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Minutes for May 17, 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

Gov. Szymczak

Gov. Mills

Gov. Robertson

Gov. Balderston

Gov. Shepardson

Gov. King

1/ Meeting with the Federal Advisory Council.

A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the offices of the Board of Governors in Washington on Tuesday, May 17, 1960, at 10:30 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

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

Messrs. Prochnow and Korsvik, Secretary and Assistant Secretary, respectively, of the Federal Advisory Council

President Livingston stated that Messrs. Hays and Persons, members of the Council from the Fourth and Sixth Districts, respectively, were unable to attend this meeting because of another commitment, but that they attended the meeting of the Council yesterday and participated in the discussion of the topics listed on the agenda for today's meeting.

Before this meeting the Federal Advisory Council had submitted to the Board a memorandum setting forth its views on the subjects to be discussed. The topics, the Council's views, and the discussion were as follows:

1. What are the views of the Council regarding the current business situation and prospects for business activity during the remainder of the

current calendar year? The Council's judgment as to the current expectations of the business community and the general public and the impact of those expectations on capital expenditures, business inventories, and consumer expenditures would be appreciated.

The members of the Council report that business is at a relatively high level. While there was some hesitation in the economy in the latter part of the first quarter, employment, retail sales, and business activity in general improved in April. However, the output of steel, the production of durable goods, and construction, including housing, are not enjoying the high level of activity that characterizes the economy generally.

The Council believes that the expectations of the business community and the general public indicate that capital expenditures and consumer purchases will be at a high level for the remainder of the year. Despite the favorable outlook, the rate of business buying for inventories will probably lessen, as total inventories are at record levels, reflecting the rapid buildup in the first quarter. While the ratio of inventories to sales is below historical averages, there are some indications that it is less favorable than it was earlier this year.

Although business may not be as buoyant as the optimistic forecasts early this year, the Council believes that business will continue good during the remainder of the current calendar year.

After President Livingston read the statement of the Council on this topic, there followed an informal exchange of views with regard to current international developments, including the breakdown of the Summit Conference, and the effect they might have on the United States economy. The views expressed were generally to the effect that it would be necessary to await further developments before definite opinions could be formulated.

Governor King then referred to the portion of the Council's statement which noted that the output of steel, the production of durable goods, and construction, including housing, were not enjoying the high level of activity that characterized the economy generally. He inquired whether this observation was based primarily on national statistics or reports by Council members from the various districts.

The reply by President Livingston was in terms that the comment on steel output and the production of durable goods was based primarily on current statistics for the nation as a whole, but that the comment on construction reflected a composite point of view. This led to a question by Governor Shepardson regarding the demand for housing, to which President Livingston replied that the demand, as reported by members of the Council, was spotty and varied according to areas. Mr. Frankland commented that in some parts of the Twelfth District, including Southern California and the Northwest Coastal area, there seemed definitely to have been overbuilding. However, this was not so apparent in other places, such as the San Francisco Bay area, where business expansion was continuing. Mr. Betts said that in Houston, where commercial construction was flourishing, there were approximately 4,600 unsold speculative houses.

Governor Shepardson referred to reports indicating a leveling off or even a decline in farm land prices and inquired whether the members of the Council had observed any significant trend.

President Livingston replied that in the Seventh District there was definitely a decline in enthusiasm for purchasing farm land and that this was reflecting itself in lower prices. Mr. McClintock reported that without question there had been a decline in farm land prices in most parts of the Tenth District. Mr. McCloy summarized reports made recently to the directors of an insurance company which indicated that the tendency to go into farm land as an inflationary hedge was now substantially out of the picture and that prospective purchasers were looking at land values more closely. However, it appeared from those reports that there was not too much activity in the farm land market because owners were holding out for prices that others were not willing to pay.

President Livingston expressed the view that the fear of inflation was tending to diminish and that the tendency of prospective purchasers to be more cautious in the acquisition of farm land was only one phase of the general picture.

Chairman Martin then inquired regarding foreign competition in United States markets, and Mr. McClintock stated that this was the subject of much discussion in the Tenth District, with emphasis on steel imports. Mr. Frankland commented to the same general effect with regard to the situation in the Twelfth District, and Mr. Murray referred to increased competition of foreign goods resulting from the opening

of the St. Lawrence Seaway. Mr. Sienkiewicz said that, in addition to continuing imports of soft goods, there was more evidence of heavy goods coming in from abroad in the past three to six months.

With regard to the reaction of domestic producers to foreign competition, President Livingston said it was of concern to him that more and more people seemed to be thinking in terms of protection. He then referred to the quantity of explanatory material regarding the United States balance of payments that had been distributed in recent months and suggested that this had made the public more conscious of the effect of higher wages in placing United States producers at a competitive disadvantage.

2. How does the current demand for credit compare with demands at this season of other recent years? What is the prospective demand for bank loans and other credit during the remainder of this year? Will the anticipated substantial increase in plant and equipment expenditures be financed by internal funds, term loans, or resort to capital markets?

Most members of the Council report that the current demand for credit exceeds that at this season in other recent years.

The Council believes that the demand for bank loans and other credit will be strong during the remainder of the year. The anticipated substantial increase in plant and equipment expenditures will be financed largely by internal funds with some resort to the capital markets. In those instances where internal funds prove to be inadequate, principally in medium and smaller businesses, term loan financing by banks may be required.

President Livingston said it was the belief of the Council that, with loans in the banking system already at a high level, the demand for

loans was going to increase and intensify. In the circumstances, the Council members were concerned about the ability of the banks to service the demands for credit that were envisaged during the remainder of 1960, particularly in view of the usual tendency for loans to build up after the end of June. Most of the larger banks had substantially liquidated their holdings of Government securities in order to obtain funds to lend to customers having legitimate requirements for credit, and the superimposing of the demand seen ahead was a matter of concern. While he hesitated to make this point, he felt that the availability of the discount window would be of increasing importance.

In response to a question by Governor Balderston, President Livingston said that term lending was on the increase but not to a significant extent. After expressing agreement with an observation by Governor Balderston that expenditures for business plant and equipment probably would be satisfied to an unusual extent out of retained earnings, he noted that many large corporations and some smaller corporations had accumulated quantities of Treasury bills and commercial paper. When they started making expenditures, presumably they would start disposing of the bills, and this led to the question whether the process would depress the Government securities market. However, the Council was not inclined to feel that this would be a significant factor because the selling of the bills would not occur at any one particular time and because, in the Council's opinion, a

substantial amount of the funds that had been invested in bills would not be converted for this purpose.

3. Has there been a reduction in liquidity of banks so great as to hamper them in meeting the more essential needs for credit? Are there differences in this respect among groups of banks, such as money market banks, banks engaged principally in industrial and commercial lending, and banks in agricultural areas?

While there have been increases in certain types of longer-term credit, indicating some lessening in the liquidity of banks, the reduction has not been so great as to hamper the banks in meeting the more essential needs for credit. The Council uses the phrase, "essential needs for credit," in the sense of customary, short-term or seasonal credit requirements. In the opinion of the Council there are no significant differences in these developments among groups of banks. However, banks which are reluctant to liquidate portions of their bond portfolios at a loss may be hampered in meeting all of the essential needs for credit in their communities.

President Livingston said the Council, in considering this question, assumed that it was not addressed to the problem of depreciation in Government bond accounts and related more to whether commercial banks were going too heavily into term loans, so that perhaps the banking system would not have enough liquidity to take care of the traditional function of servicing short-term needs for credit.

4. What have been recent developments in the volume of the various forms of savings? Is public interest in United States Government securities as widespread as it was last fall?

Total savings appear to be increasing with a larger share of the increase going to those institutions, such as the savings and loan associations, which are paying higher rates. While the public interest in United States Government securities now is greater than it was a year ago, it is not as great as it was at the time of the issuance of the "magic 5's."

President Livingston said the Council had some question as to whether the Board's inquiry related to the savings bond program or to marketable Government securities, including the very favorable reception of the "magic 5's" last fall in contrast to what had happened since that time. In the view of the Council, the favorable reception of the "magic 5's" had in general tended to increase the interest of the public in marketable Treasury issues, as opposed to savings bonds.

Mr. Murray reported that in the Minneapolis area savings had increased during the first quarter of the year, but in April the commercial banks, the mutual savings bank, and the savings and loan associations in Minneapolis all lost savings deposits. During that month retail sales, automobile sales, and other forms of consumer spending were strong. Some part of the decline in savings also reflected tax payments, but the trend continued after the tax date.

Mr. McCloy noted that in recent months savings deposits at commercial banks and mutual savings banks had been barely rising, while at savings and loan associations the increase was comparable to that which occurred last year.

Chairman Martin then commented that an increase in savings was undoubtedly occurring, but that there was a real question as to the sufficiency of the increase to provide for the expansion that apparently was ahead.

5. The Board would be glad to have the views of the Council regarding the appropriateness of monetary and credit policy in recent months.

The members of the Council believe the Board's monetary and credit policy in recent months has been appropriate and well executed. The degree of restraint appears to have been suitable under prevailing conditions.

President Livingston noted that on this occasion the Council had responded to a question phrased in terms of the appropriateness of monetary and credit policy in recent months. In response to an inquiry as to the view of the Council regarding the policy that would be appropriate in the period ahead, he said the Council had not discussed the matter. Personally, however, he felt the System should continue the policy it was presently following. From available information, he assumed the objective at the present time was a level of net borrowed reserves of around $200 million, in contrast to the level of around $500 million that prevailed several months ago. If the Council had a view one way or the other about a change, he felt it would be in the area of making money somewhat easier rather than tighter. He had in mind the statement of the Council that it believed business would be good during the remainder of the year. Nevertheless, if the System

moved from its present posture, he believed the Council would feel that the move should be in the direction of being easier rather than tighter.

Mr. McCloy agreed. He then turned to a discussion of the provisions of the present reserve requirement law relating to the termination of central reserve cities not later than mid-1962 and suggested that the Board might wish to consider acting on the reserve requirements of central reserve city banks before the deadline specified by the statute. Mr. McCloy also suggested that use of the reserve requirement instrument might be considered as a method of dealing with the problem of high loan ratios of banks in New York City and, increasingly, banks throughout the country.

President Livingston said he shared the view Mr. McCloy had expressed on the matter of central reserve cities. He would not want to suggest action on the reserve requirements of central reserve city banks if that would be in conflict with general policy. On the other hand, since no one could know what the picture would be in 1962, it might be worth while to consider the gradual achievement of parity in reserve requirements as between central reserve and reserve city banks. This might be more difficult, in the light of other considerations, if delayed until the end of the period specified by law than if accomplished over a period of time.

Chairman Martin indicated that the various questions involved in implementing the reserve requirement legislation were under continuing study by the Board, and that the Board was aware of the problem mentioned by Messrs. Livingston and McCloy.

This concluded the discussion relating specifically to the topics on the agenda for this meeting. However, the discussion that followed touched upon a number of the topics on the agenda and the statements of the Council relative thereto.

During this discussion Governor Robertson noted that the Council appeared to feel that the System might provide more reserves. He asked how much easier it was thought the System could get and still not stimulate expansion unduly.

President Livingston replied by suggesting a balance of excess reserves against borrowed reserves, indicating that he felt such a position would not disturb the posture that had been achieved by the System. After pointing out that almost half of the calendar year had elapsed, he said that, barring unforeseen international developments, it did not appear as though anything drastic would occur to alter business expectations for the remainder of the year. In view of the current outlook, he felt the position on reserves that he had mentioned could be achieved without harmful effects.

President Livingston again brought out that many members of the Council were concerned about the declining liquidity of the

commercial banking system, not so much from the standpoint of safety as from the standpoint of being able to provide for legitimate short-term credit requirements.

Governor Shepardson noted that the Council had indicated, in connection with the third topic on the agenda, that the reduction of liquidity had not been so great as to hamper the banks in meeting the more essential needs for credit. He inquired how this comment could be reconciled with the statement, also made during today's discussion, regarding the liquidity position of banks and the rather difficult situation that the banks might be facing.

President Livingston replied in terms of the need to define one's approach to the problem of liquidity. Putting aside the factor of safety, the primary question would be whether the banks had sufficient funds to take care of essential short-term credit needs. With the present reserve requirements and the current demands for credit, the banks might not be able to take care of those needs if there was any question about their having access to the discount window periodically.

Governor Shepardson inquired as to how banks would meet the problem if the loan ratios were to go higher, and in reply President Livingston said his own bank recognized an obligation to take care of needs for short-term commercial credit. If necessary, the bank would turn down term loans and reduce consumer credit, so as always

to be in a position to take care of essential needs for short-term commercial credit, which is the primary business of commercial banks. If it had to borrow to meet those needs, it would have no qualms. This was the definite policy of his own bank and it was also the policy, he felt, of every large commercial bank in the country.

In further comments, President Livingston said he would like to be able to say that he thought the Federal Reserve should reduce reserve requirements substantially to meet the liquidity problem. However, he could not make such a statement. He would not suggest reducing reserve requirements substantially in order to accommodate this problem, and he would rather go through the difficult period that the banking system was now experiencing, a period which required turning down some prospective new business in order to be able to accommodate essential needs for short-term credit.

Chairman Martin expressed agreement with an observation by President Livingston that inflationary psychology seemed to have died down and recalled having stated publicly that in his opinion the inflationary psychology had been partially liquidated. He then proceeded to a discussion of the problem of the cost and availability of money, during which he said that in his view the most significant unexplained development thus far in 1960 was the dramatic change in interest rates. At some point an equilibrium had developed, but it could not be said precisely when that occurred. He then referred to

developments with regard to bank holdings of securities, the savings bonds program, and corporate holdings of short-term securities, along with the relationship of the discount rate and the Treasury bill rate. With regard to short-term rate fluctuations in the money market, he noted that, although temporary, they were the cause of some concern in attempting to evaluate the situation.

Chairman Martin inquired whether any reduction of the prime rate was believed to be in prospect on the basis of the present levels of supply and demand, and the responses that were heard were in the negative. The Chairman then stated again that the problem currently calling for judgment involved a combination of the availability and cost of credit. He noted that the Board of Governors and the Federal Open Market Committee had been examining developments closely. Thus far, it had been difficult to arrive at answers, although it was to be hoped that more light would be shed on the situation as the year progressed. Meanwhile, it seemed necessary for the System to continue to feel its way, bearing in mind all of the problems that had been mentioned at this meeting.

Governor King commented regarding the general firmness of the money market, and particularly the Federal funds rate, during a period when the level of net borrowed reserves had been declining. This seemed to illustrate, he suggested, that the true degree of

restraint cannot be measured by any one figure such as net borrowed reserves.

President Livingston brought out that his bank had consistently followed the practice of purchasing Federal funds, with the objective of staying out of debt to the Federal Reserve Bank, and that this practice on the part of banks had tended to keep the Federal funds rate at the level of the discount rate. He suggested that it was possible to get too preoccupied with short-term rates and that it seemed doubtful whether the Treasury bill rate had too much significance in view of the gyrations that had occurred. Over the longer run, he felt that the trend of interest rates would probably be upward, because it seemed doubtful whether the accumulation of savings would be sufficient to take care of the needs for credit.

Chairman Martin said that he was inclined to agree generally with President Livingston's observation about the short swings in the market and that this applied also to the net borrowed reserve figure, which is not too significant on the basis of any single week. One difficulty in appraising the situation had to do with the variety of near-term money substitutes and changes in the patterns of saving. All of the things that had been mentioned at today's meeting were in a sense interrelated.

The discussion then turned to the subject of the maximum rate of interest payable by member banks on time and savings deposits.

President Livingston said the Council was aware that Bank of America National Trust and Savings Association had suggested consideration of a change in Regulation Q that would permit member banks to issue time certificates of deposit bearing a rate as high as 4 per cent. The banks in California had been hurt badly by savings and loan competition and it was understandable why this relief was sought. The Council had again discussed the problem in general terms, including the question of an increase in the maximum permissible rate or the possibility of legislation that would eliminate the requirement for the fixing of such rates. The feeling of the Council was that banks generally would be opposed to an increase in the ceiling beyond 3 per cent. Mr. Livingston added that, speaking as the member of the Council representing the Seventh District, he shared that feeling. In that District the banks, generally speaking, were apprehensive about increasing the ceiling for a variety of reasons, principally because the payment of interest at the rate of 3 per cent had been costing them a good deal and because an increased rate would tend, perhaps, to impair the solvency of the banking system by forcing banks to reach for higher-yielding assets.

President Livingston repeated that he thought he was correct in stating that the Council generally would recommend that the ceiling of 3 per cent not be increased.

Mr. Frankland noted that he represented an area where there had been some divergence of opinion. In the Salt Lake City area, and in the case of Bank of America National Trust and Savings Association, there had been some change of attitude since the Council meeting in February of this year, but otherwise most bankers throughout the District continued to favor maintaining the present ceiling, for reasons that he (Mr. Frankland) had outlined at the February meeting.

President Livingston noted that there might be a question whether the law prohibiting the payment of interest on demand deposits should not be changed; it might be argued that the markets should determine such things as the rates payable on deposits in a free enterprise system. If one could assume that the level of interest rates, over the longer run, was likely to move gradually upward, this was a phase of the matter to which thought might be given.

Governor Robertson inquired whether he understood correctly that the members of the Council thought it was not necessary to increase the rate on time certificates of deposit in order for the banks to compete with savings and loan associations.

All of the members indicated that this was their view. President Livingston added, however, that the previously-expressed opinion of the Council with respect to the appropriateness of increasing or even eliminating the ceiling as to time deposits of foreign governments

or central banks had not changed. The Council recognized, of course, that a difficult problem was involved in that regard.

In reply to a question, Mr. McCloy stated that the pressure on foreign-owned time deposits still prevailed, although it may have diminished a little. The transfer of deposits to foreign branches of American banks was continuing.

Chairman Martin then outlined the reasoning behind the charge in some quarters that the monetary authorities were caught in a "bundle of inconsistencies." The argument, he said, began with the public status of banking and its exclusion from free enterprise in the ordinary sense of the word. This led to the question of how much regulation was needed, which involved, among other things, the prohibition of interest on demand deposits and the limitation of interest on time deposits. One school of thought was pressing actively the view that no free market was left; the proponents of more government were insisting that the decisions of the market place could not be relied upon and that governmental decisions would be necessary to produce growth and other desired objectives. To those who hold that market processes still exist, within limitations, in the face of all the interferences with them, these parties would ask why the government would want to preclude the person who wanted to save more from being paid more.

Obviously, the Chairman pointed out, if interest rates were going to tend to be permanently higher, and if the present rate ceiling should be maintained, at some point there must be a conflict, and it could then be asserted that there had been undue interference with the market process. Chairman Martin said he did not agree with those who claimed that the market process had already been destroyed. In his opinion, the key to obtaining the growth and development being sought was to discourage unnecessary government interference and turn to market forces.

Mr. Sienkiewicz noted that the saver has a rather wide range of choices. If rates were to go up, eventually there would come a point where one must recognize that a 3 per cent rate was not enough, but at the present time he felt it was quite a fair rate. Also, the soundness and solvency of the banking system must be borne in mind. In his opinion, many small banks would be in bad shape at the moment if they went beyond 3 per cent, for they could not meet their costs.

Chairman Martin said he could sympathize with that point of view, but it was necessary to struggle to maintain market forces. Timing might be an important element, but it should not obscure the basic problem that might appear in the longer run.

Governor Robertson said he understood Mr. Sienkiewicz was saying it was important to look at the soundness of the entire banking system

and not merely to provide individuals with an investment opportunity fully guaranteed by the Government.

Mr. Sienkiewicz replied that in his opinion this was a prime consideration.

Mr. Betts commented that in the Eleventh District the banks had become more competitive in the savings field to the extent that many more small and medium-sized banks were now operating savings departments and paying interest on deposits.

After Chairman Martin outlined the theory of a member of the Congress that commercial banks should be prohibited from holding savings deposits, Governor Balderston inquired whether the Council had any view about the availability of mortgage funds through the remainder of the year.

President Livingston indicated that the Council had not discussed the question. However, from a recent check by his bank with a number of insurance companies, it appeared that, although commitments were rather heavy for the balance of this year, mortgage money might be more available thereafter. Mr. Livingston felt that there was, in fact, no dearth of mortgage money, although a lot was heard on the subject.

In response to a question, Chairman Martin indicated that the Board had not yet received complete information with respect to

the plans of the Subcommittee of the House Banking and Currency Committee that had announced its intention to hold hearings shortly on a bill introduced by Congressman Patman that would call for the retirement of Federal Reserve Bank stock.

It was agreed that the next meeting of the Federal Advisory Council would be held on September 14-15, 1960.

The meeting then adjourned.

Secretary