Minutes for October 6, 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, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin  [Signature]
Gov. Szymczak  [Signature]
Gov. Mills  [Signature]
Gov. Robertson  [Signature]
Gov. Balderston  [Signature]
Gov. Shepardson  [Signature]
Gov. King  [Signature]
Minutes of the Board of Governors of the Federal Reserve System

on Tuesday, October 6, 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. King

Mr. Sherman, Secretary
Mr. Riefler, Assistant to the Chairman
Mr. Thomas, Economic Adviser to the Board
Mr. Fauver, Assistant to the Board
Mr. Young, Director, Division of Research and Statistics
Mr. Hackley, General Counsel
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Noyes, Adviser, Division of Research and Statistics
Mr. Koch, Associate Adviser, Division of Research and Statistics
Mr. Conkling, Assistant Director, Division of Bank Operations
Mr. Benner, Assistant Director, Division of Examinations
Mr. Landry, Assistant to the Secretary
Mr. Ford, Economist, Banking Section, Division of Research and Statistics

Discount rates. The establishment without change by the Federal Reserve Bank of Boston on October 5, 1959, of the rates on discounts and advances in its existing schedule was approved unanimously, with the understanding that appropriate advice would be sent to that Bank.

Maximum permissible rates of interest under Regulation Q. Upon invitation from the Chairman, Mr. Thomas presented his views on the question of the desirability of raising the maximum permissible rates of interest under Regulation Q, Payment of Interest on Deposits. He
noted that there were two principal questions involved: (1) Adjusting bank rates of interest on savings to fluctuations in the general structure of interest rates; and (2) making it possible for commercial banks to compete for the rather sizable balances which moved into and out of their hands as their owners sought to maximize their return among alternative liquid investments as market rates of interest fluctuated. With respect to the first issue, he said that it was apparent the recent rise in the general level of interest rates reflected a large investment demand for funds and that the flow of savings would be correspondingly increased. Since commercial banks were partially savings institutions, it could be appropriate to permit an increase in the rate they paid on savings deposits to maintain their competitive position. With respect to the second question, Mr. Thomas felt it would not be appropriate to raise the permissible ceiling rate on time deposits only, a suggestion that had been made by several large New York City banks. He went on to say that since the Treasury bill rate was likely to rise even higher, he doubted that these banks could meet competition from the bill rate by going to 3-1/2 or 3-3/4 per cent on time deposits. Finally, he suggested that some consideration might be given to use by these banks of a one-year certificate of deposit carrying a higher rate of return than time deposits; but he was not sure of the feasibility of this suggestion.

Mr. Ford then proceeded to summarize the findings of his study of this question, presented in a memorandum on recent behavior of commercial
bank time deposits, copies of which had been distributed under date of September 15, 1959. Mr. Ford stated his conclusions as follows: (1) Savings deposits, which are characterized by availability on demand, appeared to be relatively unaffected by changes in interest rates, and changes in their volume were more a function of dollar income than of interest rate changes. (2) Time deposits, on the other hand, represented an investment in a short-term security whose volume fluctuated inversely with market rates on other forms of investment securities, especially in New York City.

Mr. Young stated that it was difficult to justify a 3 per cent ceiling on savings and time deposits in view of the higher interest rate being paid on Series E and H savings bonds. A strong argument could be made for an increase in the savings deposit ceiling to 3-1/2 per cent, even though it appeared that in mid-1959 only about 20 per cent of commercial banks were paying the maximum rate of 3 per cent. A consideration weighing against an increase was that the legislative record of the interest rate ceiling on savings and time deposits showed that Congress had intended to prevent a repetition of the unfortunate situation which developed during the early 1930's. At that time, although market conditions had justified banks lowering the rate, cash drains into the public had caused banks to maintain and even increase rates paid in order to stem the outflow of deposits, with consequent harmful effects on their earnings and quality of assets and accentuation of the bank failure rate.
Agreeing with Mr. Ford that foreign time deposits at New York banks were short-term securities, Mr. Young said that the danger in this connection was that the banks were not maintaining equivalent short-term assets behind these deposits in every case. This fact, in conjunction with the adverse influence of rising bill rates, created a difficult problem for administration, suggesting the possibility of a formula tying the rate paid by banks on this type of liability to the Federal Reserve discount rate in the New York District or to average yields on competing short-term investments. He went on to note that even a formula would not touch the problem of the volatility of this type of liability occasioned not only by interest rate differentials but also by psychological considerations.

Mr. Koch observed that essentially the problem was supervisory in nature rather than economic. From a purely economic standpoint an interest rate ceiling made no sense; but from the viewpoint of maintaining soundness in the asset structure of banks, such regulation had been considered to be necessary. He then cited an article in the Journal of Finance which tended to show that commercial banks would have earned more per unit of capital invested in 1957 if they had not raised the rate paid on savings deposits at that time. Mr. Koch said, however, that as an economist he recognized that the interest rate paid on savings deposits probably should be raised as a competitive matter. He questioned whether the loss of foreign-owned time deposits at New York banks had been
very severe to date, although he admitted that this type of deposit was a form of "hot money." As an economist, he would see no justification for changing the rate on time deposits only, but he would have no objection if that rate were raised along with an increase in the rate on savings deposits.

Mr. Riefler suggested that draft legislation be prepared by the Board for consideration by the Congress to place time deposits, properly defined, in a new category, with a stipulation that this type of liability should be covered by short-term liquid assets. The purpose of such legislation would be to keep these deposits from adding to a bank's capacity to take on long-term obligations such as mortgages. With New York emerging as a money market, Mr. Riefler felt that the problem of how to treat these short-term funds, including foreign funds, now going into time deposits, should be dealt with. So far as the rate on savings deposits was concerned, Mr. Riefler said he liked the differential of three-fourths of one per cent between savings bonds and savings deposits. The latter were 30-day obligations of the banks, actually payable on demand, whereas savings bonds should be looked upon as longer-term investments. Thus, he would maintain the present differential, but he was uncertain as to whether 3-3/4 per cent was a high enough rate of return on savings bonds.

Mr. Farrell said that his feelings were related to those just indicated by Mr. Riefler: if the ceiling rate on savings deposits was
raised now, it would increase the problem of the Treasury in trying to get the public to hold savings bonds.

Mr. Conkling commented that when the maximum rate for savings deposits was raised to 3 per cent at the beginning of 1957, many insured banks regarded it as a command that they go to that rate. The Division of Bank Operations figures showed that the average rate paid on savings had risen, but the effective rate was well below 3 per cent even though a bank advertised that as its rate. Although some banks could pay a higher rate on the basis of their earnings, he was not sure that an increase in the present ceiling would be desirable if a large number of banks regarded it as an indication that they should go to that rate.

Mr. Solomon agreed that the questions of savings and time deposits were distinct and that, as Mr. Koch had already observed, the maintenance of an interest rate ceiling was primarily an arm of bank supervision to supplement moral suasion. From his contacts with banks, it was apparent that most of them would be reluctant to have the maximum permissible rate increased. Such a step would of course increase competition, but if that logic were pursued it brought the conclusion that there should be no ceiling at all. The impact on banks’ earning power was probably relatively unimportant when the ceiling was raised. He confessed some puzzlement at the apparently contradictory views taken by the big New York banks regarding the nature of foreign time deposits kept with them: on the one hand they represented these deposits as being essentially stable in seeking
to gain Board approval of an interest rate ceiling increase while, on the other hand, they seemed to imply that these deposits were quite volatile, necessitating the payment of a higher interest rate in order to hold them.

Mr. Thomas remarked that the very fact that these banks wanted to increase the rate on time deposits whenever rates went up indicated to him that such deposits were "hot money".

Chairman Martin questioned this statement. Such time deposits were largely reserves of foreign central banks, he said, and they might be shifted from the form of bank deposits to Treasury bills, but that did not mean to him that they were "hot money".

Mr. Thomas responded that he meant that the banks holding such deposits would constantly be facing the problem of how to meet their loss, depending on what happened to market rates of interest and whether the owners wanted them invested in something paying more than the rate on deposits.

Chairman Martin commented that he was never quite sure what people meant when they referred to "hot money". It could mean money that might flow out of the country for a variety of reasons, or it could mean money that might flow out of a bank. On the question of how stable the foreign time deposits in New York banks were, Mr. McCloy, a member of the Federal Advisory Council, had given him some figures that indicated a substantial percentage of such deposits had remained in the
banks for several years. However, they had been obtained under a different structure of interest rates, and the significance of the figures Mr. McCloy had used was not clear. Chairman Martin noted that Chairman Mills of the House Ways and Means Committee still believed that commercial and savings banking should be divorced and that the present interest rate ceiling law represented a compromise arising from the fact that they were not divorced.

The Chairman then said that there was one observation he wanted to emphasize. A number of the remarks that had been made around the table were to the effect that savings were insensitive to changes in the interest rate. This was a dangerous view for a central banker to take. He noted that there was a time lag between any change in the interest rate and a corresponding change in the over-all supply of savings. Because of the interest rate structure that had existed in this country almost since the time of the Treasury-Federal Reserve Accord, it was difficult to discover the timing relationship, but sooner or later the rate had an effect. Having raised the permissible ceiling from 2-1/2 per cent to 3 per cent not so long ago, was the Board prepared to make a further upward adjustment? He suggested that the Board should proceed slowly on this question, adding that he would dislike having banks adjust their rates upward at a time when there was a big demand for the new 5 per cent Treasury notes of August 1964. The confusion
that already existed on the part of the public was indicated by the report that some investors in this Treasury issue were buying it as a hedge against inflation.

Mr. Thomas referred to the Chairman's comment on Mr. McCloy's statistics, stating that to him the interesting point was that 40 per cent of the time deposits of the New York banks were short-term in actual experience. He did not see how the New York banks could continue to compete for such deposits against the Treasury bill rate without getting more illiquid or running into losses.

After further discussion, Governor Balderston said that he felt the Board's primary problem was to decide whether to do something with respect to the savings deposit ceiling rate, since he judged that it would not take action on the time deposit rate alone despite the problem the New York banks presented in holding foreign deposits. On this primary point, the nub of the question seemed to him to be how long high interest rates would prevail. If something should turn them down shortly, the Board would perhaps be sorry if it had just raised the maximum on savings deposits. On the other hand, if the present structure remained with us for a long time, it would be an anachronism for the System to have retained the present ceiling on savings deposits.

Chairman Martin indicated agreement with these comments. The Board did not seem ready to take action today, but it should continue to watch the rate structure closely. What the System was trying to do,
he said, was to get equilibrium in the economy, and it was trying to get as low interest rates as it could without producing inflation.

The Chairman then raised the question whether this matter should be taken up at the next Open Market Committee meeting on October 13.

Governor Robertson said that this would seem desirable but suggested that the topic be introduced by the Chairman during the meeting rather than to list it as an agenda item to be distributed beforehand.

Following further discussion, there was agreement with this suggestion and it was understood that the Board would give consideration to the matter again after it had had an opportunity to study an additional memorandum to be prepared under Mr. Young's supervision regarding the issues involved in raising the interest rate ceiling under Regulation Q.

Mr. Ford withdrew from the meeting and Mr. Smith, Assistant Director, Division of Examinations, entered the room at this point.

Mr. Knowles of the Joint Economic Committee staff had telephoned him on October 5, stating that he was doing his best to present to staff and Committee members the plan discussed at the Board meeting on September 25, 1959, for obtaining statistics on the Government securities market that would meet the desires of the Joint Economic Committee. However, Mr. Knowles said that he was handicapped because he was not able to say definitely what data would be available or when. After reviewing Mr. Knowles' comments in some detail, Mr. Young said that
what apparently was in question was the ability of interested persons to obtain retrospective data covering the entire period since 1945 so that they could study the 1945-1951 period up to the Treasury-Federal Reserve Accord as well as that since. For some reason, he said, the Committee had the notion that the System was attempting to prevent a comparison of the Government securities market figures in these two periods.

Chairman Martin said that he thought an effort should be made to obtain data for the entire post-war period, not only to comply with the request of the Joint Economic Committee but also because the Federal Reserve had a degree of responsibility for developing adequate figures in this field.

Governor Robertson suggested that since Mr. Young had indicated the basic figures for individual firms were still in existence, and since one of the main difficulties was that the firm of Aubrey G. Lanston & Co., Inc. had refused to supply them on grounds of cost, it might be worth while to sound out that firm as to whether it would cooperate if persons from the Federal Reserve were provided to do the work of compiling the statistics.

No objection being indicated, Mr. Young was authorized to proceed in accordance with this suggestion, with the understanding that he would keep Mr. Knowles informed of efforts being made to provide the data.

Messrs. Riefler, Fauver, Young, Noyes, and Koch then withdrew from the meeting.

There had been circulated to the Board, with the customary supporting memoranda from the Division of Examinations, the report of examination of the Federal Reserve Bank of Philadelphia as of June 22, 1959.

In commenting on the examination, Mr. Smith noted that one member bank had been a rather continuous user of the Federal Reserve Bank's discount window and that the Reserve Bank had been bringing strong moral suasion to bear on this borrower in consequence. Nothing in his comments was deemed to require further inquiry or action on the part of the Board.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board the following items:

Memoranda from appropriate individuals concerned recommending the following actions affecting the Board's staff:

Leave without pay


Acceptance of resignation

Toni E. Painter, Stenographer, Division of Examinations, effective September 30, 1959.

Letter to the Federal Reserve Bank of New York (attached Item No. 1) approving the appointment of John P. Ringen as examiner.
10/6/59

Letter to the Federal Reserve Bank of Richmond (attached Item No. 2) approving the appointment of Lloyd Woodson Bostian, Jr., as assistant examiner.

[Signature]
Secretary
October 6, 1959.

Mr. William F. Treiber,
First Vice President,
Federal Reserve Bank of New York,
New York 45, New York.

Dear Mr. Treiber:

In accordance with the request contained in your letter of September 25, 1959, the Board approves the appointment of John P. Ringen as an examiner for the Federal Reserve Bank of New York, effective today.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.
Mr. N. L. Armistead, Vice President, 
Federal Reserve Bank of Richmond, 
Richmond 13, Virginia.

Dear Mr. Armistead:

In accordance with the request 
contained in your letter of September 28, 1959, 
the Board approves the appointment of Lloyd 
Woodson Bostian, Jr., as an assistant examiner 
for the Federal Reserve Bank of Richmond, 
effective October 1, 1959.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman, 
Secretary.