



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

JAMES LOUIS ROBERTSON
MEMBER OF THE BOARD

December 9, 1965

Dear Mr. Patman:

In response to your request that members of the Board of Governors of the Federal Reserve System appear before your Committee on Monday, December 13, I regret to advise you that because of an out-of-town engagement related to the President's Balance of Payments Program, I will be unable to appear on that date.

However, in order to assist as fully as possible in the achievement of your objective of disclosing the factors that entered into the Federal Reserve's recent decision to raise the discount rate and the ceilings on interest rates payable on time deposits, I am enclosing copies of two statements which set forth my own reasons for opposing both actions. The one relating to the discount rate increase was presented to the Board at the time that action was taken. The one opposing higher maximum interest rates was written subsequent to the meeting and submitted for the Board's record. These statements include the main points that I would make orally if it were possible for me to be present Monday.

In the event you wish to make these statements available to members of your Committee, its staff, and other interested people, I am submitting additional copies herewith.

Sincerely,

A handwritten signature in dark ink, appearing to read "J. L. Robertson", written over a large, stylized flourish.

Enclosures

The Honorable Wright Patman
Chairman, Joint Economic Committee
Congress of the United States
Washington, D. C.

Statement of Governor Robertson's Reasons for Opposing an Increase in the Discount Rate, December 3, 1965

Changes in monetary policy should not be triggered by fear of prosperity. A prosperous and growing economy has been the goal of public policies, and substantial achievement in that direction in the 1960's should be a cause of gratification rather than concern. It is not inevitable that inflation, boom, and bust must follow from the kind of prosperous performance the United States economy has been giving, and consequently there are no valid grounds for arguing that tightening now is needed to forestall inflationary developments that are sure to come later.

This is not to deny the need for very careful scrutiny of the progress of economic events and a willingness to act to further restrain credit if and as excessive demand pressures actually emerge. I conceive of the present as a time of delicate balance in the economy. Supply and demand forces seem so tentatively poised that abrupt action to change monetary conditions could tip the scales significantly - towards inflation if policy was actively eased, or on the other hand, towards recession if credit availability were sharply tightened.

Financial markets have only recently calmed somewhat after being buffeted by rumors of an impending discount rate

change. Such a rate increase now would come as a distinct surprise, with reactions aggravated by the impending seasonal peak of money market pressures. Such action would insure undoubtedly that the heavy volume of Treasury cash borrowing to be done in January would have to be undertaken at substantially higher interest costs to the government.

If, for whatever reasons, a tightening action is to be initiated, it would be far preferable to use a subtle rather than a slam-bang method. An appropriately mild and indirect line of action might be to (1) dampen bank issuance of promissory notes by defining them as deposits; (2) hold Regulation Q ceilings on time deposit interest rates at existing levels for the time being; and (3) take no action on the discount rate, expecting that banks would undoubtedly have to cover some portion of their net December loss of CD's by substantial temporary resort to the discount window. This combination of steps should serve to moderate somewhat the rate of advance in bank credit, while not triggering immediate expectations of higher interest rates in the market and yet, at the same time, placing banks in a position of dependence on the discount window that could lead fairly naturally to a more overt tightening of monetary policy should inflationary developments begin to appear.

Whether or not a breakout of inflationary pressures will in fact occur cannot now be predicted. Accordingly, the best practical course is to adopt a policy of "watchful waiting", meanwhile continuing to supply a reasonable flow of reserves to finance much-needed economic growth. Despite large and sustained expansion since the last recession in 1961, a small but significant margin of human and real capital resources remains unutilized in this country. Further orderly expansion in aggregate demand can effectively employ some of these resources. The accompanying growth in credit and money during this period has been orderly, and has contributed to overall economic growth. Continued orderly credit expansion is needed if our economy is to move on up to the goal of sustainable full employment of available resources.

The price pressures to date from this economic growth have been small and selective, stemming mostly from worldwide shortages of particular nonferrous metals, temporary scarcities of certain agricultural products, and market-testing mark-ups in a few administered-price industries. These are not the types of price increases appropriately dealt with by a dampening of aggregate domestic demand. The temporary nature of some of the recent increases is

indicated by the fact that the rate of rise in the whole-sale price index has already slowed since mid-year from an annual rate of 2 per cent to 1 per cent. Meanwhile, recent successful Administration actions against aluminum and copper prices reduce the likelihood of other administered-price increases.

The U. S. balance of payments performance does not now supply reasonable grounds for further monetary tightening. The chief burden for further improvement in the balance falls on other policies. The allegedly interest-sensitive components are already performing very well under the discipline of the Voluntary Foreign Credit Restraint program. I see no sign that this program is weakening in so far as its influence on financial institutions is concerned. Corporate direct investment abroad, the category of capital flow that has been least reduced to date, is notoriously insensitive to changing general credit conditions in the United States.

U. S. interest rates are already high by historical standards, and I believe they are generating all the credit restraint that ought to be attempted in the current delicate situation. The federal fiscal position will be shifting to a somewhat less stimulative policy for a time after

the turn of the year, and we should be wary of imposing a coincident restraining influence from additional monetary tightening at this juncture. The appropriate monetary policy for later in 1966 can be best judged after we have the benefit of the official federal budget message in January and see the public reaction thereto.

Statement of Governor Robertson's Reasons for
Opposing an Increase of the Ceilings on Interest
Rates Payable on Time Deposits from 4 and
4-1/2 per cent to 5-1/2 per cent, December 3, 1965

Governor Robertson dissented from this action generally for the same reasons given for his dissent from the action to raise the discount rate. The latter action, he assumed, was designed to tighten credit, in view of the rapid expansion of bank credit; it surely was not designed simply to raise interest rates. However, in his view, the raising of the ceilings on interest rates payable on time deposits would - in virtually the same breath - enable banks to acquire more funds to expand their lending but at higher rates, and thus not serve to reduce bank credit expansion - if that were the aim. In addition, he felt, the larger banks would be able to attract funds away from smaller financial institutions which did not actively engage in the issuance of time deposits but relied on inflows of savings and demand deposits with which to meet loan demands, or, alternatively, to force those smaller banks to also engage in the risky business of competitively bidding for highly interest-sensitive short-term funds with which to make long-term loans.