

Minutes for January 16, 1959

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.

	A	B
Chm. Martin	x <u>(M)</u>	_____
Gov. Szymczak	x <u>[Signature]</u>	_____
Gov. Mills	x <u>[Signature]</u>	_____
Gov. Robertson	x <u>[Signature]</u>	_____
Gov. Balderston	x <u>[Signature]</u>	_____
Gov. Shepardson	x <u>[Signature]</u>	_____

Minutes of the Board of Governors of the Federal Reserve System
on Friday, January 16, 1959. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Szymczak
Mr. Mills
Mr. Robertson
Mr. Shepardson

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Thomas, Economic Adviser to the Board
Mr. Young, Director, Division of Research
and Statistics
Mr. Hackley, General Counsel
Mr. Masters, Director, Division of Examinations
Mr. Farrell, Director, Division of Bank
Operations
Mr. Shay, Legislative Counsel
Mr. Robinson, Adviser, Division of Research
and Statistics
Mr. Koch, Associate Adviser, Division of
Research and Statistics
Mr. Sammons, Associate Adviser, Division of
International Finance
Mr. Solomon, Assistant General Counsel
Mr. Benner, Assistant Director, Division of
Examinations
Mr. Conkling, Assistant Director, Division of
Bank Operations
Mr. Daniels, Assistant Director, Division of
Bank Operations
Mr. Hill, Assistant to the Secretary
Mr. Eckert, Chief, Banking Section, Division of
Research and Statistics
Mr. Hald, Economist, Division of Research and
Statistics
Mr. Fisher, Economist, Division of Research and
Statistics

Discount rates. Unanimous approval was given to telegrams to
the Federal Reserve Banks of New York, Minneapolis, and Kansas City
approving the establishment without change by those Banks on January 15,
1959, of the rates on discounts and advances in their existing schedules.

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Items circulated to the Board. The following items, which had been circulated to the Board and copies of which are attached to these minutes under the respective numbers indicated, were approved unanimously:

- | | <u>Item No.</u> |
|---|-----------------|
| Letter to the Central Trust Capital Bank, Harrisburg, Pennsylvania, granting an extension of time within which to establish a branch in the Colonial Park Shopping Center. (For transmittal through the Federal Reserve Bank of Philadelphia) | 1 |
| Letter to the Monroe City Bank, Monroe City, Missouri, approving an investment in bank premises. (For transmittal through the Federal Reserve Bank of St. Louis) | 2 |
| Letter to The Stone Fort National Bank of Nacogdoches, Nacogdoches, Texas, approving its application for fiduciary powers. (For transmittal through the Federal Reserve Bank of Dallas) | 3 |
| Letter to the Federal Reserve Bank of Kansas City approving the total expenditure in connection with the Omaha Branch building program. | 4 |

Mr. Daniels then withdrew from the meeting.

Proposed nursing home and land development mortgage insurance programs. Pursuant to the discussion at the meeting on January 14, 1959, a revised draft of letter to the Bureau of the Budget regarding proposed legislation which would provide mortgage insurance for nursing homes and neighborhood development programs had been distributed to the Board.

After some discussion as to how far the Board should go in questioning the desirability of the neighborhood development proposal,

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it was agreed to distribute for the Board's consideration another revised draft which would reflect suggestions made by Governor Mills.

With respect to the program for insuring mortgages on nursing homes, it was suggested that the new draft might go somewhat further than the present one in questioning the desirability of the discretionary authorities that would be given to the Commissioner of the Federal Housing Administration to regulate charges, methods of operation, capital structure, and rate of return on insured nursing homes, particularly since the proposed legislation would direct the Commissioner, in administering the program, to consult with and ask the advice and recommendations of the Department of Health, Education, and Welfare. In this connection, Governor Mills commented that the reason for requesting the Board's advice on the proposed legislation presumably was because of its competence in the financial field. He expressed doubt whether, in such circumstances, it would be advisable for the Board to take a position with respect to the administration of such a program, especially when it had not had the benefit of hearing the proponents of the measure.

Mr. Molony, Special Assistant to the Board, joined the meeting during the foregoing discussion.

Maximum interest rates on time deposits. Following receipt of a memorandum from a member bank suggesting liberalization of maximum interest rates on time deposits under Regulation Q, the Federal Reserve

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Bank of New York last fall recommended to the Board establishment of a uniform maximum rate of 3 per cent for time deposits having a maturity of 90 days or more. The New York Bank also suggested the need for an extensive staff study of the principles which should govern the establishment of the maximum rates payable on time and savings deposits. Such a study had now been completed by the Board's staff and copies had been distributed to the members of the Board with a memorandum from Mr. Young dated November 14, 1958.

After referring, by way of background, to the legal basis for Regulation Q contained in section 19 of the Federal Reserve Act, which was added by the Banking Act of 1933 and amended by the Banking Act of 1935, the staff memorandum pointed out that since the Regulation was first issued in 1933, there had been only two substantive rate changes--a reduction in 1935 and an increase in 1957. Using legislative intent as a guide to policy, it appeared that a leading purpose of the limitation of interest paid on saving and time deposits was to prevent banks from competing for deposits with such aggressiveness as to lead to unsound banking. The shifting of funds from country banks to big city banks in the form of interbank deposits also appeared to have been a matter of special concern. However, a number of new economic factors had emerged since Regulation Q was originally issued. For example, with the payment of interest on demand deposits prohibited, a rate of interest on time and savings deposits considered attractive

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by bank customers tended to provide an incentive to shift deposits in excess of current needs from one classification to the other. Also, commercial banks were now competing more keenly for savings deposits with other types of financial institutions, mainly savings and loan associations. As to regulatory philosophy, the memorandum suggested that the economic circumstance lying back of the Regulation was roughly as follows: Interest rates paid by commercial banks and dividend rates paid by individual mutual savings banks and savings and loan associations frequently go unchanged for long periods of time as the result of a traditional preference of savings institutions for reasonable stability in their interest rates. However, since savings institutions much prefer raising rates to lowering them, the underlying philosophy of regulation might be said to be that commercial bank rates must be limited. This general background, it was noted, left considerable latitude for the determination of a regulatory philosophy and indicated that the System had three basic concerns with respect to commercial bank participation in the time and savings deposit business: (1) how far commercial banks should be permitted to go in competing for permanent or semi-permanent savings funds, (2) how an interest rate limitation, authorized by statute, could be made to keep in step with relevant market rates so that flexible administration of maximum interest rates might effectively confine the commercial bank savings function to individual savings for limited or intermediate-term objectives, and (3) the problem of competition between a portion of the time deposit

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business of commercial banks and liquid money market obligations.

Assuming that the savings and time deposit function was accepted as a legitimate phase of commercial banking activity, there would still be alternative underlying philosophies with respect to the administration of the interest rate maxima. One alternative would be to regard Regulation Q as a general structural regulation aimed only at curbing the excessive zeal of commercial banks in their competitive efforts. If this philosophy prevailed, the permissible maxima would be adjusted rather rarely and never in response merely to boom-time economic conditions, when banks, because of attractive interest rates, might be tempted to compete for semi-permanent or permanent savings funds. The maximum rates established would, in effect, be aimed at the levels a reasonably well-managed bank could afford to pay, and such a regulation would have little influence or significance in relation to monetary policy. As a second alternative, Regulation Q might be viewed as a prod to make banks do what their individual managerial prudence should induce them to do under changed monetary conditions. Under this philosophy of regulation, banks would be obliged to adapt themselves to changes in the permissible rate structure and level. This would tend to protect smaller, less aggressive banks against their own indecision induced by fear of competitors' actions. As a third alternative, the Regulation could be viewed as more than a bank supervisory instrument and as a supplement to monetary policy. Under such a philosophy, the Regulation would be administered with the purpose of

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influencing the interest rate structure and preventing shifts between the active and inactive money supply components tending to work against prevailing monetary policy.

The method of implementing regulatory policy would differ according to the several philosophical approaches. If regulation of rates of interest paid on time and savings deposits were viewed as a general supervisory safeguard, very broad considerations would govern the setting of permissible rates and bank supervisory attitudes would exercise considerable influence. Evidence that unsafe and unsound competitive practices were developing might be the single most important guide to action. In many ways, it was noted, this could be viewed as the philosophy that had prevailed thus far in administering Regulation Q. If a cycle-conforming philosophy were followed, more frequent and closer adjustment to changing levels of interest rates would be needed. Time deposits, because of their more volatile nature, would require more frequent scrutiny than savings deposits, the fulcrum of the time deposit rate schedule might be the rate for maturities of 90 days to six months, and the comparative rate most closely followed might be the rate on Treasury bills. Thus, the rate set on 90-day to six-month time deposits might be determined by using a formula based on an average of the Treasury bill yield for some preceding period. On the one hand, a formula approach would relieve the Board of considering frequent discretionary changes in Regulation Q, but on the other hand

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the use of a formula would result in changes that lagged somewhat after the fact. The rate on under-90-day deposits presumably should be relatively low, on the theory that competition for them probably should not be encouraged; and the "over-six-month" rate probably could be determined by a formula related to shorter-term time deposit rates, the Treasury bill rate, or some other criterion. The maximum rate on savings deposits, which would not need to be changed so frequently, might be related to a guide such as the prevailing rate on conventional mortgages and presumably should not be higher than the United States savings bond rate.

In conclusion, the memorandum suggested that Regulation Q was not well suited for use as a monetary policy supplement; that maximum rates, if changes were relatively infrequent, should be set at a level which would allow banks latitude for changing their individual rates both up and down but at the same time not encourage unsound banking practices; and that, if Regulation Q were kept in somewhat closer touch with the market, particularly in the 90-day to six-month time deposit category, the Board must either consider amendments repeatedly or follow some formula approach. The use of a formula would facilitate adaptation of the ceiling rate to market rates, but it would result in a lag behind the market in periods of rapid change. In addition, the formula approach might be considered too radical a departure from the principle of discretionary monetary administration.

Following preliminary comments by Mr. Young, Mr. Eckert reported on recent time deposit trends, Mr. Hald reviewed the legal

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basis for the regulation of maximum interest rates and discussed the development of the time deposit function, and Mr. Robinson commented on alternative approaches to regulatory policy, including the possibility of a formula approach.

In his comments, Mr. Eckert traced the relative growth of time deposits in commercial banks, deposits in mutual savings banks, and share accounts in savings and loan associations prior to the 1957 amendment of Regulation Q and more recently, including the trends in savings and other time deposits during the year 1958. From available information it appeared that savings deposits continued to increase in the last part of 1958, while in New York City foreign and other time deposits declined somewhat during most of the third and fourth quarters. Toward the end of the year there was some rebound, and at the end of 1958 foreign time deposits at New York City banks were substantially above year-ago levels. Because of tax exemptions, it appeared that New York City banks could retain foreign time deposits if the rate on Treasury bills was not more than one-half per cent higher. This was not true in the case of domestic time deposits, which tended to explain why the New York City banks had not been able to hold them to the same extent. If there should be any appreciable rise in Treasury bill rates, the problem of the New York City banks apparently could become acute very quickly.

Mr. Eckert concluded with the observation that the smaller bank was less likely to be paying ceiling rates at the present time than

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the large city bank, and that the rate structure for time certificates of deposit was higher than that on savings accounts.

Mr. Hald pointed out in the course of his comments that the growth in time deposits recently had made it somewhat difficult to assess monetary policy in terms of demand deposits and currency. With respect to competition, he noted that commercial banks holding certain types of time deposits were faced with strong competition from the rate available on Treasury bills. Ideally, one might be tempted to argue that commercial banks should not hold either very short-term funds or permanent savings, but it must be recognized that commercial banks had been in the savings account business for some time and in some sections of the country were the principal institutions available for savings.

In supplementing Mr. Hald's remarks about possible alternative regulatory philosophies, Mr. Robinson referred to the tendency of commercial banks to fail to reduce interest rates on savings and other time deposits in periods of change in the general interest rate structure. He suggested that if the Board had been following a more meticulous theory of regulation, changes in the maximum rates at least once each year since 1952 might have been indicated. In discussing possible operating procedures under a formula approach, along with advantages and disadvantages in the use of a formula, he suggested that application of the formula technique to this one regulatory area might be something

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like having a small tail wagging a big dog and that there might be efforts to escape from such regulation into other areas whenever it seemed advantageous to do so.

The possibility of relating a formula to the Federal Reserve Bank discount rate rather than the Treasury bill rate was discussed briefly, following which Governor Balderston raised the question whether it made a substantial difference from the standpoint of the national economy if funds were held in Treasury bills or in the form of time deposits at New York City banks. He also inquired whether the Board was not in effect faced with the question of doing something for persons having small savings balances if it took action which would aid the large banks in retaining their time deposits.

With respect to Governor Balderston's first question, Mr. Koch suggested that if the distribution of foreign money continued to follow the general pattern of the past, the situation was not unduly complicated; however, if a formula were established and time deposit rates were changed frequently, it was conceivable that foreign money would tend to flow more heavily into the New York banks than into Treasury bills. Aside from the fact that an attribute of the domestic Government securities market is a strong nonbank bill market, it is much easier from the point of view of managing the money market to have foreign money go through a Federal Reserve Bank into Treasury bills.

With reference to Governor Balderston's second question, it was suggested that, although adoption of a formula might assist the large

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banks in retaining time deposits, the Board would not be precluded from administering the maximum rate on savings accounts in whatever manner it deemed most appropriate in the light of prevailing conditions.

Chairman Martin then inquired whether any Board member had strong convictions on the subject, and Governor Mills stated that he did not care to comment in detail unless there was a disposition to depart from the status quo. He would favor continuing to regard the Board's responsibility under the statute as one within the area of bank supervision which did not call for the injection of monetary policy considerations.

Governor Robertson concurred. His reasoning, he said, was in line with the view expressed in the staff memorandum that Regulation Q was not well suited for use as a supplement to monetary policy and that maximum interest rates should not be fixed so high as to encourage unsound banking practices.

Question was raised whether it would be desirable to send copies of the staff memorandum, including the correspondence with the Federal Reserve Bank of New York, to the Presidents of the Federal Reserve Banks for their information and any comments they might wish to make, and it was agreed that this should be done.

In this connection Chairman Martin observed that President Hayes had seen a copy of the staff memorandum, presumably furnished to him by a New York staff member of the System Research Advisory Committee, and

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that, in the opinion of Mr. Hayes, it fulfilled the need for a comprehensive study of this subject.

The procedure to be followed in distributing the staff memorandum and the fact that President Hayes had already seen a copy suggested to the Board that it was not necessary to reply formally to the correspondence from the New York Reserve Bank with regard to the suggestion for a revision in the current schedule of maximum rates on time deposits.

At the suggestion of Governor Balderston, it was understood that the Division of International Finance would prepare a memorandum for the Board's information on the relationship of short-term Government securities and time deposits in the London market.

Invitation to testify on housing legislation (Item No. 5)

Chairman Martin referred to a letter from Chairman Sparkman of the Subcommittee on Housing of the Senate Banking and Currency Committee dated January 14, 1959, inquiring whether the Board would wish to provide testimony at the hearings on housing legislation scheduled to begin on January 22.

After a brief discussion, agreement was expressed with Chairman Martin's view that it would be advisable to respond in terms that it seemed doubtful whether the Board would have anything specific to offer at this time relative to housing legislation. A copy of the reply sent by Chairman Martin to Senator Sparkman pursuant to this understanding is attached as Item No. 5.

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Effect of interest rate level on State and local government bond issues. Chairman Martin said that he had been in receipt of several inquiries as to whether the Board, in testifying on the President's Economic Report, intended to deal with the extent to which it appeared that State and local government bond issues previously deferred because of high interest rates had come to market in 1958 when such rates were more favorable.

A discussion resulted in agreement with the suggestion that, for these hearings and other purposes, it would be desirable to request the Federal Reserve Banks to contact borrowers in their respective districts with a view to obtaining information on specific issues.

All of the members of the staff then withdrew and the Board went into executive session.

Trip by Mr. Marget. Governor Shepardson later informed the Secretary that in executive session the Board, after considering a memorandum from Mr. Marget dated January 12, 1959, authorized him to accept an invitation from the President of the International Economic Association to participate in a Round Table on Inflation to be held in Denmark in September of this year, with the understanding that in addition to the eight days of the meetings in Denmark he would be allowed up to two weeks to visit the Central Banks of Sweden and Norway, and perhaps the Bank of England. Mr. Marget's travel was authorized on the basis of actual necessary transportation expenses plus per diem in lieu of subsistence at the rates stipulated in the

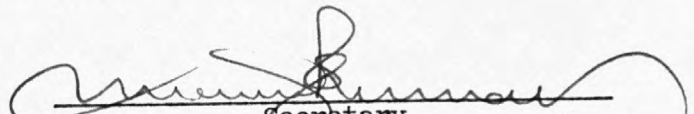
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Standardized Government Travel Regulations.

Salary of Mr. Rouse. The Chairman also reported that during the executive session the Board discussed a letter dated December 19, 1958, from Mr. Hayes, President of the Federal Reserve Bank of New York, concerning the action taken by the Board in approving a salary for Mr. Rouse for the calendar year 1959 as indicated in the Board's letter of December 12, 1958. During this discussion, it was noted that Mr. Hayes apparently had some misunderstanding of the procedure contemplated at the time the Salary Administration Plan for officers of Federal Reserve Banks was adopted in 1953, in that his letter indicated a belief that under this plan the matter of individual salaries of officers would be left very largely to the directors of the Federal Reserve Bank concerned, reserving to the Board of Governors general control over such aspects as the aggregate of salaries and the increases therein. It was pointed out that the Board's letter of February 20, 1953 to the Chairmen and Presidents of the Federal Reserve Banks regarding the Salary Administration Plan stated expressly that "The Board of Governors would continue to exercise the power to approve or disapprove in its discretion each individual salary proposal." The Secretary's Office was also informed that the Board concluded that no reply would be sent to Mr. Hayes' letter of December 19.

The meeting then adjourned.


Secretary



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

Item No. 1
1/16/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

January 16, 1959.

Board of Directors,
Central Trust Capital Bank,
Harrisburg, Pennsylvania.

Gentlemen:

Pursuant to your request submitted through the Federal Reserve Bank of Philadelphia, the Board of Governors of the Federal Reserve System extends until December 23, 1959, the time within which Central Trust Capital Bank, Harrisburg, Pennsylvania, may establish a branch in the Colonial Park Shopping Center, Jonestown Road and Colonial Road, Dauphin County, Pennsylvania, under the authorization contained in the Board's letter dated December 23, 1957.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

Item No. 2
1/16/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

January 16, 1959.



Board of Directors,
Monroe City Bank,
Monroe City, Missouri.

Gentlemen:

Pursuant to your request submitted through the Federal Reserve Bank of St. Louis, the Board of Governors approves, under the provisions of Section 24A of the Federal Reserve Act, an additional investment of \$61,000 in bank premises by Monroe City Bank, Monroe City, Missouri.

It is understood that depreciation will be taken in accordance with Federal income tax allowables.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

Item No. 3
1/16/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

January 16, 1959.



Board of Directors,
The Stone Fort National Bank of Nacogdoches,
Nacogdoches, Texas.

Gentlemen:

The Board of Governors of the Federal Reserve System has given consideration to your application for fiduciary powers and grants you authority to act, when not in contravention of State or local law, as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State of Texas, the exercise of all such rights to be subject to the provisions of Section 11(k) of the Federal Reserve Act and Regulation F of the Board of Governors of the Federal Reserve System.

A formal certificate indicating the fiduciary powers which The Stone Fort National Bank of Nacogdoches is now authorized to exercise will be forwarded to you in due course.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

Item No. 4
1/16/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

January 16, 1959.

Mr. H. G. Leedy, President,
Federal Reserve Bank of Kansas City,
Kansas City 6, Missouri.

Dear Mr. Leedy:

This refers to your letter of December 23, 1958, concerning the total cost of the addition to and alterations of the Omaha Branch building.

It is noted that the total amount expended on the building program was \$2,017,751.59, which exceeded the amount authorized in the Board's telegram of October 22, 1954, by \$242,368.59. It is also noted that this overexpenditure resulted very largely because the costs of vault and cafeteria equipment (\$98,077) and of change orders (\$108,009) were not included in the general contract, and because no allowance for contingencies was provided for in the bid data, on which the Board's authorization was based, although all of these items are normally included in authorizations of building programs by the Board.

In the circumstances, the Board approves the total expenditure indicated in the preceding paragraph.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.



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

Item No. 5
1/16/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

January 16, 1959.

The Honorable John Sparkman,
Chairman, Subcommittee on Housing,
Senate Banking and Currency Committee,
Washington 25, D. C.

Dear Senator:

Your letter of January 14 announced the beginning of hearings on housing legislation on January 22 and inquired whether the Board would wish to provide testimony at the hearings.

While we appreciate receiving your letter, it would seem doubtful that we have anything specific to offer at this time relating to housing legislation.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

