regarding the administration of the discount window as commented upon during the recent examination of this bank.

Subsequent to the examination, the policies and procedures followed in the administration of the discount window were discussed in detail with the Executive Committee of our Board of Directors, especially the criticisms mentioned by the Chief Examiner. A discussion also was held with our full Board in Executive Session at its meeting the following morning. Each member of our Board had been furnished with a copy of the Board's letter of July 19 with respect to the policies to be followed. I would like to say that our Board is very sensitive to the appropriate administration of the discount window in this District and that it conforms to Regulation A and the objectives of current monetary policy.

As our records will show, there is no loan made to any bank in this District that is not reviewed by our Executive Committee. In regard to the insufficient documentation in the files of the Discount Department, we are now placing a memorandum in the files of all phone conversations with borrowing banks that pertain in any manner to the bank's indebtedness with us.

Sincerely yours,

Harold T. Patterson

Harold T. Patterson
President

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

CONFIDENTIAL (F.R.)

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

AUG 15 1966

Mr. Harold T. Patterson, President,
Federal Reserve Bank of Atlanta,
Atlanta, Georgia 30303.

Dear Mr. Patterson:

The Board has just received an excerpt from the report of the recently concluded examination of the Federal Reserve Bank of Atlanta relevant to the administration of the discount window. From this it appears that the pattern of borrowing in the Atlanta District may not be consistent with Regulation A, and the present stance of monetary policy. The examination report notes that the documentation in the files of the Discount Department is insufficient and that borrowing banks may not have been communicated with in a timely fashion.

The Board has your letter of August 9, 1966, and understands that the entire matter was to be reviewed by the Executive Committee of your Board. It would be appreciated, therefore, if you would inform the Board as promptly as possible regarding the Executive Committee's discussion of the matters referred to with particular reference to the conclusions reached and actions planned or taken.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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Federal Reserve Bank of St. Louis

FR 468
(Rev. 3-63)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MEMO Date_____ Time_____

To: Gov. Brimmer

From: _____

Tel. No. _____ Ext._____

☐	Please call	☐	For your approval
☐	Returned your call	☑	For your information
☐	Will call again	☐	Note and return
☐	Phone me re attached	☐	For comments and suggestions
☐	See me re attached	☐	Preparation of reply

MESSAGE:

As promised

MD

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RECD IN RECORDS SECTION
MAR 19 1963
Z-5656 (On office copies only)
415.3

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

ADDRESS OFFICIAL CORRESPONDENCE TO THE BOARD

March 22, 1963. Dated

Z-5656

Dear Sir:

In its letter of July 31, 1959, Z-4905 the Board indicated that it would appear desirable as a general rule to defer consideration of applications by individual banks for permission to carry reduced reserves until standards for the classification of cities for reserve purposes could be established. It was recognized, however, that there might be exceptions warranting consideration by the Board, and in such cases the Reserve Banks were asked to forward their recommendations along with a full discussion of the factors upon which the recommendations were based.

During the interval since Section 19 of the Federal Reserve Act was amended in July 1959, the Board has granted permission to 94 banks to carry reduced reserves. Among these, there were 28 newly organized or new member banks and many others that were so small as to leave no doubt about the character of their business being typical of country banks. In a few cases, however, the Board has had to weigh carefully the factors outlined in Section 204.2(a)(2) of Regulation D, supplemented by the following information suggested in the Board's letter of July 31, 1959:

(1) Volume of debits against deposit accounts, and turnover ratios, in comparison with other banks in the same or similar cities.

(2) Distribution of ownership of demand deposits.

(3) Average ratios of excess reserves to required reserves.

(4) Activity in the markets for Federal funds, Treasury bills, and bankers' acceptances, and use of the credit facilities of the Reserve Banks in maintaining reserve positions.

Approved
MINUTES
MAR 22 1963

Copies filed 415.-M
Z-Letters

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Federal Reserve Bank of St. Louis

(5) Ratios of commercial and industrial loans, of loans to brokers and dealers in securities, and of loans to non-bank financial institutions to total loans or to total assets.

As a result of a recent review of the over-all situation, the Board feels that there may be a question as to whether some further consideration should be given to other reserve city banks which have not applied, for one reason or another, for permission to carry reduced reserves. As may be observed from the enclosed statement showing deposit data for all member banks in reserve cities, there are a number of banks that would appear to qualify for reduced reserves on the basis of any factors that have so far been considered. Accordingly, the Board would appreciate comments from your Bank with respect to whether it would be generally appropriate for the Federal Reserve Banks to take the initiative in inviting banks that would appear to be eligible to apply for permission to carry reduced reserves.

The Board believes that in determining such eligibility careful consideration should be given to the extent to which the bank under consideration may be competing with other banks not eligible for reduced reserves. This is a question that goes beyond size. For instance, in New York the Sterling National Bank and Trust Company, with demand deposits of $123 million, was granted permission to carry reduced reserves because it appeared that this bank was not in significant competition with the large money market banks for the types of business that seemed relevant to the question of reserve city status. On the other hand, in Chicago the reasons for denying permission to the Central National Bank, Drovers National Bank, and Exchange National Bank, with demand deposits ranging from $70 million to $95 million, included evidence indicating close competition, at least for some types of business, with the larger Chicago banks. Another case under frequent review by the Board concerns a bank which has its head office outside of a reserve city but which is opening new branches in the outlying sections of the reserve city. The opening of additional branches by this bank within the reserve city has necessitated review of the nature and extent of its competition with downtown banks.

It may be that the factors mentioned in Regulation D and the Board's letter of July 31, 1959, are sufficient to determine the question of competition for reserve purposes. However, since this is not an easy question to answer, the Board would appreciate receiving any additional ideas your Bank may have in this regard.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosure

JRF:AND:ag

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

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REC'D IN RECORDS SECTION
AUG 27 1959

1/15

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

Z-4905 (On office copies only)

ADDRESS OFFICIAL CORRESPONDENCE TO THE BOARD

July 31, 1959.

10

Z-4905

CARDED

Dear Sir:

The Board is giving preliminary consideration to the question of what actions will be necessary or appropriate as a result of the recent amendment to Section 19 of the Federal Reserve Act, which concerns bank reserves. Briefly, the problems fall into three general categories: counting of vault cash as reserves, new standards for classification of reserve cities, and new standards for reclassification of individual banks.

In the light of the changes made by the new legislation, including the abolition of central reserve city designation of New York and Chicago in three years, it will be necessary to reconsider the standards for classification of reserve cities with greater emphasis upon the nature of deposit accounts other than interbank and less upon interbank accounts. Accordingly, the standards for classification of reserve cities (F.R.L.S. #4220) and the triennial designation of reserve cities scheduled to become effective March 1, 1960, must be reviewed. In this connection, the Board would be glad to have the benefit of your ideas regarding what standards should be used, and it contemplates asking that this topic be placed on the agenda for discussion with the Presidents of the Reserve Banks at their meeting to be held September 21-23.

The Board believes that, until standards for the classification of cities are established, it will not be possible to fix new criteria to be used when considering applications of individual banks to carry reduced reserves. Accordingly, it would appear desirable as a general rule to defer consideration of applications by individual banks until the standards for the classification of cities can be established. However, it is recognized that in the meantime your Bank may receive applications from some member banks that have been denied requests for reduced reserves on the basis of their location. It is suggested that such cases as you feel to be fully justified and of an urgent nature, because of hardship or other reasons, be forwarded to the Board along with your recommendations. Please include in your recommendation a full discussion of the factors upon which the recommendation is based.

Approved
MINUTES ON
JUL 31 1959

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Basically, it appears that the criteria for the reclassification of individual banks should include most of those set forth in F.R.L.S. #6050 but should be much broader in scope with greater emphasis upon nature of deposits other than interbank. Relevant additional items might include the following:

1. Volume of debits against deposit accounts, and turnover ratios, in comparison with other banks in the same or similar cities.

2. Distribution of ownership of demand deposits, similar to figures obtained in the annual surveys of ownership.

3. Average ratios of excess reserves to required reserves.

4. Activity in the markets for Federal funds, Treasury bills, and bankers' acceptances, and use of the credit facilities of the Reserve Banks in maintaining reserve positions.

5. Ratios of commercial and industrial loans, of loans to brokers and dealers in securities, and of loans to nonbank financial institutions to total loans or to total assets.

The last three of these considerations are being used in the selection of the new "money market" subseries of the weekly reporting series as set forth in an attachment to the Board's letter of May 20, 1959. filed 430.4

The various alternatives and technical questions regarding the counting of vault cash as reserves are being studied and will be referred to in a separate communication. 12-4907 8/4/59 filed 415.

Very truly yours,

Merritt Sherman,
Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 12, 1966

To Members of the Board

Subject:

From Mr. Sherman

CONFIDENTIAL (FR)

Attached is a tentative draft of entry for the policy record concerning action taken by the Board on Friday, July 15, 1966, regarding the discount rate. This rough draft, which has not yet had the full benefit of pertinent staff comment and revision, is being distributed to the members of the Board at this time because of the interest that has been expressed in the entry. A revised draft, which will take account of staff suggestions, will be distributed for the Board's consideration shortly. In the meantime, any first-reaction suggestions from members of the Board would be appreciated.

In connection with this entry the members of the Board may wish to refer to the entry contained in the Board's Thirty-sixth Annual Report for 1949, on page 107, regarding the Board's action on October 10, 1949, in disapproving a discount rate action by a Federal Reserve Bank.

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CONFIDENTIAL (FR) ROUGH DRAFT

July 15, 1965

1. Disapproval of proposed discount rate increase.

The Board disapproved actions taken by the Boards of Directors of the Federal Reserve Banks of New York, Cleveland, Chicago, and St. Louis on July 14 establishing a rate of 5 per cent (an increase from 4-1/2 per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act, along with appropriately corresponding subsidiary rates on advances under other sections of the Act.

Votes for this action: Messrs. Robertson, Shepardson, Daane, Maisel, and Brimmer. Votes against this action: None.

Pursuant to the policy established by this action, the Board subsequently disapproved similar rates established by the Boards of Directors of the Federal Reserve Banks of Boston and Philadelphia. The effect of the Board's action was that the rates on discounts and advances in the existing schedules of the respective Federal Reserve Banks automatically continued in effect.

(In accordance with provisions of the Federal Reserve Act, the Federal Reserve Banks establish rates on discounts and advances to member banks at least every 14 days and submit such rates to the Board for review and determination. No changes had been made in such rates since those referred to on pages 63-70 of the Board's ANNUAL REPORT for 1965.)

In considering the discount rates established by the several Federal Reserve Banks, the Board was not unmindful of considerations that might ordinarily have formed a basis for approval. As described in the Record of Policy Actions of the Federal Open Market Committee, published elsewhere in this ANNUAL REPORT, the Committee had been pursuing for several months a policy of gradually reducing net reserve availability in an effort to restrain inflationary pressures. This monetary policy process, in the face of strong credit demands, had resulted in an upward movement of market interest rates, thus causing

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the 4-1/2 per cent discount rate to fall substantially out of alignment. The latter circumstance had led to rather widespread expectations of a discount rate increase and had contributed to market uncertainties. Hence, an argument could be made that an adjustment of the discount rate would serve as a stabilizing influence. In addition, a discount rate increase could have been viewed as helpful in symbolizing continued concern about the persistent deficit in the U.S. balance of international payments. Further, in the absence of fiscal policy action in the form of a tax increase to inhibit excessive credit demands, an argument could be made that the use of the discount rate instrument, along with other instruments of Federal Reserve policy, was called for to ~~maximum~~ minimize the effectiveness of monetary policy in the ~~current~~ prevailing circumstances.

For a variety of reasons, however, it was the conclusion of the Board that on balance a discount rate increase was not warranted at this particular time. The several reasons leading to this conclusion were not accorded equal weight by each of the members of the Board. From the timing standpoint, ~~however~~, there had been a recent international development on which some members placed considerable stress. Only ~~yesterday~~ on the preceding days announcement had been made of an increase from 6 per cent to 7 per cent in the British Bank Rate (the discount rate of the Bank of England). This raised the question whether the effect of the British announcement, designed to strengthen the position of the pound sterling, should be weakened by offsetting action here.

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On the domestic side, some doubt was expressed within the Board as to whether a discount rate increase of 1/2 of 1 per cent would be sufficient to quiet prevailing uncertainties, and therefore to provide a stabilizing influence, or whether such an increase might not simply promote speculation concerning the possibility of additional discount rate action. On the other hand, in view of the many strains and crosscurrents prevailing in financial and credit markets, it appeared possible that the announcement effect of even a modest discount rate change could be exaggerated and such action misconstrued, with ramifications extending beyond the intended scope of the action. Further, although the discount rate was out of touch with market rates, it was not evident that this circumstance was hampering the pursuit of a policy of monetary restraint or that it was causing insurmountable problems in the administration of the Reserve Bank discount windows.

A further contributing factor in the Board's decision was a recognition of the widespread desire to avoid further escalation of interest rates, including those being offered for funds by banks and nonbank financial institutions. Along that line, action was being announced ~~Friday~~ on July 15 by the Board and the Federal Deposit Insurance Corporation to lower the maximum rates payable by banks on time deposits with multiple maturities. This followed the recent Board action raising the reserve requirement against time deposits over $5 million in any member bank. ~~In addition,~~ Moreover, also on July 15, the Board was ~~even~~

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~~now~~ submitting to the Congress, with a recommendation for prompt action, a legislative proposal to broaden the regulatory power over rate practices of banks and savings and loan associations.

Still another point of view advanced against a discount rate increase was that in a period when monetary policy was directed toward restraining credit expansion the degree of effective restraint might well be greater if the market was uncertain as to what might happen than if it had been given some assurance. For the longer run, according to this thesis, if the Federal Reserve gave in consistently to market expectations, it would reduce its options and allow control of monetary policy to shift from the System to the market.

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GOVERNOR BRIMMER

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

Z-6277 (On office copies only)

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

July 19, 1966.

Dear Sir:

In light of the current objectives of monetary policy and in order to make doubly sure that appropriate general principles are being applied with reasonable uniformity, the Board believes that it would be helpful if the Presidents and Discount Officers of all Federal Reserve Banks would review carefully the administration of their discount windows. Among the matters that the Board considers it important to have clearly in mind under present conditions are those mentioned in the following paragraphs. Each Reserve Bank can, of course, think of others.

On any occasion when monetary policy becomes more restrictive, it can be expected that borrowing activity at the discount window will tend to increase. In fact, growth in aggregate borrowing is an indicator of the degree of monetary restraint on banks. As banks borrow, they come under pressure to make adjustments, thereby helping to spread the effects of restraint throughout the banking system. To this end, Regulation A provides that credit extended through the discount window should be short term and on a noncontinuous basis, except in exigent circumstances.

Access to Federal Reserve discount facilities should, of course, continue to be available to member banks for appropriate purposes as outlined in Regulation A. In the current situation, however, every effort should be made to induce member banks to liquidate their borrowings as promptly as possible, not only by appropriate portfolio adjustments but by the adoption of more restrictive lending policies. Moreover, fuller utilization of credit lines and larger takedowns of commitments to lend do not constitute

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adequate justification for extended use of the discount window. And, of course, extension of Federal Reserve credit to member banks borrowing for the purpose of selling funds in the Federal funds market is clearly inappropriate.

The recent expansion of borrowing by country member banks suggests the need for particularly careful review. The fact that large city banks are cutting down on advances to correspondent country banks is not, of itself, a sufficient justification for extended or continuing country-bank borrowing from the Federal Reserve Banks. Also to be guarded against are demands by country banks for longer-term accommodation on the ground that their lines of credit to national or regional firms, which may have found that they are unable to get all the credit they desire from their usual sources, are now being activated.

The Board will appreciate your special review of discount window administration against the background of considerations of this kind. It would be glad to receive your comments, including advice on developments that would appear to be of significance to the Federal Reserve System generally.

Very truly yours,

Merritt Sherman,
Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

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GOVERNOR BRIMMER

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FEDERAL RESERVE BANK OF NEW YORK
NEW YORK 45, N.Y.
REctor 2-5700

CONFIDENTIAL (F.R.)

ALFRED HAYES
PRESIDENT

July 22, 1966

CONFIDENTIAL

S i r s :

Reference is made to our telegram of yesterday advising the Board that our directors, at their meeting yesterday, voted to re-establish without change the existing schedule of rates in effect at this Bank. At their meeting, the directors requested that the Board of Governors be advised of the reasons for their action.

The directors had before them yesterday the letter from the Board of Governors, dated July 16, 1966, advising that the Board had not approved the rates on discounts and advances established by our board of directors on July 14, and setting forth the considerations leading the Board of Governors to conclude on balance that action approving a discount rate increase would not be warranted at that particular time. After reviewing the considerations set forth in the letter, our directors expressed their belief that their action of last week was a correct one in the light of the circumstances then prevailing, and that an increase in the discount rate at that time would have been a constructive move.

The directors indicated that they were prepared to follow the same course of action this week and to confirm their judgment that an increase in the discount rate is necessary. However, recent international developments have created a problem of timing. In view of the financial program announced on Wednesday by the Government of the United Kingdom, and in view of the position of the pound sterling in the exchange markets both before and after that announcement, the directors were of the view that a change in the discount rate at this time might jeopardize the success of the program, which has the full support of the United States Government. For that reason, and for that reason alone, the directors concluded that, on balance, it would be preferable not to increase the discount rate at this time.

Respectfully,

Alfred Hayes

Alfred Hayes
President

Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

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GOVERNOR BRIMMER

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B

December 15, 1966

TO: Board of Governors

SUBJECT: Implementation of Discount Administration

FROM: Division of Examinations

B. C. L.

There is attached a memorandum which summarizes the various matters discussed during the conference call with discount officers on December 6.

Attached.

TA-NON-KA
B.P.M.
MIMEO BOND

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TO: Division of Examinations SUBJECT: Conference Call on Discount Administration

FROM: Priscilla Ormsby

Another in the present series of conference calls to discuss discount administration was held Tuesday, December 6, 1966, among members of the Board staff and the discount officers of the twelve Reserve Banks. Representing the Board staff were Mr. Leavitt, Mr. J. C. Smith, Mr. Sundberg, and Miss Ormsby.

Borrowing by member banks was described as being moderate in most Districts. Several Districts expressed the opinion that their reserve city banks were borrowing Federal funds in preference to coming to the discount window. However, at least in San Francisco, there were indications that borrowing in this market was also relatively light. The overall tone was one of ease. Borrowing by country banks was somewhat heavier than this would indicate, however, especially in terms of numbers of banks. This was generally attributed to seasonal influence (e.g., cattle buying in the seventh District), but the New York District suggested that it might indicate increasing sophistication and decreasing reluctance to borrow on the part of their country banks.

In the Minneapolis District, some agricultural banks were experiencing delays in expected deposit increases as farmers were holding crops over year-end in hopes of a better price. These banks held notes of the Commodity Credit Corporation which they did not want to sell, and as an alternative they were borrowing at the discount window. Mr. Fossum questioned whether this could be regarded as sufficient justification for prolonged borrowing (4 or 5

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bi-weekly reserve periods). St. Louis reported somewhat the same situation, as farmers were holding soybean and corn crops over year-end, and suggested that the appropriateness of the borrowing would depend in large part upon the bank's past record. Mr. Moffatt (Chicago) added that, while the Reserve Bank might indicate that it was aware the banks held CCC notes, it was not the discount officer's place to turn them out of the discount window with instructions to liquidate a specific asset.

Kansas City reported that a drought condition appeared to be delaying the appearance of a seasonal demand for agricultural loans in their District, but they anticipated that any appreciable rainfall would be followed by an upswing in member bank borrowing.

In line with the above atmosphere of ease, only one District reported any evidence of mid-month tightness as the December 15 tax date approached. This was in Philadelphia where there was some concern over possible CD attrition. Several other Districts commented on possible ramifications of the approaching tax date and the Federal debt limit squeeze, although they reported that there were no apparent signs of tightness among their member banks.

In the Cleveland District there was some question of Treasury Tax and Loan accounts being drawn down at year-end, apparently as the debt ceiling became an increasing problem and before Congress could convene and ease the situation by raising the temporary ceiling. Mr. Euans (Kansas City) asked for opinions on the expected effects of 100% Treasury Tax and Loan account withdrawals. Would these produce increasing tightness in the money

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market? Mr. Bilby suggested that a general tightening was not likely, as the funds would be expended and redeposited. However, a redistribution of funds among banks was inevitable and this would no doubt cause hardship to individual banks. He felt that smaller banks would probably be hurt most. They were short of liquidity, and the deposit losses would probably loom larger in their overall portfolios.

The Boston District reported that one of its smaller banks was experiencing some pressure as payments from the Federal Government in connection with a local sewerage project were being held up. This was judged as being consistent with the government shortage of funds as the tax date approached and the debt ceiling limited borrowing. However, few other Districts had had definite instances of hardship due to delayed payments. Chicago reported that the National Aeronautics and Space Administration was slow in its payments, but this had been so for several months and did not seem to be directly attributable to the present situation. The possibility of the Treasury borrowing directly from the Federal Reserve was mentioned in connection with the above.

Several Districts reported that they expected increased borrowings in the future for various reasons other than the tax date and directly related factors. In New York there was still concern with the outflow of Eurodollars at year end. However, it was felt that if the relatively low Federal funds rate were maintained banks losing Eurodollars would turn to this market more frequently than to the discount window. In the Minneapolis District

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at least two reserve city banks had indicated that they expected to borrow in the future. One was expected to be the window rather heavily on December 29. This was because of the three-day holiday, which meant that borrowing on December 30 would go on the books as a four-day borrowing. The other bank anticipated a prolonged need next year. In the Cleveland District the larger banks were expected to borrow in February because of seasonal deposit losses.

Several Districts reported some increase in the use of eligible paper as collateral, but this was not regarded as a sign of increased tightness.

Widespread interest in V-loans was again apparent. San Francisco had reported one rather large application ($75 million with a 75% guarantee). There was some talk of the services participating in the guarantee in this case. The Chicago Disstrict reported having heard rumors of the existence of an unpublished executive order to agencies providing defense financing. The contents were unknown, but speculation was that it concerned the necessity to hold spending to reasonable proportions so long as inflationary trends in the economy persisted. It was suggested that this might have a discouraging effect on the willingness of these agencies to provide V-loan guarantees.

The Boston and Chicago Districts each reported a further inquiry from an insurance company. However, the seventh District company reported a definite easing of its position and the first District company, while reporting it was not out of the woods, did

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seem to have a less pressing shortage of funds. Its cash flow now exceeded its policy loans and it was able to cover its current commitments. However, it felt that holding back on new commitments would cause further damage to the construction industry.

The Philadelphia District asked if other Banks had received inquiries on the expected year-end condition of savings and loan associations. The third District had received one such inquiry from a member bank that had been asked to reconfirm an outstanding commitment to an S & L. The Boston Bank reported that savings and loans in Connecticut were reported as being rather tight, but this did not seem to be a general condition.

The next conference call is scheduled for Monday, December 19 at 3:30 P.M. E.S.T.

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GOVERNOR BRIMMER

For Information Only

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(Mr. Ellis)
Mr. Sherman mail +
Send 6 on Mon 18 July
4

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

July 16, 1966.

CONFIDENTIAL (FR)

(Letter to Presidents of Federal Reserve Banks of New York, Cleveland, Chicago, and St. Louis; copies sent to eight other Reserve Bank Presidents.)

This supplements the Board's telegram of July 15, 1966, in which your Bank was advised that the Board had not approved the rates on discounts and advances established by your Board of Directors on Thursday, July 14. This action by the Board of Governors means, of course, that the rates in your Bank's existing schedule automatically continue in effect.

In considering the rates fixed by your Board of Directors, the Board of Governors was not unmindful of the arguments favoring a discount rate increase, including the fact that the current discount rate has fallen substantially out of alignment with market rates and that an increase might tend to remove uncertainties affecting the markets. For a variety of reasons, however, the Board concluded that on balance these arguments were not sufficiently compelling to warrant a discount rate increase at this particular time and that it would be better to preserve flexibility, especially in light of international uncertainties.

The several arguments against a rate increase were not necessarily accorded equal weight by each of the members of the Board. On the domestic side, however, there was some question whether a discount rate increase of 1/2 of 1 per cent would be sufficient to calm existing uncertainties, and therefore to provide a genuine stabilizing influence, or whether such an increase might simply promote speculation concerning the possibility of additional action being taken. Similarly, in view of the many crosscurrents prevailing in financial and credit markets, it appeared possible that the announcement effect of a discount rate change could be overemphasized and that such action might be misconstrued, with ramifications extending beyond the intended scope of the action.

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There was also some feeling that the increase in the British Bank rate earlier this week, designed to strengthen the position of the U.K., should not be weakened by offsetting action here.

It was also noted that, even though the present discount rate was out of touch with market interest rates, this apparently was not hampering monetary restraint significantly or causing unsurmountable difficulties in the administration of the discount window.

As you have been advised, the Board yesterday announced changes in Regulation Q to lower the maximum rate that member banks may pay on time deposits with multiple maturities, and the Board has also sent to the Congress, with a recommendation for prompt consideration, legislative proposals to broaden regulatory powers over rate practices of banks and savings and loan associations.

The foregoing were among the considerations leading the Board to conclude on balance that action approving a discount rate increase would not be warranted at this particular time, and the Board wanted you and your directors to be informed.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

July 16, 1966.

CONFIDENTIAL (FR)

Dear Sir:

Enclosed for your information is a copy of the text of a letter that has been sent today to the Presidents of certain Federal Reserve Banks.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosure.

This letter sent to the Presidents of all FRBanks except New York, Cleveland, St. Louis, and Chicago.

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Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

July 16, 1966.

CONFIDENTIAL (FR)

(Letter to Presidents of the Federal Reserve Banks of New York, Cleveland, Chicago, and St. Louis; copies sent to eight other Reserve Bank Presidents.)

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Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, N.Y. 10045

AREA CODE 212 RE 2-5700

July 14, 1966

CONFIDENTIAL

Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

S I R S :

Reference is made to my telegram of today's date to the Board of Governors. The full statement referred to therein is as follows:

"INFIT: (A) - 5; (B) - 5½; (C) - 6½."

"Among reasons for the Board's action is the absence of an affirmative fiscal policy by the Government, which the directors believe greatly accentuates the need for their action today. In addition, international factors were given very serious consideration by the Board in making its decision, equal in importance to domestic factors."

Respectfully,

Richard A. Debs

Richard A. Debs,
Secretary

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Federal Reserve Bank of St. Louis

Mr. Sherman
(Copies sent to Mr. Hackley
Messrs. Leonard
Daly - 7/25
5:30 p.m.)

FEDERAL RESERVE BANK OF NEW YORK
NEW YORK 45, N. Y.
REctor 2-5700

ALFRED HAYES
PRESIDENT

July 22, 1966

CONFIDENTIAL

S i r s :

Reference is made to our telegram of yesterday advising the Board that our directors, at their meeting yesterday, voted to re-establish without change the existing schedule of rates in effect at this Bank. At their meeting, the directors requested that the Board of Governors be advised of the reasons for their action.

The directors had before them yesterday the letter from the Board of Governors, dated July 16, 1966, advising that the Board had not approved the rates on discounts and advances established by our board of directors on July 14, and setting forth the considerations leading the Board of Governors to conclude on balance that action approving a discount rate increase would not be warranted at that particular time. After reviewing the considerations set forth in the letter, our directors expressed their belief that their action of last week was a correct one in the light of the circumstances then prevailing, and that an increase in the discount rate at that time would have been a constructive move.

The directors indicated that they were prepared to follow the same course of action this week and to confirm their judgment that an increase in the discount rate is necessary. However, recent international developments have created a problem of timing. In view of the financial program announced on Wednesday by the Government of the United Kingdom, and in view of the position of the pound sterling in the exchange markets both before and after that announcement, the directors were of the view that a change in the discount rate at this time might jeopardize the success of the program, which has the full support of the United States Government. For that reason, and for that reason alone, the directors concluded that, on balance, it would be preferable not to increase the discount rate at this time.

Respectfully,

Alfred Hayes

Alfred Hayes
President

Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

See Minutes
7/22/66
EJ Files

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FEDERAL RESERVE BANK OF NEW YORK
NEW YORK, N.Y. 10045
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ALFRED HAYES
PRESIDENT

Confidential

July 6, 1966.

Hon. J. L. Robertson,
Vice Chairman,
Board of Governors of the
Federal Reserve System,
Washington, D.C. 20551

Dear Robbie:

Enclosed herewith is a memorandum along the lines of our discussion this morning. I hope you will find it useful.

Yours sincerely,

Alfred Hayes.

Encl.

Copies were distributed to Bd Members, Mr. Hackley, Mr. Sherman on July 7, 1966

mjm

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Federal Reserve Bank of St. Louis

CONFIDENTIAL

July 6, 1966

NOTES ON POSSIBLE DISCOUNT RATE ACTION

For some time it has been the System's policy to apply gradually increasing monetary restraint through open market operations while avoiding moves of such intensity that they would virtually force consideration of a discount rate increase and perhaps of a modification of the Regulation Q ceilings. It seems to me, however, that conditions have changed sufficiently in the last week or two so that we might well review this whole situation with a view to determining whether a rather prompt discount rate increase is now warranted. Among these new conditions are the following:

(1) The Board's change of reserve requirements against time deposits was advertised and generally construed as a further overt move in the direction of restraint.

(2) The prime rate has increased by 1/4% in the past week or so.

(3) Most market rates of interest, both short and long, have moved up considerably, and even Treasury bill rates which were notably behind other rates, have moved up sharply.

(4) The mid-year withdrawal period of various savings institutions seems to have been passed without a serious withdrawal problem as had been feared in some quarters.

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Moreover, there have been widespread "defensive" increases in rates offered by such institutions, in keeping with the general upward trend of other interest rates.

A number of factors may be cited as arguing in favor of an increase in the discount rate in the near future. Among these factors are:

(1) The discount rate has become increasingly out of line with virtually all market interest rates, including even the 90-day Treasury bill rate. We are therefore in a position to increase the rate as a more or less "passive" move, bringing it into closer adjustment with market rates generally. In fact, a rise in the discount rate might to some extent "clear the air" and reduce market uncertainties.

(2) While administration of the discount window has not as yet given rise to any serious problems, in this district at least, it may be expected that demands for discounts will increase substantially. Already we have noted a continuous and significant increase in borrowing, and in particular there has been an increase in the number of country banks coming to the discount window, as city banks are increasingly unable or unwilling to meet their needs for additional reserves. This is a process typical of periods of tightening monetary policy. Moveover, demands will be swelled by those coming from banks which have so far not been borrowing, but which will find irresistible the availability of funds at a rate roughly 1% below the market. Indeed, a discount rate

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so considerably below the cost of alternative sources of funds is an open invitation to use the window.

(3) In keeping with the strong business outlook, credit demands are large and are likely to remain so. Banks are confronted with sizable and impressive demands, many coming from good old customers, despite two further increases in the prime rate since the one at the time of the December discount rate action. Bank credit is now rising at a rate considered in recent discussions as excessive by many Federal Reserve officials. Other types of credit extension are also large and rising. While corporate and municipal offerings have moderated somewhat by reason of the usual summer lull in financing activities, they may be expected to rise through the balance of the year. A reinforcement of credit restraint through discount rate action will be useful under these conditions.

(4) The same conclusion is reinforced by the fact that inflationary forces remains strong. While the future course of events in Vietnam is as uncertain as ever, even the beginning of some kind of peace negotiations will not resolve uncertainties for quite some time. In the meantime, defense spending projections given at the last FOMC meeting show a continuing sharp rise.

(5) The deterioration of our balance of payments poses a critical problem. Although further monetary restraint can make only a rather limited contribution toward re-establishing

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equilibrium, nevertheless it is clear that a discount rate increase would have a salutary effect abroad as a symbol of our concern with our balance of payments and of our recognition of the need for action. (Of course this effect would be strengthened if the discount rate increase were to form a part of a larger "package" to deal with the widening payments deficit.)

While consideration of a rate increase must take into account the precarious situation of sterling, there seems to be some likelihood that the U.K. will already have raised their rate by the time action is taken in this country.

(6) It is true that there has been general agreement, at least within the System, that the general economic situation and the balance-of-payments outlook call for a tax increase, and that monetary policy is already carrying too much of a burden. In some quarters there has been a disposition to delay a discount rate move in the belief that such a move would weaken the chances for a tax increase. However, the likelihood of prompt tax action now seems remote, further restraining action is needed, and realistically it can probably only come from the monetary authorities.

(7) With the critical days of the withdrawal period for thrift institutions now behind us, we can give full weight to longer-run considerations. The drains have been lower than expected, and they have not triggered any critical developments. It is not impossible that, now that thrift institutions have

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weathered the storm, they will be able and willing to resume mortgage lending and making of commitments on a larger scale.

(8) The timing of the Treasury's financing programs over the next month or two indicates that unless we move in the near future we will be precluded from any rate action until well into September. Treasury consulting groups will meet in Washington on July 25-26 to discuss the refunding. There is likely to be a cash financing in August, following the refunding. Action on July 21, the date of our regular Directors meeting, might leave too little time for the market to adjust, prior to the fixing of terms for the August refunding. A week earlier might be preferable.

There are of course certain arguments that can be made against a near-term increase in the discount rate:

(1) A move on our part would probably trigger a further rise in the prime rate to 6% and some accompanying upward adjustment in other market rates. Market reactions and the impact of portfolio adjustments triggered by a discount rate increase are difficult to assess, but the System must be ready to pass judgment as to how far and how fast rates should be permitted to rise without raising the threat of a financial crisis. The possibility of undesirable effects of discount rate action on asset value and on money and capital markets must be given some weight. It might be argued that market uncertainty may settle down somewhat if the discount rate is held at the present level, although the uncertainty will not

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be removed. However, monetary policy is sufficiently flexible to be modified and indeed reversed should market developments approach a critical range in the wake of a discount rate increase.

(2) There is always a possibility that the pace of economic expansion is already slowing, so that a near-term discount rate increase would prove to be ill-timed. I might add, however, that this is the type of judgment we are inevitably making almost continuously, and here again there will be ample opportunity for subsequent modification or reversal of policy.

I have not mentioned the implications with respect to Regulation Q as an argument either for or against a discount rate increase. Since our objective is to increase monetary restraint, it would not be appropriate, in my judgment, to raise Regulation Q ceilings at the time of the rate move. Admittedly, certificate-issuing banks, many of which are now paying ceiling rates on the shortest maturities, will be subject to attrition, but the accompanying adjustments on the asset side will serve to reinforce desirable restraint, and any specific problems might be met through greater flexibility at the discount window. There is great merit in at least delaying a move on Regulation Q until the nature of the adjustment process and of its effect on banks and other market participants can be observed and assessed. Naturally a discount rate increase may bring somewhat closer the time when Regulation Q might have to be modified, but this is sufficiently remote not to weigh heavily in our rate decision.

Alfred Hayes

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8/10

Governor Brimmer

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

Z-6277 (On office copies only)

ADDRESS OFFICIAL CORRESPONDENCE TO THE BOARD

July 19, 1966.

Dear Sir:

In light of the current objectives of monetary policy and in order to make doubly sure that appropriate general principles are being applied with reasonable uniformity, the Board believes that it would be helpful if the Presidents and Discount Officers of all Federal Reserve Banks would review carefully the administration of their discount windows. Among the matters that the Board considers it important to have clearly in mind under present conditions are those mentioned in the following paragraphs. Each Reserve Bank can, of course, think of others.

On any occasion when monetary policy becomes more restrictive, it can be expected that borrowing activity at the discount window will tend to increase. In fact, growth in aggregate borrowing is an indicator of the degree of monetary restraint on banks. As banks borrow, they come under pressure to make adjustments, thereby helping to spread the effects of restraint throughout the banking system. To this end, Regulation A provides that credit extended through the discount window should be short term and on a noncontinuous basis, except in exigent circumstances.

Access to Federal Reserve discount facilities should, of course, continue to be available to member banks for appropriate purposes as outlined in Regulation A. In the current situation, however, every effort should be made to induce member banks to liquidate their borrowings as promptly as possible, not only by appropriate portfolio adjustments but by the adoption of more restrictive lending policies. Moreover, fuller utilization of credit lines and larger takedowns of commitments to lend do not constitute

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adequate justification for extended use of the discount window. And, of course, extension of Federal Reserve credit to member banks borrowing for the purpose of selling funds in the Federal funds market is clearly inappropriate.

The recent expansion of borrowing by country member banks suggests the need for particularly careful review. The fact that large city banks are cutting down on advances to correspondent country banks is not, of itself, a sufficient justification for extended or continuing country-bank borrowing from the Federal Reserve Banks. Also to be guarded against are demands by country banks for longer-term accommodation on the ground that their lines of credit to national or regional firms, which may have found that they are unable to get all the credit they desire from their usual sources, are now being activated.

The Board will appreciate your special review of discount window administration against the background of considerations of this kind. It would be glad to receive your comments, including advice on developments that would appear to be of significance to the Federal Reserve System generally.

Very truly yours,

Merritt Sherman,
Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

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Federal Reserve Bank of St. Louis

Mr Sherman
Mr Holland
Mr F. Solomon

FEDERAL RESERVE BANK
OF BOSTON

GEORGE H. ELLIS
PRESIDENT

August 1, 1966

Mr. Merritt Sherman, Secretary
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Dear Merritt:

The Board in its letter of July 19, 1966, raises the issue of the need to review carefully the administration of the discount window in order to insure that the objectives of monetary policy are being applied with reasonable uniformity.

We agree that present restrictive monetary policy and the strong credit demands upon banks, together with the wide differential in the discount rate and other short term rates, have increased pressure and amplified the need for alert administration of the discount window. We are finding it increasingly necessary to discuss with member banks their use of the discount window as provided in Regulation A. Recently we adopted the policy of initiating a request for information leading to a discussion of discount needs with individual banks if borrowing continues into the fourth consecutive period or into the third period if the amount of borrowing is large in relation to reserve requirements. We feel that our member banks as a whole are making an attempt to hold down increases in loan portfolios. However, the demands of good customers are such that loans are being made under threat of losing such customers to a competing institution where there is no assurance that uniform tests of restraint are being applied.

Generally, we have been successful in effecting reasonably prompt adjustments on the part of continuous borrowing banks. However, there are situations where, because of variations in the flow of deposits or where portfolio adjustments would entail substantial losses, bankers are reluctant to adjust. Two outstanding cases in point are the Norway National Bank, Norway, Maine, and the Canal National Bank, Portland, Maine, which were commented upon in detail in our quarterly discount report, dated July 8, 1966. Both of these cases involved matters of management judgment. In the case of the Norway National Bank an exceptionally large municipal loan to the Town of Norway, with subsequent difficulty and delay in placing a substantial portion of that loan with its

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city correspondent, placed the bank in an extended condition. Deposit buildup and success in participating out the municipal loan has enabled that bank to reduce its loan at the discount window, with final liquidation on July 28, 1966.

The Canal National Bank case involves a substantial and progressive depreciation in its government securities portfolio and a reluctance to liquidate that portfolio or to seek other credit accommodations in the face of expected deposit gains. After several discussions, we have insisted upon a gradual reduction in discounting, with a promise of final liquidation not later than August 17, 1966.

As reported at the FOMC meeting of June 7, 1966, evidence does not support the conclusion that banks in this district are pursuing a policy of borrowing at the discount window for the purpose of selling federal funds.

Our banks repeatedly report that the Fall demand for credit is expected to be large and to exert considerable pressure on their reserve positions. In anticipation of this demand and with reduced availability of governments to pledge against discount window borrowings, the larger banks in this district are actively educating their staffs in the procedures and requirements with respect to the pledge of eligible paper.

Sincerely,

George

George H. Ellis
President

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Federal Reserve Bank of St. Louis

Mr. Sherman
Mr. Hackley

FEDERAL RESERVE BANK OF NEW YORK
NEW YORK 45, N.Y.
REctor 2-5700

Mr. F. Solomon

ALFRED HAYES
PRESIDENT

August 4, 1966

Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

S i r s:

This is in reply to your letter of July 19, 1966 suggesting that a special review of discount window administration be made by the Reserve Banks in the light of the current objectives of monetary policy, and requesting our comments including advice on developments that would appear to be of significance to the Federal Reserve System.

In the early part of this year, I and certain senior officers of this Bank held a series of meetings, on an individual basis, with the management of each of the New York money market banks and comparable discussions with the management of other large banks in the District. The purpose of the meetings was to review each bank's general position in the light of credit conditions and the objectives of monetary policy. The discussions appear to have been effective in developing fuller understanding of current System policy and may have resulted in some lessening of discount window use since average daily borrowings by reserve city banks were $94.8 million in the first six months of 1966 against $107.7 million in the comparable 1965 period.

The expansion of borrowing by country banks in this District, especially in recent months, however, has been quite noticeable. In the period January 1 to June 30, 143 banks borrowed $56.8 million on average daily as compared with 115 and $20.3 million, respectively, in the same period in 1965. There has been some tendency for more than the usual number of country banks to use the discount window on an intermittent basis in a number of reserve computation periods, though rarely for many consecutive days or for heavy percentages of reserve requirements. This situation has caused a marked increase in the use of administrative counseling of member banks. Thus, there have been

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24 instances of administrative counseling of member banks through July 25, 1966 against 10 instances in the comparable 1965 period. In addition, there have been more cases this year where more than one call to the same bank has been necessary. We believe that the increase in discount window use and administrative counseling reflects the permeating effects of the System policy of credit restraint.

We are particularly conscious of the possibility of abuse which might arise if member banks were to borrow at the discount window for the purpose of selling funds in the Federal funds market, especially so since the discount rate is currently so clearly out of line with Federal funds rates and other money market rates. In this regard we have paid particular attention to the operations of the money market banks, and while these banks in the general course of their business are both buyers and sellers of Federal funds on a daily basis, there have been only two instances where money market banks have been net sellers of Federal funds while borrowing from us, and in both instances we learned through conversations with the banks that the situation was brought about inadvertently.

We are continuing to follow closely the borrowings of both reserve city and country banks and, as suggested in your letter, we are, in appropriate instances, encouraging member banks to liquidate their borrowings and to assist the Federal Reserve System in achieving its policy objectives by adopting more restrictive lending policies.

Finally, we are planning discussions with country member banks similar to those conducted with the large money market banks, in those cases in which obvious loan expansion may lead to borrowings at this Bank which might run contrary to System credit policy. These could, in special cases, result in the counseling of member banks even before there is recourse to the discount window.

Very truly yours,

Alfred Hayes

Alfred Hayes
President

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Federal Reserve Bank of St. Louis

Mr. Solomon
Mr. Holland

FEDERAL RESERVE BANK OF PHILADELPHIA Mr F Solomon

PHILADELPHIA, PENNSYLVANIA 19101

OFFICE OF THE
PRESIDENT

July 27, 1966

Mr. Merritt Sherman, Secretary
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Dear Mr. Sherman:

Your letter of July 19 concerning administration of the discount window was timely, and pointed up several important current problems. We feel that our own practices and procedures have been quite consistent with the policy implied in your letter, and we shall continue to be alert to member bank borrowing which is not appropriate under Regulation A.

We believe it would be helpful if the substance of your letter, including the illustrations of inappropriate borrowing, could be made available to all member banks in all districts. This might be done through publication in the Federal Reserve Bulletin or in the monthly Reviews of the Federal Reserve Banks, or through a circular letter. It might also be made the leading subject of a speech by one of the Governors. In any case, we hope there will be no objection to our using the letter in individual borrowing cases and in other limited ways, where it can be helpful to an understanding of Regulation A.

N.Y. Legislation

A recommendation for an annual conference of discount officers has been approved by the Presidents' Conference. If a meeting can be called in the near future, I shall suggest to the Conference of Presidents Committee on Discounts and Credits that a discussion of your letter and its implications be placed on the agenda and that Board staff be invited to participate. Information obtained in recent studies in connection with the Fundamental Reappraisal of the Discount Mechanism and in the quarterly reports of member bank borrowing submitted by the Federal Reserve Banks to the Board is undoubtedly pertinent to administration of the discount window under present circumstances.

It has been pointed out frequently that the rules and standards of Regulation A do not vary over time. While this is true, it is quite obvious that changing conditions within the banking system and the economy generally, create new administrative problems from time to time, and every possible step should be taken to assure that these are handled uniformly and in a manner consistent with current policy.

Sincerely,

Karl R Bopp

Karl R. Bopp

cc: Alfred Hayes

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Federal Reserve Bank of St. Louis

Mr. Sherman
Mr. Holland
Mr. F. Solomon

FEDERAL RESERVE BANK OF RICHMOND

RICHMOND, VIRGINIA 23213

August 5, 1966

Board of Governors
of the Federal Reserve System
Washington, D. C. 20551

Dear Sirs:

As suggested in the Board's letter of July 19, we have carefully reviewed administration of the discount window at this Bank in light of the current objectives of monetary policy and the general principles of Regulation A.

We have continued to keep in mind, in administering the discount window, considerations such as those mentioned in the Board's letter and we agree that it is particularly important that we do so under present conditions. In this connection, the increase in borrowings in this District in recent months, particularly by country banks, has led us to discuss use of the discount window with a number of banks within the past two months. These discussions, as well as discussions initiated with us by banks anticipating borrowing, have had a salutary effect, we feel, in holding down possible inappropriate borrowings. We might note also that our more persistent country bank borrowers have for the most part been banks which in the past have resorted to borrowing from us during this time of the year.

The discussions referred to above indicate that some country banks are feeling increasing pressures because of the decreased availability of funds from their correspondents, although this does not yet appear to be significant. Also, a few banks in this District, both Reserve city and country, are beginning to receive requests to activate lines of credit to national or regional firms which are unable to obtain from their usual sources the amount of credit they desire. We will continue to keep these and similar developments in mind in administering the discount window.

Our review of the situation did not reveal any developments in this District which would appear to be of significance to the System generally.

Very truly yours,

Edw. A. Wayne

Edw. A. Wayne
President

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Federal Reserve Bank of St. Louis

Mr. Holland

Mr. F Solomon

FEDERAL RESERVE BANK OF ST. LOUIS
P. O. Box 442
ST. LOUIS, MISSOURI 63166

DARRYL R. FRANCIS
PRESIDENT

July 25, 1966

Board of Governors
of the Federal Reserve System
Washington, D. C. 20551

Gentlemen:

As suggested in the Board's letter dated July 19, 1966, we have reviewed the administration of our discount window keeping in mind the several factors mentioned in that letter.

With respect to country member banks, 26 borrowed in the first six months of 1966 while only 12 borrowed in the same period in 1965. However, the average number of reserve periods borrowed per bank was slightly less in 1966 than in 1965 and the average daily amount borrowed per bank was virtually the same. On the other hand, while only about the same number of reserve city banks borrowed in the first six months of 1966 as in 1965 the average number of reserve periods of borrowing per bank increased from 6.72 periods in 1965 to 11.30 periods in 1966 and the average daily amount outstanding approximately tripled in 1966 over what it was in 1965. The average daily borrowing per country member bank in 1966 was $165,000 and per reserve city bank was $1,811,000.

In the first six months of the year, the Discount Committee has had to give special attention to eight reserve city banks. In the case of all but three, the weekly report of condition we require of borrowing banks indicated steady progress toward a better liquidity position which resulted in decreased borrowings and finally pay out. Three of the cases necessitated conferences, two have paid out and we are having additional conferences with the third looking toward pay out. The country member bank borrowing in the first six months of the year included four banks with which it was necessary to have conferences or telephone conversations. All but one, a bank with a liquidity crisis work out in progress, have been corrected. Attached are tables showing, by reserve period, the borrowing reserve city and country member banks together with a brief resume of the consideration given the borrowing record of each bank.

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Another analysis we made was to review the record of each of the eight reserve city banks that borrowed in the four reserve periods ended July 20. A copy of that analysis is attached and shows that with the exception of one bank, the longest consecutive borrowing covered four reserve periods. The one bank that has borrowed in twelve consecutive periods is being engaged now in conferences for correction. In the case of the country member banks, the attached analysis shows that fourteen borrowed in the two reserve periods ended July 20 and that with the exception of two banks the longest term of borrowing was six consecutive reserve periods. That bank paid out on July 10. Of the two, one borrowed consecutively for nine periods and after conferences paid out on June 29. The other is a bank with which we are in constant conference working out a severe liquidity crisis. In this case, a condition of availability of our credit is steady curtailment in loan volume.

While the record at the close of the last reserve period looks fairly good we are not sanguine about administrative problems in the future, particularly with reserve city banks. However, we are watching the record of borrowing banks closely and will be in contact with them promptly if continuous or other inappropriate borrowing patterns develop.

Sincerely,

Darryl R. Francis

Darryl R. Francis
President

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RESERVE CITY BANK BORROWINGS
FIRST SIX MONTHS - 1966

Commercial National Bank
Little Rock, Arkansas

While the bank borrowed in eleven periods, they were rather intermittent and in a number of such periods the bank borrowed only on the last day for amounts ranging from 1% to 3% of required reserves. The borrowings had all the aspects of short-term reserve adjustments.

Citizens Fidelity Bank & Trust Company
Louisville, Kentucky

The bank borrowed in twelve reserve periods. The case was reviewed by the Discount Committee on May 16 on basis of seven consecutive reserve periods of borrowing. At the time of review, the bank had been paid out for two reserve periods so the Committee decided to watch.

The case was again referred to the Committee on June 7, at which time the bank had borrowed in two of the then last four periods. The case was returned to regular departmental review. Since then the bank has borrowed in but three of the last eight reserve periods.

First National Lincoln Bank
Louisville, Kentucky

The bank borrowed in ten reserve periods. Case was reviewed on April 26 on basis of seven consecutive reserve periods of borrowing. Bank had shown some downward asset adjustment and the percentage of required reserves borrowed had been nominal in the last two of the seven reserve periods. It was decided to watch the case. Bank paid out on May 27 and has borrowed in but two reserve periods since.

Liberty National Bank & Trust Company
Louisville, Kentucky

Bank borrowed in eight reserve periods. Case reviewed on May 16 on basis of borrowing in eight of the then last nine reserve periods (four in, one out, four in). In three periods the percentage of required reserves borrowed was quite nominal and bank had made an asset adjustment during the borrowing period. It was decided to watch the case. Bank has not borrowed since May 2.

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Louisville Trust Company
Louisville, Kentucky

Bank borrowed in twenty reserve periods. Initially reviewed on March 11 on basis of five consecutive reserve periods of borrowing. Bank had experienced substantial loss of deposits and percentage of reserves borrowed in some periods was nominal. Decided to watch.

Again reviewed on April 6 on the basis of nine consecutive reserve periods. Decided if bank reborrowed to contact. Before contact made, more recent CRC figures showed asset adjustments in securities and in loans. Decided to await later CRC figures.

Again reviewed April 26. Bank continued to decrease loans. Decided to watch.

Next review May 10. Bank had continued to borrow and by that time was in fourteen consecutive periods. Decided to contact.

Contact made May 18. It developed the bank was experiencing heavy loan demand from large national firms. Bank was considering an asset adjustment through sale of securities, pending decision of chief executive officer. We decided to watch.

Since May 18 through June 29 the bank has borrowed in but three intermittent periods. In July the bank borrowed on but one day and in that reserve period has excess reserves larger than the amount borrowed. A memorandum dated July 21 is being circulated to the Discount Committee in which we recommend the case be returned to regular departmental review.

First National Bank
Memphis, Tennessee

Bank borrowed in seventeen periods. Case was reviewed June 13 on basis of six consecutive reserve periods of borrowing. In three of these periods, percentage of reserves borrowed was modest and bank had made reserve adjustment in loans and securities. It was decided to watch.

Again reviewed June 23 and it was decided to watch as bank had not borrowed in the then last two reserve periods. Currently memorandum being circulated to Discount Committee in which recommendation is being made that bank be contacted as it has now borrowed in the last five consecutive reserve periods.

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National Bank of Commerce
Memphis, Tennessee

Bank borrowed in thirteen periods. The bank had been borrowing consecutively in the last part of 1965. The case had been reviewed in late December and it was decided if the bank reborrowed, we should contact.

Case again reviewed February 7, 1966. Decided that notwithstanding the bank had heavy loan demand for cotton financing and was laying off loans, we should contact.

Contact made February 14. Bank stated it had heavy loan demand but expected to get out shortly. Bank paid out in late February, was out for nine reserve periods. Reborrowed in early May, was in for five periods, but paid out in early June and has not reborrowed.

Union Planters National Bank
Memphis, Tennessee

Bank borrowed in twenty reserve periods. Case was referred to the Committee on June 20 on basis of eight consecutive reserve periods of borrowing. It was recommended that we contact the bank.

Before the case was formally reviewed at a meeting of the Committee, more recent Condensed Report of Condition figures were received which showed the bank had an increase in time deposits of $20,000,000 within the week ended June 20. In each of the next three reserve periods following the increase, the percentage of required reserves borrowed decreased substantially to a rather modest figure. The Committee decided to continue to watch the case for another reserve period.

The bank continues to borrow in reduced amount and the case has been referred to the Committee with recommendation that the bank be contacted.

National Stock Yards National Bank
National Stock Yards, Illinois

While the bank borrowed in sixteen reserve periods, the borrowings have been intermittent. The bank had been in touch with us to inform that they are cognizant of provisions of Regulation A and borrowings would be in accordance with the provisions.

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First National Bank
St. Louis, Missouri

Bank has borrowed in only seven intermittent periods.

Mercantile Trust Company National Association
St. Louis, Missouri

Bank has borrowed in only nine intermittent periods.

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COUNTRY BANK BORROWINGS
FIRST SIX MONTHS - 1966

City National Bank
Fort Smith, Arkansas

Bank borrowed in eight consecutive reserve periods. The bank had been cut off from its usual source of fed funds previously obtained from a correspondent. We had agreed that we would remain with the bank at least through latter May. Bank paid out in June and has not reborrowed.

First National Bank
Fort Smith, Arkansas

Bank borrowed in eleven periods, ten being consecutive.

Case was reviewed April 11 on basis of six consecutive reserve periods. In view of downward deposit behavior, it was decided we would continue to watch.

Case again reviewed May 16. It was decided to contact the bank.

Contact was made on June 1. Bank stated it would make some asset adjustments and would pay out. Bank paid out in early June.

Fulton National Bank
Fulton, Missouri

Bank has borrowed in ten reserve periods. This was a case of the bank having been cut off from its usual source of disposition of real estate mortgages through an insurance company and it had to seek F.N.M.A. as an outlet. The latter was rather swamped with similar requests and in the meantime we carried the bank. Bank paid out in latter June and has not reborrowed.

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First National Bank
Sikeston, Missouri

Bank has borrowed in eleven consecutive reserve periods. This, of course, was a case of extreme illiquidity. A current memorandum is being circulated to the Discount Committee.

It is recommended that after additional capital stock payments have been received and U. S. Government and municipal securities released from pledge, as planned by the bank, we should press for continued reduction in the amount of its borrowing.

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EIGHTH DISTRICT
RESERVE CITY BANKS
BORROWINGS
FIRST SIX MONTHS - 1966

	RESERVE PERIODS ENDED AS OF																											Total Number Reserve Periods Borrowed
	Jan. 5	Jan. 12	Jan. 19	Jan. 26	Feb. 2	Feb. 9	Feb. 16	Feb. 23	Mar. 2	Mar. 9	Mar. 16	Mar. 23	Mar. 30	Apr. 6	Apr. 13	Apr. 20	Apr. 27	May 4	May 11	May 18	May 25	June 1	June 8	June 15	June 22	June 29	
LITTLE ROCK BRANCH																												
Commercial National Bank Little Rock	X						X	X	X	X			X	X		X			X		X	X						11
Union National Bank Little Rock																				X	X							2
First National Bank Little Rock	X																											1
Worthen Bank & Trust Co. Little Rock																												1
LOUISVILLE BRANCH																												
Citizens Fid. Bk. & Tr. Co. Louisville	X											X	X	X	X	✓	✓	X		X	X				X	X		12
First National Lincoln Bk Louisville										X	X	X	X	X	X	X	X					X	X					10
Liberty National Bk & Tr Co Louisville										X	X	X	X		X	X	X	X										8
Louisville Trust Company Louisville	X	✓				X	X	X	X	X	X	X	✓	X	X	X	X	X	X	X	✓		X			X		20
MEMPHIS BRANCH																												
First National Bank Memphis	X				X		X		X	X	X	X		X		X	X	X	X	X	X	X	X			X		17
National Bk of Commerce Memphis	X	X	X	X	X	X	X		X									X	X	X	X	X	X					13
Union Planters Nat'l Bk Memphis	X	X			X		X	X	X	X		X	X	X		Y		X	X	X	X	X	X	X	X	✓		20
ST. LOUIS																												
Nat'l Stock Yards Nat'l Bk N. S., Ill.	X		X	X	X			X	X				X	X		X	X	X		X	X	X			X	X		16
Boatmen's Nat'l Bk - St. L																												—
First National Bk - St. L	X	X			X										X						X				X	X		7
Mercantile Tr. Co. N/A St. Louis	X	X		X			X			X			✓					X	X	X								9

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Federal Reserve Bank of St. Louis

IGHTH DISTRICT
OUNTRY BANKS
ORROWING FIRST SIX MONTHS - 1966

	RESERVE PERIODS ENDED													
	Jan. 5	Jan. 19	Feb. 2	Feb. 16	Mar. 2	Mar. 16	Mar. 30	Apr. 13	Apr. 27	May 11	May 25	June 8	June 22	Total Number of Reserve Periods Borrowed
ITTLE ROCK BRANCH														
Exchange Bk & Tr. Co. - El Dorado, Ark												X	X	2
City National Bank - Ft. Smith, Ark						X	X	X	X	X	X	X	X	9
First National Bank - Ft. Smith, Ark.	✓		X	✓	✓	X	X	X	X	X	X	X		11
Bank of Lake Village, Lake Village, Ark.									X	X				2
OUISVILLE BRANCH														
First Bank of Charlestown, Charlestown, Indiana										X				1
Tell City National Bank, Tell City, Ind.													X	1
Planters Bk & Tr. Co., Hopkinsville, Ky.			X		X		X						X	4
EMPHIS BRANCH														1
T. LOUIS														
Belleville Nat'l Savings Bank, Belleville, Illinois									X					1
First National Bank - Belleville, Ill.											✓		X	2
St. Clair Nat'l Bk - Velleville, Ill.											X		X	2
Farmers & Merchants Nat'l Bk - Carlinville, Ill.					X									1
First Nat'l Bank - Carlyle, Illinois														1
City National Bank - Centralia, Ill.										X	X	X	X	4
First National Bank - Columbia, Ill.					X	X		X						3
First National Bank - Lebanon, Ill.							X							1
First National Bank - Madison, Ill.	✓		X											2
City NationalBank - Murphysboro, Ill.											✓	X		2
First Nat'l Bank - Centralia, Missouri			X					X						2
Exchange Nat'l Bank - Columbia, Mo.				X	X	X				X	X	X	X	7
Fulton National Bank - Fulton, Mo.		✓	X	X	X		X	X		X	X	X	X	10
Kirkwood Bank - Kirkwood, Mo.											✓			1
Citizens Nat'l Bk of Greater St. Louis - Maplewood, Mo.			X				X	X	X	X		X	X	7
First Nat'l Bk - Mexico, Mo.														—
First National Bank - Sikeston, Mo.	X		X	X	X	X	X	X	X	X	X	X	X	12
Maries County Bank - Vienna, Mo.											X	X	X	3
First National Bank - Wellston, Mo.														—
Lindell Trust Company - St. Louis, Mo.			X	X	X							X		4
South Side Nat'l Bk - St. Louis, Mo.										X				1
Tower Grove Bank & Tr. Co. - St. Louis		X	✓	X	X	X	X	X	X	X				9

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Eighth Federal Reserve District

Records of the Fourteen Country Banks that borrowed
in the Two Reserve Periods Ended July 20, 1966

Bank	Borrowed in periods ended 7-6	7-20	Range of % of Required Reserves borrowed	No. of Consecutive Periods	Last day in Debt	In Debt 7-21
A	X		30-34	2	7-5	
B	X	X	13-22	2	7-12	
C	X		33	5	7-6	
D	X		8	1	6-27	
E	X	X	11	2	7-7	
F	X		24	5	6-26	
G	X	X	36-59	6	7-10	
H		X	3	1	7-20	X
I		X	6-9	1	7-20	
J *	X	X	13-161	13	7-20	X
K		X	6-7	1	7-20	X
L	X		14-30	9	6-29	
M	X	X	3-11	2	7-20	
N		X	23-32	1	7-18	

* Weekly conferences to work out liquidity crisis.

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FEDERAL RESERVE BANK

OF MINNEAPOLIS

OFFICE OF
THE PRESIDENT

July 22, 1966

Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Dear Sirs:

Our Discount officers and I have carefully reviewed the administration of the discount window at this bank, keeping in mind the conditions outlined in the Board's July 19, 1966 letter. Having done so, we are able to report that it appears to us we have handled the increased demand for Federal Reserve credit in the Ninth District in a manner harmonious with existing monetary policy.

We perhaps should mention that we have made several loans this year with maturities exceeding 15 days in cases where it has been clear to us that the need for credit has been for a longer period. (In recent years we have limited advances to a maximum maturity of 15 days.) This change of policy, however, does not reflect any relaxation in the over-all length of time credit will be made available to a member bank. Rather, it simply represents a realistic way of setting up longer term credits and eliminates our former irksome requirement that a member banker apply for 15-day renewals on a loan recognized at the outset by all concerned as a longer term credit.

We are in complete agreement with the Board's suggested manner of coping with the increased loan demand which must be expected in a period of growing restraint. We believe we have been operating in just such manner and the Board has our assurance we will continue endeavoring to do so.

Sincerely yours,

Hugh D. Galusha, Jr.
President

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FEDERAL RESERVE BANK
OF DALLAS

WATROUS H. IRONS
PRESIDENT

August 1, 1966

Board of Governors of the
Federal Reserve System
Washington, D. C.

Attention: Mr. Merritt Sherman, Secretary

Gentlemen:

I have reviewed with the discount officers and the First Vice President of this Bank the administration of the discount window and especially the specific problems that have developed in recent months in the light of the current monetary policy of the System.

Undoubtedly, some of these problems have arisen as a direct result of the monetary policy in effect, others have arisen indirectly as a consequence of current monetary policy, while still others, arising out of local situations, are little different than we would expect under more or less normal circumstances. In the administration of the discount window we believe it is important that a clear distinction be maintained between these types of problems.

It is also important, in our judgment, that we do not take steps that would so restrict access to the window as to preclude member banks from the use of the window as a "last resort" to meet a seriously illiquid unbalanced position or banks which regularly need more extended access to the window as a result of financing agricultural crops.

We should not use the window to force liquidation as has been done on some occasions in the past in the System, but to help such banks work out the appropriate adjustment as smoothly and as effectively as possible, and this may require an "extended" period in some cases.

Certain problems, especially those falling in the first and third categories cited above, are comparatively easy to detect and to handle. For example, as cited in your letter of July 19, 1966, the extension of credit through the discount window to member banks borrowing to obtain Federal Reserve credit to sell in the Federal Funds market would be clearly inappropriate.

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It would also be inappropriate, as you point out, to borrow at the window to obtain funds to permit fuller utilization of credit lines and larger take-downs of commitments, especially when the System is urging member banks to ration and limit loan expansion. This type of problem is somewhat more difficult to detect because it may be submerged in the general statement of "strong loan demand."

Also included in the first category are those banks, mostly in the larger cities, which have been operating on a basis of a built-in deficit which they plan to meet—and generally do—by access to the Federal Funds market, but rely on the discount window as a last resort when the Funds market is very tight and the rate high. We do not regard this practice on a continuing basis as an appropriate resort to the window. An adjustment of their deficit position as promptly as possible is to be desired of these banks rather than supporting through the window the maintenance of the deficit. Available data generally make this practice reasonably clear.

Most of the cases that would fall in the third category are reasonably clear on the basis of information available. One such type of case would be the individual bank, generally a country bank in a small town, which, because of mismanagement, excessively aggressive competition, reaching out of its territory for loans, or for other causes, finds itself in a problem status as measured by our Examination Department. This problem would require a workout over time.

Of course, the typical agricultural loan problems of many country banks are annual and seasonal, and those banks should have access to the discount window as it has normally been provided. We may expect that the need for funds on the part of these banks will run from 60 days to 90 days or longer. We would continue as we have in the past to keep in touch with these banks and to supplement such information obtainable from them with other information regarding agriculture to which we have access through our Bank and Public Relations and Research contacts. In other words, while helping such banks to meet their agricultural financing problems, we would maintain some degree of pressure on them, although we would recognize that the final solution to this type of problem rests with the harvest of the crop.

Out of this group of banks, although not exclusively so, there have arisen cases of country banks which in the past have been financed by their city correspondents but which now, due to the pressures on the latter banks, are being referred to the Federal Reserve discount window. This type of problem would fall in our middle category listed above. Probably the solution to this problem is to

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meet the country bank's requirements but to determine its former source of credit and observe closely the borrowing requests, with respect to both frequency and amount. In this District there have been a few of these cases, but not many in number nor much in amount.

The obverse side of this transaction would involve the city correspondent bank which formerly provided credit to its country correspondent and, hence, should experience in this particular reference a lessened credit need.

I think these cases will suffice to illustrate the type of problems we have been meeting or expect to face. In general, there has not been undue pressure on the discount window of this Bank, although we have had a few cases of extended use of the window. In our judgment, however, we have considered them as within appropriate limits, but in most such cases have had numerous discussions with the borrowers.

It would be our intention, within reasonable limits, to operate within the concept of Regulation A. We do not think the discount window should be drastically tightened, nor do we expect it to operate as an "escape hatch" to the tightness achieved by other instruments. We do believe, however, that there is a dual character of the discount window: (1) as a general instrument of credit control, and (2) as a direct, specific, or localized instrument of credit control. We fully recognize that after the Federal Reserve credit has been provided, its source is immaterial, but the window does provide bank borrowers with an approach that is localized and is effective and should not be distorted in its application merely because of the objectives of the tight money policy.

The most difficult problems posed by this aspect of the discount window and its administration are "what is continuous?" and "what is short-term?" These problems are not new ones but are with us continuously in connection with the administration of the window. In our judgment, they represent questions which have to be worked out equitably by each Federal Reserve Bank working with its member bank borrowers. This has not proved to be an unmanageable task in our relationships with our borrowers in the past and to date.

If we can provide further information to you in connection with this matter, please let me know.

Sincerely yours,

Watrous H. Irons
President

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Mr. Sherman
Mr. Hackley
Mr. F. Solomon

FEDERAL RESERVE BANK OF SAN FRANCISCO

SAN FRANCISCO, CALIFORNIA 94120

August 5, 1966

Board of Governors of the
Federal Reserve System,
Washington, D. C. 20551

Dear Sirs:

Our review of the administration of the discount window at the Head Office and branches of this bank confirms our belief that it is being administered in accord with the considerations mentioned in the Board's letter of July 19, 1966.

However, as would be expected under existing conditions, we have experienced an increased activity in the discount function recently. We also note increasing interest by member banks both in pledging customers' notes as collateral for borrowing under Section 13, and in discussions followed by the deposit of credit files for review on a so-called "dry run" basis.

This increasing activity has led us to expand the personnel assigned to the discount function and to review factors relative to the flows of funds at borrowing member banks somewhat earlier in borrowing periods than heretofore. We have recognized that the substantial spread between the discount rate and the Federal funds rate might serve as an inducement to the management of some member banks to borrow from us and have found it advantageous to review even more promptly this aspect of the positions of borrowing banks, although we should add that this does not appear to be a major or continuing problem as yet.

Yours very truly,

Eliot J. Swan,
President.

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Mr. Sherrod
Mr. Kenyon

FEDERAL RESERVE BANK OF PHILADELPHIA

PHILADELPHIA, PENNSYLVANIA 19101

#815

OFFICE OF THE
PRESIDENT

September 2, 1966

Mr. Kenneth A. Kenyon
Assistant Secretary
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Dear Mr. Kenyon:

Our Board of Directors has directed me to supplement our telegraphic notice of yesterday's discount rate action with a letter setting forth some of the considerations on which it was based.

The Board has reiterated its recommendation for a rate increase in support of its belief that a continued policy of monetary restraint is called for, particularly in view of what appears to be an expanding military effort in Viet Nam. The present rate is technically inconsistent with such a policy.

The Board recognizes that rate recommendations cannot be approved or disapproved solely on the basis of pure economics and monetary management techniques. The real world requires attention to many other factors, and it is understood that some of these are known to the Board of Governors and not to the Board of this Bank. Our Directors, however, do not want to be in the position of "second-guessing" the action of the Board of Governors and have made their recommendation on the facts available to them.

Special circumstances were taken into account in deciding the amount of the rate increase recommendation. While technical consistency might have indicated an increase of as much as one per cent, the Board felt that the condition of the financial markets did not warrant the sharp and unequivocal action which a large increase would imply. They were aware, too, of pending action on discount policy and felt that the smaller increase might be consistent with it, leaving room for further adjustment after the results of the statement on discount policy could be assessed.

Despite its recommended rate increase, our Board is very sensitive to the limitations of monetary policy, acting virtually alone in the present situation. It feels that we are approaching a dangerous area in which extreme caution must be used, and it urges the Board of Governors to redouble its efforts to reach an accommodation with the Administration which would include appropriate fiscal action.

Very truly yours,

Karl R. Bopp

Karl R. Bopp,
President

FOR FILES
Carolyn Bickel

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BD

BD MIN 228-19-320

Reserved 13-13a 10(b) Para 9 Sec 13

TELEGRAM
LEASED WIRE SERVICE
RECEIVED AT WASHINGTON

1965 AUG 19 PM 4 42

INFUE (A) FIVE AND ONE-HALF (B) SIX (C) SEVEN

Secs 13-13a 5½% | 10(b) 6% | Last ¶ Sec 13 7%

THE FACTORS THAT IMPELLED OUR EXECUTIVE COMMITTEE IN A SPECIAL MEETING CALLED TODAY BY OUR CHAIRMAN, TO TAKE THE ABOVE ACTION WERE THE FOLLOWING:

1. STRONG INFLATIONARY PRESSURES CONTINUE VERY MUCH IN EVIDENCE IN THE ECONOMY.

2. THE DISCOUNT RATE AS EITHER A PRIMARY OR AUXILIARY IMPLEMENT OF MONETARY POLICY MAY LOSE EFFICACY IF THE RATE IS PERMITTED TO CONTINUE AT A LEVEL SIGNIFICANTLY BELOW SHORT- TERM MONEY RATES. THEY WERE PARTICULARLY APPREHENSIVE THAT PERSISTENCE AT AN UNREALISTICALLY LOW DISCOUNT RATE LEVEL WILL LEAVE THE SYSTEM WITHOUT A USEFUL AND IMPORTANT MEANS FOR SIGNALING A CHANGE IN MONETARY POLICY DIRECTION.

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3. THE PRESENT RATE IS CONTRADICTORY TO THE THRUST OF OTHER ELEMENTS OF MONETARY POLICY; UNDER PRESENT CONDITIONS, IT PROVIDES ARBITRAGE TO THE BANKING SYSTEM. APART FROM THIS IS THE PUBLIC VIEW THAT THE PRESENT DISCOUNT RATE STRUCTURE IS INDICATIVE OF THE FEDERAL RESERVE SYSTEM'S VIEW AS TO THE FAIR MARKET PRICE OF MONEY, THUS SUGGESTING THAT BANKS HAVE UNJUSTIFIABLY INCREASED THEIR PROFIT MARGINS. THIS BELIEF MAY FIND SOME APPARENT SUPPORT IN THE FIGURES REVEALING THAT THE BANKING SYSTEM IS ENJOYING THE BENEFITS OF MORE THAN ONE-HALF BILLION DOLLARS OF 4 1/2 PER CENT ADVANCES FROM THE FEDERAL RESERVE BANKS.

4. THERE ARE MISGIVINGS AMONG THE EXECUTIVE COMMITTEE MEMBERS THAT MONETARY POLICY MAY BE REACHING THE LIMITS OF USEFULNESS IN RESTRAINING THE ECONOMY, BUT IN THE ~~ABENCE~~ Absence OF RESTRAINT APPEARING FROM ANY OTHER QUARTER, THE SYSTEM HAS AN OBLIGATION TO DO ALL IT CAN TO FULFILL ITS RESPONSIBILITIES.

CAREFUL CONSIDERATION HAS BEEN GIVEN TO THE POSSIBLE POLITICAL AND PUBLIC IMPLICATIONS OF A DISCOUNT RATE INCREASE. THERE IS A POSSIBILITY THAT SHORT TERM MARKET RATES WILL BE INCREASED TO SOME EXTENT, BUT THIS MAY BE MODERATED BY CHARACTERIZING THIS AS A TECHNICAL ADJUSTMENT TO BRING THE DISCOUNT RATE TO RELEASTIC LEVELS WITHIN THE EXISTING MARKET STRUCTURE.

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GOVERNOR BRIMMER

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June 1, 1967

TO: Board of Governors SUBJECT: Implementation of Discount Administration

FROM: Division of Examinations

B. C. L. There is attached a memorandum which summarizes the various matters discussed during the conference call with the discount officers on May 23.

Attachment.

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CONFIDENTIAL (FR) June 1, 1967

TO: Division of Examinations SUBJECT: Conference Call on Discount Administration

FROM: Priscilla Ormsby

Another in the present series of conference calls to discuss discount administration was held Tuesday, May 23, 1967, among representatives of the Board staff and the discount officers of the twelve Reserve Banks. The Board staff was represented by Mr. Leavitt, Mr. Sundberg, and Miss Ormsby.

Almost no discounting activity worthy of note was reported by any District. Most of what little borrowing was occurring was for seasonal or last-minute adjustment purposes. One reserve city bank in the Seventh District was borrowing as a result of drawdowns of TT&L accounts, and some use of the window in New York City to cushion losses of demand deposits was reported. (Demand deposits were also declining in the Philadelphia District, although this was not resulting in any discounting activity.) But aside from a few such instances, borrowing was extremely light.

In contrast to this atmosphere of extreme ease at the window, several Districts reported that their larger banks were appearing more frequently as net buyers of Federal funds. A counterpart to this trend was an increased willingness of smaller banks to sell Federal funds, at least in the Philadelphia District. The larger Philadelphia banks had moved from net sellers to net buyers within the past few weeks.

Longer term rates were moving fractionally higher in some Districts. This was most apparent in mortgages rates and rates on long-term negotiable CD's. However, neither tendency was universal. In the case of

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mortgage rates, several Districts reported a stable rate and Boston suggested that mortgage rates in the First District were still easing somewhat. At least one of their mutual savings banks was charging 5 3/4%, although the prevailing rate was 6%. Several Districts noted some increased activity in the real estate and construction industries and suggested that ample mortgage money was available at a price. Mr. Melnicoff suggested that the problem in the industry was the increasing costs of building rather than a shortage of funds. Mr. Merritt added that the industry was such as to require a rather lengthy "start-up" time, and perhaps it had not yet fully recovered from the severely depressed conditions of 1966.

In the case of certificates of deposit several Districts noted a stability in the rate. Philadelphia banks were maintaining their time deposits with rates generally lower than those being paid in New York. The rise in New York rates was attributed in part to an aggressive attempt on the part of banks to replace the demand deposits they were losing. In this connection, New York banks continued to run a heavy basic deficit, and the First District reported a like condition in its city banks.

In spite of these trends, no District analyzed its situation as displaying any tightening of monetary conditions. Chicago reported that, because of its negligible borrowing activity, it was turning its attention to attempts to educate smaller member banks on the potential uses of the discount window.

Some continued activity in V-loans was reported. Richmond had had one inquiry, Kansas City had one application awaiting approval, and

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of six outstanding V-loans at the Cleveland Bank, four were coming up for renewal, one with a substantial increase in amount. Mr. Berge reported that the Boston Bank had been asked whether it would be consistent with the guaranteeing agreement for a parent company to guarantee, to the financing institution only, the unguaranteed portion of a V-loan to a subsidiary. This question had been referred to the guaranteeing agencies and had been answered by them in the negative. It was noted that, since the Board opposed changes in the guaranteeing agreement to suit individual circumstances, this apparently precluded such an arrangement. As Mr. Moffatt noted, the parent company usually guaranteed the entire loan, but this was apparently not possible in the specific instance under consideration.

Several changes were requested in the memorandum describing the April 14 conference call. Revised pages showing those changes are attached to this memorandum.

The next call was tentatively planned in about four weeks. Definite arrangements would be made by wire.

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Mr. Merritt reported that the large California banks were experiencing some problems with the charge-off of consumer credit as auto dealers encountered increasing financial difficulties. Kansas City reported similar problems, but felt that in their case it was largely due to a localized situation.

Mr. Fossum reported that the V-loan which had been pending in the Ninth District had been made. It was for $300,000 of revolving credit. The Kansas City District reported a $1.5 million V-loan in process.

Mr. Farmer raised a question as to the rate at which rebates on prepayments should be made immediately following a change in the discount rate. He reported the Richmond Bank was making them at the new rate. Boston and Kansas City used the rate at which the original loan had been made; St. Louis felt that they would do so, should the occasion arise. San Francisco expressed agreement with the latter practice, but reported that they presently used the new rate. It was suggested that the issue should be put on the agenda for discussion at the next Discount Officers Conference.

Mr. Bilby reported that plans were well underway for the establishment of a training program in collateral evaluation for discounting personnel. Governor Robertson had suggested such a program at the last FOMC meeting, in light of the possible passage of the eligible paper bill. An ad hoc subcommittee, consisting of Mr. Bilby as chairman, and Mr. Lewis of St. Louis, Mr. Merritt (~~accompanied by Mr. Jennings as consultant~~) of San Francisco, (with Mr. Jennings of San Francisco serving as consultant) and Mr. Holland and Mr. Leavitt from the Board staff /had met in Washington and outlined the curriculum and faculty. These would both draw heavily on

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the existing examinations school. The first session was planned for the two weeks beginning June 12. It was hoped that people at a supervisory level could attend this first session, so that they might both learn and contribute to the development of the courses and return to their Banks with a clear idea of the nature of the school and who might best attend future sessions. Several subsequent sessions were planned, although the school would not represent a permanent program. Reserve Banks could expect to receive further details shortly.

Mr. Holland discussed a possible new reporting procedure on member bank borrowing which was, as yet, merely an idea on which he was seeking opinions. Currently the Trading Desk had to treat the amount borrowed as a single homogeneous total. However, the response of the banking system to a given level of borrowing was not invariant, but might depend on such things as where in their borrowing spans the banks were (i.e., how subject to the pressure of administrative discipline). Therefore, Mr. Holland suggested the possibility of Reserve Banks including in their reports to the Trading Desk a breakdown of borrowing based on whether or not administrative pressure was being exerted (or was about to be exerted) on the borrowing banks. Mr. Berge questioned whether this was necessary for all banks or could be limited to the large ~~money-market~~ banks. Mr. Holland replied that this probably ought depend largely on the aggregate amount of borrowing being done by the smaller banks. The discount officers agreed to give further thought to the feasibility of such a reporting system.

The next conference call was planned to be held in 4-5 weeks.

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8/19 am

To be considered at the morning meeting, August 19, 1966.

Governor Brimmer

**FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.**

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STRICTLY
CONFIDENTIAL

August 18, 1966.

STRICTLY CONFIDENTIAL (FR)

TO: Board of Governors

FROM: Staff

Attached is a staff draft of a memorandum on coordination of discount administration with other instruments of monetary policy. This document is intended to carry out the purposes of the proposed communication with the Reserve Banks on this subject that was discussed by the Board on Wednesday.

Attachment

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STRICTLY CONFIDENTIAL (FR)

August 18, 1966

DRAFT MEMORANDUM ON
COORDINATION OF DISCOUNT ADMINISTRATION
WITH OTHER INSTRUMENTS OF MONETARY POLICY

A. Policy Background and Objectives

1. The current economic and financial situation is giving rise to special pressures on Federal Reserve discount facilities, but it is also creating special opportunities for discount administration to contribute to effective monetary policy, provided that timely, appropriately oriented, and reasonably uniform adaptation of conventional discounting procedures can be achieved. This memorandum outlines the means by which such an objective may be sought.

2. The current inflationary economic situation is generating extraordinary demands for credit, rising interest rates, and substantial dislocations in flows of funds, with particularly harsh impacts on the financing of housing and, to a lesser extent, state and local governments.

3. In this environment, it is the current aim of monetary policy to restrain the pace of credit expansion, particularly bank credit expansion, while achieving a somewhat better balance of such restraint among the various categories of final credit users. Secondary but nonetheless important qualifying considerations are the desire to avoid disruptions of financial processes and the desire to avoid needless escalation of interest rates.

4. In implementing current monetary policy, the Federal Reserve has relied on several measures of restraint, some conventional and some ~~novel:~~ reflecting innovations.

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(a) Through open market operations, reserve availability has been progressively restrained relative to demand in a fashion typical of most business expansions of the 1950's and 1960's.

(b) In addition, however, reserve requirements have been raised twice, the first such action in 15 years.

(c) Besides such action on the reserve supply front, the System has also recently been taking some steps to ~~inhibit~~ moderate bank ability or willingness to seek funds from other sources. Ruling that promissory notes were deposits and reducing the rate ceiling on multiple-maturity deposits were two actions of this type.

(d) To limit the escalation of interest rates, and to moderate the impact of monetary restraint on the housing industry, the Board has maintained the Regulation Q ceiling on single-maturity CD's. With market rates on competitive instruments now higher in some cases than on such CD's, a good many larger banks undoubtedly are facing substantially larger CD run-offs than they might have anticipated even a few weeks ago.

(e) Given the above constraints on supply of reserve and non-reserve funds, banks have been scrambling hard for remaining nondeposit-types of funds, (e.g., borrowing outside the System) at progressively higher rates. In addition, banks will undoubtedly be led to increase their demand for accommodation at the discount window. In this connection, bank attitudes toward borrowing may have been affected by mention of this possible avenue of relief in the Board's press statement concerning the increase in reserve requirements on time deposits.

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(f) In the meantime, the discount rate on Federal Reserve credit has been held down, to avoid a still more rapid escalation of rates and for other purposes cited in the Board's letter of July 16 to the Reserve Bank Presidents.

5. In view of these developments, it becomes essential to have appropriately designed discount policy that will mesh with the other policy actions already taken. Besides performing the usual kind of "cushioning" function, an appropriate discount policy at this juncture needs to do four particular things:

(a) provide an extra degree of cushioning against extraordinary pressures that might concentrate at certain points in the banking system, particularly because of substantial run-offs of CD's;

(b) counter, at least partly, the demonstrated tendency for banks to respond to credit restraint by running down their net liquidity and selling portfolio investments while postponing effective restriction of lending policies, particularly with respect to loans to good business customers;

(c) avoid releasing so much reserves in the above process as to erode the effectiveness of overall credit restraint; and

(d) accomplish all this with a minimum of disruption and confusion and a maximum of uniformity in the treatment of similar cases.

The discount window is uniquely suited to undertaking these tasks. No other existing monetary policy instruments, singly or in combination, are likely to be able to achieve them.

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B. Implementing Stated Discount Policy Objectives

It is conceived that the best approach to the above discount policy objectives is to develop a set of general guidelines extending the present interpretation of the meaning of Regulation A at those points that will come under greatest stress in the current and prospective situation. This should leave substantially intact the intent and philosophy of the Regulation, the present administrative apparatus for policing the discount window, and the traditional "rules of the game" for dealing with the conventional kinds of member bank needs for temporary, seasonal, or emergency credit assistance. The recommended supplementary guidelines are listed in succeeding paragraphs.

1. Borrowing member banks shall be considered for greater than usual accommodation at the discount window when the clear proximate cause for their borrowing is one of the following:

(a) a sharp run-off of CD's which the bank is unable to replace because of the Regulation Q rate ceiling (it is not intended as a prerequisite for this type of discount accommodation that the member bank should be required to engage in maximum promotion of small consumer-type CD's at ceiling rates in an endeavor to offset, insofar as it can, run-offs of large CD's).

(b) a sudden and substantial drying up of non-Federal Reserve sources of borrowed funds (Federal funds, RPs with corporations, loans from correspondents, transfers from foreign branches) on which the bank had previously relied to finance its position;

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(c) an increase in percentage reserve requirements against deposits;

(d) temporary credit extensions to finance, directly or indirectly (through loans to recognized dealers or underwriters), minimum underwriting activities essential to the continued functioning of securities markets.

2. Repayments of any borrowing undertaken for reasons cited in Item B. 1. above shall be expected on a reasonable and orderly basis, but Federal Reserve Bank officials should encourage banks to obtain funds for such repayment by adopting more restrictive lending practices in preference to selling off investments, borrowing funds elsewhere, or soliciting consumer time deposits more aggressively. For this purpose, Reserve Bank officials should contact each borrowing bank as early as practicable in its borrowing span to ascertain the cause of borrowing and, if other than a purely temporary case, to raise the question of adjustment of bank lending policies. If, and only if, the borrowing bank indicates that its need for borrowing arises from causes cited in Item B.1. above and demonstrates that it is in fact tightening lending policies significantly, it may be allowed to borrow for a more extended period than would otherwise be allowable under the present interpretation of Regulation A. How much longer will have to be a matter for judgment by the discount officer, but it should be contingent upon continuing and substantial progress in curtailing new loan commitments (although not ceasing them altogether).

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3. Encouragement of tightening of lending policies, as recommended in Item B.2., should not extend to Reserve Bank specification of particular borrowers or classes of borrowers to be curtailed. Varying bank-customer relations and the long-run efficiency of private decisions in this area need to be respected. What can be done, however, is to urge banks not to exempt any major category of customer (and especially not business customers) from some degree of tightening, and urge them to encourage their own customers, of all types and sizes, to hold down their loan requests as much as possible.

4. Additionally, banks borrowing for any except very infrequent and temporary needs should be encouraged to maintain their net liquidity at a reasonable level. This point of view should be pressed strongly with any bank borrowing under the terms of Items B.1. and B.2. above. While such banks should not be led to borrow extra funds from the Federal Reserve simply to buy liquid assets or reduce their borrowing from others, they should be pressed to continue their tightening of loan policies beyond the point that permits repayment of current Federal Reserve indebtedness, whenever such extended tightening is needed in order to permit some rebuilding of their liquidity positions to an appropriate level over a reasonable period of months. An "appropriate" level of liquidity cannot be defined with any assurance. As a rough rule of thumb, however, a discount officer might use as a normative value the liquidity position of the typical bank in the borrowing bank's reserve class and size range. This would be in effect measuring the banker against the demonstrated judgment of his peers.

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5. In all the above kinds of contacts, room will have to be left for the borrowing banker to exercise his own judgment in choosing among alternative courses. If, rather than submit to a program of tightening loan policies and rebuilding liquidity in order to gain added discount accommodation, he chooses to effect his adjustment through more conventional means, he should be allowed to do so, but with the benefit of no more discounting assistance than would accrue to him under the present interpretation of Regulation A. The latter standards should be strictly observed, however, as underlined in the Board's letter of July 19, 1966, and the responses thereto by the Presidents.

6. To support the indicated administrative activities, Reserve Banks should feel free to call on borrowing banks for whatever reasonably available data might help to illuminate the relevant circumstances. For example, when the bank's regular reports of loans outstanding are not indicative of tighter policies because of current take-downs of previous commitments, separate and regular reports on new loan commitments should be requested. Borrowing banks should be asked to report regularly on their borrowings from non-Federal Reserve sources, in order to permit a suitable up-to-date judgment of their liquid liabilities to offset against their liquid assets. If, in the judgment of the Reserve Bank, the borrowing bank's liquid asset position is not sufficiently revealed by other reports, a special supplemental report on such assets could also be requested periodically.

7. To help in coordinating open market operations and other aspects of monetary and regulatory policy with these adaptations in discounting, special supplemental reports to the Trading Desk and the Board would be needed:

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(a) Daily report on the total dollar amount of borrowing and number of borrowing banks falling into categories shown in Items B.1.(a), (b), (c) and (d) above, and thus eligible for the extra adjustment credit described in Item B.2.

(b) Daily report on the total dollar amount of borrowing and number of borrowing banks making use of the extra adjustment credit specified in Item B.2. above, in exchange for commitments to their Reserve Banks to adjust their lending policies.

(c) Brief but regular comments on the extent of problems, or lack thereof, arising at each Reserve Bank in administering discount facilities in this fashion. These reports might need to be weekly at first, but less frequent later on.

The Reserve Bank should understand that this modification in discount operations does not reflect Board dissatisfaction with present discount administration. On the contrary, while there are always areas in which such activities can be improved, the Board believes that the System presently has the most effective discount administration in its history. This demonstrated competence in the discount function is an important reason for believing that the System in concert can successfully accomplish the adaptations in discount administration that are herein described.

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To be dictated ok 8/31 B. Mitz

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 31, 1966

To Members of the Board

Subject:

From Mr. Kenyon

(CONFIDENTIAL FR)

Attached is a draft of minutes covering the joint meeting of the Board and Presidents on Tuesday, August 23, relative to discount window administration. The minutes will be circulated for approval in the usual manner.

Attachment.

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A meeting of the Board of Governors of the Federal Reserve System with the Presidents of the Federal Reserve Banks was held at the Federal Reserve Building in Washington, D. C., at 9:30 a.m. on Tuesday, August 23, 1966.

All of the members of the Board were in attendance at the meeting, along with all of the Reserve Bank Presidents. Other attendance from the Board and the Reserve Banks was essentially the same as at the meeting of the Federal Open Market Committee that convened following the adjournment of this joint meeting.

The purpose of this meeting was to discuss a staff draft of a proposed memorandum regarding the coordination of discount window administration with other monetary policy instruments. The preliminary draft statement had been prepared at the Board's direction and had been distributed to the Presidents under date of August 19, 1966.

Vice Chairman Robertson said the Board felt that the problem was a very real one which should be resolved quickly. As all were aware, in the past few months a significant degree of tightening had been achieved through monetary policy, but unfortunately the impact of that tightening had been felt more heavily in some areas than others. The types of credit that were being tightened least were those that in some respects were the most inflationary and unsustainable. On the other hand, housing credit had been hit particularly hard, and State and local Government financing might also be facing a real pinch in the near future. This differential impact was typical of previous periods of tightening. The Board had endeavored to offset it by moving in the area of reserve requirements

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and by refusing to move on Regulation Q ceilings. There were no plans for alleviating pressure on CDs by moving Q ceilings for the time being. The Board hoped that the System could achieve a greater effectiveness of policy than achieved thus far through a change in discount policy. Therefore, the Presidents had been given a proposed program, on which he hoped everyone would feel free to comment.

This was something about which the Board felt fairly keenly, Governor Robertson said. There was probably going to be a need to continue tightening through monetary policy, which was carrying the load in the absence of fiscal restraint, in order to deal with inflationary pressures. There would no doubt be further liquidity pressures, and without effective policing of the discount window there was likely to be a further dumping of municipals by banks onto an already congested market. There was also a need for curtailment of business loans.

There were limits beyond which the Federal Reserve should not go in terms of being specific with respect to particular types of borrowers, but the System could at least exercise prudence and pressure in an endeavor to obtain curtailments in those areas that were most inflationary. This could be done by adjusting discount window administration. Banks that came to the window without any indication that they were attempting to curtail their expansion of credit should not be welcomed with open arms. This did not mean, of course, that there was any idea of closing the window or changing the rules and regulations in the area of meeting seasonal and temporary needs. But insofar as banks endeavored to make greater use of the window--as they would no doubt be doing--the System would have to do a job of policing. Not every bank would be in a

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position to roll over its CDs if there was further tightening. This would mean a real adjustment problem on which banks must be helped, but not at the expense of providing funds for further expansion of credit. What the System should be endeavoring to do was to enlist the assistance of all banks in the country in the job of making monetary policy effective in fighting inflation. It was to be hoped that in this particular instance monetary policy could be made more effective on the up side than it had in the past.

Governor Robertson said that personally he was not bothered by interest rates as such. However, he was bothered by the expansion of credit, particularly in the business loan area. What the Board was seeking, he added, was even-handed administration of the discount window. Different kinds of operations in twelve Banks could not be afforded. Further, a program must be devised that could become effective immediately. The Board would propose to give careful consideration to the views expressed today, and then formulate the program and send it to the Reserve Banks. From then on it would be a System proposition. He was hopeful that the Presidents would call in the officers of the principal banks and discuss the program with them.

The Board would not propose to make whatever statement was adopted a public document, at least until the bugs were ironed out, Governor Robertson continued. It was not possible to change administration of the window in one jump, and there would undoubtedly be problems, but they must be avoided to the extent possible. If borrowing increased, there would be more and more need for the use of a price mechanism (the discount rate) as a means of policing, but in his opinion that point had not yet

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been reached. At the moment the mere fact that the discount rate was out of line with market rates did not affect the administration of the window, at least in his judgment, but the point could be reached where a discount rate move would have to be made. At that point the System would have to face the consequences and move. There might be real flaws in the program outlined in the staff draft memorandum. The Board had devoted considerable time to it, but realized that the Presidents had not had much opportunity to go over it.

Governor Brimmer said, on the question of a public announcement, that because this was such a substantive change in the approach to the window, he would hope that at some point early in the process some kind of public announcement would be made to clarify the underlying rationale. He thought it vital that not only banks but borrowers have an appreciation of what was involved.

Vice Chairman Robertson then called for views around the table, and President Hayes said he had qualms aside from some important substantive questions. Such a fundamental change was involved that if the views of the Presidents were to be given some weight a one-day perusal of the memorandum hardly allowed time for the preparation of considered views. This was the kind of change that could profitably be discussed by the whole System over a period of weeks, rather than hours, before it was put into effect. He understood from Governor Robertson's comments, however, that there was an intention to put it into effect immediately. This raised difficult questions for the determination of open market policy over the coming weeks, and therefore it was probably necessary to clarify this particular issue in advance of the open market meeting,

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though he was frank to say that whatever resolution was made of the matter, difficult problems might be created in terms of open market policy.

President Hayes then said that the Board staff's draft memorandum seemed to be predicated on the premise: (a) that the present primary reliance on open market operations was inadequate to achieve the desired policy goals; and (b) that developments arising from possible large run-offs of CDs, combined with other losses of funds and large seasonal demands, could not be handled by the discount window under the present interpretation of Regulation A. The memorandum further stated that a current goal of monetary policy was to achieve "a somewhat better balance of such restraint (of credit growth) among the various categories of final credit users." It was by no means certain that this was a position which could be identified with any specific System decisions.

The procedures proposed in the memorandum, President Hayes continued, would in effect establish a separate lending procedure to meet additional borrowing needs arising from specific enumerated circumstances. The "additional adjustment assistance credit," under the new proposed policy, would be made available under an extended interpretation of the meaning of Regulation A, and the credit's duration would depend on commitments involving a specific program on the part of the borrowing bank to tighten its loan policy and to take specific steps towards rebuilding liquidity. Normal lending under the present interpretation would be continued, but it was not clear how the two would be distinguished and coordinated. Apparently, only borrowing under the new procedure was to be offset automatically by open market operations. The memorandum implicitly raised, but did not

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specifically answer, difficult questions with regard to the coordination of discount policy with open market operations. It had little to say about System coordination of the implementation of the new policy proposed and the setting up of workable and uniform criteria for implementing the new program.

The new policies proposed in the staff memorandum came close to placing the discount window in the position of providing guidance to the borrowing banks with regard to the distribution of credit, without ever stating specifically that the purpose of the new policy would be to reduce business loans. If reduction of lending to business, in particular to large corporate borrowers, was to be a declared purpose of current Federal Reserve policy, it was doubtful that the suggested broadening of the interpretation of Regulation A was the best means of achieving it. Moreover, it was likely that large corporations would be able to obtain elsewhere funds denied by the banking system, and that they would be willing to pay the required price.

It appeared to him, President Hayes said, that it was entirely feasible to accommodate, without any essential change in the methods of administering the Reserve Banks' discount window, any borrowing needs that might arise from pressures on bank reserve positions discussed in the Board staff memorandum. Borrowing to permit orderly adjustment of lending and portfolio policies to massive losses of CDs (or other types of volatile funds) would be consistent with the spirit and current application of Regulation A. He would expect--and welcome--an increase in borrowing by New York money market banks in the weeks ahead. Indeed, this would be the automatic effect of any tightening through the tested

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instrument of open market operations. But placing on the discount window a vastly enlarged responsibility for supplying reserves in the coming months would involve many complex problems for the System, the banking system, and financial markets. The System was not adequately prepared to make such a shift, and it was undesirable to undertake a fundamental change under present conditions. Proposals as sweeping as those submitted required and deserved more than one day's cursory study. It might be that the fundamental reappraisal of the discount mechanism now under way would suggest the desirability of significant changes in the role assigned to the various tools of monetary policy, but there did not seem to be any need to undertake a basic shift now.

Some of the policies and procedures discussed in the memorandum could be put into effect independently of the proposed change in Regulation A, President Hayes said. This was true in particular for a better coordination of discount and bank supervisory activities, which was needed to better link discount window assistance to the observation of proper liquidity policies. It would be a mistake, however to insist on a rebuilding of bank liquidity at a time when banks might be properly expected to make use of liquidity cushions built up against volatile deposits, including certificates of deposit, to absorb at least part of the expected losses. It might also be feasible and desirable to improve the flow of information on bank lending and borrowing, in particular for money market banks. He had considerable doubt, however, whether it would be possible to obtain meaningful statistics on lending commitments as an advance indicator of bank lending activities.

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Some aspects of the proposed policy needed considerable study because of their ultimate implications--for instance "temporary credit extensions to finance, directly or indirectly, minimum underwriting activities essential to the continued functioning of securities markets."

It was President Hayes' opinion that to implement a new policy along the lines outlined in the memorandum, a public announcement would be required; and the effect of such an announcement might be to create the impression of an easing of reserve policy. Moreover, offsetting open market operations, envisaged in the staff memorandum, could provide the basis for undesirable credit expansion, and they might contribute to confusing and disturbing the market.

In summary, then, it appeared to him that there was no compelling need to resort to a radical change in the implementation of discount policy to achieve present monetary policy goals and to meet any pressures that might arise in the near future. In view of the present highly sensitive state of the market, this did not seem to be the proper time to experiment with new policies that involved complex adjustments in reserve flows and might therefore result in confusion among market participants and possibly have perverse effects on the rate of credit growth. He did not see how the Open Market Committee could hope to reach a meaningful consensus on open market operations and devise proper instructions to the Manager if the proposed operations policy were to be put into effect in the next three weeks.

Mr. Ellis said he had some questions that required response if the Reserve Banks were to try to implement the program responsibly.

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Conversations with large banks in the First District showed clearly that they expected to rely on the window to meet unusual problems associated with the change in reserve requirements, the tax and dividend dates, and run-off of negotiable CDs. The press release issued by the Board in connection with the change in reserve requirements had built up that expectation; now came the staff memorandum having as its theme a suggestion that these member banks be permitted a longer than normal borrowing period in exchange for a commitment to adjust lending policies.

His first question, President Ellis said, was what the Reserve Banks would offer to the borrowing banks in terms of borrowing facilities beyond those they would rightfully expect to be available to them at present. This would be the first question the banks would direct to the discount officers, and the program would have no ready acceptance until the Reserve Banks could supply the answer. There must be a definition, in specific terms, of weeks of unchallenged borrowing. If that answer was given, however, it would mean some lessening of the tightening posture of monetary policy to make it easier for specific banks to readjust their positions, which they were in fact going to have to do anyway.

Mr. Ellis's second question related to the degree of formality of the program. Were the commitments referred to in the staff memorandum to be in writing? Were the commitments to be in some defined form the Reserve Banks could measure to see if they agreed? The memorandum spoke in terms of demonstrating that tighter lending policies were being followed, which meant that there must be a reporting system. If the program was really intended to be that formal, then it stopped short

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of adequacy in being specific and comprehensive enough. On the other hand, it proposed to do much more than could be accomplished under an informal program, wtihout written commitments and reports.

His third question, Mr. Ellis said, was how active the Reserve Banks should be in promoting the program. Normally member banks were allowed to borrow for short periods without much question. A Reserve Bank did not launch requests for information on the first occasion that a bank showed up at the window. It assumed the borrowing was temporary, and in most cases it was. Under the proposed program, however, unless the Reserve Bank launched requests at the onset of each borrowing, banks would be able to avoid the program. There was also the question of the degree of involvement of the Reserve Banks in urging realignment of assets and restoration of liquidity positions, even after a bank was in position to discontinue borrowing. It would be a new and somewhat different policy objective if the Reserve Banks became arbiters of the allocation of credit among final users. This raised the question whether Federal Reserve infringement on management prerogatives would be helpful in longer-range relationships with member banks.

Mr. Ellis said his difficulty in resolving these questions forced him to the conclusion that the Federal Reserve should strive during the period immediately ahead to intensify present efforts to encourage and guide banks to restrain their lending activities without the complication of imposing a new formal program, with all the troubles that would necessarily be involved if it were placed in operation on short notice and with all the upsetting factors that would go with such an approach.

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President Irons commented that the last paragraph of the Board's press release on the change in reserve requirements had been sufficient to cause a number of bankers to contact the Reserve Bank to find out what change was taking place. In view of this release and the press reports thereon, it seemed to him that a further announcement would be almost necessary, and such a release would have to be written with great care in view of the differing interpretations that had been placed on the earlier release.

On preliminary review of the staff memorandum, President Irons said, he felt that the Reserve Banks probably could accomplish under the present Regulation A all that needed to be accomplished in the present circumstances. He failed to see how credit could be extended liberally on the one hand and tightened with the other hand. In the Eleventh District there would be more banks involved in, or at least stimulated, by this program than might be thought at first. Normally, one would think of 6 or 12 banks being active in the Federal funds market, but reports on Federal funds transactions now being obtained by the Dallas Bank on a weekly basis showed that some 180 member banks had been buying or selling Federal funds during the last reporting period. If Federal funds dried up, this would affect not only the largest banks in the District, with their built-in deficit positions, but also perhaps as many as 50 or 75 country banks who could be cut off from loans from their correspondents. The proposed program would generate in the minds of bankers an attitude of funds being more readily available than before, and in that kind of situation the window would be hard to administer. If

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aggressive banks caught in the run-off of CDs were fitted in under the program, they might take 10 days, 30 days, or even 3 months to work their way out. At present, if such a bank should come to the window, the Reserve Bank could give it a lecture and let it have some money for three days, following which that bank would come back and the Reserve Bank would take another look. In this manner discount window administration kept pressure on the bank. Finally, the bank would get tired of coming back, the Reserve Bank would not see it at the window for a while, and the member bank would go to the Federal funds market.

Problems could arise, of course, as a result of the circumstances foreseen in the staff memorandum, President Irons observed. But he was not sure they were of such nature that the Reserve Banks could not meet them under Regulation A, as pressure developed through a run-off of CDs, without opening a door that would clearly liberalize the discount window. A lot of terms were used in the memorandum that were not defined timewise, and that also might create problems. In fact the proposed program would almost amount to setting up two standards, if the System tried to retain Regulation A and at the same time introduce the new program. Many banks had become increasingly illiquid, but had been meeting their requirements. Those banks apparently would be expected to stay under Regulation A. However, other banks that had been reaching out were now going to be told that the Federal Reserve would work the matter out with them. This could produce a discriminatory situation.

In summary, President Irons said, he thought the situation was not so pressing that the System must take action today or tomorrow.

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He noted that a fundamental reappraisal of the discount mechanism was in progress. While that study obviously would not be completed for some time, he felt that the System could attempt to meet the current situation with its present tools, programs, and regulations--deviating whenever necessary to meet any unusual situation. With or without the proposed program, but particularly without it, he considered it important that the discount departments of the Reserve Banks keep in close informal contact with each other to see if they were operating along similar lines. It was important for the people at each Bank to know what other Banks were doing in certain situations.

Governor Mitchell, as Chairman of the Steering Committee for the Fundamental Reappraisal of the Discount Mechanism, commented that the study had three or four major focal points. One related to the experience at the discount window in the various districts and the nature of the administrative problems encountered, mainly with the idea of evaluating the degree of conformity. This study indicated that there had not been uniformity in administration of the window. On the Federal Reserve experience, most of the studies had been completed. A link had been maintained with the academic people, and about all had been obtained that was going to come from those quarters, although contracts had been entered into for some additional studies by individuals. The discount study group was still wrestling with the problem why some banks borrowed and some did not, and with the problem of the relationship of borrowing from the Federal Reserve to borrowing from correspondent banks. Sufficient information, however, was now available to contend with the basic problem

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of administration versus rate, and in a relatively short time the committee and staff might be able to come out with some answers. The question was whether, under the circumstances, it would be desirable to reverse the tool of administration and substitute the tool of rate. This was the fundamental problem, and the time was getting close for debate of this issue within the discount study group and the System. If the System wanted to move in the direction of having the discount rate as the primary tool, it probably could take that course. However, his intuition told him this was not the time to change discount policy so drastically as the System might want to change it after the discount study had been completed.

President Swan said that, like President Hayes, he had some question about listing temporary credit extensions to finance minimum underwriting activities essential to the continued functioning of securites markets as a reason why borrowing member banks should be considered for greater than usual accommodation at the discount window. It seemed to represent quite a different thing from the other categories listed in the staff memorandum. He then asked why it was thought that the proposed program should be limited to banks that had gotten into an illiquid position because of CD run-offs or the drying up of Federal funds. Why should it not be applied to any borrowing bank? He was not sure of the distinction in terms of what the memorandum proposed to accomplish. In terms of attitudes to be taken, he had a question about the extent to which the Federal Reserve would be getting into particular uses of funds. The memorandum indicated that encouragement of a tightening of lending policies should not extend to Reserve Bank specification of what particular

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borrowers or classes of borrowers should be curtailed. However, what would a Reserve Bank's reaction be if a member bank tightened only in the real estate loan area? The question was how far the Reserve Banks should go in terms of types of lending, and he had considerable reservation about the implications of the memorandum and the application of the program. He also had a question about what the commitment figures would mean; they might mean different things to different banks.

President Swan suggested that if the program was approached in terms of minimum scope--emphasis on loan reduction against liquidation of securities--it seemed to him that this could be accomplished quite well within Regulation A. If all could agree on some facets of emphasis short of a complete new program, it might be better to see how that worked. He would expect a substantial run-off of CDs to lead to additional borrowing, and even under Regulation A the Reserve Banks would have to accommodate it.

If the proposed program were adopted, President Swan said, he would prefer to have some announcement made. However, if the System took minimum steps and tried to accomplish the necessary things within Regulation A, he doubted whether a further announcement beyond that contained in the Board's recent press release would be necessary. In any event, he felt that a substantial increase in borrowing could be expected, especially if the differential widened between the discount rate and the Federal funds rate. He did not think it was a question of rate versus administration; the two must go together. He hoped it would be possible to get a little help from a higher discount rate before the

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amount of borrowing grew substantially. If it was really felt that a great problem existed, consideration of getting some help from a higher discount rate should not be deferred until after the fact.

President Galusha said that the proposed program represented to him a disturbing change of a substantive nature in Regulation A. As one who had practiced administrative law, he had a strong distaste for the practice of some agencies in changing public posture without changing their regulatory expressions. It seemed to him that a substantial modification of Regulation A was proposed when one tried to cure the problems of monetary tightness through the discount window by directing banks away from business loans. To him this was the first real new dimension added by the memorandum. The other new dimension was in allowing borrowings to continue for more extended periods than previously allowed. In his view the variety of banking problems found in individual applicants at the discount window was so mixed that it would be difficult indeed to try to get uniformity. It was necessary to look at each individual bank. It appeared to him that all the direction needed to accommodate the situation, that is, to tide banks over the possible run-off of CDs, was found in Regulation A, unless the intent was to change the approach of the Reserve Bank to the borrowing bank so as to investigate kinds of loans. If that was the intent, it involved a substantive change in Regulation A. If this was the purpose, he would prefer to change Regulation A.

Mr. Scanlon suggested that if the proposed program was going to be adopted, the Board should give further study to some of the words used in it and give the Presidents a change to study them. Some of the expressions would seem to lend themselves to better definition. He agreed with

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Governor Mitchell that the discount study did reveal a lack of uniformity, but he did not regard this too seriously. If anything, the current kind of proposal would only aggravate matters and lead to less uniformity.

President Scanlon said he felt that he was able to find in the foreword to Regulation A, and in the Regulation itself, authority to take care of the varying situations that he took it the quidelines in the draft memorandum were intended to take care of. As he recalled, Governor Robertson had spoken of borrowing at the window as not having been excessive. Actually, the reason was that the Reserve Banks had in effect told the member banks to stay away. If the Reserve Banks were to relax, borrowing would rise immediately. In the past six months the Chicago Reserve Bank had sat down on numerous occasions with the chief officers not only of money market banks but the larger reserve city banks and tried to lay the ground rules before them; in other words, get them to understand the rules of the game. The last paragraph of the Board's recent press release had caused some of them to come in and raise questions. He was disturbed to hear several of the bankers saying that they thought the Federal Reserve was backing away from its program of restraint, that the Board had taken a mild action, and that it then more than offset the action by opening the discount window. He did not think that such a reaction was wanted. If a further announcement was made, this should be cleared up.

President Scanlon said he did not feel it was possible to achieve both credit restraint and comfortable liquidity without specifying liquidity requirements by regulation. If liquidity standards were going to be set, he would favor having the supervisory agencies specify that

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banks had to maintain a certain liquidity. It was inappropriate to use this as a criterion for eligibility to borrow; it rather smacked of the compensating balance technique. The System needed to retain the posture that it was the ultimate source of liquidity for all member banks.

President Scanlon also felt that an attempt to distinguish between existing and new loans in determining eligibility to borrow would be difficult and ineffective. A change in total loans might be used for this purpose, but the Reserve Banks were in effect using that now. The first thing a Reserve Bank looked at, when a bank came to the window, was what had happened to its total loans.

President Scanlon noted that the draft memorandum stated that detailed reports on the purpose of borrowing would be required. He was not sure what the use of such reports would be, but apparently borrowing for some purposes would be offset by open market operations while borrowing for other purposes would not. He saw no logic in attempting to link the operations of individual banks with open market operations. If it was desired to promote any particular asset segment, there were ways to do this without opening the discount window to a policy that could have unpredictable results.

President Clay said he had no doubt but that the discount window should be used to supply funds temporarily for the variety of reasons outlined in the staff memorandum. However, he would have no difficulty in interpreting the present Regulation A to permit supplying such funds on a temporary basis. If the problems covered in the memorandum all rolled up together at one time, a massive movement toward the window

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could be expected without any more announcement than had already been made. As soon as banks began to see an increase in borrowings, they would come in and test the window. Very soon it would be necessary to have a price mechanism also at work in order to have orderly administration of the window. If the proposed program was instituted, the necessity of moving on the discount rate should be recognized.

President Clay thought it would be almost impossible to distinguish between traditional types of borrowing under Regulation A and borrowings for the purposes described in the memorandum. He thought the Reserve Banks probably would wind up by putting almost all borrowing on the basis stated in the memorandum. He added that he did not pretend to know how to run all of the banks in the Tenth District. He doubted that anyone around the table had the knowledge to run all of the banks in the respective districts. If a bank came to the window for reasons outlined in the memorandum, he would have no hesitancy in making suggestions as to what the bank might do to make the borrowing period temporary, but he would ask the bank to formulate its own program. It would have the judgment as to where credit was needed and what was in the best interests of the bank and its community. He would find it difficult to sit down with a bank and say that it must stop making certain loans. The bank might find it could go into the Federal funds market, do a better job there, and get through the period.

In summary, President Clay said, he thought the proposal was unnecessary and carried the danger of moving the Federal Reserve into the operations of the individual member banks. He thought this was the wrong way for the Federal Reserve to move.

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President Wayne said that, like President Hayes, he was rather startled to read in the memorandum that it was the current aim of monetary policy to restrain the pace of credit expansion, particularly bank credit expansion, "while achieving a somewhat better balance of such restraint among the various categories of final credit users." He had not been aware that this was a part of current monetary policy, and it was his feeling that the objective could not be achieved through monetary policy. If the Federal Reserve tried to do that, it would be undertaking to substitute the System's judgment for the managerial judgment of the member banks. It was doubtful that the System was qualified, and it was an illusion to think that the objective could be accomplished. Actually, this was one of the original concepts of the System--to direct the flow of credit into appropriate channels--but the effort proved ineffective. If attempted in 1966, it would be ineffective and frustrating. Further, the effort would apply only to banks that came to the discount window.

President Wayne said the key banks in the Fifth District were aware of and concerned about the problem of rising business loans. However, it must be recognized that a commercial bank operates--properly--on depositor relationships. If the Federal Reserve moved into this area, it would be moving along a road of no return because it would have to be specific. Banks would say to the public that their refusal to extend certain credits flowed from accepting the System's advice. This would involve a vast change in concept and approach.

President Hickman said the proposal appeared to be designed to favor large money market banks that had relied heavily on CDs, RPs with

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corporations, etc., over smaller and more conservative banks. Like the change in Regulation Q last December, the proposal might be interpreted as an effort to bail out the aggressive banks from a liquidity squeeze, which was precisely the position they should be in under conditions of tight money. Second, unless the discount rate were raised to 5-1/2 per cent, the large banks would find it profitable to replace CD money with funds from the discount window. Third, it was not clear from the proposal, as stated, whether the Account Manager should absorb the reserves provided through increased borrowing or whether these reserves should be allowed to provide the base for multiple credit expansion. If the total increase of borrowed reserves was not fully offset by sales into the market, credit creation would be inflationary. If it were fully offset, the System would be in roughly the same position as if it had not allowed the additional borrowing in the first instance. This raised the question whether the System could not help out the banks temporarily under Regulation A as now written, encouraging the banks to repay their debt in the shortest time possible.

Perhaps he was old-fashioned, President Hickman said, but it seemed to him there was a danger in trying to guide the banks too closely in their asset management. Complete control over bank assets is one way in which totalitarian governments control their economic system. One of the principal advantages of general controls over selective controls in a free enterprise system is that there is a minimum of interference with market processes. Demand-pull inflation is caused by the fact that aggregate demand exceeds the capacity to produce. The most efficient producers are, by and large, the large corporations who are tied closely

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to the large banks. If business loans were further rationed by large banks, the capacity of the most efficient producers would be curtailed, thus leading to further inflation.

President Hickman noted that one of the ancillary purposes of the proposal was to counter bank sales of investments into the market; yet a major purpose of banks in holding such secondary reserves was to be able to liquidate them in periods of strong loan demand or credit stringency. Banks hold liquid investments to liquidate them, not to hoard them in periods of credit stringency. In sum, he felt that the proposal should be given further study.

President Bopp asked what was really so different about the proposed new procedure, in view of the fact that at present one of the first things asked by a Reserve Bank was what had happened to a borrowing bank's deposits and loans. This was a usual circumstance in connection with accommodation under Regulation A. There were some differences in administration between banks, and Regulation A was not precise. The proposed procedure would presumably add something precise to a base that was not precise, and it might introduce serious confusions. He noted that the memorandum stated that an "appropriate" level of liquidity could not be defined with any assurance, but that as a rule of thumb a discount officer might use as a normative value the liquidity position of the typical bank in the borrowing bank's reserve class and size range. The question of the ability to get accurate, meaningful, current information apparently had not been recognized. Further, the memorandum said that borrowing banks should be asked to report regularly on their borrowings from non-Federal Reserve sources, in order to permit a

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suitable judgment of their liquid liabilities to offset against their liquid assets. He noted that the greatest liquid liability of a bank was its demand deposits. This was the very nature of banking; the meaning of liquidity in the case of banking was quite different from the meaning in the case of a corporation. His suggestion would be that in any redrafting assistance be sought from people with general experience as discount officers, not only to make verbal changes in the draft statement but to determine whether the types of information described in the statement could actually be obtained.

President Patterson said he shared the feeling that the administration of the discount window had been effective. A tightening had been achieved, and this was generally known among bankers. He would hesitate to get into the area of asset management without some definite criteria that could be presented to banks in order to let them know what was expected of them. While he was not opposed to the broad objectives of the program, he was opposed to the memorandum in its present form. A great deal of study was needed before adopting anything that might be regarded as an amendment of Regulation A.

President Francis said he supposed part of the problem reflected comments being heard from bankers and others about a liquidity problem this fall. At the same time, reports were also being heard from bankers and others about some anticipatory borrowing. In his view, the situation might develop to be something like the midyear problem of savings and loan associations. Some preparations were made, but the problem turned out not to be so difficult as it earlier appeared from some angles. In

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any event, he would be reluctant to make any announcement of basic changes in Regulation A or the discount function at this time, lest this wound up being more of an invitation to excessive use of the discount window than anything else. He shared the views already expressed by several persons that Regulation A afforded the tools to do about anything that could actually be read into the memorandum. As to the special circumstances outlined in it, the St. Louis Bank had been working for months with cases of that kind, more or less from the view of helping the management of the banks concerned to straighten things out. A move into some of the areas outlined in the memorandum gave him the feeling that the System would find itself in the position of injecting itself into portfolio management, and this was not where the System belonged. He sensed the possibility that some of the implied commitments could develop into more or less of an invitation to some institutions to use the discount facility. He agreed with the thought that in all of this there was implied some special advantage to less prudent bankers, and penalties to those who had attempted to maintain an investment position that would enable them to weather periods of this kind.

President Francis felt that if the problem developed in substantially the way indicated in the statement it should be made a matter of policy to accommodate liberally through the window, rather than through open market operations. He thought that without any basic change in the present tools it would be possible to ride out whatever might reasonably develop. He would hate to see the System involve itself in something that might not work out as the System would like.

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Governor Mitchell noted that several people had said that they thought they could do under Regulation A about all that was implied in the memorandum. He felt this was true. The proposal was not brought forth as a new regulation; it was just an attempt to elaborate types of situations that might occur in the next month or so. The Account Manager had been worried about the municipal market, and bankers who had been attempting to liquidate their portfolios also were nervous. The market was extremely delicate. The situation was apt to become more gloomy as the weeks unfolded and CD runoffs became larger. His view was that it was desirable to move toward more uniformity in the administration of the discount window--and here he was talking about the problems of the large banks and leaving out of account seasonal borrowing--if in fact a period was approaching when borrowings would be very large. The staff document was an attempt to try to pinpoint some of the problems that might arise. Many people had talked today about substituting the System's judgment for that of a member bank's management. Actually, the Reserve Banks had been doing some of this constantly. They had all talked to member banks about lending and investment policies. It was the way in which this was done that made it acceptable or unacceptable.

This was a period of monetary restraint, Governor Mitchell added, and it might be assumed that more restraint would be forthcoming, even if simply through the market tightening itself. Accordingly, there was certain to be pressure on the discount window. The memorandum attempted to explore the problems and obtain a meeting of the minds

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as to how to deal with those problems as they might develop. Fault might be found with some aspects of the staff memorandum, but the major problem would still be there.

Governor Daane said he shared the philosophical bias expressed by a number of others against injecting the discount window into the allocation process. The System had seen the error of its ways when it attempted to do this in the early days. At present, the market was extremely sensitive, and he agreed with President Hayes that this was not the time to experiment with an almost impossible chore of differentiation that could only lead to further confusion of banker attitudes. He would prefer to rely on the continuing efforts and good sense of the discount officers rather than to construct elaborate new rules and arrangements.

Governor Maisel observed that there was the question of contingency planning--whether or not it should be attempted. The basic question was what would happen if banks could not roll over their CDs and many of them came to the discount window simultaneously. How should the System adjust? Should it be assumed that it would adjust automatically under Regulation A? It seemed to him that it would not. There appeared to be a basic difference between the micro problem and the macro problem. The macro problem could not be solved by saying that every bank that found itself in difficulty could come to the window and borrow as much as it wanted for several weeks. If banks came to the window, the question was what the System would say that it was going to do about monetary policy in this period. It was not a matter of dealing with imprudent banks. It was an effort to set up

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some general rules under which open market operations could be conducted during the next several weeks or months in relation to what was going on at the discount window.

The broader question, Governor Maisel continued, was whether the System was satisfied with the present thrust of monetary policy. There might be some question whether an aggregate policy was succeeding in doing what monetary policy was supposed to be doing. He saw no logic in trying to say that the Federal Reserve should not be concerned with individual bank portfolios. The mere fact of the large increase in business loans made it necessary to ask whether it was desirable to continue along current lines. As he read the staff memorandum and listened to discussion around the table, he felt that this was the second basic question: whether monetary policy was successful if the result was to have the types of distortions that had occurred in this period of restraint.

Governor Maisel said he thought there was no other central bank that did not have a firmer policy along this line than was proposed in the staff memorandum, which suggested nothing very radical. As he had said, he thought that the two basic questions to which he had referred were critical and must be decided, particularly the question whether the System was satisfied with the manner in which credit was now being distributed.

Governor Brimmer commented that the staff document had been drafted to help put into a systematic scheme some of the issues that might have to be faced. The reactions around the table today were not surprising in view of the short time the draft document had been made

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available to the Presidents and in view of the implied shift in discount window administration, but he thought the document proposed a desirable change. He was not convinced that the System should refrain from innovating at all simply because it was in a difficult situation. Normally he tended to be conservative, and on several occasions he had stressed that the System should not innovate unnecessarily, but he was concerned about the differential impact of monetary policy. In his opinion, contingency planning was clearly indicated.

Governor Brimmer said he thought no one should have read the Board's recent press release as an open invitation to come to the discount window. The purpose was to say, in recognition of the action on reserve requirements and the failure to lift Regulation Q ceilings, that this necessarily implied some run-off of CDs. The intent was not to offer aid to overly aggressive and irresponsible banks, but rather to say that the System was not irresponsible and would not let banks go down the drain because of liquidity problems. However, if banks wanted to be accommodated, then as a condition to their borrowing--other than regular seasonal borrowing--they ought to be willing to meet some of the objectives of monetary policy. In his view, the use of traditional instruments would not serve to cope with the present situation.

Governor Robertson commented that it should be clear that no amendment to Regulation A was contemplated. Instead, the purpose of whatever action was decided upon would be to provide uniformity among the Federal Reserve Banks in coping with the problems that seemed certain to lie ahead. From the System's standpoint, he was apprehensive about

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a monetary policy that had a major impact in only limited areas. There was a substantial body of opinion, he added, to the effect that the use of monetary policy had served only to push up rates, and that it had not served to curtail credit in such a way as to cut down on inflationary pressures. He thought it should be obvious to anyone who had read the Board's press release that the intent was not to open up the discount window. The purpose of the change in reserve requirements was to indicate clearly an intent to tighten monetary policy further in order to make it effective and put the System in a position where it could cope with the present problems. The current proposal was not designed to penalize the prudent lender and benefit the imprudent lender, or to bail out aggressive banks that had gotten into an illiquid position. Rather, it was an effort to make clear that there were conditions attached to the use of the discount window, one being to obtain through monetary policy a curb on credit expansion. There might be differences of opinion as to just how to proceed. There might be the question whether the System would be interfering unduly with bank management. In any event, on the basis of today's comments the Board would proceed to work on the memorandum further to produce the kind of document that could be helpful to the System in coping with the problems that were going to be presented at the discount window, not by way of amendment of Regulation A but by carrying out what he conceived to be the purpose of the Regulation and the general language used therein.

Governor Shepardson agreed with Governor Robertson's statement of concept as to the objectives of the proposal. He also said that he agreed with the statements that had been made about the danger of trying

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to run a member bank's business. Nevertheless, it was his impression that in many cases Reserve Banks, in talking with member banks, had looked at their portfolios and suggested that they liquidate investments, even at a cost, in order to get out of the window.

Governor Shepardson added that last December it was hard to foresee so fast and so great a movement in interest rates. This movement had produced some distortions, more than the System would have liked to see. Presently the market for municipal securities was mentioned as being very tight. However, activity financed through municipal offerings was in many cases not only desirable but essential, and the market must not be cramped too tightly. His thought was that the Reserve Banks, in counseling with member banks, would emphasize the desirability of cutting back some of their lending rather than forcing municipal securities into an already congested market. It had not been his thought that the staff memorandum would involve a change in Regulation A or that it would be made a public statement. Rather it was a means of developing a common approach in order to achieve more uniformity in discount window administration and in order to lay stress on restraint in lending rather than liquidation of securities.

In further discussion, President Wayne observed that the Reserve Banks would be pressed into being specific and then would be quoted. If the objectives were as indicated by Board members, they could not be realized effectively through the discount window. Instead, the System would have to state specifically that this was a time when credit should not be extended to certain areas, that is, if the System intended to

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become active in determining the uses of credit. This might be nothing radical in terms of what other central banks had done, but it would be quite radical in this country. Such a substantial departure from traditional practices should not be undertaken lightly.

Governor Robertson commented that he was sure no one at this table would want to see the Federal Reserve get into passing on individual credit applications. However, the System should do everything possible to see that those who utilized the discount window were in a position to establish that they were willing to participate in a program designed to curtail inflationary pressures.

President Hayes said he shared the apprehension expressed by President Wayne that once the System embarked on a route of expressing preferences concerning types of borrowers, the end of the road could not be foreseen. There were always dangers, admittedly, of political interpretations as to what a central bank was doing. There was never a business expansion or cycle when the differential aspects of monetary policy did not lead to a certain amount of criticism. The way to meet this was not to acquiesce in the correctness of such criticism but rather to hold to the general philosophy that the beauty of monetary policy lay in its impersonal quality. There were many ways of assisting specific segments of the economy to meet over-all Governmental policy, but he would regret to see monetary policy assume the role of trying to affect that outcome.

Governor Daane commented that if the proposal really represented a major change and involved a different System approach to implementation

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of monetary policy, then it was not merely a question of getting bugs out of the staff memorandum. Instead, the matter deserved full consideration by all parts of the System.

Governor Robertson concluded the meeting by requesting that the Presidents submit any further comments in writing this week, to which he added that it might be necessary to call another joint meeting of the Board and the Presidents.

The meeting then adjourned.

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Roosa thru CEA

Late Yesterday Roosa called Dewey.

Board should issue a Statement.

2 1/2 minutes

1. Roosa Knew of draft.
   Roosa
2. Talked to CEA (Duesenberry)
3. Talked to someone at Board.

Restrictive steps

DD should be reassuring

Doane talked to Hayes yesterday

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letter

Federal Reserve policy has been based upon the belief that, if credit financed spending does not exceed the bounds that can be accommodated by the nation's growing physical resources, inflation can be restrained. For the past year business demands for bank credit have been particularly intense. While such credit requests often appear justifiable when looked at individually, the aggregate total of credit-financed business spending has tended to reach unsustainable levels while adding appreciable to inflationary pressures. Other problems have arisen from the fact that this record-breaking loan expansion has been financed by liquidation of other banking assets and by curtailment of other lending in ways that tend to be prejudicial for other major sectors of the economy, for financial markets, and the future of the banking system.

The System believes that the national economic interest will be better served if the rate of expansion of bank loans to business is moderated so that its expansion approaches closer to that of the over-all growth in money and credit. For the banking and monetary system to perform its most useful function in the current period, it is necessary for all banks to cooperate in attempting to see that the supply of credit no longer is concentrated in a continued expansion of business loans which have been the most inflationary in recent periods. This objective will be kept in mind

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31/8 ans

for 31/8 mtg

Governor Brimmer

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 31, 1966.

To Board of Governors

From Robert C. Holland

Subject: Amplification of Public Statement on Discount Administration Suggested by President Hayes.

President Hayes of the New York Reserve Bank spoke to Governor Shepardson and me yesterday urging the amplification of the proposed public statement on discount administration (cf. my memorandum of August 29, 1966) in the manner attached. He said he had two aims in mind:

(1) He wished to counter what he felt would otherwise be an adverse market impact from the original draft of the proposed letter to member banks.

(2) More important, he felt that the extremely unsettled state of financial markets, abetted by expectations of still tighter monetary policy, needed to be tranquilized by a moderate public statement from the Federal Reserve System, speaking with one voice.

My own judgment is that the first lines of the Hayes draft go a bit too far in recognizing rumors and explicitly denying any intent to tighten credit further; but that with some modifications of such expressions, a blend of his draft and the discount staff draft of August 29 would prove helpful in quieting reactions to the documents inside and outside the System without altering the basic substance of the program. For similar reasons, I believe some moderation of tone in the early pages of the proposed internal System memorandum would also be a good idea. Some suggestions in this same vein have also been received from individual Governors and staff members. If the Board will indicate the general tenor of the revisions which it wishes to have incorporated in these documents, the staff will endeavor to polish up the specific language, clear it as appropriate, and wire the revised text to all Presidents this afternoon for comment promptly.

Attachment

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August 30, 1966.

Strains in financial markets have recently been aggravated by reports suggesting that the monetary authorities intend to prevent any further growth in bank credit. In order to prevent any misunderstanding, the Federal Reserve System feels called upon to deny such reports. The growing economy clearly requires a continued growth of both bank credit and bank lending, and the Federal Reserve System is prepared to provide the reserves necessary for such growth.

On the other hand, it must be stressed that growth of credit and lending at an excessive pace would add to the inflationary pressures that are already visible. To put the matter in perspective, total bank credit grew at an annual rate of 8-1/2 per cent during the first seven months of this year, total bank loans at a 14-1/2 per cent rate, and bank lending to business at a 22 per cent rate. While the growth of total bank credit and total bank lending has moderated somewhat as compared with last year, the rise in business loans has actually accelerated.

The recent growth of all three measures exceeded the rise that occurred in 1961-1964, with the excess in the case of total loans and business loans being very substantial. That was of course a period when prices were relatively steady and unemployed resources relatively large. By the same token, the current situation, marked by inflationary pressures and relatively full use of resources, is not one in which credit and loan growth can appropriately continue at the recent pace.

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It is the Federal Reserve System's present intention to moderate the growth of bank credit and loans and particularly to discourage excess growth of bank lending to business, while at the same time providing the reserves for a growth of credit appropriate to the present situation.

In implementing this policy, both open market operations and the discount windows at the twelve Federal Reserve Banks will have a role to play. In particular the System is aware that a policy of moderating the growth of bank credit and lending, along with the probability of deposit losses at individual banks, is likely to result in an increase in member bank borrowing at the discount window. The System will be prepared to meet any such legitimate needs, but will expect banks which have experienced unusually rapid growth in business lending to make the necessary adjustment by cutting back on the rate of expansion in this sector. Bearing in mind that any substantial adjustment through the liquidation of bank investments would threaten a further increase in the strains already present in financial markets, the System believes that much of the brunt of member bank adjustments must take the form of moderation in the rate of expansion of loans and particularly business loans.

The curtailment of the recent pace of bank credit and lending to business is in the public interest and in the interest of the entire banking system. In the present inflationary environment, the Federal Reserve System expects all banks to be aware of this whether or not they seek recourse to the discount window.

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To be considered at the joint meeting of the Presidents,
August 23, 1966.

8/22am

Governor Brimmer

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STRICTLY
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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

August 19, 1966.

STRICTLY CONFIDENTIAL

Dear Sir:

Enclosed is a staff draft of a proposed memorandum regarding the coordination of discount window administration with other monetary policy instruments. This preliminary draft of statement has been prepared at the Board's direction and is being distributed for study by the Board members and the Presidents prior to the joint discussion of the subject on Tuesday, August 23.

While the draft of memorandum is strictly confidential, you should feel free to discuss it with your discount officers or other officials at your Bank. The Board is seeking the best thought in the System looking toward even better coordination between discount administration and other instruments of monetary policy.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosure

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.

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STRICTLY CONFIDENTIAL (FR)

August 19, 1966.

DRAFT MEMORANDUM ON
COORDINATION OF DISCOUNT ADMINISTRATION
WITH OTHER INSTRUMENTS OF MONETARY POLICY

A. Policy Background and Objectives

1. The current economic and financial situation is giving rise to special pressures on Federal Reserve discount facilities, but it is also creating special opportunities for discount administration to contribute to effective monetary policy, provided that timely, appropriately oriented, and reasonably uniform adaptation of discounting procedures can be achieved. This memorandum outlines the means by which such an objective may be sought.

2. The current economic situation is generating extraordinary demands for credit, rising interest rates, and substantial dislocations in flows of funds, both among financial intermediaries and between intermediaries and market instruments. The impacts of such credit pressures have been uneven, with particular effects on housing and potentially on state and local governments.

3. In this environment, it is the current aim of monetary policy to restrain the pace of credit expansion, particularly bank credit expansion, while achieving a somewhat better balance of such restraint among the various categories of final credit users. A secondary but nonetheless important qualifying consideration is the desire to avoid disruptions of financial processes.

4. In implementing current monetary policy, the Federal Reserve has relied on several measures of restraint, some conventional and some novel:

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(a) Through open market operations, reserve availability has been progressively restrained relative to demand in a fashion typical of most business expansions of the 1950's and 1960's.

(b) In addition, however, reserve requirements have been raised twice, the first such unilateral action in 15 years.1/

(c) Besides such action on the reserve supply front, the System has also recently been taking some steps to inhibit bank ability or willingness to seek funds from other sources. Ruling that promissory notes were deposits and reducing the rate ceiling on multiple-maturity deposits were two actions of this type. In addition, the Board has maintained the Regulation Q ceiling on single-maturity CD's. With market rates on competitive instruments now higher in some cases than on such CD's, a good many larger banks undoubtedly are facing substantially larger CD run-offs than they might have anticipated even a few weeks ago.

(d) Given the above constraints on supply of reserve and non-reserve funds, banks have been scrambling hard for remaining nondeposit-types of funds, (e.g., borrowing outside the System) at progressively higher rates. In addition, banks will undoubtedly be led to increase their demand for accommodation at the discount window. In this connection, bank attitudes toward borrowing may have been affected by mention of this possible avenue of relief in the Board's press statement concerning the increase in reserve requirements on time deposits.

1/ An upward adjustment from 11 to 12 per cent in the reserve requirement on demand deposits at country banks was introduced in November 1960, coordinate with the action making all vault cash reserve-eligible.

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(e) In the meantime, the discount rate on Federal Reserve credit has been held down, because, in the Board's judgment, there has been more to be lost than gained from the announcement effect of an increase. Supporting reasons for maintaining the discount rate unchanged at this juncture were cited in the Board's letter of July 16 to the Reserve Bank Presidents.

5. In view of these developments and the current environment, it becomes essential to have a discount policy that, besides performing the usual kind of "cushioning" function, will do four particular things:

(a) provide an extra degree of cushioning against extraordinary pressures that might concentrate at certain points in the banking system, particularly because of substantial run-offs of CD's;

(b) counter, at least partly, the demonstrated tendency for banks to respond to credit restraint by running down their net liquidity and selling portfolio investments while postponing effective restriction of lending policies, particularly with respect to loans to good business customers;

(c) avoid releasing so much reserves in the cushioning process as to erode the effectiveness of overall credit restraint; and

(d) accomplish all this with a minimum of disruption and confusion and a maximum of uniformity in the treatment of similar cases.

The discount window is uniquely suited to undertaking these tasks. No other existing monetary policy instruments, singly or in combination, are likely to be able to achieve them.

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B. Implementing Stated Discount Policy Objectives

It is conceived that the best approach to the above discount policy objectives is to develop a set of general guidelines extending the present interpretation of the meaning of Regulation A at those points that will come under greatest stress in the current and prospective situation. This should leave substantially intact the intent and philosophy of the Regulation, the present administrative apparatus for policing the discount window, and the traditional "rules of the game" for dealing with the conventional kinds of member bank needs for temporary, seasonal, or emergency credit assistance. The recommended supplementary guidelines are listed in succeeding paragraphs.

1. Borrowing member banks shall be considered for greater than usual accommodation at the discount window when the clear proximate cause for their borrowing is one of the following:

(a) a sharp run-off of CD's or savings deposits which the bank is unable to replace because of the Regulation Q rate ceilings (it is not intended as a prerequisite for this type of discount accommodation that the member bank should be required to engage in maximum promotion of small consumer-type CD's at ceiling rates in an endeavor to offset, insofar as it can, run-offs of either large CD's or savings deposits).

(b) a sudden and substantial drying up of non-Federal Reserve sources of borrowed funds (Federal funds, RPs with corporations, loans from correspondents, transfers from foreign branches) on which the bank had previously relied to finance its position;

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(c) an increase in reserve requirements against deposits;

(d) temporary credit extensions to finance, directly or indirectly (through loans to recognized dealers or underwriters), minimum underwriting activities essential to the continued functioning of securities markets.

2. Repayments of any borrowing undertaken for reasons cited in Item B. 1. above shall be expected on a reasonable and orderly basis, but Federal Reserve Bank officials should encourage banks to obtain funds for such repayment by adopting more restrictive lending practices in preference to selling off investments, borrowing funds elsewhere, or soliciting consumer time deposits more aggressively. For this purpose, Reserve Bank officials should contact each borrowing bank as early as practicable in its borrowing span to ascertain the cause of borrowing and, if other than a purely temporary case, to raise the question of adjustment of bank lending policies. If, and only if, the borrowing bank indicates that its need for borrowing arises from causes cited in Item B.1. above and demonstrates that it is in fact tightening lending policies significantly, it may be allowed to borrow for a more extended period than would otherwise be allowable under the present interpretation of Regulation A. How much longer will have to be a matter for judgment by the discount officer, but it should be contingent upon continuing and substantial progress in curtailing new loan commitments (although not ceasing them altogether).

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3. Encouragement of tightening of lending policies, as recommended in Item B.2., should not extend to Reserve Bank specification of particular borrowers or classes of borrowers to be curtailed. Varying bank-customer relations and the long-run efficiency of private decisions in this area need to be respected. What can be done, however, is to urge banks not to exempt any major category of customer (and especially not business customers) from some degree of tightening, and urge them to encourage their customers, of all types and sizes, to hold down their loan requests as much as possible.

4. Additionally, banks borrowing for any except very infrequent and temporary needs should be encouraged to maintain their net liquidity at a reasonable level. This point of view should be pressed strongly with any bank borrowing under the terms of Items B.1. and B.2. above. While such banks should not be led to borrow extra funds from the Federal Reserve simply to buy liquid assets or reduce their borrowing from others, they should be pressed to continue their tightening of loan policies beyond the point that permits repayment of current Federal Reserve indebtedness, whenever such extended tightening is needed in order to permit some rebuilding of their liquidity positions to an appropriate level over a reasonable period of months. An "appropriate" level of liquidity cannot be defined with any assurance. As a rough rule of thumb, however, a discount officer might use as a normative value the liquidity position of the typical bank in the borrowing bank's reserve class and size range. This would be in effect measuring the banker against the demonstrated judgment of his peers.

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5. If a borrowing banker, rather than submit to a program of tightening loan policies and rebuilding liquidity in order to gain added discount accommodation, decides to effect his adjustment through other means (e.g., selling investments, borrowing funds elsewhere), he should be allowed no more discounting assistance than would accrue to him under the present interpretation of Regulation A. The latter standards should be strictly observed, as underlined in the Board's letter of July 19, 1966, and the responses thereto by the Presidents.

6. To support the indicated administrative activities, Reserve Banks should feel free to call on borrowing banks for whatever reasonably available data might help to illuminate the relevant circumstances. For example, when the bank's regular reports of loans outstanding are not indicative of tighter policies because of current take-downs of previous commitments, separate and regular reports on new loan commitments should be requested. Borrowing banks should be asked to report regularly on their borrowings from non-Federal Reserve sources, in order to permit a suitable up-to-date judgment of their liquid liabilities to offset against their liquid assets. If, in the judgment of the Reserve Bank, the borrowing bank's liquid asset position is not sufficiently revealed by other reports, a special supplemental report on such assets could also be requested periodically.

7. To help in coordinating open market operations and other aspects of monetary and regulatory policy with these adaptations in discounting, special supplemental reports to the Trading Desk and the Board would be needed:

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(a) Daily report on the total dollar amount of borrowing and number of borrowing banks known to fall into categories shown in Items B.1.(a), (b), (c) and (d) above, and thus eligible for the extra adjustment credit described in Item B.2.

(b) Daily report on the total dollar amount of borrowing and number of borrowing banks making use of the additional adjustment assistance credit specified in Item B.2. above, in exchange for commitments to their Reserve Banks to adjust their lending policies.

(c) Brief but regular comments on the extent of problems, or lack thereof, arising at each Reserve Bank in administering discount facilities in this fashion. These reports might need to be weekly at first, but less frequent later on.

The Board recognizes that the program herein outlined places a very heavy responsibility upon the discount function, and may well involve heavy demands upon Reserve Bank resources. If a program of this sort can be carried through, however, it will make a major contribution to the effectiveness of System monetary policy, at a vital time--a time when monetary policy is carrying a very heavy load in the struggle to resist inflation.

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MONETARY POLICY MAY BE REACHING THE LIMITS OF USEFULNESS IN RESTRAINING THE ECONOMY, BUT IN THE ~~ABENCE~~ Absence OF RESTRAINT APPEARING FROM ANY OTHER QUARTER, THE SYSTEM HAS AN OBLIGATION TO DO ALL IT CAN TO FULFILL ITS RESPONSIBILITIES.

CAREFUL CONSIDERATION HAS BEEN GIVEN TO THE POSSIBLE POLITICAL AND PUBLIC IMPLICATIONS OF A DISCOUNT RATE INCREASE. THERE IS A POSSIBILITY THAT SHORT TERM MARKET RATES WILL BE INCREASED TO SOME EXTENT, BUT THIS MAY BE MODERATED BY CHARACTERIZING THIS AS A TECHNICAL ADJUSTMENT TO BRING THE DISCOUNT RATE TO RELEASTIC LEVELS WITHIN THE EXISTING MARKET STRUCTURE.

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Governor Shepardson suggests that the telegram from Minneapolis be discussed at the close of the meeting, Monday, August 22, 1966.

8/22 am

Governor Brimmer

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INFUE (A) FIVE AND ONE-HALF (B) SIX (C) SEVEN

Secs 13-13a 5½% 10(b) 6% Last ¶ Sec 13 7%

THE FACTORS THAT IMPELLED OUR EXECUTIVE COMMITTEE IN A SPECIAL MEETING CALLED TODAY BY OUR CHAIRMAN, TO TAKE THE ABOVE ACTION WERE THE FOLLOWING:

1. STRONG INFLATIONARY PRESSURES CONTINUE VERY MUCH IN EVIDENCE IN THE ECONOMY.

2. THE DISCOUNT RATE AS EITHER A PRIMARY OR AUXILIARY IMPLEMENT OF MONETARY POLICY MAY LOSE EFFICACY IF THE RATE IS PERMITTED TO CONTINUE AT A LEVEL SIGNIFICANTLY BELOW SHORT- TERM MONEY RATES. THEY WERE PARTICULARLY APPREHENSIVE THAT PERSISTENCE AT AN UNREALISTICALLY LOW DISCOUNT RATE LEVEL WILL LEAVE THE SYSTEM WITHOUT A USEFUL AND IMPORTANT MEANS FOR SIGNALING A CHANGE IN MONETARY POLICY DIRECTION.

3. THE PRESENT RATE IS CONTRADICTORY TO THE THRUST OF OTHER ELEMENTS OF MONETARY POLICY; UNDER PRESENT CONDITIONS, IT PROVIDES ARBITRAGE TO THE BANKING SYSTEM. APART FROM THIS IS THE PUBLIC VIEW THAT THE PRESENT DISCOUNT RATE STRUCTURE IS INDICATIVE OF THE FEDERAL RESERVE SYSTEM'S VIEW AS TO THE FAIR MARKET PRICE OF MONEY, THUS SUGGESTING THAT BANKS HAVE UNJUSTIFIABLY INCREASED THEIR PROFIT MARGINS. THIS BELIEF MAY FIND SOME APPARENT SUPPORT IN THE FIGURES REVEALING THAT THE BANKING SYSTEM IS ENJOYING THE BENEFITS OF MORE THAN ONE-HALF BILLION DOLLARS OF 4 1/2 PER CENT ADVANCES FROM THE FEDERAL RESERVE BANKS.

4. THERE ARE MISGIVINGS AMONG THE ~~EX~~EXECUTIVE COMMITTEE MEMBERS THAT MONETARY POLICY MAY BE REACHING THE LIMITS OF USEFULNESS IN RESTRAINING THE ECONOMY, BUT IN THE ~~ABENCE~~ Absence OF RESTRAINT APPEARING FROM ANY OTHER QUARTER, THE SYSTEM HAS AN OBLIGATION TO DO ALL IT CAN TO FULFILL ITS RESPONSIBILITIES.

CAREFUL CONSIDERATION HAS BEEN GIVEN TO THE POSSIBLE POLITICAL AND PUBLIC IMPLICATIONS OF A DISCOUNT RATE INCREASE. THERE

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GOVERNOR BRIMMER

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For Information Only

Mr Sherman
Mr Holland
Copies to Bd.

FEDERAL RESERVE BANK OF PHILADELPHIA

PHILADELPHIA, PENNSYLVANIA 19101

August 29, 1966

OFFICE OF THE
PRESIDENT

Dear Merritt:

In response to Governor Robertson's request, we are enclosing our views on the Board's draft memorandum of August 19 concerning the coordination of discount administration with other instruments of monetary policy.

Sincerely,

Karl R. Bopp

President

Mr. Merritt Sherman, Secretary
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

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FEDERAL RESERVE BANK OF PHILADELPHIA

Comments on the Board's Draft Memorandum of August 19, 1966,
concerning the Coordination of Discount Administration
with other Instruments of Monetary Policy

As we understand the Board's memorandum of August 19, the very broad objectives of the proposed change in the thrust of discount policy are two-fold: First, to exert a countervailing influence on the tendency for monetary policy to have an uneven impact on the various end-uses of credit (thus (a) tempering inflationary pressures in particular sectors of the economy, such as inventory and plant and equipment spending, and (b) reducing the inequities of monetary restraint and stemming criticism of those inequities); and second, to assure that individual banks and the banking system will not be adversely affected by mounting liquidity pressures. To secure these objectives, the memorandum sets forth "a set of general guidelines extending the present interpretation of the meaning of Regulation A at those points that will come under greatest stress in the current and prospective situation." (Page 4, paragraph 1)

As a corollary to these two broader objectives, the Board's memorandum may be viewed by some as a tactical tour de force. By influencing banks to restrict lending instead of liquidating investments in the coming period of credit stringency, upward pressures might be diverted from market rates, thereby (a) helping to avoid criticism of high and rising interest rates on securities and (b) reducing pressures to raise the Q ceiling.

We should like to comment briefly on each of these goals and then discuss some of the technical problems involved in a program of the scope set forth in the memorandum.

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The Incidence of Monetary Restraint

Though we share the concern expressed in the memorandum over the uneven impact of monetary restraint, we feel it would be a mistake to attempt to influence the end-use of credit through administration of the discount window. There are several reasons for this:

(1) The discount officer would be placed in the position of advising a large number of banks on questions of overall asset allocation and perhaps even of advising on individual loans. The result would be a substitution (to a greater or less degree) of the discount officers' judgments for those of individual bankers in their own communities throughout the nation. In our opinion, the System's discount officers do not now have and could not readily acquire the background and information needed to make intelligent judgments on the multitude of cases and questions which would come to them for decision.

(2) Implementation of the Board's memorandum would create inequities among individual banks within the banking system. Some banks, anticipating credit stringencies and liquidity pressures, have been restricting credit rather drastically for months. Others have done very little to restrain credit so far. Since a program based on the Board's memorandum presumably would take effect on a given date, the banks which already have taken restrictive action would be penalized relative to the more liberal banks.

In addition, the program would penalize banks which have built up liquid assets in order to meet liquidity pressures

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from their own resources, relative to other less liquid banks allowed to use Federal Reserve credit to provide for their liquidity needs. Also, the Fed might find it more difficult to sell the liquidity philosophy in the future if it now favors banks which do not pursue such a philosophy.

(3) An attempt to influence the incidence of monetary policy through discount administration -- even if successful in reducing the volume of bank loans relative to other credit -- could actually aggravate the problem of monetary policy's uneven impact in other areas. For instance, since banks are the primary lenders to small business and since pressures to reduce loans would probably fall most on smaller business borrowers, such pressures would tend to tilt the flow of credit to larger firms and away from smaller ones.

(4) There are other ways to influence the allocation of credit, including the direct funneling of capital to particular sectors of the economy through the intermediation of governmental agencies. In view of the problems associated with use of the discount window in policing the end-use of credit, these other channels might prove more suitable if it were decided that a more balanced incidence of credit restraint were an overriding goal of public policy.

(5) Such a fundamental departure from traditional discount policy as that suggested in the Board's memorandum raises many questions and deserves long and careful study. For instance, what are the implications of such a posture for

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the System's "independence" in the longer run, for membership in the System, for the System's other policy tools and guides to policy? Should such a program apply just to inflationary periods or to all phases of the business cycle? These are but a few of the questions deserving careful consideration. Since the System now is undertaking a fundamental review of the discount function, a ready opportunity is provided to explore in more depth the issues raised in the memorandum.

(6) The Federal Reserve represents the ultimate source of liquidity to the banking system, a fact which is well-known to bankers. Moreover, the discount window has long been associated with the function of "lender of last resort." To maintain an unquestioned role as the ultimate source of liquidity, the System should avoid attaching strings to the discount window, especially before a period of potential financial crisis.

(7) We share the concern expressed by others in the System over regulatory agencies which change their public policies without changing their public regulations. Given the prevailing sensitivity of markets and the possibility of marked liquidity pressures in the near-term, we would be hesitant to announce publicly the substance of the Board's memorandum; hence we would be reluctant to undertake a program of the scope outlined in the memorandum on grounds of equitable regulatory practice.

(8) By encouraging banks to restrict lending and avoid liquidating investments, could the Fed reduce upward pressures

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on interest rates (thereby relieving the beleaguered Q ceiling and stilling Congressional and other criticism of rising interest rates)?

Whether such a program would indeed relieve upward pressures on interest rates is highly problematical. Larger borrowers, deprived of bank credit, would tend to borrow in the capital markets. To the extent that reduced bank liquidation of securities were offset by an increase in new issues, little downward pressure on rates could be expected. Moreover, a significant reduction in bank credit could have the initial effect of hiking rates if expectations were engendered of severe future credit stringency.

Near-term Liquidity Problems

The second broad objective of the Board's memorandum (as noted previously) is to assure that the banking system will not be affected adversely by mounting liquidity pressures.

In our opinion, the particular problem areas pinpointed by the Board can be dealt with effectively under the present language of Regulation A, particularly under Section 201(d) which states that:

> Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks.

We would stress, however, that member banks even then should make internal adjustments as quickly as possible. Extended discount accommodation to some banks (accompanied by open market operations to prevent a spurt in growth of the reserve base) has the effect of rewarding those banks which have aggressivly expanded loans and

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liabilities while penalizing the institutions which have behaved more conservatively.

Technical Problems Associated with the Board's Memorandum

Among other things the memo proposes, in effect, a quid pro quo administrative procedure -- that is, a borrowing bank "shall be considered for greater than usual accommodation" (p.4, para.2) under certain conditions "if, and only if, (it) demonstrates that it is in fact tightening lending policies significantly." (p.5, para.1, italics added) The memo also proposes a daily reporting system by the Reserve Bank on the "banks making use of the additional adjustment assistance credit...in exchange for commitments to their Reserve Banks to adjust their lending policies." (p.8, para.2)

To carry out the specifics of the memo would involve problems of timing, definition, and interpretation.

Timing. Information on loans and investments presently received by the Research Department, processed by the Data Processing Department, and made available to the Discount Department is limited and late. Such information consists of totals only and does not classify loans in any detail. It is received as of two Wednesdays each month and is submitted voluntarily by member banks. Most reports are not received by Research until Friday and Monday following the Wednesday closing. A compilation of this information is not available to Discount until two weeks after the end of a given reserve period, although current data on a given bank may be physically searched out somewhere along the processing line.

Information on federal funds, although submitted daily, is not received from any country bank until at least two business days

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have elapsed. The Discount Department reviews daily reports submitted by the banks, but this is not until after four or five business days have elapsed. Full details for an entire reserve period are not available until one week after the close of the period. Again data on individual banks are available by search in processing.

Definition. Such terms as "net liquidity, at a reasonable level," "liquid assets," "liquid liabilities," "liquid asset position," "typical bank," "demonstrated judgment of his peers," "tightening lending practices significantly," etc. raise questions of definition that could lead to less rather than more uniformity in administration. Comparative ratios can be developed on a current basis only if information is available on a current basis. The Chicago Reserve Bank prints out in its July "Business Conditions" (p.9) that "There is no statistic that can adequately measure bank liquidity nor is it possible to develop one." Very rough rule-of-thumb ratios can, of course, be obtained, but to apply them to individual bank situations, without much more detailed information, could lead to misjudgment.

Interpretation. We are not sure how one can determine for an individual bank the amount of borrowing under the regular provisions of Regulation A and the suggested provisions of the memorandum. How does one determine whether a bank has tightened lending practices "significantly"? For example, a decline in loans could be seasonal, could result from conditions in the region, etc. Does a slower rate of expansion reflect significant tightening? Also, maybe some banks have tightened up several months ago so that it would be difficult for them to tighten further. The real "purposes" of borrowing often involve a mix of factors, the banker interpreting the "purpose" one way, the discount officer and others interpreting it another. For example,

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many bankers say the purpose of borrowing is to get reserves to meet Federal Reserve requirements; only time-consuming analyses over time sharpens his awareness of what is really happening or has happened to his funds.

Not only would it be difficult to get data on "commitments" but the idea of "commitment" is extremely difficult to define. "My word is as good as my bond," says the banker. Is this a commitment? "Commitments" range from "All right, come in when you are ready; we will take care of you" to a firm commitment with the borrower paying a commitment fee.

In summary, while the technical problems involved in timing, definition, and interpretation could undoubtedly be worked out, the memorandum proposes an apparatus of borrowing bank and Reserve Bank reporting that may well tend to create inflexibilities in a function, the nature of which calls as much for "feel" and judgment to accomplish objectives as it calls for information.

Moreover, the proposal has two serious weaknesses. It would have no effect on the lending policies of the large number of banks -- member and nonmember -- that do not borrow from the Reserve Banks. It would also discriminate against member banks that do borrow from the Reserve Banks.

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Mr. Sherman
Mr. Holland

FEDERAL RESERVE BANK OF CHICAGO

OFFICE OF THE PRESIDENT

Copies sent to
Mr. Holland

August 26, 1966

Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Gentlemen:

This letter supplements my oral comments of August 23 on the staff draft of a proposed memorandum regarding the coordination of discount window administration with other monetary policy instruments, dated August 19.

It has been difficult to achieve uniform administration of the discount windows under the 1955 interpretation of Regulation A, as is demonstrated in Bernard Shull's recent analysis. We believe that any change in policy which placed greater reliance upon discretionary decisions of discount officers would cause still greater problems in achieving uniformity of administration, at least for some considerable period of time. Furthermore, since it is reasonable to assume that the extensive study of the discount function now under way will lead to some modifications of discount policy, it would be undesirable to suggest to member banks that standards of appropriateness of borrowing are being changed now. We have succeeded recently, we think, in obtaining relatively good understanding on the part of our member banks of what constitutes appropriate use of the window. We are fearful that frequent changes in administrative standards--real or apparent--would make it nearly impossible to maintain reasonably good understanding of policy by the member banks and reasonable uniformity of administration by the Reserve Banks.

The months ahead may present critical problems for a number of commercial banks and certain segments of the securities markets. However, we feel that such situations are provided for under the existing "principles," as described in the introduction to Regulation A, which state that Federal Reserve credit is available to meet "unusual situations" and

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Board of Governors of the
Federal Reserve System

August 26, 1966

"exceptional circumstances." The cases cited under Section B.1 of the memorandum would appear to be covered by these provisions. We agree that these cases, unless accommodated, could result in serious problems in the current environment and should, therefore, be regarded as appropriate reasons for borrowing. It is our view that no special steps are needed to inform bankers of this posture. In the present circumstances, applications for advances are very likely to rise as a result of any of these developments without any special encouragement by the System.

As Mr. Shull's analysis strongly suggests, the appropriateness of purpose of borrowing is largely a matter of whether, in fact, the borrowing turns out to be of short or long duration. The real question, then, is how soon should the borrowing be liquidated. It still seems appropriate to discourage individual banks from making continuous use of the window. But if we undertake to provide more of the reserve expansion in the months ahead through the discount window, more and more banks, especially the large ones, will come to the window. We can then move somewhat less promptly and less vigorously in getting them out if they are faced with any of the four problems the memorandum poses as deserving of special consideration and are exercising appropriate restraint in their loan policies. This would follow without engaging in discussions which would cause banks to surmise that basic discount policies had been changed.

Meanwhile, Federal Reserve officials could include in speeches or other statements comments on the objectives of monetary restraint and the desirability of spreading its impact to all sectors of demand including commercial and industrial loans. They could also stress the responsibility of managers of private financial institutions to maintain reasonable liquidity so as to assure a sound financial structure generally and viability of individual firms.

We feel that "deals" with individual banks, as suggested in Item B.2 and again in Item B.7.(b) of the memorandum, would be inappropriate and impossible to administer equitably. Moreover, we would be at a loss to determine specifically the appropriate length of a "more extended" period of borrowing. This should be decided on the basis of the circumstances in each case, with continuous exchange of information between discount officers and between the Reserve Banks and the Board serving to maintain reasonable uniformity of administration.

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Board of Governors of the
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August 26, 1966

With respect to the suggested attempt to set liquidity standards as a part of the discount operation, we believe such a policy would not be workable. Indeed, it could backfire; for if bankers believe the window has been opened wider, many banks--not necessarily borrowing banks--may be tempted to further reduce alternative sources of liquidity. In any case, we do not feel that it is possible to develop specific criteria with respect to either loan trends or liquidity positions of individual banks that could provide a rational basis on which to distribute credit among member banks. There is a danger that efforts to develop and implement such criteria would lead some banks to conclude that the System is unwilling or unable to fulfill its role as an ultimate source of liquidity for the banking system. This would be very unfortunate.

We believe, therefore, that anticipated problems can be dealt with under existing interpretations of Regulation A while substantially achieving the policy objectives stated in the staff memorandum. While discount officers should continue to require necessary information from banks on which to base lending decisions, we do not believe that this necessitates an expanded System-wide reporting program at this time or that the Manager of the Open Market Account can utilize effectively, or should attempt to utilize, information on bank borrowings by purpose in conducting open market operations. Information on total borrowings is more relevant to his responsibilities.

Sincerely,

Charles J. Scanlon

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Mr Sherman
Mr Holland

FEDERAL RESERVE BANK OF SAN FRANCISCO

SAN FRANCISCO, CALIFORNIA 94120

Copies sent to Mr Holland

August 26, 1966

Board of Governors of the
Federal Reserve System,
Washington, D. C. 20551

Dear Sirs:

This refers to the Board's letter dated August 19, 1966, and the staff draft of a proposed memorandum enclosed therewith, regarding the coordination of discount window administration with other monetary policy instruments. Subsequent to the discussion at the Board on August 23, this subject has been given further consideration and we do not favor adopting the policy==in its fullest implications--set forth in the draft memorandum, for the reasons stated below. If it is believed that the need to curtail loans selectively has reached the proportions which might be implied in the draft memorandum, we believe voluntary credit restraints imposed on all financial institutions should be sought. In addition, legislation which would give the Board authority to adopt selective credit controls presumably would also be in order.

As we understand the proposed program, it is intended to facilitate the flow of Reserve System credit through the discount window in greater measure to those banks which experience unusual pressures in the current economic environment--particularly those arising from a runoff of large CD's --provided such banks "submit" to a program of significant tightening in particular lending policies and a rebuilding of liquidity. The impact of the proposed policy would fall on the borrowing banks only. If general credit restraints need modification at this time to effect selective loan curtailment, we would prefer voluntary guidelines applicable to all institutional lenders instead of restricting only those member banks which borrow from the System, leaving unaffected other member banks and all nonmember banks to say nothing of other financial institutions. We believe it not only desirable but necessary that the System stand ready to advance funds through the discount window to member banks experiencing the pressures mentioned above, but we do not believe accommodation should be available only to those member banks which are willing and able to curtail certain types of loan activities. Certainly under Regulation A advances would be appropriate even though other sorts of adjustments were undertaken by the borrowing banks.

On the other hand, we would preclude neither the possibility of extended borrowing nor indirect encouragement of loan curtailment. If, in connection with the type of borrowing under consideration, it develops that a member bank chooses to repay in an orderly manner through loan liquidation --rather than, for example, by sale of investments--it should be recognized that such borrowings probably would be outstanding for a more extended period of time, and, indeed, this might be a factor in a bank's choice of this avenue of adjustment. Despite the problems of defining an appropriate "more extended period of time", we would have no objection to this and think such a policy

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could be adopted within the present framework of Regulation A. This would permit the borrowing bank to judge whether its interests are best served through one type of internal adjustment as compared to another. We are not implying that we avoid discussion of various means of adjustment with a borrowing bank. However, we do not believe that we should require a borrowing bank to curtail lending, liquidate investments, issue promissory notes, or take some other particular action to repay its debt to its Reserve Bank. To substitute our judgment for that of the member bank, we suggest, implies a question regarding the competence of management of the member bank, or at least doubt that the management will take the action we think it should. Only when an individual bank is in a most adverse and serious situation should our judgment on sources of repayment be imposed on a borrowing member bank. The proposed mandate to borrowing banks to build up their liquidity is a somewhat separate issue, but one subject to the same objections.

If one interprets the intent of the draft memorandum in a more minimal sense, however, it seems to us to be not too far out of line with our position that borrowing for longer periods be permitted banks which choose loan liquidation. If the proposed policy should go no farther than this, we do not believe any supplement or amendment to Regulation A is necessary or desirable. In our opinion, this has already been brought to the attention of all member banks and the public in the last paragraph of the Board's press statement dated August 17.

Apart from the general questions raised hereinabove and even though we do not favor the draft memorandum, the comments which follow relating to its specific provisions may be of interest.

Page 1 A. Policy Background and Objectives

3. ". . . , while achieving a somewhat better balance of such restraint among the various categories of final credit users."

From this phrase, one must assume that (1) a "better balance" would result automatically from demonstrated general loan restrictions at borrowing member banks, or (2) some specific guidelines would be furnished borrowing member banks to bring about the "better balance" sought. If one agrees a "better balance" is necessary or desirable, it could not be said that loan curtailment per se would bring about a "better balance." As guidelines are not being suggested at this time (see B.3., page 6), we suggest that the phrase quoted above from A.3. be deleted, for it seems to be in conflict with what may be accomplished within the proposed framework.

Page 2 A.4.(c) Line 4. We suggest "short-term" be inserted between the words "that" and "promissory."

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Page 3. A.5.(b) It is provided herein that it is "essential to have a discount policy that also will counter, at least partly, the demonstrated tendency for banks to respond to credit restraint by running down their net liquidity and selling portfolio investments while postponing effective restriction of lending policies, particularly with respect to loans to good business customers."

We are unable to rationalize this view with the General Principles set forth in the Foreword to Regulation A. The question of maintaining an appropriate level of liquidity rests primarily in the supervision of banks by the proper authority, not, we submit, in the formulation or administration of discount policy.

Page 4. B.1.(a) Greater than usual discount accommodation is to be considered for banks requiring funds because of "a sharp runoff of CD's or savings deposits which the bank is unable to replace because of the Regulation Q rate ceilings."

This implies that a bank must pay the ceiling rates prior to consideration for special accommodations at the discount window. Some well-managed banks may not wish to engage in the rate war for time deposits and, therefore, lose significant amounts of such funds. We believe such member banks should not be treated less favorably than those members paying Regulation Q ceiling rates but which have lost deposits.

B.1.(b) This paragraph provides for more than usual accommodation for a member bank experiencing a loss of substantial non-Federal Reserve sources of borrowed funds upon which the bank previously had relied to finance its position. Although the System may find it necessary in the final analysis to lend support to such member banks, we are not sympathetic toward the management of a bank which, to take advantage of interest differentials, operates in a constant deficit position requiring at all times short-term borrowed funds for the maintenance of legal required reserves. Unless no reasonable alternative existed, we would not consider it appropriate to provide discount accommodations for an extended period to such an institution.

Page 5. B.1.(d). This provides for greater than usual discount relief to a member bank requiring funds because of the temporary needs of recognized dealers or underwriters to cover minimum underwriting activities essential to the continued functioning of securities markets. We agree that the purposes here are worthy, but we do not see the necessity of singling out for special mention borrowings by member banks for such purposes, since we would view such advances as being within the intent of the Foreword to Regulation A.

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Page 6. B.4. Banks are to "be encouraged to maintain their net liquidity at a reasonable level." This, again, raises the question of the relationship of bank supervision to the discount administration. (See our comments under A.5.(b) above.)

Page 7. B.6. The problems of interpreting data on loan commitments were brought out during the August 23 discussion, and we simply wish to emphasize them again.

Yours very truly,

Eliot J. Swan,
President.

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8/26 sw

Governor Brimmer

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

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STRICTLY
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MEMORANDUM

STRICTLY CONFIDENTIAL (FR) August 26, 1966.

TO: Board of Governors SUBJECT: Revision of

FROM: Robert C. Holland discount administration program

As directed by the Acting Chairman, the staff is undertaking revisions of the draft program for discount administration (memorandum dated August 19, 1966) in the light of oral comments by the Reserve Bank Presidents at the joint meeting on August 23 and written comments expected to be received by August 29. Pending distribution of the minutes of the joint meeting, I have prepared the attached draft reference list of issues raised orally by the Presidents.

Discount officers from three Reserve Banks (New York, Philadelphia, Chicago) will be meeting with the staff on Monday to modify and reformulate one or more versions of the program in ways that might be operationally feasible, depending upon how the Board resolves the basic issues of principle involved. Attached is a rough outline of one possible set of implementing arrangements, assuming a particular set of Board decisions as to the issues of principle cited. The staff would appreciate any guidance that the Board members might be moved to give, individually or collectively, concerning the use of this material as grist for the staff revision effort Monday.

The staff drafting group will be meeting in Room 2019 beginning at 9:30 a.m. Monday. Governor Mitchell will make some opening remarks and the group is invited to lunch with the available Governors at 1:00 p.m. in the Blue Room.

Attachments (2)

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REVISED DISCOUNT ADMINISTRATION PROGRAM

II. POSSIBLE COMPROMISE PROGRAM

A. Issues of principle involved (to be resolved by Board, after consideration of comments by the Presidents):

1. Allocation of credit:

Some tightening of lending policies, and some corresponding lightening of bank securities sales, but minimum of interference with bank decisions as to what borrowers get credit.

2. Release of reserves:

Moderate net increment of reserves to be released.

3. Extent of publicity:

Only borrowing banks in need of adjustment contacted explicitly, but general theme might be mentioned in speeches, etc.

B. Implementing procedures needed (to be developed by staff):

1. Only banks to be explicitly contacted would be those who ordinarily would be due for contact by discount officer in any event, because of their borrowing record.

2. Discount officer to raise question of possible resort to curtailment of new lending as one among several possible avenues of adjustment, with the banker left free to pick which means of adjustment he might prefer in the circumstances.

3. Banker to be encouraged to consider loan curtailment, especially business loan curtailment, as action in the public interest--a way for him to contribute to the fight against inflation that is the

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key current objective of monetary policy. Emphasis that choice of borrowers to be cut back is up to him.

4. If borrowing bank decides to undertake loan curtailment as a means of adjustment, it should be allowed as much--but no more--time to repay its borrowing as would have been allowed by discount officer if the bank had made such an adjustment choice without special Federal Reserve encouragement. Hence, there is no need for definition of any special added borrowing privileges. However, so long as loan curtailment proceeds at reasonable pace, there would be no Federal Reserve pressure to accelerate repayment of borrowing by pressing for sale of any free investments.

5. Net additional reserves released under this program should be fairly moderate. Presumably some more borrowing banks would choose to adjust by curtailing loans in preference to other means (e.g., selling investments, borrowing elsewhere, pushing small CD issuance), and presumably such adjustment would take longer than would adjustment by sale of securities. Hence, the average amount of borrowed reserves outstanding would probably be larger than otherwise, but not greatly so.

6. Banks would not be invited into the window (no "circumstances qualifying banks for special assistance," as suggested in the August 19 memo), but as occasions arise banks could be reminded that if they found themselves under more pressure than they could handle (e.g., from CD run-offs), the discount window was available

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as a lender of last resort, adding the comment that it would be hoped that they would conduct their adjustment programs, including borrowing, in a manner consonant with the public interest in (a) orderly financial processes, and (b) fighting inflation.

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STRICTLY CONFIDENTIAL (FR) August 26, 1966.

SUMMARY OF COMMENTS BY FEDERAL RESERVE BANK PRESIDENTS
ON DRAFT MEMORANDUM ON COORDINATION OF DISCOUNT ADMINISTRATION
WITH OTHER INSTRUMENTS OF MONETARY POLICY
AT JOINT BOARD-PRESIDENTS MEETING, AUGUST 23, 1966

1. Monetary policy should not be used to influence allocation of credit among various users; at least, discount policy should not be so used.

2. CD run-offs can be handled adequately under existing Regulation A.

3. Extending credit beyond regular Regulation A limits would create problems for open market operations, as follows:

   a) would release too much reserves, easing credit restraint;

   b) would require offsetting open market operations of a size that could strain the securities market;

   c) would require more carefully thought through integration with open market operations.

4. Proposed program would create bank and public relations problems:

   a) disrupt existing member bank understanding of dis count mechanism;

   b) would aid aggressive, illiquid banks the most;

   c) raises questions as to how much publicity to give program (Board's announcement has already stirred up questions);

   d) any significant change should be made openly, not secretly;

   e) would be difficult to communicate accurately to banks other than borrowing banks, but inadequately effective if applied only to banks after they come to discount window.

5. Numerous problems of practical definition and measurement:

   a) amount of extra borrowings;

   b) new loan commitments;

   c) needs for financing underwriting;

   d) kind of member bank commitment to Reserve Bank to reduce lending, and for how much and how long;

   e) orderly adjustment;

   f) liquid liabilities.

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6. Difficult to insist on banks' maintaining or rebuilding liquidity when they are under pressure; that is precisely the kind of need for which banks would expect to use their previously husbanded liquid resources; to effect better bank liquidity, need supervisory standards.

7. Proposed program might involve extra borrowing by many banks, small as well as large, in preference to borrowing elsewhere, with large number of cases hard to handle.

8. Will be hard to achieve uniformity of administration of the proposed program; on the other hand, discount administration under existing Regulation A procedure is regarded as sufficiently uniform to cause no serious problem.

9. Not logical or necessary to link reserve adjustment of individual bank to general monetary policy.

10. Would result in rising borrowings that would soon require discount rate increase to help control.

11. Proposed program is too specific or mechanical, out of keeping with more generalized language of Regulation A.

12. A workable minimum program would simply be to have discount officers increase their emphasis on loan tightening as compared with investment liquidation in contacting borrowing banks regarding adjustment.

13. More study of proposal needed, and situation not so pressing but that several weeks could profitably be spent on review and discussion of idea. Proposal represents a basic change in discount administration; perhaps should be reviewed by committees responsible for the longer-range discount study.

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FR 468
(Rev. 3-63)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MEMO Date 8/26/66 Time 11:30 am

To: Gov. Brimmer

From: Robert C. Holland

Tel. No. _____ Ext. _____

	Please call		For your approval
	Returned your call	X	For your information
	Will call again		Note and return
	Phone me re attached		For comments and suggestions
	See me re attached		Preparation of reply

MESSAGE:

Here's a supplement to my memo of this morning--outlining a more aggressive discounting program as an alternative. I'd propose to use this on a second set of assumed Board decisions, and try to get the discount officers to draft implementing language for this as well as for the compromise program, to the extent time permits. How does this strike you?

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STRICTLY CONFIDENTIAL (FR) August 26, 1966.

REVISED DISCOUNT ADMINISTRATION PROGRAM

III. AGGRESSIVE PROGRAM

A. Issues of principle involved (to be resolved by Board, after consideration of comments by the Presidents):

1. Allocation of credit:

Definite effort to curtail bank lending, and to moderate pressure of bank asset sales and borrowing from others upon the money and capital markets.

2. Release of reserves:

Considerable additional volume of reserves released through discount window, to be offset to the extent necessary by open market operations.

3. Extent of publicity:

Every member bank notified of program by letter; letter also released to press with brief public statement.

B. Implementing procedures needed: (to be developed by staff)

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FR 468
(Rev. 3-63)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MEMO Date 8/29/66 Time _____

To: Governor Brimmer

From: Daniel H. Brill

Tel. No. _____ Ext. _____

☐	Please call	☐	For your approval
☐	Returned your call	☐	For your information
☐	Will call again	☐	Note and return
☐	Phone me re attached	☐	For comments and suggestions
☐	See me re attached	☐	Preparation of reply

MESSAGE:

In light of the luncheon discussion today, I think we ought to cram this down the discount officers' throats.

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Excerpt from Federal Reserve Act (Section 4, paragraph 8):

"8. Administration of affairs; extension of credit

". . . . The Board of Governors of the Federal Reserve System may prescribe regulations further defining within the limitations of this Act the conditions under which discounts, advancements, and the accommodations may be extended to member banks. Each Federal reserve bank shall keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse advances, rediscounts or other credit accommodations, the Federal reserve bank shall give consideration to such information. ..."

Excerpt from Regulation A (Section 201.0--Foreword: General Principles):

"Section 201.0--Foreword: General Principles

. . .

(e) In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally. ..."

Underlining supplied.

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Governor Brimmer

August 29, 1966

Governors Mitchell, Maisel, Brimmer ✓ Statements on discount policy

Daniel H. Brill

CONFIDENTIAL (FR)

Discussion at the luncheon we had yesterday with the three discount officers in to assist in drafting principles for window administration clearly underscores the need for a System public statement on the subject. Earlier I had thought it might be possible to effect our objectives through some well-timed speeches by System brass, but it is evident that something more authoritative is needed, internally and externally. Perhaps a letter addressed to all member banks, accompanied by a press release announcing that such a letter had been sent (along with a copy of the letter) would be the best device.

The objectives of the letter would be to reach banks not coming to the window--either because they have no need or because they are making adjustments in fear of being turned away--and to provide discount officers with a "talking paper" to use on recalcitrant banks. (An incidental value to such a letter would be that of enfilading any remaining internal opposition.)

There are some hazards, however, to keep in mind. First is the possibility that it would be construed as an additional tightening measure, rather than a spelling-out of the way in which a specific degree of tightness is to be administered. This is no time to be unsettling financial markets unnecessarily.

Second, how do we explain our intent to curtail financing of plant expansion when another arm of economic policy is subsidizing it via the investment tax credit? In other words, are we willing to seem to be at cross-purposes with the Administration? Remember that the world out there doesn't know how much opposition there is to the tax credit in official circles outside the Treasury.

Third, what do we do if banks fail to cooperate? Are we far enough along on back-up plans with real muscle in them to risk this first mild step at credit allocation? And would we be willing to ask for legislation empowering us to undertake specific allocation? I'm not trying to raise hobgoblins, or cross bridges too soon, but it seems to me a perfectly appropriate question for a reporter to ask.

Finally, should such a letter be issued before discussion with the Presidents of the revised statement of principles or after? It would be hard getting it cleared before the next FOMC meeting on September 13, considering the Labor Day holiday, but waiting until then may miss an important opportunity to catch banks during the early stages of the feared CD run-off as tax date approaches.

If there is a possibility that the Board will want the staff to prepare drafts of such a letter, it would be helpful if some of the issues raised above could be discussed at a meeting sometime this week.

cc: Governor Shepardson, Mr. Holland, Mr. Molony

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Governor Brimmer

FOR INFORMATION
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MEETING OF THE BOARD.

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STRICTLY CONFIDENTIAL

STRICTLY CONFIDENTIAL (FR) August 29, 1966.

TO: Board of Governors SUBJECT: Development of revised program for discount administration.

FROM: Robert C. Holland

Pursuant to the direction of the Board, discount officers from the Federal Reserve Banks of New York, Philadelphia, and Chicago met today with members of the Board's staff in an endeavor to develop a practical program for adapting discount administration insofar as feasible to the restraint of business lending. Attached are the results of that meeting, in the form of two drafts:

(1) "Revised Program for Discount Administration in the Current Economic Environment", and

(2) "Letter to Member Banks Concerning Need to Restrain Business Lending".

While the discount officers had at their disposal the Board staff memorandum of August 19, 1966, "Draft Memorandum on Coordination of Discount Administration with Other Instruments of Monetary Policy", and a summary of the oral comments and selected written comments of that memorandum by the Federal Reserve Bank Presidents, they found it most practicable to develop fresh language for the attached documents. The program encompassed in these documents, they believe, represents as far as the System can feasibly go in adapting discount administration to the objectives which the Board has expressed, so long as the existing institutional framework is to be maintained. The kinds of contacts with member banks proposed in this program they regard as no more than an extension of the kinds of representations concerning total loan curtailment that have already been made by some discount officers to their member banks.

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The discount officers caution that the effectiveness of the program suggested below will be hard to measure, and will probably be no more than modest at best. Furthermore, they feel this program may not remain viable if business needs for bank credit to finance defense production should accelerate.

While all the caveats expressed by the discount officers may be well taken, I think the program herein presented represents an effort in the direction of rebalancing credit pressures that might usefully be undertaken.

If the Board finds this program to be worthy of consideration, copies of it might be forwarded to each Reserve Bank President with a request for his further comment. President Wayne, in his capacity as Chairman of the Conference of Presidents, has written the Board requesting that time be allowed "for a careful review of the proposed policy by System discount officers and for further discussions with members of the Conference." At the moment, the next convenient opportunity for a meeting of the Board and the Presidents would be in conjunction with the Federal Open Market Committee meeting on September 13; and the first practical opportunity for a round-table discussion by System discount officers would be at their scheduled conference, September 19-20. Potential market developments in the interim, however, may very well make it inadvisable to delay until these dates System discussion and final adoption of the program in question.

Attachments 2

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DRAFT

FOR INTERNAL SYSTEM USE ONLY STRICTLY CONFIDENTIAL (FR)

August 29, 1966.

REVISED PROGRAM FOR DISCOUNT ADMINISTRATION
IN THE CURRENT ECONOMIC ENVIRONMENT

In the current business and financial situation, it is contemplated that it will prove necessary and desirable within the next few weeks and months to impel member banks to borrow substantially greater amounts than at present from their respective Reserve Banks. This would be accomplished by maintaining current Regulation Q ceilings while conducting sufficiently restrictive open market operations so as to give rise to a substantial run-off in CD's or declines in other types of deposits, and perhaps also occasional drying up of sources of inter-bank borrowing.

This operational strategy is deemed necessary in order to slow down the rate of bank credit expansion. From an economic stabilization point of view, however, this strategy can only be effective if the lending policies of the Reserve Banks tend to curtail bank lending to those segments of the economy where the greatest recent expansion has taken place. At the same time, it is necessary that pressures on the banking system do not result in a demoralization of other financial markets, e.g., the municipal market, as the banks endeavor to adjust their positions.

It is believed that Federal Reserve Bank discount administration can help to accomplish the desired objectives within the framework of the present Regulation A. It is likely that in those situations

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where there is a sharp run-off of CD's or a drying up of inter-bank sources of funds, it may be necessary, as the Regulation in fact has anticipated,[1/] to lend to banks for somewhat longer than usual periods of time. Such longer periods of credit extension would permit the borrowing bank to make some adjustment in the area of business loans rather than concentrating their adjustment in the earning asset categories of investments, real estate mortgages, and other loans.

While discount officers should refrain from making decisions for member banks, they should nevertheless urge the desirability of undertaking adjustments in business loans. In any case, it should be made clear--again in accordance with the present Regulation[2/]--that expansion of business loans at current rates is not in the public interest and will not be condoned while the member bank is in a position of having to borrow from the Federal Reserve Bank.

Indicated needs for industrial credit during the next few months are such that it is altogether likely that member banks will have to forego loans to some well-established prime customers. It is not intended that System policy prevent member banks from meeting legitimate and normal seasonal needs, especially where they have made some preparation to take care of this themselves; it is intended,

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1/ ". . . Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks. . . ." Regulation A, Section 201.0, par. (d).

2/ Regulation A, Section 201.0, par. (e), quoted on page 3.

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however, that the seasonally adjusted rate of expansion of business loans shall be reduced.

The emphasis on slowing down the rate of growth of a particular category of loan is a departure from recent discounting tradition and practice. It is felt to be necessary because of the Board's conclusion that the present rate of expansion of business loans is supporting an unsustainable rate of growth of business investment, with unsound consequences for economic and financial conditions. The Foreword to Regulation A has anticipated this possibility. It specifies that "each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally." It is this concern for "sound credit conditions," rooted in the Federal Reserve Act itself, which makes it currently necessary to bring to bear those aspects of discount administration which are designed to deal with unusual circumstances.

While the standards of discount accommodation outlined above can only affect directly those banks that are indebted to the Federal Reserve Banks, the Federal Reserve Banks are encouraged to continue to take the initiative in communicating with the larger any other banks whose general liquidity position and lending activity are such that they might soon need to borrow from the Federal Reserve. The System's policy and the reasons for it should be explained to them in an effort

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to encourage them to anticipate their needs and to make adjustments in their lending policies that would be appropriate to the situation.

In addition, the examination function will be asked to pay particular attention to the liquidity position of all member banks. Where appropriate, examination officials might be invited to participate jointly with discount officials in contacts with member banks whose liquidity position and lending activity are out of keeping with the program herein enunciated.

The accompanying statement from the Board of Governors addressed to all member banks supplies a public expression of the Federal Reserve's point of view on these matters that may be usefully referred to in discussions with member banks.

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STRICTLY CONFIDENTIAL (FR) August 29, 1966.

D R A F T

FOR PUBLIC RELEASE

LETTER TO MEMBER BANKS
CONCERNING NEED TO
RESTRAIN BUSINESS LENDING

It is the view of the Federal Reserve System that currently strong demands for credit need to be restrained in order to hold credit-financed spending within the bounds that can be accommodated by the Nation's physical resources. Business demands for bank credit are particularly intense, and while such credit requests often seem justifiable when looked at individually, the aggregate total of business spending so financed is reaching unsustainable levels and adding substantially to inflationary pressures. Furthermore, such loan expansion is being financed by liquidation of other banking assets in ways that can be prejudicial to other financial markets.

The System believes that it serves the national economic interest to reduce the rate of expansion of bank loans to business, within the context of a program of overall monetary restraint. Accordingly, this objective will be kept in mind by the Federal Reserve Banks in granting credit to those member banks that are led to borrow at the discount window by reason of shrinkages in deposits or other sources of funds. Borrowing banks will be expected to cooperate in reducing the rate of business loan growth as part of the orderly adjustment of their positions. This is in conformity with

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Section 201.0, par. (e) of the Board's Regulation A governing lending to member banks:

> "In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally. ..."

Federal Reserve credit assistance to member banks to meet temporary, emergency, or normal seasonal demands from their customers will continue to be available in accordance with the standards set forth in Regulation A.

The curtailment of the recent extraordinary rate of business loan expansion is in the interest of the entire banking system. The Board expects all banks to be aware of this consideration, whether or not they need to borrow. Management of bank resources in accordance with the principles outlined above can make a constructive contribution to sustainable economic prosperity.

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September 1, 1966.

TO PRESIDENTS OF ALL FEDERAL RESERVE BANKS

(which transmitted text of proposed internal System document)

~~SUBJECT:~~ Following up earlier telegram today, following is text of proposed letter to all member banks:

QUOTE

It is the view of the Federal Reserve System that [continued] orderly bank credit expansion is appropriate in today's economy. However, that expansion should be moderate enough to help insure that spending--and particularly that financed by bank credit--does not exceed the bounds that can be accommodated by the nation's growing physical resources, ~~without~~ aggravating inflationary pressures that are already visible.

While the growth of total bank credit and total bank lending has moderated somewhat as compared with last year, total bank credit has grown at an annual rate of over 8 per cent during the first eight months of this year, and total bank loans at a rate of over 12 per cent. Meanwhile bank lending to business has [~~continued to~~] increased at an annual rate of about 20 per cent.

It is recognized that business demands for bank credit have been particularly intense. While such credit requests often appear justifiable when looked at individually, the aggregate total of credit-financed business spending has tended towards unsustainable levels and ~~to~~ has add appreciably to current inflationary pressures. Furthermore, such exceedingly rapid business loan expansion is being financed in part by

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liquidation of other banking assets and by curtailment of other lending in ways that could contribute to disorderly conditions in other credit markets.

The System believes that the national economic interest would be better served by a slower rate of expansion of bank loans to business within the context of moderate overall money and credit growth. Further substantial adjustments through bank liquidation of municipal securities or other investments would add to pressures on financial markets. Hence, the System believes that a greater share of member bank adjustments should take the form of moderation in the rate of expansion of loans, and particularly business loans.

Accordingly, this objective will be kept in mind by the Federal Reserve Banks in granting credit to those member banks that seek to borrow at the discount window by reason of shrinkages in deposits or other sources of funds. Borrowing banks will be expected to cooperate in reducing the rate of business loan growth--apart from normal seasonal requirements--as part of the orderly adjustment of their positions. It is recognized that bank adjustment through such loan curtailment ~~will often~~ may at times involve a longer period of time than would be involved in the orderly disposition of securities.

This program is in conformity with the provision in Section 201.0, par. (e) of the Board's Regulation A governing lending to member banks:

> "In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance

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of sm sound credit conditions, both as to the individual institution and the economy generally. ..."

Federal Reserve credit assistance to member banks to meet appropriate seasonal, temporary, or emergency needs of demands from their customers will continue to be available as in the past.

Curtailment of the extraordinary rate of business loan expansion is in the interest of the entire banking system and of the economy as a whole. All banks should be aware of this consideration, whether or not they need to borrow from the Federal Reserve. Management of bank resources in accordance with the principles outlined above can make a constructive contribution to sustained economic prosperity, and the Federal Reserve System is confident that the banks will give their whole-hearted support to this effort.

UNQUOTE

KENYON

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GOVERNOR BRIMMER

B

For Information Only

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Federal Reserve Bank of St. Louis

TO: Board of Governors

SUBJECT: Implementation of Discount Administration

FROM: Division of Examinations

B. C. L.

There is attached a memorandum which summarizes the various matters discussed during the conference call with discount officers on December 12.

Attached.

TA-NON-K
EPM
MIMEO BOND

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Federal Reserve Bank of St. Louis

December 22, 1966

TO: Division of Examinations SUBJECT: Conference Call on Discount Administration

FROM: Priscilla Ormsby PO

Another in the present series of conference calls to discuss discount administration was held Monday, December 19, 1966 among members of the Board staff and the discount officers of the twelve Reserve Banks. Representing the Board staff were Mr. Holland, Mr. F. Solomon, Mr. Leavitt, Mr. Axilrod, Mr. J. C. Smith, Mr. Massey, Mr. Hocter from the Chicago Bank, and Miss Ormsby.

Borrowing continued to be light in most Districts, and the atmosphere of ease reported in the December 6 call still existed. A large bank in the Boston District had borrowed, with at least part of the cause being CD attrition. However, this bank typically runs in a fairly tight position at this time of year, and the present situation was thought to be seasonal for the most part. A city bank in the Chicago District had cited stringency in the Eurodollar market as one of the reasons for its borrowing. However, the circumstances did not seem to indicate actual tightness in that market. Rather than having to pay off Eurodollar loans, it had been led to borrow by a strong loan demand and relatively weak deposit condition, and a lack of available additional Eurodollars. This was only a few days after the same bank had indicated that it foresaw no problem in attracting Eurodollars, and, although the initial borrowing was on a thirteen day note, the bank was out of the discount window in one day. This indication of slight, isolated pressure in the

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Eurodollar market was further minimized by the report of the New York District, where banks not only were not experiencing any sizeable outflow of Eurodollars, but were actually borrowing increased net amounts in this market.

Mr. Holland noted that there were other signs of ease in the market. Runoffs in certificates of deposit in December had so far been moderate, the Federal funds rate was relatively low, and the Treasury bill rate was down (Mr. Berge noted that an immediate rise in the rates on Government bonds had resulted from the just-announced letter from Ambassador Goldberg to Secretary General U Thant concerning a possible cease-fire in Viet Nam, but, at least until further evidence was available, this had to be regarded as a transitory movement).

In contrast to the generally reduced rate of growth in business loans since early fall, the Philadelphia District reported that some of its larger banks were once again beginning to show noticeable increases in the category of commercial and industrial loans. However, these banks were not borrowing at the discount window, but were net purchasers of Federal funds. Also in the Third District, the largest bank had announced that it was reentering the mortgage market. It had only committed itself for a relatively modest $25 million and was, at least for the present, limiting such loans to its depositors, but its overt entry into the field was nonetheless a significant development.

Country banks were still borrowing rather heavily in some

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Districts compared to city banks. This was again attributed mainly to seasonal influences. Some banks were experiencing a lag in deposit increases as crops were held over year-end for tax purposes, and in a few cases there were seasonal increases in agricultural loans. The Philadelphia District reported an increasing aggressiveness on the part of its country banks, necessitating some administrative contacts.

The Philadelphia District also reported that its small suburban bank which had been mentioned in an earlier call was now in its eleventh period of borrowing, but was showing continued improvement in its condition. It was expected to be out of the window by year-end.

Interest in V-loans was still apparent, although perhaps somewhat less so than in previous weeks. One bank in the Third District was in a position of overdraft as a result of delayed payments from a Government agency and was interested in the possibility of a V-loan. Mr. Massey suggested that to process an application would require a minimum of one to two weeks. Mr. Massey also reported that the article in the December 7 issue of the Journal of Commerce, which contained a number of inaccuracies with regard to V-loans, had been noted by the Board staff, and Mr. Fauver had talked with the paper and corrected their misunderstandings.

Mr. Holland reported that the suggested rescission of the September 1 letter had been discussed at the FOMC meeting. The

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matter had not been finally settled, but a number of people, inclucing Chairman Martin, had serious reservations about the wisdom of issuing another letter.

Mr. Berge asked about the status of the Board's position paper on lending to life insurance companies. Mr. Holland predicted that, in view of changed conditions, this would not be issued. However, he did report that the discount study was planning a paper discussing and taking some position on emergency credit assistance to various types of financial institutions; insurance companies would be considered in this paper. He suggested that the people responsible for the paper would welcome comments, suggestions, and/or pertinent reports experiences with insurance companies from any of the Reserve Banks.

Mr. Holland also reported that the Interim Report of the discount study was essentially complete and would be distributed very shortly.

Mr. Fossum asked whether any thought had been given to holding a discount officers conference in conjunction with the American Bankers Association credit conference at the end of February. The feeling was, as in the past, that discount officers' conferences should be held independently rather than take all discount officers away from their Banks for too long a period.

The frequency of calls was again discussed, and it was generally agreed that they might usefully be held monthly unless some special need arose. Mr. Melnicoff suggested that the Board

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staff could plan to keep watch of the borrowing statistics submitted by the Reserve Banks so that any unusual situations which showed up in these would not be missed on the call. The date of the next call was not decided, but discount officers would be notified by telegram.

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MERRITT/ SWAN
HEMMINGS
WILLIAMS
JENNINGS
CRAVEN
JAMISON

#

GA BD 27 1118

PRESIDENTS-

QUOTED BELOW IS THE TEXT OF A STATEMENT THAT THE BOARD WILL HAND TO THE PRESS FOR RELEASE AFTER 3:30 P.M. EASTERN STANDARD TIME TODAY, DECEMBER 27.

"ON SEPTEMBER 1, 1966, THE PRESIDENTS OF THE FEDERAL RESERVE BANKS SENT A LETTER TO ALL MEMBER BANKS WITH RESPECT TO THE USE OF THE DISCOUNT WINDOW. SINCE THEN CREDIT CONDITIONS HAVE CHANGED, THE EXPANSION OF BUSINESS LOANS HAS BEEN REDUCED TO A MORE MODERATE RATE, AND BANKS NO LONGER ARE UNLOADING SECURITIES IN UNRECEPTIVE MARKETS. CONSEQUENTLY, THE PURPOSES OF THAT LETTER HAVING BEEN SERVED-- AND SERVED WELL, THANKS TO THE COOPERATIVE EFFORTS OF MEMBER BANKS-- THE BOARD OF GOVERNORS HAS AUTHORIZED THE FEDERAL RESERVE PRESIDENTS TO ADVISE MEMBER BANKS IN THEIR DISTRICTS THAT THE SPECIAL DISCOUNT ARRANGEMENTS ANNOUNCED IN THE SEPTEMBER 1 LETTER ARE TERMINATED."

AS INDICATED IN VICE CHAIRMAN ROBERTS'S TELEGRAM OF DECEMBER 23, ISSUANCE OF THIS STATEMENT BY THE BOARD DOES NOT PRECLUDE THE SENDING OF AN APPROPRIATE LETTER BY A RESERVE BANK TO ALL MEMBER BANKS IN ITS FEDERAL RESERVE DISTRICT AT THE DISCRETION OF THE PRESIDENT.

ORIGINAL

.....Answered
.....Ansd. by Routine Advice
X No Answer Required

SHERMAN

Direct to File

Rv

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FEDERAL RESERVE BANK OF SAN FRANCISCO

TRANSLATION OF TELEGRAM RECEIVED

From BOARD, WASH. DEC. 23, 1966

Copied and Translated:.....

To FEDERAL RESERVE BANK OF SAN FRANCISCO Checked:.....

Copy routed to Mr.

WITH REFERENCE TO VICE CHAIRMAN ROBERTSON'S WIRE THIS NOON REGARDING SEPTEMBER 1 LETTER, IF YOUR BANK CONTEMPLATES SENDING A LETTER TO ALL MEMBER BANKS IN YOUR DISTRICT ON THE SUBJECT, AVAILBLE MEMBERS OF THE BOARD SUGGEST THAT IT BE DEFERRED UNTIL YOU HAVE HAD AN OPPORTUNITY TO HEAR FUTHER FRO THE BOARD ON TUESDAY, DECEMBER 27, REGARDING A POSSIBLE STATEMENT FOR THE PRESS.

SHERMAN

Copy delivered to Mr.

SWAN B
HEMMINGS
WILLIAMS
JENNINGS
JAMISON
CRAVEN

To be handled by Mr.

MERRITT-2

Function or Unit Number

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(For information only)

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GA BD 23-1246

DEC 23 10 51 AM '66

PRESIDENT

IN VIEW OF STORY AND EDITORIAL IN AMERICAN BANKER TODAY AND THE CONSEQUENT NECESSITY FOR RESPONDING TO INQUIRIES, I SUGGEST THAT EACH FEDERAL RESERVE BANK SHOULD REPLY BY INDICATING THAT SINCE CREDIT CONDITIONS HAVE CHANGED AND THE PURPOSE OF THE SEPTEMBER 1, 1966 LETTERTO ALL MEMBER BANKS HAS BEEN WELL SERVED, THE LETTER IS BEING TERMINATED AS OF THIS DATE (DECEMBER 23).

AS REQUESTED IN THAT LETTER, COMMERCIAL BANKS HAVE ACHIEVED A SUBSTANTIAL MODERATION IN THE RATE OF EXPANSION OF BUSINESS LOANS. FURTHERMORE, THEY HAVE BECOME LESS AGGRESSIVE LSELLERS OF SECURITIES AS A MEANS OF ADJUSTING TO PRESSURES, AND PARTLY FOR THIS REASON THERE HAS BEEN A LESSENING OF THE EXTREME STRINGENCIES IN STATE AND MUNICIPAL MARKETS APPARENT EARLIER THIS FALL. IN VIEW OF THESE DEVELOPMENTS (AND THE SOMEWHAT LESS TAUT GENERAL MONETARY CONDITIONS), THE FEDERAL RESERVE SYSTEM BELIEVES THAT SPECIAL EMPHASIS ON RESTRAINING THE EXPANSION OF BUSINESS LOANS WITHIN THE CONTEXT OF GENERALLY MODERATE CREDIT GROWTH IS NO LONGER NECESSARY.

MEMBER BANKS SHOULD BE COMPLIMENTED ON THE COOPERATION THEY HAVE EXTENDED TO THE SYSTEM IN THIS RESPECT DURING THE PAST SEVERAL MONTHS. THIS APPROACH DOES NOT PRECLUDE LETTER TO SAME EFFECT TO ALL MEMBER BANKS IN ANY FEDERAL RESERVE DISTRICT AT THE DISCRETION OF THE PRESIDENT.

ROBERTSON

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FEDERAL RESERVE BANK OF CHICAGO
230 SOUTH LA SALLE STREET
CHICAGO, ILLINOIS 60690
(312) HA 7-2320

Circular No. 1895
December 27, 1966

To the Member Banks in the
Seventh Federal Reserve District:

The extremely tight credit conditions experienced earlier this year have eased and the purpose of our September 1, 1966, letter to all member banks has been well served. As requested in that letter, commercial banks have achieved a substantial moderation in the rate of expansion of business loans. Furthermore, they have become less aggressive sellers of securities as a means of adjusting to pressures, and partly for this reason there has been a lessening of the extreme stringencies in state and municipal markets apparent earlier this fall. In view of these developments (and the somewhat less taut general monetary conditions), the Federal Reserve System believes that special emphasis on restraining the expansion of business loans within the context of generally moderate credit growth is no longer necessary. Therefore, the special discount arrangements announced in the September 1 letter are terminated.

The member banks in the Seventh Federal Reserve District are to be complimented on the excellent cooperation they have extended to the System in this respect during the past several months.

Charles J. Scanlon
President

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FEDERAL RESERVE

press release

For Immediate Release. December 27, 1966.

The Board of Governors of the Federal Reserve System today issued the following statement:

On September 1, 1966, the Presidents of the Federal Reserve Banks sent a letter to all member banks with respect to the use of the discount window. Since then credit conditions have changed, the expansion of business loans has been reduced to a more moderate rate, and banks no longer are unloading securities in unreceptive markets. Consequently, the purposes of that letter having been served--and served well, thanks to the cooperative efforts of member banks--the Board of Governors has authorized the Federal Reserve Presidents to advise member banks in their Districts that the special discount arrangements announced in the September 1 letter are terminated.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

December 23, 1966

Robbie,

In a conversation with Secretary Fowler this afternoon, I described the substance of your telegram to the Reserve Bank Presidents regarding the September 1 letter. I also mentioned the subsequent discussion in which the Board members present agreed that a press statement on Tuesday would be appropriate. Since information in the telegram could be made available to any newspaper reporter who called the Reserve Bank, I thought the Secretary of the Treasury should also be aware of it.

Andy Brimmer

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Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 23, 1966.

To Records Section

Subject:

From Governor Brimmer

Governors Shepardson and Maisel, and Merritt Sherman, and I discussed Governor Robertson's telegram to the Reserve Banks regarding the September 1 letter. All of us agreed that a statement should be put out on Tuesday, December 27, 1966. Merritt Sherman's opinion is that a telephone conference is not necessary to accomplish that, since Governor Daane also expressed himself (according to Governor Shepardson) in favor of a short statement. It appears that there is consensus among the five (5) Board Members present this afternoon that a press release should be put out. Consequently, the Board Members present on Tuesday will reflect further on the question as to the contents of the press release and put it out. In the meantime, we agreed that Merritt Sherman should send a follow-up wire to the Reserve Bank Presidents this afternoon asking them to postpone sending a letter to member banks in their District until they hear further from the Board (which presumably will be Tuesday).

cc: Board Members

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Governor Brimmer

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 23, 1966.

To Records Section

Subject:

From Governor Robertson

In arriving at the decision to send the attached telegram to the Presidents of all Federal Reserve Banks, I talked with President Hayes and Governors Mitchell, Daane, and Brimmer; however, the nature of the action was taken on my own volition and risk in view of the importance of obtaining a prompt and uniform System approach to the termination of September 1 letter. Responses made to inquiries in accordance with the substance of this telegram should achieve that objective without any other formal action.

cc: Board Members

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TELEGRAM
LEASED WIRE SERVICE

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

December 23, 1966.

TO PRESIDENTS OF ALL FEDERAL RESERVE BANKS.

In view of story and editorial in American Banker today and the consequent necessity for responding to inquiries, I suggest that each Federal Reserve Bank should reply by indicating that since credit conditions have changed and the purpose of the September 1, 1966 letter to all member banks has been well served, the letter is being terminated as of this date (December 23).

As requested in that letter, commercial banks have achieved a substantial moderation in the rate of expansion of business loans. Furthermore, they have become less aggressive sellers of securities as a means of adjusting to pressures, and partly for this reason there has been a lessening of the extreme stringencies in state and municipal markets apparent earlier this fall. In view of these developments (and the somewhat less taut general monetary conditions), the Federal Reserve System believes that special emphasis on restraining the expansion of business loans within the context of generally moderate credit growth is no longer necessary.

Member banks should be complimented on the cooperation they have extended to the System in this respect during the past several months.

This approach does not preclude letter to same effect to all member banks in any Federal Reserve district at the discretion of the President.

ROBERTSON

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Federal Reserve Bank of St. Louis

American Banker, Dec. 23, 1966

Fed's September Letteron Credit Policy is Outdated; Practices outlined will be allowed to lapse - by Ben Weberman.

New York--The September 1 Federal Reserve Bank President's Letter to member banksofficials, covering credit policy and administration of thhdiscount window, clearly hs has outlined its usefulness. In the opinion of Federal Reserve policymakers.

But there is little likelihood a second letter will be sent out stating that concepts and policies enumerated in early September have been revoked.

Conversation along these lines have been held within the Central Banking System,it is understood, but prevailing opinions maintained that the initial communication x engendered so much misunderstanding and misinterpretation that it is preferable to allow the directive to die slowly of its own accord.

Basically, business loans have expanded barely since the start of September, bank credit has grown at an even slower pace and any bank that must sell securities can go into a reception market without any need for dumping.

In the letter distributed September 1, it was pointed out that bank credit in the first eight months of the year had grown at an annual rate of more than over 8 per cent, loans were rising at a 12 per cent rate and business

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loans in particular were shooting up at an unsustainable 20 per cent annual rate.

Bank officials were told "the System believes that a greater share of member bank adjustments should take the form of moderation in the rate of expansion of loans and particularly business loans."

It was further explained that "this objective will be kept in mind by the Federal Reserve Banks in th ir extension of credit to member banks through the discount window."

And to permit banks to adjust loans and investment portfolios in an orderly manner without being forced to resort to the kind of massive liquidation of securities that had continued through August, bringing near panic conditions in capital markets, the Fed stated that "banks adjusting their position through loan curtailment may at time need a longer period of discount accomodation than would be required for the disposition of securities," implying that it would entertain requests for lengthy utilization of the discount privilege.

Now bank credit, as seasonally adjusted by the Federal Reserve Bank of St. Louis, has declined at a 2.8 per cent annual rate since the start of September and total loans hav e expanded at a rate of only 2.8 per cent, without business loans growing at only a slightly faster pace.

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Business loans, which were rising at the troublesome 20 per cent annual rate through the end of August, since have simmered down and for the past three months, since issuance of the September letter, have been expanding at a sustainab le 7 per cent rate.

From a policy standpoint, some Federal Reserve officials, it is understood, are worried the economy may have pieced out and are now firmly in favor of encouraging loan expansion. This opinion is not shared by all policy makers. At the other end of the spectrum are those who attribute the fourth quarter sluggishness to nonrecurring increases in tax collections withmexpected forthcoming budget deficitsxx seen as strong stimulants.

All, however, are not concerned about credit expansion and the view would not be contes ted anywhere in the Federal Reserve System h that the September 1 letter no longer serves much purpose.

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So the Fed is quietly letting it be known that moderate resumption of speed will be acceptable.

These tactics may be appropriate. The extreme uncertainties and turbulence in the area of financial policy during the past year are such that almost anything goes that works.

But it is too bad that the execution of policy has to be so untidy.

The Fed, under the pressure of carrying virtually alone the burden of the fight against inflation, has been forced to take actions which, if not actually distastefully to it, have clearly been variations from previous procedures.

And while the quiet abandonment of a dramatic tactic which has outlent its usefulness is normal its political maneuver, it is unusual for the Fed.

And it cannot fail to be disconcerting to the financial community that policy should be conceived and executed in such an ad hoc manner.

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American Banker, Sept. 23 - editorial, page 4

Bang in, Wimper out -

The Federal Reserve does not normally send letters to bank presidents telling them how to run their business but on September 1 it did.

By the same token, the Fed does not normally let the money market deteriorate into a condition of disarray verging on panic yet in August it did.

There is some belief in the financial community that the Fed did not realize the depth of the concern set off last August by the highest rate in four decades and Fed spokesmen themselves have tended to play down the sense of peril which scared the money market, in public statements issued after the crisis had subsided. These statements are taken in many quarters to be attempts at justification for excessive monetary restraint at that time which was really more dangerous than the Fed now cares to admit and these comments after the dust had settled are not taken as reassuring as to understanding on the part of the Fed of the highly volatile markets where it is supposed to exert its influence.

Now the Fed seems to be letting the impact of its September blockbuster phase out with hardly a wimper, and nothing like the bang with which it came on.

It has apparently been decided within the Fed that the purpose of the September letter has been accomplished. Bank lending has eased back sharply from its excessive rate of 20 per cent, to about 7 per cent.

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Even with hindsight, it is difficult to determine just how important the letter was in bringing about this result. Certainly the impact of a directive from the Fed telling its member banks that "a great share" of their adjustments "should take the form of moderation in the rate of expansion of loans and particularly of business loans" cannot be ignored in any analysis of the results achieved.

But other forces of restraint, most of them stemming from the same basic policy decisions in the Fed to restrain inflationary pressures, certainly did their part. There are some that maintain that these forces would have done the job without the Fed taking the relatively drastic step of actually telling bankers what to do.

In this case, even hindsight does not provide 20-20 vision.

And now, the determination has been made not to rescind the letter, but simply to let it fade away.

The leadership in the Fed is known to believe, as Ben Weberman reports in today's American Banker that we're the "bang"introduction with appropriate, so is the "whimper" exit.

There is a feeling that whereas the red light had to be snapped on full to bring the excesserating forces of inflation to a halt, an unheralded change to flashing green will accomplish the resumption of moderate speed now, without fanfare. There is a conviction that calling too much attention to the discontinuation of the stop edict will be taken as an urging to resume speed at the previous unsafe rate.

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December 22, 1966.

TO: Governor Brimmer

FROM: Robert C. Holland

SUBJECT: Rescission of the September 1 discount administration letter

Attached is my effort to synthesize a new draft rescission of the September 1 letter out of the various Gubernatorial drafts, with a wary eye out for words that might antagonize the opposition.

I think the essential meat of the letter is in the second and fourth paragraphs. You might even want to consider negotiating away the third paragraph if that seems to be representing an obstacle. I also put in parentheses the reference to easing of monetary conditions in the last sentence of the second paragraph, since, depending on conditions and our policy position at the time of issuance of this letter, such a reference might or might not be desirable in the minds of the various parties concerned.

Attachment

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DRAFT

December 22, 1966.

TO THE CHIEF EXECUTIVE OFFICER OF THE MEMBER BANK ADDRESSED:

This is to inform you that the modification in discount administration announced in the Federal Reserve letter of September 1, 1966, to all member banks has been terminated effective this date.

As requested in that letter, banks have achieved a substantial moderation in the rate of expansion of business loans. Furthermore, they have become less aggressive sellers of securities as a means of adjusting to pressures, and partly for this reason there has been a lessening of the extreme stringencies in state and municipal markets apparent earlier this fall. In view of these developments (and the somewhat less taut general monetary conditions), the Federal Reserve System believes that special emphasis on restraining the expansion of business loans within the context of generally moderate credit growth is no longer necessary.

In an expanding economy, orderly growth in bank credit is both necessary and appropriate. Such credit expansion, however, should not be so vigorous as to enable total spending in the economy to exceed the bounds that can be accommodated by the nation's growing physical resources. Prudent banking practices designed to maintain the quality of loan and investment portfolios and

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to promote economic stability are in the best interests of banks, their customers, and the country as a whole.

On behalf of the System, I wish to thank member banks in this District for the cooperation that they have extended in this respect during the past months.

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President.

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President.

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In connection with Mr. Holland's memorandum dated December 9, 1966, regarding the discount administration letter.

Governor Brimmer

**FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.**

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

STRICTLY
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Office Correspondence

Date December 12, 1966

To Board of Governors

From S. J. Maisel

Subject: Alternative version of letter re discount administration

Attached is my draft for a letter to be sent by the Presidents to their member banks rescinding the September 1 letter. This version is the one which I passed out at the Board meeting this morning. It is based on Governor Mitchell's draft with my changes appearing in the last sentence of the first paragraph and the entire second paragraph.

Attachment

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DRAFT:SJM:12/12/66

Since the issuance of the Federal Reserve letter to member banks on September 1, 1966 requesting a moderation in the rate of expansion of business loans, this category of loans has expanded at a seasonally adjusted annual rate less than half that of the first eight months of the year. Banks have also been less aggressive sellers of securities as a means of adjusting to pressures. Partly for this reason, the extreme stringencies in State and municipal security markets, apparent earlier, have lessened. These developments have taken place with a minimal use of the special discount facilities made available in the September 1 letter. In view of these developments and some over-all easing of monetary pressures, the Federal Reserve System feels that a special effort to moderate the expansion of business loans within the context of general restraint of credit growth is no longer necessary. Therefore, the letter of September 1 is hereby withdrawn.

In an expanding economy, orderly growth in bank credit is both necessary and appropriate. However, this credit expansion should not be so vigorous as to enable total spending in the economy to exceed the bounds that can be accommodated by the Nation's growing physical resources. Prudent banking practices designed to improve the individual bank's loans and securities portfolio and to promote economic stability are in the best interests of banks, their customers, and the country as a whole.

On behalf of the System, I wish to thank member banks in this District for the cooperation that they have extended during the difficult period of the last few months.

_____
President

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In connection with Mr. Holland's memorandum dated December 9, 1966, regarding discount administration letter.

Governor Brimmer

12/12 pm

FOR INFORMATION PRIOR TO CONSIDERATION AT A MEETING OF THE BOARD.

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Draft: AFB/12/9/66

The program of discount administration announced in the Federal Reserve System's letter of September 1, 1966, is terminated effective this date.

As requested in that letter, banks have achieved a substantial moderation in the rate of expansion of business loans. During the last few months, this category of loans has expanded at a seasonally adjusted annual rate less than half that of the first eight months of the year. Banks have also reduced their liquidation of securities as a means of meeting loan demand. This latter action has contributed to a lessening of the extreme pressures on capital markets apparent in the late summer and early fall.

In view of these developments and some overall easing of monetary pressures, the Federal Reserve System feels that a special effort to moderate the expansion of business loans within the context of general restraint of credit growth is no longer necessary. Orderly growth in bank credit is appropriate in an expanding economy. However, this credit expansion should not be so vigorous as to enable total spending in the economy to exceed the bounds that can be accommodated by the nation's growing physical resources.

Member banks can be assured that the discount window will be available to assist them in meeting temporary, seasonal, or emergency needs for credit in accordance with the provisions of Regulation A.

On behalf of the System, I wish to thank member banks in this District for the cooperation that they have extended during the difficult period of the last few months.

President

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GOVERNOR BRIMMER

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Federal Reserve Bank of St. Louis

For Information Only

July 6, 1967

TO: Board of Governors SUBJECT: Implementation of Discount Administration

FROM: Division of Examinations

B.E.L.

There is attached a memorandum which summarizes the various matters discussed during the conference call with discount officers on June 26.

Attachment.

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CONFIDENTIAL (FR)

TO: Division of Examinations SUBJECT: Conference Call on Discount Administration

FROM: Priscilla Ormsby

Another in the present series of conference calls to discuss discount administration was held on Monday, June 26, 1967, among representatives of the Board staff and the discount officers of the twelve Reserve Banks. The Board staff was represented by Mr. Leavitt, Mr. J.C. Smith, Mr. Sundberg, and Miss Ormsby.

Discounting activity continued extremely light throughout most of the System. Several Districts reported some sporadic increase in borrowing, but even in these cases the amounts borrowed were generally quite small. In the case of country banks the increases were generally identified as seasonal. Country banks in the Chicago District were experiencing deposit declines which were resulting in some borrowing. In contrast, country banks in the Minneapolis District were having inflows of deposits and borrowing significantly less than their past seasonal patterns would suggest. The Kansas City Reserve Bank expected increases in country bank borrowing in the near future as the result of flood damage in Nebraska and Kansas.

In the case of reserve city banks, increases in borrowing were even more atypical. The New York Reserve Bank suggested that at least in the Second District, the few increases had been partially attributable to the June 15 tax date.

No recent increases were reported in the interest rates on mortgages. One local lender in the San Francisco District had increased

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the rate it charged earlier, but this move had not been followed by other institutions. Mortgage money was apparently plentiful in all Districts. It was reported that there was some talk of a decrease in the rates paid at savings and loans in the Dallas District as of July 1. However, the Bank felt that chances for this were 50-50 at best.

A few instances of increases in the rates paid on certificates of deposit were reported. One Chicago bank was paying 5 1/8% on its longest-term CD's. The Philadelphia banks, among others, continued to hold firm on their CD rates, despite some increases by nearby New York banks.

City banks continued in general to be net buyers of Federal funds. Country banks were most often net sellers, although their activity ranged from heavy in the Philadelphia District to increasingly light in the Boston District.

The St. Louis District had just received a new V-loan inquiry.

The next conference call would be held in approximately a month.

Addendum

In a phone call to Mr. Leavitt on June 28, 1967, First Vice President Latham of the Federal Reserve Bank of Boston reported recent interesting developments in rates charged by the five Boston based savings banks. At the time of the monthly call (6/26/67) to all discount officers Boston reported that rates on real estate mortgages were trending downward. Mr. Latham said that in the past few days three of these

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five banks have increased the rate charged on prime conventional real estate mortgages from 6 per cent to 6-1/4 per cent. One other, the largest savings bank of the city, has announced it will go to 6-1/4 per cent after the 4th of July. The other savings bank is charging 6-1/2 per cent and requiring a minimum down payment of 25 per cent. The favorable rates available from corporate bonds are believed to be the chief reason for the firming of rates on real estate notes. Corporates with five-year call protection at 6 per cent are competitive with real estate mortgages at 6-1/4 per cent or perhaps even more. It is understood that several savings banks plan to buy the recently announced AAA offering of AT&T, which will yield 6 per cent.

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