

Minutes for March 17, 1959

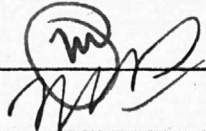
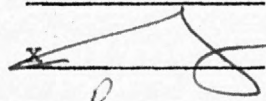

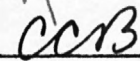
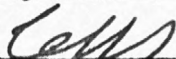
To: Members of the Board

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 
Gov. Szymczak	_____	x _____
Gov. Mills	x 	_____
Gov. Robertson	x 	_____
Gov. Balderston	x 	_____
Gov. Shepardson	x 	_____

Minutes of the Board of Governors of the Federal Reserve System
on Tuesday, March 17, 1959. The Board met in the Board Room at 10:00 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Thomas, Economic Adviser to the Board
Mr. Hackley, General Counsel
Mr. Molony, Special Assistant to the Board
Mr. Shay, Legislative Counsel
Mr. Noyes, Adviser, Division of Research and
Statistics
Mr. Solomon, Assistant General Counsel
Mr. Benner, Assistant Director, Division of
Examinations
Mr. Conkling, Assistant Director, Division of
Bank Operations
Mr. Collier, Chief, Current Series Section,
Division of Bank Operations

Proposed revision of condition reports (Item No. 1). There had been distributed to the members of the Board copies of a memorandum from the Division of Bank Operations dated March 14, 1959, presenting certain proposed revisions in the weekly condition reports from banks in leading cities designed to enhance the usefulness of those reports. It was indicated that the proposals resulted from periodic System staff review of the report form and the selection of reporting banks, and that the proposals had been considered by the System Research Advisory Committee and an associate committee composed of economists from every Reserve Bank and the Board's staff. Approval of the Board was requested for clearing the recommendations with interested agencies and obtaining

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agreement by the other Federal bank supervisory agencies to a revision in the loan schedule (Schedule A) of the call report of condition so as to add an item of loans to financial institutions other than banks and redefine other loan items. This would enable banks to establish a consistent classification system for record-keeping and reporting purposes and diminish classification difficulties and inaccuracies in reporting. Submitted with the memorandum were drafts of letters to the Comptroller of the Currency and the Federal Deposit Insurance Corporation regarding the proposed changes in Schedule A of the call report.

The memorandum expressed the hope that it would be possible to begin using the revised call report not later than in connection with the call at the end of this year. Also, it was hoped that a slip-sheet could be attached to the mid-year call informing banks of the basis to be required thereafter and requesting them to report their loan data on the revised form as well as on the present basis. This would have the advantage of obtaining data on both bases for one date and thus providing comparative statistics. The revised weekly report could then be instituted early in July, with reporting banks requested to report on both bases on the beginning Wednesday date.

Following comments by Mr. Thomas on the background, nature, and intent of the proposals, and by Mr. Conkling on the favorable results of preliminary checking with staff members of the other Federal bank supervisory agencies, the Board authorized taking the necessary steps

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to obtain the agreement of the other bank supervisory agencies to the suggested changes in the loan schedule of the call report of condition. A copy of the letter sent to the Comptroller of the Currency pursuant to this action is attached as Item No. 1, and a similar letter was sent to the Chairman of the Federal Deposit Insurance Corporation.

It was understood that advice on the status of the matter would be sent to the Presidents of the Federal Reserve Banks. Question then was raised regarding the Federal Advisory Council. After some discussion of this point, it was agreed to advise the Council by letter after clearance from the other bank supervisory agencies had been obtained, thus serving to afford the members of the Council an opportunity to submit any comments they might desire while at the same time avoiding undue delay in instituting the proposed changes. Agreement was expressed with the suggestion that the advice to the Federal Advisory Council should emphasize the objective of the proposals, namely, an improvement in available data, in order to avoid any misunderstanding.

Messrs. Benner and Conkling then withdrew from the meeting.

Letter to Senator Johnson. Pursuant to the discussion at yesterday's meeting, there had been distributed to the members of the Board copies of three alternative drafts of material that might be sent in letter or enclosure form to Senator Lyndon Johnson of Texas for his use in replying to a constituent, Mr. H. E. Cutcher of Lockhart, Texas,

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who had interpreted certain remarks by Congressman Patman in the Congressional Record to mean that the Federal Reserve Banks were allowed to "give away" tax money to the commercial banks. A fourth alternative draft, prepared by Mr. Thomas, was distributed at this meeting.

After consideration of the alternative drafts from the standpoint of the approach that would be most helpful to Senator Johnson in responding to his constituent, the suggestion was made that the Board's reply be relatively brief and couched in lay language. Such a letter, it was suggested, might refer to the right of individual banks to apportion the use of resources at their disposal, as distinguished from the function of the Federal Reserve System in providing and absorbing total reserves in accordance with the needs of the economy. It was further suggested that the draft statement prepared by Mr. Thomas, supplemented by portions of one of the other drafts, be sent as an enclosure to Senator Johnson in order to provide a more thorough description of the role of the Federal Reserve System in regulating the supply of money and credit.

Agreement was expressed with such a response, and it was understood that a letter and enclosed statement framed along such lines would be prepared.

Messrs. Young, Director, and Hald, Economist, Division of Research and Statistics, entered the room at this point.

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Replies to Douglas-Patman questions (Item No. 2). With a covering memorandum from Mr. Young dated March 16, 1959, there had been distributed to the Board draft replies to certain questions that Senator Douglas and Congressman Patman had addressed to Chairman Martin on the occasion of his appearance before the Joint Economic Committee on February 6, 1959. The first question, raised by Senator Douglas, was whether it would not be preferable in implementing monetary and credit policy for the Federal Reserve to rely on open market operations to achieve restraint or ease and refrain from changing discount rates. The second question, raised by Mr. Patman, related to the effect of the Federal funds market on the Federal Reserve discount operation. The third question, also raised by Mr. Patman, related to whether interbank deposits had not increased rapidly and were not approaching the level that existed prior to the passage of the Federal Reserve Act.

The general reaction of the Board to the proposed replies was favorable and suggestions were limited principally to changes deemed advisable in the interest of clarification and improved phraseology. At the conclusion of the discussion, unanimous agreement was reached on the form of the replies to be made to the three questions, and it was understood that the replies would be transmitted to Chairman Douglas in such form. Copies of the transmittal letter sent to Chairman Douglas pursuant to this action and of the replies enclosed therewith are attached hereto under Item No. 2.

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Messrs. Young and Hald then withdrew from the meeting.

Testimony on reserve requirement legislation. At the meeting on March 6, 1959, it was agreed that Vice Chairman Balderston would appear on behalf of the Board before the Senate Banking and Currency Committee on March 23, 1959, at hearings with respect to proposed reserve requirement legislation. Accordingly, there had been distributed to the Board under date of March 16, 1959, a draft of statement to be presented by Governor Balderston. This draft was almost identical with a draft of possible statement prepared under date of June 5, 1958, by Messrs. Thurston and Molony following discussion of an earlier draft by the Board. Since no hearings on reserve requirement legislation were held during the last session of Congress, occasion had not arisen to use the statement.

At the request of the Board, Mr. Thomas described certain material that might be used to augment the draft statement. However, it was deemed preferable to adhere basically to testimony in the form of the distributed draft, with the understanding that the additional material referred to by Mr. Thomas would be put in a form in which it would be available to Governor Balderston at the hearing if there should be need for it.

Certain other substitutions and modifications also were mentioned by Mr. Thomas. The reaction to them was generally favorable and it was understood that a revised draft reflecting them would be

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distributed prior to further consideration of the testimony by the Board.

Governor Balderston then presented for consideration the type of responses that might be most appropriate in the event certain questions were addressed to him at the hearing. The first of these related to a possible request for a spelling out of the standards that the Board might utilize in considering requests from individual member banks in central reserve or reserve cities for permission to carry lower reserves. Views expressed by members of the Board on this point suggested the inadvisability of being drawn into a discussion of specific standards because this might tend to circumscribe the Board in discharging its administrative functions if reserve requirement legislation of the type before the Banking and Currency Committee should be enacted. The suggestion was made that it might be appropriate to make use of examples drawn from requests made of the Board by member banks under the present statutes, without specific reference to individual applicant institutions. It was also suggested that there be drawn up for Governor Balderston's use a list of factors to which the Board might be expected to give consideration in handling any requests from member banks under revised statutes.

The second possible question referred to by Governor Balderston related to a charge of inconsistency in establishing the same range of requirements for central reserve and reserve city banks while at the

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same time indicating unwillingness to discard the central reserve city classification. After some discussion of this point, it was understood that further thought would be given to the subject and that the staff would prepare certain material in support of the validity of maintaining a distinction between banks in central reserve and reserve cities based on the nature of business conducted.

The meeting then adjourned.

Secretary's Note: Pursuant to recommendations contained in memoranda from appropriate individuals concerned, Governor Shepardson today approved on behalf of the Board increases in the basic annual salaries of the following persons on the Board's staff in the amounts indicated, effective March 22, 1959:

Edythe J. Bascom, Records Clerk, Office of the Secretary, from \$4,040 to \$4,135.

Paula G. Hauprich, Stenographer, Legal Division, from \$4,230 to \$4,325.

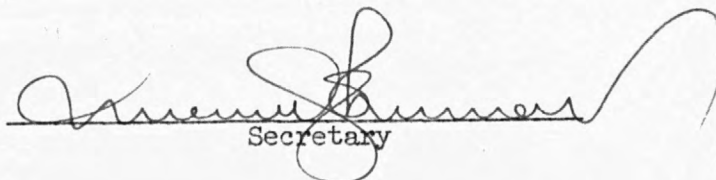
Gerald F. Millea, Chief, Division Administration Section, Division of Research and Statistics, from \$9,050 to \$9,290.

Joseph B. Dunn, Assistant Federal Reserve Examiner, Division of Examinations, from \$6,135 to \$6,285.

Doris J. Hodge, Secretary, Division of Bank Operations, from \$4,190 to \$4,340.

Kathryn A. Jackson, Statistical Clerk, Division of Bank Operations, from \$4,040 to \$4,190.

Charlie H. Ward, Laborer, Division of Administrative Services, from \$3,150 to \$3,245.


Secretary

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

Item No. 1
3/17/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 17, 1959

The Honorable Ray M. Gidney,
Comptroller of the Currency,
Washington 25, D. C.

Dear Mr. Gidney:

The Board is planning revisions in the condition reports received weekly from member banks in leading cities in order to obtain some additional information needed for more effective analyses of credit and business developments. One of the principal changes the Board would like to make would be the addition of an item covering loans to financial institutions to be shown separately. It is felt that if this change is made a similar separation should be made in loan schedule A of the call report of condition. The weekly condition form has been comparable with the official call form since 1938, through combinations of items, and it does not seem practicable to ask weekly reporting banks to report on a basis substantially different from the call report.

If agreement is reached among the supervisory agencies on loan schedule A, it is contemplated that the weekly reporting member banks will be asked to report a two-way breakdown of the new item as defined for call report purposes: (a) loans to sales finance, personal finance, and other business credit companies, and (b) loans to all other financial institutions (mainly, mutual savings banks, insurance companies, mortgage companies, savings and loan associations, and Federal lending agencies).

The purpose of the separation of loans to financial institutions from other bank loans is to provide a cleaner commercial loan figure and to identify that part of bank credit that flows directly to and from business. A separate figure on loans to financial institutions would provide users with a more accurate measure of the amount of bank credit that is being channeled through those financial intermediaries.

The proposal also contemplates a redefinition of real estate mortgages acquired under repurchase agreements (now reported as real estate loans) so that they would be treated as loans to

The Honorable Ray M. Gidney -2-

mortgage companies, to insurance companies, etc.; this would be consistent with present reporting instructions on securities subject to repurchase agreements.

It will be appreciated if you will advise us whether you are agreeable to the adoption of the proposals. If so, it is hoped that the revised form and instructions could be cleared for use not later than the 1959 year-end call. Members of your staff have been informed of the proposals.

A similar letter is being sent to Mr. Wolcott, Chairman of the Federal Deposit Insurance Corporation.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Merritt Sherman

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 2
3/17/59

OFFICE OF THE VICE CHAIRMAN

March 20, 1959



The Honorable Paul H. Douglas,
Chairman,
Joint Economic Committee,
Congress of the United States,
Washington, D. C.

Dear Mr. Chairman:

Attached is a memorandum of reply to questions asked of Chairman Martin by you and by Congressman Patman at the Hearings before your Committee on February 6, 1959.

I trust you will find these replies responsive and of interest to the Committee.

Sincerely yours,

A handwritten signature in cursive script that reads "Canby Balderston".

C. Canby Balderston,
Vice Chairman.

Attachment

Replies to Questions by Senator Douglas and Congressman
Patman at Joint Economic Committee Hearings
February 6, 1959

Question by Senator Douglas: Would it not be preferable, in implementing monetary and credit policy, for the Federal Reserve to rely on open market operations to achieve restraint or ease, but refrain from changing discount rates? In these circumstances interest rates generally would not rise, or not rise as much, in periods of credit restraint. When there is considerable unemployment and excess capacity, would you agree that this result would be desirable, since higher interest rates would tend to "hold back full recovery?"

Answer:

As an instrument of credit policy the discount rate is one aspect of the discount operation as a whole, which functions as a complement to the open market instrument. In a period of rising business activity, demands for bank credit may rise to such an extent that banks are unable to meet these demands on the basis of their existing reserves. There are essentially two ways in which banks can obtain additional reserves; the Federal Reserve System can, on its own initiative, supply reserves by purchase of Government securities in the open market; alternatively, banks can on their own initiative increase their reserves by borrowing at Federal Reserve Banks.

When credit demands are in such strength as would promote growth in credit and money in excess of the expansion of goods and services available for purchase, the Federal Reserve, in the interest of economic stability, tempers the amount of reserves available to meet such demands. When the Federal Reserve does not furnish on its initiative all of the reserves sought by banks in circumstances of very active credit demands from

private sources credit conditions in the economy as a whole tend to tighten. Individual banks, finding that their available reserve funds are not adequate to permit them to meet all credit demands, may react to the situation either by selling or running off liquid assets, or by borrowing from their Federal Reserve Bank. In either event, one effect is likely to be a rise in market interest rates.

Which method a particular bank uses to adjust its position will depend on a number of factors, including the kinds and amounts of securities or other open market paper in its portfolio, its earning rate on these securities, and the rate it must pay on borrowings at the discount window. Banks are generally reluctant to become indebted to the Federal Reserve except for very short periods, and when in debt feel constrained to liquidate assets. The deterrents to borrowing are greatly weakened if market yields on securities owned become and remain substantially higher than the discount rate. In these conditions, banks may even be induced to borrow for profit, a development which renders difficult effective administration of the discount window.

Federal Reserve Banks, in acting on member bank requests for credit, must therefore weigh each request in the light of the needs of the individual bank, the uses to which reserves are being put, and the general character and rate of credit expansion in the economy. While banks may expect that requests based on temporary needs resulting from reserve shifts beyond their individual control will be met, it is recognized that borrowing at the Federal Reserve is a privilege, not a right. Continued borrowing under circumstances pointing to unhealthy or unsound expansion of credit will be discouraged.

Federal Reserve Regulation A, revised in February 1955, sets forth the following guiding principles applicable to member bank borrowing:

Federal Reserve credit is generally extended on a short-term basis to a member bank in order to enable it to adjust its asset position when necessary because of developments such as a sudden withdrawal of deposits or seasonal requirements for credit beyond those which can reasonably be met by use of the bank's own resources. 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. Under ordinary conditions, the continuous use of Federal Reserve credit by a member bank over a considerable period of time is not regarded as appropriate.

In applying these principles it is of prime importance that the general reluctance of banks to borrow at the Federal Reserve be reinforced by a discount rate with real deterrent power at times when a tempering of bank credit growth is in the public interest. In other words, in order to make the discount mechanism an effective supplement to open market operations the Federal Reserve is obliged to maintain discount rates not markedly lower than market yields on the most readily available alternative source of bank reserves, Treasury bills. If the Federal Reserve in these circumstances did not adjust its discount rates to keep them "in touch" with market rates, the task of administering the discount window to prevent excessive credit expansion would become very difficult. In the absence of a rate deterrent to borrowing, Federal Reserve Bank officers would be without workable guidelines in acting on a great number of borrowing requests from banks, many of whom would be in the position of profiting directly from the relatively low rate on borrowings.

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The need for frequent reappraisal of the discount rate in order to maintain the effectiveness of the discount operation as a credit instrument is recognized in the Federal Reserve Act itself. Section 14(d) of the Act empowers each Federal Reserve Bank

"To establish from time to time, subject to review and determination of the Board of Governors of the Federal Reserve System, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business; but each such bank shall establish such rates every fourteen days, or oftener if deemed necessary by the Board;" (Italics added)

At times conditions are such that market rates and discount rates vary from each other for extended periods. When credit demands are relatively light and banks have abundant reserves with negligible borrowings, short-term market rates are likely to fall well below the discount rate. This occurred in 1954 and also in 1958.

There have been other times when market rates have remained above the discount rate for a considerable period and have been little affected by changes in the discount rate. For example, last year the market yield on 90-day Treasury bills rose sharply from below 1 per cent in July to around 2-3/4 per cent by early October, while discount rates were raised from 1-3/4 per cent to 2 per cent in August and September, as shown on the attached chart. Since early October the yield on 90-day Treasury bills has fluctuated generally within a narrow range--between 2-5/8 and 3 per cent, while discount rates were raised in late October to 2-1/2 per cent and in early March to 3 per cent--a total increase of 1 percentage point. Rates on longer term securities likewise rose

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sharply in the summer and early fall and have shown little further change since early October. In this period member bank borrowings have averaged close to \$500 million, a much smaller amount than prevailed in other recent years when market interest rates were around present levels. The recent period provides an excellent illustration of the fact that market rates are strongly influenced by other factors than Federal Reserve policies.

Rising market rates of interest almost inevitably follow along with rising business activity because expansion of credit demands are an essential accompaniment of such a rise. The discount rate is essentially a technical rate, relating to the availability of borrowed reserve funds for banks. It is not a rate at which public and private borrowers in the market can avail themselves of funds.

In periods of active credit demands, market rates will generally array themselves in closer relationship to the discount rate, because banks are always in a position to supplement their lending capacity by borrowing at the Federal Reserve. It is to keep this source of supplementary lending power under continuous and effective regulation that the Federal Reserve must rely on flexible adjustment of the discount rate to changing market and economic conditions. In any case, if the discount rate were not used for this purpose but access to the discount window were limited by instruction, a similar impact on market rates of interest would occur, as individual banks sold Treasury bills or other securities to acquire the reserves denied through the discount window. Conceivably, the short-run impact on market rates would be greater.

Question by Mr. Patman: What is the effect of the Federal Funds Market on the Federal Reserve discount operation? Are not banks using this market really by-passing the Federal Reserve?

Answer:

The existence of the Federal Funds Market, a loosely organized market in which banks having excess reserves lend these balances to other banks, usually for one day, enables many banks to manage their reserve positions to a closer degree of tolerance than would otherwise be possible. The net result may be that the banking system has fewer pockets of excess reserves, and perhaps also a smaller total volume of reserves. Another way of saying the same thing is that short-run reserve shifts through the Federal Funds Market result in more nearly optimum use by the banking system of the existing reserve base, with less use of Reserve Bank credit.

From the standpoint of the individual bank, borrowing reserves in the Federal Funds Market as a way to adjust to a reserve deficiency adds a liability to its balance sheet. In this respect Federal Funds borrowing is similar to borrowing from the Federal Reserve. In either case, adjustment by borrowing is a temporary expedient; if the need for reserves continues, the bank will be obliged to reduce its holdings of securities or curtail its lending activities to bring its reserve position into balance.

While an individual bank which borrows Federal Funds may thus avoid borrowing at a Federal Reserve Bank, it does not necessarily follow that the existence of the Federal Funds Market materially impedes

Federal Reserve discount policy. In the first place, participation in the Federal Funds Market is confined to a relatively small number of banks, most of them the larger banks in financial centers. In the second place, transactions through the Federal Funds Market do not alter the total supply of reserves available to the banking system, which can be influenced by Federal Reserve policy actions. The supply of funds in the market is closely related to the general state of reserve availability for the banking system. When reserve availability is tight, interest rates in the Federal Funds Markets will tend to rise to, or close to, the discount rate. With the supply of reserve funds limited at such times, the discount mechanism, including the discount rate, can perform effectively its function of supplementing the open market instrument in regulating the volume of money and credit so that it is kept in alignment with the needs of the economy at a stable level of prices.

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Question by Mr. Patman: Have not interbank deposits increased rapidly, approaching the same level that existed prior to the passage of the Federal Reserve Act when too much money was concentrated in too few banks?

Answer:

Prior to the establishment of the Federal Reserve System, banks kept substantial portions of their cash liquidity reserves in the form of deposits at other banks. Under today's conditions, however, the first line of reserves of member banks is maintained in the form of legal reserves on deposit at Federal Reserve Banks. Under these circumstances, banks now maintain balances at other banks primarily as a part of correspondent relationships--for liquidity purposes, to facilitate check clearance, and to obtain a variety of services and advice.

The total of interbank balances increased substantially between 1939 and 1945, as the table shows. There has again been some growth in the last year or so, but total interbank balances held at member banks were only \$600 million higher in 1958 than in 1945. New York banks actually held fewer deposits due to domestic banks in 1958 than in 1945, although they continued to hold substantial deposits for foreign banks. Moreover, as would be expected, a substantial portion of total interbank balances held by member banks represented the approximately \$4 billion which nonmember banks keep on deposit--an amount which in large part represents the legal and working reserves of nonmember banks.

The growth of member bank interbank deposits for the period shown is of diminished significance when compared to the large growth in

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the total of demand deposits of all banks. Interbank deposits at member banks, which represented 27 per cent of total demand deposits of all banks in 1939, declined by 1945 to 16 per cent, and in recent years have remained at about 11 per cent.

March 17, 1959

Selected Data on Interbank Demand Deposits and Total Demand Deposits, 1939-1958

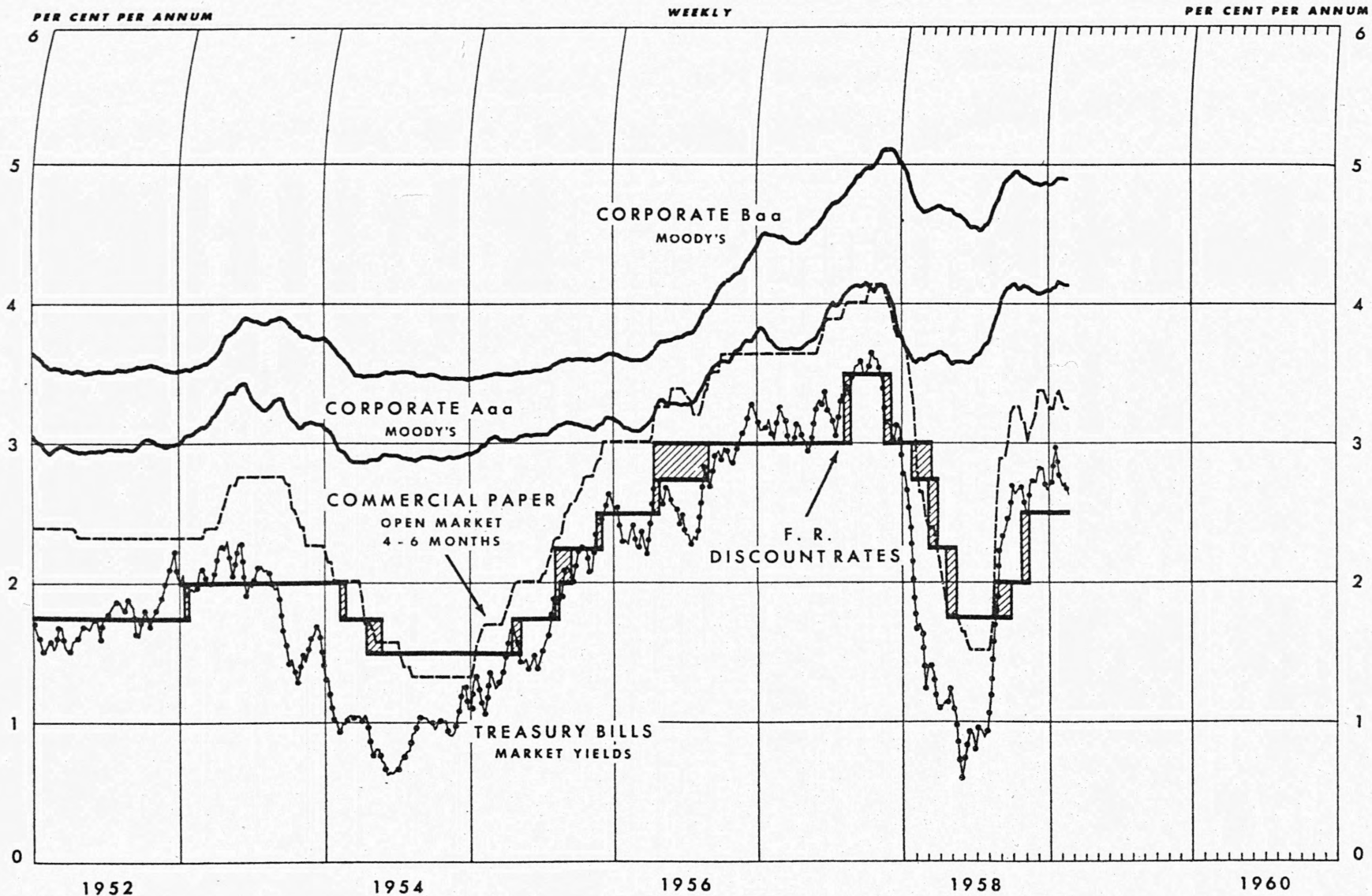
(Millions of dollars)

Year (June call date)	Demand deposits of domestic banks held by member banks					Nonmember banks-- balances due from domestic banks	All commercial banks-- demand deposits adjusted ^{2/}	Per cent of member bank interbank de- posits to total demand deposits
	New York	Chicago	Reserve city	Country	All member banks			
1939	2,992	746	2,920	439	7,097	1/	27,355	25.9
1945	3,271	1,174	5,510	1,108	11,064	1/	69,053	16.0
1946	3,127	1,047	5,220	997	10,391	1/	79,476	13.1
1947	2,898	1,056	4,773	885	9,612	1/	82,186	11.7
1948	2,830	1,055	4,751	798	9,433	3,163	82,697	11.4
1949	2,680	962	4,460	762	8,864	3,037	81,877	10.8
1950	2,692	977	4,848	850	9,368	3,214	85,040	11.0
1951	2,744	1,006	4,996	913	9,659	3,394	88,960	10.9
1952	3,193	1,136	5,624	1,060	11,013	3,833	94,754	11.6
1953	2,979	1,175	5,744	1,049	10,947	3,843	96,898	11.3
1954	3,237	1,287	6,220	1,212	11,956	3,958	98,132	12.2
1955	3,129	1,125	5,979	1,249	11,482	3,811	103,234	11.1
1956	3,080	1,149	6,078	1,321	11,627	4,000	104,744	11.1
1957	2,775	1,133	5,648	1,243	10,799	3,816	105,706	10.2
1958	3,084	1,211	6,115	1,267	11,676	3,964	106,169	11.0

^{1/} Beginning with December 31, 1947, the all-bank series was revised; previous data not strictly comparable.

^{2/} Excludes interbank and U. S. Government deposits and collection items; data are partly estimated prior to 1947.

MONEY RATES



Latest Figures Plotted: FEBRUARY 20

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM