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Minutes for February 16, 1960.

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. 1/

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 WMM

Gov. Szymczak

Gov. Mills

Gov. Robertson R

Gov. Balderston CCB

Gov. Shepardson

Gov. King

1/ Meeting with the Federal Advisory Council.

A meeting of the Board of Governors of the Federal Reserve System and the Federal Advisory Council was held at the Federal Reserve Building in Washington, D. C., on Tuesday, February 16, 1960, at 10:30 a.m.

PRESENT: Mr. Balderston, Vice Chairman
Mr. Szymczak
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. King 1/

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Enders, McCloy, Sienkiewicz, Hays, Alfriend, Persons, Turner, Murray, McClintock, Betts, and Frankland, Members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively

Mr. Prochnow, Secretary, Federal Advisory Council 2/
Mr. Korsvik, Assistant Secretary, Federal Advisory Council

Vice President Sienkiewicz introduced the new members of the Federal Advisory Council, Messrs. Enders, Persons, Turner, and Betts, and stated that the following officers of the Council had been elected for the year 1960: Mr. Livingston, President; Mr. Sienkiewicz, Vice President; Mr. Prochnow, Secretary; and Mr. Korsvik, Assistant Secretary. He also stated that Messrs. McCloy, Hays, and Murray had been elected to serve on the Executive Committee with Messrs. Livingston and Sienkiewicz, members ex officio.

1/ Withdrew from meeting at point indicated in minutes.

2/ Mr. Prochnow also attended this meeting as alternate for Mr. Livingston, Member of the Federal Advisory Council from the Seventh Federal Reserve District, who was unable to be present because of illness.

Before this meeting the Council had submitted to the Board a memorandum setting forth its views on the subjects listed on the agenda for consideration. The topics, the statement of the Council with respect to each, and the discussion were as follows:

1. What are the views of the Council regarding the current business situation and the prospects for business activity during approximately the next six months?

The members of the Council report that the over-all economy has returned to a high level of activity following the settlement of the steel strike. Production, employment and income are at record levels. Consumer spending, capital investment, and the replenishment of inventories are major factors accounting for the present high volume of business. To the extent that inventories are rebuilt, the demand for goods for this purpose will diminish, with the possibility that some curtailment of production will result. In these circumstances the expansion of capital investment may not be as large as was expected.

In general, the current outlook for business for the first six months of the year is favorable. However, the probable further decline in farm income, the drop in prices of common stocks, and the less than anticipated sales of new automobiles with the consequent increase in automobile inventories have given rise to some uncertainty as to the months ahead.

Vice President Sienkiewicz stated that, if agreeable to the Board, reports by individual members of the Council concerning developments in the respective districts would be omitted, as at the past two meetings, and the members would make such statements as seemed appropriate in the course of general discussion.

It being understood that the suggested procedure was agreeable to the Board, Mr. Sienkiewicz inquired of Vice Chairman Balderston whether the summary statement by the Council was generally in accord with the Board's views regarding the current business situation and prospects for business activity.

In response, Governor Balderston referred to the economic presentation that had been made to the Council yesterday afternoon by the Board's staff. He went on to say that as an individual member of the Board he had been wondering whether the usual February doldrums were covering up a continued real and substantial recovery or whether the doubts expressed in some quarters had their roots in fundamental weakness. During the early months of other years, particularly at about the present phase of the business cycle, there had been a tendency for pessimism to be rife. Accordingly, it had been expected that some pessimism would develop this year. He did not know, however, whether something more fundamental was developing under the surface. One thing that perplexed him was the light calendar of corporate issues, which raised the question of the extent to which corporate expenditures for plant and equipment could be financed out of internal funds.

After a comment by Mr. Sienkiewicz on the high degree of corporate liquidity, Mr. McCloy observed that the rate of decline in loan demand at New York City banks since the first of the year had been greater than elsewhere throughout the country and greater than in recent years. This had given rise to some feeling that more was involved than the ordinary seasonal lull. However, with the major indices of activity satisfactory and solid, bank economists were inclined to feel that there would be an upturn in the demand for loans and that New York would share in that movement with the rest of the country.

Governor Robertson mentioned the importance of public psychology and asked whether there appeared to be an overriding sense of gloom throughout the country.

Mr. Murray said that he sensed no such feeling in the Ninth District. Despite the fact that farm income in the District had suffered substantially more than in other parts of the country due to the combination of drought and lower prices, most of the area had gone into the winter season with the best moisture conditions in several years and farmers appeared to be looking forward to the new crops. In the mining sections, which were severely affected last year by strike conditions, there seemed to be a feeling that this year would be better.

Mr. McClintock referred to the unfavorable situation in the oil industry during the past several months and said that the future, so far as that industry was concerned, was being regarded with caution but not fear. He reported that loan demand continued heavy in the Tenth District.

Mr. Hays said that guarded optimism prevailed in the machine tool industry, steel production during the first half of 1960 seemed likely to be heavier than in the corresponding period during 1959, although a downward trend from the current high levels might appear, and a healthy volume of business was expected by auto parts manufacturers.

Residential construction seemed to be running off, but other construction projects, both in process and proposed, were heavy. In general, although activity was not as strong as some had envisaged, conditions were good.

Mr. Sienkiewicz commented that what Mr. Hays had reported was also true in the Third District. In this connection, he referred to a recent meeting of a number of area automobile dealers at which all but one dealer seemed quite optimistic. In his opinion, some of the current pessimism represented the normal reaction to a price decline in the stock market. Third District employment figures had improved, and unemployment was substantially less than a year ago. He had the feeling that there was not as much piling up of inventories as had been expected.

Governor Shepardson mentioned having seen reports to the effect that there probably would be greater emphasis on modernization of equipment than on expansion or building of new plants, and Mr. Hays agreed with that observation. Mr. Sienkiewicz said this was particularly true in the case of smaller businesses that do not have access to the capital markets to the same extent as larger units.

Mr. McCloy added to his previous remarks about the situation in the New York area by saying there was a general feeling among the banks that current developments probably were fortunate. The country may have avoided an inflationary boom that in turn would have produced a rapid collapse. There appeared to be general confidence with regard to prospects for 1960, although some doubts about 1961.

Mr. Betts said there was no feeling of gloom in the Eleventh District. While people were a little surprised that the tempo of activity was not quite what had been anticipated, business was generally good. The oil business continued about as it had been, with repercussions in related industries, but that situation was anticipated. The ranges and livestock were in excellent condition.

Governor Balderston inquired whether any banks represented in the Council had had occasion to warn customers about inventories; or, to put it another way, whether inventory building had proceeded in any industries or sections of the country to a point where moral suasion was needed.

Mr. Sienkiewicz said he saw no evidence as yet of pressure to borrow beyond seasonal needs, although evidence of such a tendency might appear later this month and in March. Mr. Alfriend commented that auto dealers had been cautioned to try to keep only a two-month supply of cars on hand, Mr. Prochnow said that his bank's monthly economic bulletin contained a word of caution about the building of inventories, and Mr. McCloy said his bank also had issued a word of general caution.

2. How does current demand for bank credit compare with demands at this season in recent years of high activity? Is demand for bank loans and other credit likely to rise during the spring of 1960? What is the outlook for consumer installment credit? Are banks tending to limit their commitments in any areas of demand? If so, in what areas?

The current demand for bank credit compared with demand at this season in recent years of high activity varies by districts, with the majority reporting a stronger demand. The usual seasonal pattern probably will characterize the demand for bank loans and other credit during the spring of 1960, with a likely increase in total credit.

The Council anticipates a further substantial increase in consumer installment credit, the extent of the increase depending largely on the volume of automobile sales.

Banks are tending to limit new commitments in the areas of term loans, mortgage warehouse credits, and lines to finance companies.

With respect to the last sentence of the Council's statement, Mr. Frankland said that from discussion within the Council it appeared that the attitude of banks was quite well unified toward limiting new commitments in the areas of term loans and mortgage warehouse credits. However, the market was flooded with requests from finance companies seeking to obtain new money. Those companies having lines of credit with banks were generally taken care of, but many finance companies that had not previously established relationships with banks were now seeking credit.

In response to a comment by Governor Balderston that on balance finance companies appeared to have been paying off their bank loans in recent weeks, Mr. Frankland said that this was basically correct. He added that the situation was related to the automobile market to some extent.

Mr. Sienkiewicz said that smaller business units presented a real problem; they wanted to improve their machinery, and thereby their efficiency, and to do that they needed money to buy the machines. This posed a problem because of bank-customer relationships and because some of the smaller units, at least, would find it difficult to compete if their needs for credit were not taken care of by the banks. Also, some of the smaller units using steel and steel products apparently had found it necessary to adjust wages to the scale of the steel industry, and their costs therefore had risen. Some of these companies were already adjusting their prices upward.

Governor Szymczak inquired whether the downturn of the demand for credit appeared to be more than seasonal, to which Mr. Sienkiewicz replied that in New York this apparently had been the case. In other areas, however, the decline seemed to have been in about seasonal proportions, and the upturn thus far in February seemed to be at about the normal seasonal rate. Perhaps there would not be as heavy a demand for credit as anticipated earlier, but the demand seemed to be picking up.

Governor Mills asked whether it was correct to assume that the loan-deposit ratios of banks had been a limiting factor in their discouragement of term loans and mortgage warehouse credits. He asked whether the Council saw any possibility that the unwillingness of the commercial banking system to undertake this type of financing would work back through the economy to an extent that would be reflected in employment or any lesser rate of business activity than anticipated at the present time.

Mr. Sienkiewicz replied that the ratio of loans to deposits was a factor. At present the average ratio for the country was over 60 per cent, and many banks were concerned. Admittedly, there is a certain point beyond which a bank should not go from the standpoint of liquidity.

Mr. McCloy said that his bank's ratio was high, as were those of other banks in New York City. No doubt this was a factor. However, he felt that the limitations thus far were fairly mild and doubted that there would be severe repercussions on the general economy of the country.

Mr. Frankland commented that there was bound to be some reaction if the banks did not comply with all of the requests for term loans that they received. He thought there was a question as to how much responsibility the banks had in that area. For example, much of the credit sought by Alaskan applicants was for extended term loans that would go beyond the reasonable bounds of commercial banking practice.

Mr. Hays observed that term loans lock a bank in much more definitely than short-term loans. Accordingly, the loan-deposit ratio would have a bearing on the degree of resistance by commercial banks to applications for term loans.

Governor Shepardson referred to a meeting he had attended recently at which a number of insurance company representatives expressed the feeling that banks were curtailing term loans to farmers and forcing them into mortgage loans for equipment, livestock, and general farm improvements.

Mr. Turner replied that he did not think banks in the Eighth District had ever gone into term loans to farmers. On rare occasions they might have made some loans against equipment, considered part of the crop production loan, that were carried over because of unusual circumstances.

Mr. Murray said he did not believe Ninth District banks had made too many term loans to farmers, and Mr. McClintock commented in a similar vein with respect to banks in the Tenth District.

General Persons reported a definite tendency to discourage term loans in the Sixth District. A few years ago, he said, such credits were quite fashionable due to the scarcity of loans, and the banks still had some they were unable to unload, but term loans had rather gone out of fashion. So far as he knew, Sixth District banks had never made term loans to farmers.

Mr. Prochnow said he did not believe that Seventh District banks had engaged in volume in the business of making term loans to farmers. While there had been a considerable increase in outstanding mortgages against farms, he did not think the increase represented a transfer from term loans.

Governor Robertson noted that a substantial increase in consumer instalment credit was anticipated by the Council, according to its statement, and asked whether an extension of terms beyond 36 months in the case of new automobile financing was considered likely.

Mr. Sienkiewicz replied that no member of the Council had reported such a tendency. The experience of his own bank indicated that maturities were being held down to 36 months; in fact, a recent survey by the bank of individual borrowers indicated, if anything, some tendency to shorten.

After other Council members expressed agreement that a maximum of 36 months seemed to be the general rule, Mr. Murray commented that there might be some pressure to extend maturities on used car financing and Mr. McClintock agreed with that observation.

With regard to the current business situation and the demand for credit, Mr. Prochnow said there seemed to be a little more concern this February than heretofore. He was not sure whether that concern could be supported by adequate evidence, but it was there. Probably the major factor was the haste to build inventories, which had resulted in excessively large production of steel. If this should tail off, there might be somewhat more decline than anticipated. At the moment, psychologically speaking, there was a little more caution than heretofore.

Governor Balderston asked if it would be fair to express the conclusion of the Council in terms that recovery was proceeding, but at a decelerating rate. He noted that 22 months had elapsed since the bottom of the recession in 1958. Thus, one might expect that the recovery, if it were still proceeding, would be at a decelerating rate.

Mr. Sienkiewicz observed that recovery had been rapid last year up to the time of the steel strike and that recovery was very quick in the metals industries following the strike settlement. As he saw it, recovery was now proceeding at a fairly normal seasonal rate, with activity at a high level. Therefore, the use of the word "decelerating" bothered him a little.

Mr. Sienkiewicz went on to say that the expansion of mortgage credit, particularly for housing, had been tremendous. The mortgage warehousing arrangement seemed to reflect a situation where the rate of savings was lagging behind the demand. This was of concern to him, especially since in some sections of the country there appeared to have been overbuilding which would have to be absorbed.

Governor Szymczak noted it is usual at about this time of year to discuss whether developments are seasonal or not. This year there was also a great deal of talk about economic growth and inflation; it seemed that everyone was getting into the economic field.

Mr. Sienkiewicz expressed the view that the general public was beginning to understand a little more about economic processes, although there was still a great lack of knowledge. In general, there seemed to be optimism on the part of consumers. What troubled him was the increase in individual consumer debt, and he felt that banks should watch this development carefully.

3. Have the members of the Council noted any recent change in the attitude of the public in general and of businessmen in particular toward the question of inflation? Specifically, has the publicity given to the adverse balance of payments of the United States, the wage settlement in the steel industry, and the Federal Government's budget prospect for fiscal 1960-61 appeared to affect views as to (1) whether inflationary pressures will continue strong during 1960 and (2) what actions by banks and by Government should be taken to help prevent depreciation of the value of the currency.

The members of the Council believe that the publicity given to the adverse balance of payments of the United States, the wage settlement in the steel industry, and the Federal Government's budget prospect for fiscal 1960-61 have made the public, as well as businessmen, increasingly aware of the nation's monetary and fiscal problems. Although many persons continue to believe that the long-term underlying trend is inflationary, recent events including our adverse balance of payments and the prospect of a Federal budget surplus have tended to lessen inflationary pressures during 1960.

The pursuit of sound monetary and fiscal policies by Government and a broad and intensive program of public education in support of these policies by banks and by Government are two areas for continued and expanded action to help maintain the value of the currency. The program of education might include the objective analysis and the publication of a study on the attainment in a free society of economic growth without inflation. An increased public understanding of the expansion in nondefense expenditures in the Federal budget as well as a critical review of outlays for defense are essential in furthering sound fiscal policies. There is also the need for a clearer recognition of the fact that sound monetary and fiscal policies are an integral part of an adequate national defense.

The Federal Reserve System is to be commended for the constructive position it has taken in the maintenance of sound monetary policy. The Council is in full accord with this policy.

Comments made in supplementation of the foregoing statement emphasized the concern of the Council with respect to the apparent widespread confusion regarding the concept of economic growth. It was pointed out that much of the recent discussion of the subject had been tinged with political considerations, related largely to national defense, and lacked objectivity.

Upon inquiry as to how the Council envisaged that a program of education might be conducted, it was suggested that a need existed for a comprehensive study of economic growth in a free society, without inflation, by an organization generally recognized as objective in its approach. Among other possibilities, it was proposed that a Federal Reserve study might be undertaken or that an organization such as the Ford Foundation might be interested in commissioning such a project. In this connection, the current special program of the American Bankers Association also was mentioned. In view of the complexity of the problem, the thought was expressed that a combination of efforts on the part of various public and private organizations over a period of time probably would be required.

An adequate program of education was also regarded as necessarily including speeches and discussions by Government officials and members of the banking profession that would be devoted to, or place more emphasis on, the problems of economic growth and inflation. A particular need was seen for developing a better understanding of the issues involved in university circles and among professional economists, through methods such as personal contact and seminars of the kind arranged by Federal Reserve Banks.

This led to a discussion of effective means of stimulating public interest at various levels. With much of the existing literature couched in professional language and therefore not suitable for general distribution, the suggestion was made that the development of information in interesting and understandable terms might be warranted even at the risk of some sacrifice of technical accuracy. Several instances were cited where success had been achieved in awakening the interest of depositor, classroom, and other groups through meetings or the distribution of appropriate literature.

The Council was appreciative of the heavy responsibility falling upon the banking profession, and some concern was expressed regarding the lack of knowledge with respect to fundamental concepts of fiscal and monetary policy that existed within certain areas of the banking fraternity.

One member of the Council felt that in recent months there had definitely been a growing public interest in the problem of inflation and its ramifications, perhaps attributable largely to apprehension engendered by publicity given to the gold outflow. The view was expressed that such a situation offered the possibility of making greater progress toward public understanding through the acceleration of educational programs, including those of the Federal Reserve and the banking profession.

The discussion of this topic concluded with further comments on the problem of developing material designed to appeal to laymen and inciting interest at the secondary educational levels.

> 4. The Board would appreciate having the observations of the members of the Council regarding changes in the level of farm land prices during recent months and the significance of such changes.

> The Council understands that farm land prices recently have shown little or no increase in contrast to the rather inflated appreciation which has characterized farm land prices for a number of years. Furthermore the return on farm proprietors' equities in 1959 was the lowest rate for many years, and the outlook is for a continued decline. Growing Government restrictions, increased operating costs, and the higher return on alternative investments have made the purchase of farm land less attractive. These developments suggest that the purchase of farm lands as a hedge against inflation may have lessened.

With further reference to the agricultural meeting to which he had referred earlier during this meeting, Governor Shepardson said some representatives of insurance companies and commercial banks had reported what appeared to be a definite trend on the part of lenders toward paying more attention to earnings statements and relying less upon the appraisal of land offered as collateral for a loan. Such a trend, he thought, was encouraging, particularly when one considered recent developments with regard to the price of farm land in relation to its potential earning capacity.

Mr. Turner suggested that the mechanization of farm operations due to the migration of labor to the cities, and the attendant increase in costs of operation, had awakened lenders to the hazards involved and necessitated a reappraisal of lending standards. At times when farm land was in strong demand, there was always a prospective purchaser of land held as collateral, but now the situation had changed. He agreed with Governor Shepardson that it was a healthy development if lenders were checking more closely on the earning potential of farm operators.

5. The Council would like to review again with the Board the subject of the maximum permissible interest rates on time and/or time and savings deposits which the Board and the Council discussed at the September 1959 meeting.

The Council would like to review orally with the Board the subject of the maximum permissible interest rates on time and/or time and savings deposits.

Mr. Sienkiewicz said it continued to appear, from discussion by the Council, that some banks in the larger cities would like more flexibility in the rates of interest permitted to be paid on time and savings deposits. There were one or two expressions, he said, that theoretically there should be no regulation of such rates. However, the smaller banks were up against a severe cost problem.

Discussing some of the aspects of the matter, Mr. Sienkiewicz noted that whereas commercial banks are regulated with respect to the rates they can pay, other financial institutions that compete for savings are not so regulated. As a matter of competition, this might be regarded as unfair, although the Council recognized that the banking system, simply to compete for funds, must not follow unsound practices. Then, too, there was the question of domestic deposits as against foreign time deposits. The deeper the Council got into the problem of foreign deposits, the more the unfavorable competitive features were brought out. The subject was complex, and the Council felt sure the Board must have given much thought to it, including the applicable provisions of the law.

Governor Balderston responded that this most perplexing problem was under study continuously by the Board, and had been under study much of the time since the maximum rate was increased to 3 per cent at the beginning of 1957. Previously, there had been a long period during which the ceiling was high enough above rates actually paid so that there was no great problem for the Board. The problem began to emerge when the rates actually paid began to press against the ceiling, and the maximum rate then was increased. However, the problem had now become even more difficult. The statute is applicable to all member banks, regardless of size or location, and it relates both to savings deposits and to time certificates of deposit.

In reply to a question by General Persons as to whether, under the law, different maximum rates could be established for foreign and domestic deposits, Governor Robertson said that there could be different rates for time and for savings deposits. Whether a differentiation could be made between foreign and domestic deposits was subject to question, but he would not want to say that it would be legally impossible. Even so, however, there were other considerations involved, and it might be extremely difficult to make a distinction.

Mr. Frankland stated that this topic had been placed on the agenda at his request in view of interest expressed by bankers of the Twelfth District, where there had been efforts recently by a few bankers to have the maximum rate increased. No one would want to take a fixed position on a matter of this kind for an indefinite period of time. However, it was the consensus of banker opinion in the District that an increase in the maximum rate at this time to, say, 3-1/2 per cent would only have the effect of leading to increases in direct proportion in the rates paid by mutual savings banks and savings and loan associations, with the result that no one would gain a competitive advantage. Furthermore, particularly with many banks probably still substantially under water in their bond accounts, the paying of higher rates undoubtedly would have the effect of reducing the accumulation of additional earnings into capital funds. From testing the large geographical area represented by the Twelfth District prior to this meeting, he could say that the consensus at this time favored maintaining the maximum rate at 3 per cent.

Governor Balderston noted that the latest available information, for the first half of 1959, showed the average rate of interest paid to be only 2.28 per cent. He inquired what percentage of Twelfth District banks were now paying 3 per cent.

Mr. Frankland replied that he thought the figure would be close to 100 per cent.

General Persons commented that bankers he had consulted in the Sixth District were unanimous in the view that the maximum rate of 3 per cent should be continued on domestic deposits. On the other hand, a number of bankers felt that some relief should be given to banks in the larger centers, such as New York, to enable them to retain foreign funds that had been moving out because of the attraction of higher interest rates. A suggestion had been made by some Sixth District bankers to the effect that perhaps the Federal Reserve could cooperate with the other bank supervisory agencies and the Federal Home Loan Bank Board in reaching an understanding on interest rates paid by banks and by savings and loan associations. Even though he felt that banks could not expect to compete for savings on the basis of rate alone and must gauge their competition on the basis of factors such as service, safety, and liquidity, this might be an area worthy of investigation, if it had not already been investigated, with a view to encouraging the institutions bidding for savings to consider the unsound effects of attempting to outbid each other.

Governor Robertson replied that the three Federal banking agencies had discussed this matter with the Chairman of the Home Loan Bank Board.

However, in the absence of statutory authority for the regulation of rates paid by savings and loan associations, that agency could do little more than attempt to exercise moral suasion. That had been attempted in a couple of instances, with varying results. In substance, Governor Robertson felt there was little hope from that angle of meeting the problem referred to by General Persons.

Mr. McCloy said his principal interest related to the problem of foreign time deposits. As a matter of practical application, he felt that a distinction could be made between such deposits and savings deposits. At present, the New York City banks found themselves unable to compete with foreign markets for funds that had been an important factor not only to their business in New York but also, in perhaps a more indirect sense, to the economy of the country as a whole.

Mr. McCloy recalled that at the time of the September 1959 meeting of the Board and the Council he brought with him some statistics which showed that, although foreign time deposits were more volatile than savings deposits, they exhibited a degree of stability that was quite impressive. He went on to say that the New York banks had been doing a lot of lending to foreign governments and central banks, often at the urging of United States Government agencies, to meet situations where foreign governments needed money. Now they had suffered a heavy loss of deposits. The Treasury bill rate had accounted for part of that loss, but a substantial number of accounts had moved out to foreign depositories and it appeared as though this trend might continue. Heretofore the Council had felt that if a reasonable distinction could be made between savings deposits and foreign time deposits, it would see no objection to dealing with the foreign time money. This might involve substantial problems, but it was difficult for him to see that one must necessarily weigh the over-all importance of maintaining New York as an international banking center against the economy of the country. He did not think it was necessary to do this, or to run the risk of a major series of bank failures throughout the United States, and he felt that an effort should be made to permit the New York banks to compete in the world market. He felt that it meant something to the economy to have New York City recognized as the banking center of the world. This brought transactions to the United States, and the effect was rather important.

Mr. Sienkiewicz asked for clarification as to whether the Board could, under the law, remove the ceiling on foreign time deposits of, say, six months' maturity or more without removing the ceiling on domestic time deposits of comparable maturity, and Governor Robertson replied that he thought it was highly questionable.

Governor Mills suggested focusing on the conditions that produced the law under which the Board was now operating. As he recalled, the law was passed to prevent undue competition among banks in paying interest at rates that would weaken their asset structure and credit practices, and particularly would tend to direct funds out of areas of the country that were less able to pay high rates, to the disservice of those areas except if they competed unwisely. The question that came to mind was whether the financial climate of today bore any resemblance to the financial climate that gave rise originally to the passage of the legislation. If there was even a remote comparison, there would be a case for prudence on the part of the administering body so that it would not fly in the face of a law that was passed to meet a definite situation.

Mr. Sienkiewicz commented to the effect that a number of bankers from whom he had gotten information referred strongly to the experience of the 1920's and the subsequent payoff of the 1930's. He expressed the view that it would probably be unfortunate at this time to increase the maximum rate of interest payable on domestic time and savings deposits, adding that his concern was with the soundness, standards, and practices of the banking system as a whole.

Governor Robertson inquired of Mr. McCloy whether the latter knew what proportion of the foreign time deposits that had been lost were lost to the bill market and what proportion had gone out of the country.

Mr. McCloy replied that some money could be traced specifically to foreign depositories, while in other cases the situation was more obscure. He estimated that possibly 60 per cent of the funds lost had gone into Treasury bills and that the remainder had left the country.

Governor Robertson then inquired how much of the remaining 40 per cent might have gone to foreign branches of American banks that are able to pay a rate higher than 3 per cent, to which Mr. McCloy replied that this had just been started by the foreign branches of his bank, although at least one other institution had done so a little longer. He did not feel that this procedure offered a complete answer to the problem.

In response to a question by Governor Balderston, Mr. McCloy indicated that in London his bank was offering 3-1/2 per cent, that this rate had attracted some funds, but that it was too early to tell what the effect might be.

There ensued some discussion of reports concerning transfers of funds from the London market to the continent of Europe because of the availability of higher rates of interest, following which Governor Robertson inquired what proportion of the Federal Advisory Council would favor continuing the current 3 per cent maximum rate on time and savings deposits.

Mr. Sienkiewicz replied that, as to domestic time and savings deposits, the Council was unanimously of the view that the 3 per cent maximum rate should not be changed at this time. As to foreign time deposits, the Council realized the problem that was involved. On that issue the Council was more or less silent at this meeting, except that it appreciated the position taken by the Council at the September 1959 meeting with regard to such deposits.

Mr. McCloy recalled that the Council had gone on record at its September 1959 meeting to the effect that, although it did not favor an increase in the maximum permissible rate on domestic time or savings deposits, the members believed that the maximum permissible interest rates on time deposits of foreign central or private banks and of foreign government agencies should be increased. He said that the view expressed today by the Council related only to domestic deposits and that the previous position with respect to foreign time deposits was not changed.

Mr. Sienkiewicz repeated that as to domestic deposits the Council was unanimously of the view that the Board should not go beyond 3 per cent at this time.

Governor Balderston inquired whether he understood correctly from the discussion that at least one or two of the Council members would prefer to have the ceiling removed entirely, and Mr. Sienkiewicz replied that he would favor removal of the ceiling on a theoretical basis. In theory, there should be no ceiling of this kind in a free economy. However, as Governor Mills had brought out, this particular regulation arose out of gross abuses in the 1920's.

Governor Robertson said that in his opinion it was a mistake to have passed the law in the first place. However, since the statute was in existence, the Board must work with it. He took it for granted that all of the Council members felt that the disparity between banks and other institutions competing for savings was unfortunate and that, if there was a ceiling for commercial banks, there should also be ceilings for other savings institutions.

Mr. Sienkiewicz stated that this was correct. The existing situation worked a great hardship on the commercial banks.

Governor Robertson then commented that probably the very existence of the ceiling applicable to commercial banks had given rise to the growth of other institutions competing for savings funds, and Mr. Sienkiewicz said that it had no doubt contributed to the vigor of their competition.

This concluded discussion of the topics included on the agenda for this meeting.

In further discussion, prior to which Governor King withdrew from the meeting to keep another appointment, Governor Balderston indicated that the Board would appreciate having the views of the Council on the appropriateness of the lines that Federal Reserve policy had followed.

Mr. Sienkiewicz replied that, as indicated in the Council's statement with respect to Topic No. 3 on the agenda for this meeting, the members were unanimous in their approval and support of what the Federal Reserve System had done in the past two years. In the view of the Council, the policy of restraint had been appropriate. It had been helpful in more than one area and in time would be more appreciated, even by the academicians who were raising questions at the moment.

Discussion then turned to the request of the Administration for legislation that would remove the existing 4-1/4 per cent limitation on the rate of interest that may be paid on United States Government securities having a maturity of more than five years.

The Council reiterated the unanimous view expressed at the September 1959 meeting that the interest rate ceiling on Treasury bonds should be removed. The Council further expressed a desire that its view be communicated by the Board to the Secretary of the Treasury, and it was understood that this would be done.

Secretary's Note: In accordance with this understanding, a letter reading as follows was sent to the Secretary of the Treasury over the signature of the Chairman of the Board of Governors on February 18, 1960:

The Federal Advisory Council, a statutory body provided for under section 12 of the Federal Reserve Act, has just concluded its regular quarterly meeting with the Board of Governors. During this meeting the Council raised the question of removal of the 4-1/4 per cent limitation on the rate of interest that may be paid on U. S. Government securities having a maturity of more than five years, and it reiterated a view previously expressed unanimously by the members of the Council that this interest rate ceiling should be removed.

The Council expressed a desire that this view be communicated to you.

Mr. McCloy expressed the opinion that the Board should act under the existing legislation with respect to member bank reserve requirements to abolish the central reserve city classification. He suggested that probably there would never be exactly the right time for such action and that it would be preferable not to delay longer. If this was construed as a criticism of Federal Reserve policy, he added, it was a minor one.

It was agreed that the next meeting of the Federal Advisory Council would be held May 16-17, 1960.

The meeting then adjourned.

Secretary