Minutes for November 20, 1956.

To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, if you were present at the meeting, please initial in column A below to indicate that you approve the minutes. If you were not present, please initial in column B below to indicate that you have seen the minutes.

Chm. Martin
Gov. Szymczak
Gov. Vardaman
Gov. Mills
Gov. Robertson
Gov. Balderston
Gov. Shepardson
Minutes of actions taken by the Board of Governors of the Federal Reserve System on Tuesday, November 20, 1956. The Board met in the Special Library at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Szymczak
Mr. Vardaman
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Carpenter, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Thomas, Economic Adviser to the Board
Mr. Vest, General Counsel
Mr. Young, Director, Division of Research and Statistics
Mr. Hackley, Associate General Counsel
Mr. Molony, Special Assistant to the Board.

Chairman Martin stated that in view of the likelihood that the subject of the maximum permissible rates of interest payable on time and savings deposits might come up at the meeting of the Board and the Federal Advisory Council later today, he felt that the Board should review its position on the matter. After referring to the views expressed by the Council at its last meeting with the Board and the suggestions that the Board had received from member banks, he said that he discussed the matter at some length with Secretary of the Treasury Humphrey yesterday and told Mr. Humphrey that the Board probably would reach a decision within the next week or ten days. Chairman Martin suggested that it would probably be advisable for the Board not to act until there had been a chance to discuss the matter at the next meeting of the Federal Open Market Committee, scheduled for Tuesday, November 27, so that the Board might have
the advice of the Presidents of the Federal Reserve Banks. Then, if
the Board wished to move on the maximum rates, he saw no reason why
it could not act immediately. Chairman Martin concluded by reviewing
the sentiment of the Presidents' Conference as stated at the meeting
of the Board and the Presidents on September 27, 1956.

In response to the Chairman's request for his views, Mr. Thomas
said that in talking with commercial bankers and Federal Reserve Bank
officers he was impressed that they had not given too much thought to
the fundamental reasons for establishing maximum rates of interest for
time deposits. He went on to say that an increase in the maximum rates
might defeat the purpose of the legislation, which was to prevent banks
from entering into competitive practices that in the long run would be
detrimental to them. He interpreted some of the current pressure for
an increase in the rates as a desire to compete for balances which are
essentially demand deposits. In this connection, he felt there was a
question whether the commercial banks were keeping fully in mind that
such deposits might be withdrawn at any time and were adjusting their
assets accordingly. It was obvious, he said, that the New York City
Banks were not holding Treasury bills against their foreign-owned time
deposits.

Turning to the maximum rates on savings deposits and longer-term
time deposits, Mr. Thomas felt that some case might be made for an in-
crease but he was not sure whether there was strong justification. He
pointed out that the 2-1/2 per cent maximum had just begun to be restric-
tive, since heretofore banks had not wanted to pay that high a rate. At
the present time he did not see a need for going over 2-3/4 per cent, and
for shorter-term time deposits he would retain the present maximum rates or even prohibit the payment of interest on time deposits with maturities of less than 90 days.

In response to a question by Governor Vardaman as to whether he was not quibbling with the discretion of private enterprise in proposing to go to 2-3/4 per cent rather than 3 per cent, Mr. Thomas said the law itself might be regarded as quibbling with the discretion of private enterprise. Furthermore, he said, the bankers wanted a ceiling on rates and were opposed to free competition.

After further reference to the purpose and provisions of the law, Chairman Martin recalled that in the middle 1930's the Board acted to reduce the maximum rate on time deposits from 3 per cent to the present 2-1/2 per cent, apparently reflecting a desire on the part of the Board to bring the maximum somewhat closer to the rates actually paid. In a discussion of the incident mentioned by the Chairman, it was noted that at that time neither rate served to constitute any real restriction and that for the first time in the history of the legislation the maximum rate had now come to be effective. This made it necessary to reconsider the purpose of the law and decide what action on the part of the Board would be appropriate in the prevailing circumstances.

During the discussion it was pointed out that the Federal Deposit Insurance Corporation has authority to fix maximum rates of interest paid by nonmember insured banks, that the Corporation had followed the Board in the past, and that the Board presumably would wish
to consult the Corporation before taking any final action with respect to the maximum rates prescribed for member banks in order to determine whether the other agency would want to act simultaneously.

Governor Mills said that personally he did not believe that the Board should raise the maximum rates for time deposits unless it raised the maximum rate for savings accounts. As to the timing of any action, he pointed out that the savings deposit rate is a contract between the bank and the depositor and that by and large interest payments are made at six-month intervals with one interest computation period frequently beginning at the first of the calendar year. The bank usually has to give advance notice of 30 days on any change in the interest rate, so if the Board should decide to increase the maximum rate for savings deposits it probably would be helpful to those banks that wanted to increase the rate if the Board’s action were taken by the first of December.

With reference to the monetary aspects of the problem, Governor Mills pointed out that the principal pressure for increasing the maximum rates on time deposits was coming from New York City banks that, beside wishing to check the loss of foreign-owned time deposits, presumably wanted to attract to New York City time deposits of corporations or others. He said that as an alternative to raising the maximum rates the Board might wish to consider reducing the reserve requirements for central reserve city banks, possibly within the next 45 days.

In a reference to time deposits held on open account, Governor
Mills said that such accounts can not be paid in advance of maturity except under special circumstances requiring specific approval. Therefore, in a sense they are not demand money, but they are frequently rotated in such a way that some of the deposits reach maturity periodically. He went on to say that in New York City, banks apparently had drifted into a position where they had time deposits maturing and had not provided sufficient liquidity. This, he said, raised the question whether it was advisable for the banks to be able to offer a rate of interest which would hold those deposits. In view of the current international situation, he did not feel that the rate of interest was apt to be the decisive element in determining whether such deposits would be withdrawn.

Another aspect of the matter, brought out by Mr. Young, concerned the placing of excess funds, particularly of smaller businesses, in savings and loan associations around the country to obtain a higher rate of return than obtainable from commercial banks. Mr. Young said there was no real evidence as to the amount of funds involved, but he gathered that the total amount might be rather substantial. If the commercial banks were permitted to pay a higher rate of interest on time deposits and took advantage of that opportunity, there would perhaps be some shifting of funds back from the savings and loan associations to the banks. If such a shifting should occur at a time when residential real estate markets were relatively soft, this might present a serious problem for the savings and loan associations.
Following a discussion of the implications of the situation to which Mr. Young called attention, Governor Balderston said that in his view the Board should not change the maximum rates on time deposits unless it also changed the maximum rate on savings deposits. For time deposits under 90 days, he felt that a minimum change would be the most desirable. He also felt that real savings, as distinguished from foreign-owned time deposits, ought to be encouraged. On this basis, it was his view that the maximum rate for both savings accounts and time deposits with maturities of six months or more should be increased to 3 per cent.

As to time deposits with maturities of from 90 days to six months he was somewhat uncertain but was inclined to feel that the maximum rate might be increased to perhaps 2-1/2 per cent. For shorter-term time deposits, he would keep the maximum rate at 1 per cent.

Governor Robertson then made a statement in which he reiterated his view, expressed during previous discussions of the subject, that it would be preferable not to have legislation requiring the establishment of interest rate ceilings on time and savings deposits. He then said that he considered this a bad time to increase the maximum rates for savings and longer-term time deposits, because such action might be interpreted as meaning that the Board regarded the present interest rate pattern throughout the whole economy as fixed. For this reason he would not be inclined to make any change in the current maxima except to increase to 2-1/2 per cent the maximum rate payable on time deposits with maturities from 90 days to six months. Since he did not see the necessity for maintaining three different maximum rates for time deposits and since it appeared that such a change would help the situation at the New
York City banks, he would be willing to go along with it. At some
time in the future, perhaps three months from now, he might be willing
to move to 3 per cent on both savings and longer-term time deposits,
depending on conditions in the economy and the action of the Treasury
with respect to savings bonds, but he would not want to be committed
for the future.

In response to a question by Governor Vardaman as to whether
two separate actions would not accentuate any impression of the Board's
view with regard to the permanence of the current rate structure,
Governor Robertson said that he had considered the matter carefully
and that his reaction would be the reverse. He felt that the first
action would simply recognize the situation of the New York City banks
which were losing time deposits without raising the whole question of
moving to a plateau of interest rates which might be permanent.

Chairman Martin said that he had reached tentative conclusions
different from those of Governor Robertson by using substantially the
same line of reasoning, but that he did not feel very strongly about
the matter. At a time when it was desirable to encourage savings, he
felt that the Board might be considered remiss if it did not provide
some flexibility in the maximum rate on a permissible basis. He did
not believe the Board would be freezing the rate by going to a 3 per
cent maximum for savings deposits at this time and he said that person-
ally he would not hesitate to reduce the maximum rate whenever such
action seemed appropriate. He went on to say that if the Board was
going to introduce any flexibility into the picture it could not simply
continue to maintain the present maximum rate indefinitely, as it had been doing for a period of 20 years. There was a question, he said, from the standpoint of over-all monetary policy whether the Board should wait for the Treasury to make any change in the interest rate provisions for United States Savings Bonds. He did not think the importance of the whole matter should be exaggerated, but he felt that the Board should decide what it wished to do in the next couple of weeks.

On the matter of flexibility, Governor Robertson commented that as little as three years ago less than 6 per cent of the banks were paying the maximum permissible rate of interest and that even now probably not more than 12 per cent had reached that level. Therefore, it might be said that the Board's regulation was just now becoming effective. He then referred again to the purpose of the legislation and suggested that an increase in the maximum rates of interest might encourage banks to extend themselves in fixed charges that they would have to make questionable loans to obtain earnings.

Governor Szymczak said that the problem could be approached from many different angles without any certainty of obtaining the right answer, and that it would seem preferable if the regulation of interest rates was handled as a matter of bank supervision. He saw the current problem as one involving time deposits at banks in New York City particularly, and in this connection he referred to a recent letter from the Irving Trust Company of New York setting forth the reasons which were felt by the trust company to justify some action on the part of the
Board. It appeared to him that the problem was a rather serious one for the New York City banks, in view of the position in which the banks losing time deposits now found themselves. Since he felt that a move by the Board on any one of the maximum rates should be accompanied by action on the other rates to maintain an appropriate relationship, he would favor increasing the maximum rate on savings deposits and longer-term time deposits to 3 per cent and changing the other rates proportionately.

Governor Robertson said he considered the Irving Trust Company's arguments weak for they indicated that the trust company had not been making adequate charges for its loans and services, was depending too much on the maintenance of foreign deposit balances, and had thus gotten itself into a position where it wanted the Board to take action which would permit continuation of the current practices.

Governor Shepardson commented on the matter from the standpoint of current System monetary policy directed at restraining the expansion of bank loans and asked whether it would be appropriate to take any action which would tend to provide a base for further credit expansion. He indicated, however, that he would favor increasing the maximum rate on savings and longer-term time deposits because that would be a step to encourage saving.

Governor Vardaman said that he would not want to see a decision made on the matter simply on the basis that particular banks needed relief, and that if nothing more was involved than relief for the New York City banks he would be inclined to deal with the problem through
a reduction of reserve requirements for central reserve city banks. He went on to suggest due consideration of the fact that the maximum rate is a permissive rate to be administered by the commercial banks. He felt that any actual rate increases would be gradual and in all the circumstances he would favor moving as high as 3 per cent for time deposits with maturities of longer than 90 days, with a maximum rate of 3 or even 3-1/2 per cent for savings deposits.

Governor Szymczak referred to the current earnings of the commercial banking system and said that from a public relations standpoint there was much to be said for paying out some of the earnings to depositors in the form of higher interest rates.

Following a further discussion of the matter, Chairman Martin said that to him the most important factor was the encouragement of saving. If there were any banks that wished to pay 3 per cent at a time when there was a shortage of savings, it seemed to him basically inconsistent not to allow them to pay that rate. In terms of broad concept, he questioned whether, at a time when any substantial number of banks wanted to pay a higher rate of interest, the Board was in fact protecting the banks by refusing to increase a maximum rate that was no longer tenable in terms of market rates. To await a possible further increase in the discount rate would be indicating that the Board wanted to make the market rather than the reverse. He said that System policy had been one of trying to follow and let the market forces predominate, but that now the Board appeared to be hampering the development of a
plateau. He again referred to the fact that the Board had not examined the maximum rates of interest thoroughly for some time and that meanwhile the interest rate structure had moved substantially higher.

After the Secretary had read the views expressed by the Federal Advisory Council at its last meeting with the Board, it was agreed that any discussion of the maximum rates of interest at the meeting with the Council today would be primarily in terms of obtaining the Council's current views.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board the following matters relating to the Board's staff:

Memorandum dated November 13, 1956, from Mr. Young, Director, Division of Research and Statistics, recommending the appointment of Iola B. Morgan as Secretary in that Division, with basic salary at the rate of $4,210 per annum, effective the date she assumes her duties.

Memorandum dated November 19, 1956, from Mr. Sloan, Director, Division of Examinations, recommending that the resignation of Robert R. Russell, Assistant Federal Reserve Examiner in that Division, be accepted effective November 23, 1956.