Minutes for November 15, 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 and the Federal Advisory Council was held in the Federal Reserve Building in Washington, D.C., on Tuesday, November 15, 1960, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Szymczak
Mr. Mills
Mr. Robertson
Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Enders, McCloy, Sienkiewicz, Hays, Alfriend, Persons, Livingston, Turner, Murray, McClintock, Betts, and Frankland, members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, 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

This being the last scheduled meeting of the Federal Advisory Council during the calendar year 1960, reference was made by President Livingston to prospective changes in the membership of the Council and Chairman Martin expressed, on behalf of the Board of Governors, appreciation for the Council's contribution to the work of the Federal Reserve System.

Before this meeting there had been distributed copies of a memorandum listing the topics proposed for discussion. The topics, the statement of the Council with respect to each, and the discussion at this meeting were as follows:

1. What are the views of the Council regarding the current economic situation and prospects for business activity during the next six months? The impressions of members of the Council as to expectations of the business community and as to the outlook for capital expenditures, inventories, and consumer expenditures would be appreciated.
The members of the Council report that the current economic situation is spotty both with respect to industries and geographical areas. The course of business in the months immediately ahead, which is more than usually obscure, will probably be sidewise or slightly downward. The attitude of the business community is neither one of optimism nor of pessimism, but rather one of concern about the future level of business. This concern is heightened by the declining margin of profits.

The members of the Council believe that capital expenditures will show some decline. Although there has been a shift in inventory policy during the year from substantial accumulation to liquidation, the members of the Council see no conclusive evidence indicating important inventory accumulation in the months ahead. The Council anticipates that consumer expenditures, as in recent periods of business decline, will remain at relatively high levels.

With respect to the inventory situation, President Livingston stated that there was some difference of opinion among the members of the Council. As he saw the picture, inventories were high at the present time in relation to sales. In fact, this accounted largely for his feeling that business was not likely to snap back too quickly and that in the months immediately ahead there was more probability of a downward movement than an upsurge.

President Livingston then turned to General Persons, who commented that he considered the inventory situation an element of strength rather than weakness because, as noted in the Council's statement, there had been a substantial liquidation of inventories on the part of many businesses. In the steel industry, for example, inventories had been reduced from a peak of about 18 million tons to a level of around 11 million tons. In the Sixth District, the steel industry was looking forward to a slight upturn due to the necessity of balancing inventories in order to service customers.
The situation had reached a point where it appeared that many industries were going to have to put their inventories in shape to take care of normal business requirements.

In response to a question regarding the housing situation, President Livingston said he was more pessimistic than at the time of the preceding meeting of the Council. In the view of the members of the Council, the problem was basically one of a surplus of unsold new and old houses, and this situation was not the result of a lack of credit. Builders in the Chicago area reported having houses they could not sell, and this appeared to be typical of the country as a whole.

The housing situation was one of the things, President Livingston said, that caused him to be rather pessimistic about the business outlook. Rarely had there been a booming economy when there was not a good level of residential construction.

Further discussion included a comment by Mr. McCloy regarding a substantial upward revision in the estimates of family formation, beginning in 1962, which indicated that it might not be until around that time that the demand for housing would improve significantly.

In response to a question concerning public acceptance of the new model automobiles, President Livingston said that although the situation might vary somewhat from district to district, in general the market for used cars was poor. The availability of the lower-priced compact cars had diminished the incentive to buy used cars, and the overhang of 1960 models also was exerting an effect. As to the new models, their reception appeared to be fairly good but not spectacular.
Comments of other members of the Council were to the same general effect as those of President Livingston.

2. How does the current demand for credit compare with the demand at this season of other recent years? Are there indications that the demand for bank loans and other credit will strengthen?

Although the total loans of the banking system are above the level of the preceding year, the current seasonal demand is not as great as it was at this season in most other recent years. The members of the Council have seen little evidence indicating that the demand for bank loans and other credit will strengthen significantly in the months immediately ahead. However, a substantial reduction in bank loans is not anticipated.

In comments supplementing the Council's statement, President Livingston said that loans at many money center banks were at or close to their all-time high and that the demands upon the larger banks had been heavy. Therefore, there continued to be concern about what would happen if a substantial expansion of the demand for bank loans should be superimposed upon the already high levels. When a bank's loans are in the neighborhood of two-thirds of its deposits, there is a problem of liquidity, and many banks had sold Government securities from their portfolios to the point that no real latitude remained.

The foregoing, President Livingston said, was a point of view that had been expressed by many of the members of the Council. He went on to say that the old concept of commercial loans had changed and that numerous developments in lending practices, some of which he mentioned, had contributed to the illiquidity of loan portfolios. He did not mean to suggest that there was danger at present from the standpoint of banks...
not being able to respond to their obligations, but a point might be reached where the banks would not be able to take care of larger demands for credit.

In this connection, President Livingston commented that excess reserves tend frequently to be lodged in the wrong places and that it takes quite a period of time before effective mobilization of reserves can be achieved.

Governor Mills inquired whether, if a lower rate of business activity was foreseen in the period ahead, one would not anticipate a contraction in some types of loans that previously had been expanding, such as loans to finance inventories and accounts receivable. If sales were moving downward, it appeared that there should be a lesser need for short-term credit.

President Livingston replied that this would have been the orthodox pattern. The fact that this pattern did not appear to be developing was what concerned him. Characteristically, one would expect a decrease in loans in a period of business decline, but this trend had not appeared as yet to the extent that might have been anticipated. One reason might be that inventories were not moving.

Governor Mills then inquired whether the lack of movement of inventories might account for the reduction in corporate holdings of Government securities, that is, whether corporations appeared to be under pressure to dispose of Government securities in order to obtain cash to carry inventories and slow-moving receivables.
President Livingston indicated that he did not believe such was the case. The phenomenon he had mentioned did not seem to relate to the extremely large corporations as much as to the relatively smaller corporations.

Governor Balderston inquired concerning the rate of new orders in relation to inventories, to which President Livingston replied that, as mentioned earlier, there were some differences of opinion within the Council concerning the inventory situation. However, one steel company with which he was familiar did not have the orders that it had expected to receive and did not anticipate improvement in the near future. As he saw it, there was no reason for encouragement in the relationship of orders to inventories. A lot of inventories, he noted, were in the form of finished goods rather than raw materials.

Mr. McCloy said that, although the Council's statement reflected a mixture of optimism and pessimism, nothing in the economic system seemed to be pointing toward a substantial recession. In other words, no downward spiral appeared likely to develop. There were built-in stabilizers lending strength to the economy, and the adjustment might not be as severe as in 1958.

Mr. Hays reported that in the last week in October check clearings in major cities of the Fourth District, except Pittsburgh, were higher than in any other year back to 1951, while in Pittsburgh the clearings were higher than in any of the years during that period except 1957 and 1958.
Mr. Sienkiewicz expressed the view that the present period was essentially one of readjustment and said that he was not as pessimistic as some appeared to be about the situation. He thought the prospects for the year ahead were fairly good. The inventory adjustment, he pointed out, had been quite orderly.

Mr. Frankland reported on developments in the Twelfth District which added up to the general observation that outside the central, or bay, area business activity in the District had declined considerably and was not at satisfactory levels.

3. The Board would be glad to have the views of the Council regarding recent monetary and credit policy.

Although the Council recognizes the problems inherent in increasing reserves at a time when this country has a substantial balance-of-payments deficit, it concurs with recent monetary and credit policy which provides the reserves required for the holiday season and at the same time permits the counting of all vault cash and eliminates the differential in reserve requirements between central reserve and reserve cities.

President Livingston noted that the Board's recently-announced actions on vault cash and central reserve city requirements were in accord with recommendations that the Council had made to the Board for some time.
Chairman Martin then inquired whether the members of the Council had observations regarding the measures that would be most effective, under present circumstances, in contributing to a reversal of a declining business trend.

In responding to this inquiry, President Livingston indicated first that he felt the public had gotten the impression that the Board's recent action in respect to vault cash and reserve requirements represented primarily an alternative method of supplying reserves for seasonal purposes that normally would have been supplied through open market operations. If this was substantially correct, one would assume that after the holiday season there would be some mopping up of reserves.

President Livingston then recalled that at its meeting in September the Council had expressed approval of the monetary policy being pursued by the Federal Reserve. He said a number of the Council members did not believe at that time that it would be appropriate to increase the availability of reserves beyond seasonal requirements. This statement, however, was subject to the qualification that a number of the members also believed it was of paramount importance to maintain the vigor of the domestic economy. In considering actions toward that end, one must of course evaluate their possible effect in accelerating the outflow of gold.
Chairman Martin raised the question whether a greater availability of money would achieve the desired results. It might be, he suggested, that actions in other areas, for example, in the area of taxation, would be more effective at this juncture than a further easing of monetary policy. In his own mind there was a grave question whether monetary policy could push against the string under all circumstances, and he thought it was doubtful whether more money was the answer to the present problem. To illustrate, in a recent conversation with six builders not one of them indicated that he would build more houses even if money rates were substantially lower. One builder, on the other hand, stated that he was in the process of considering changes in design.

In further comments, Chairman Martin expressed the view that the biggest shadow on the domestic business picture was cast by the balance-of-payments problem, which had a direct relationship to the credit of the United States as such. The question of the best approach to the problem was not clear, however. A strong and vigorous domestic economy certainly was desired by everyone, but there were differing theories about the nature of actions that should be taken. There were some suggestions that a reduction of the discount rate to a substantially lower level and a much greater availability of money would do a lot for the economy, but he questioned that reasoning. Others were suggesting
an increase in budget expenditures, but he questioned whether that would achieve, at the present time, the end result that deficit financing might produce under other conditions.

Comparing the present situation to the 1953-54 and 1957-58 recession periods, Chairman Martin noted that this year there had been a considerable liquidation of inventories in a shorter period of time. The principal difference was this time the expectation of inflation was not in the picture. From that standpoint, the environment was totally different.

President Livingston said that, as noted previously, the members of the Council, without exception, were convinced that there were more houses for sale than buyers. Continuing, he said he did not believe, personally, that business would be helped by making more money available or that the correction of the present situation lay in that direction. Therefore, he would not favor reducing the discount rate or supplying reserves beyond seasonal requirements. If a period of limited austerity was required to correct the situation, it would be the better part of wisdom to follow such a course.

Mr. McCloy enumerated various developments that had contributed to a general feeling of discontent and loss of confidence around the country. Among other things, he felt that there was not yet a full appreciation of the distortions brought about by the steel strike. In the present circumstances, he suggested that the country must move toward straightening out the balance-of-payments situation, and that
this would have a comforting effect on the business community and the public generally. It would also be desirable to examine the tax structure carefully. He shared the view of President Livingston that the situation would not be corrected simply by making more money available.

General Persons expressed agreement with the view of Messrs. Livingston and McCloy that the cure did not lie in making more money available. The situation might change to a point where it would be advisable and appropriate to increase the money supply, but he did not believe a move in that direction was required at the present time. He thought it was fundamental to take steps to maintain a balanced budget, recognizing that substantial difficulties would be involved.

In further discussion, Mr. McCloy noted that it had been stressed in some quarters that short-term rates were too low and long-term rates too high. It had been charged that an adjustment was vital to improvement of the domestic economy. He was convinced, however, that this evaluation was not accurate.

After Mr. Betts had expressed agreement with the views stated by Messrs. Livingston and McCloy, Chairman Martin inquired whether it was the opinion of the Council that it would be possible to raise short-term rates and bring down long-term rates by manipulation, except possibly for a short period of time. The replies made by members of the Council to this question were in the negative.

4. Would the Council care to express any views on the questions contained in the letter from Chairman Hardy that was distributed at the meeting of the Board and the Council in September?
The members of the Council have reviewed the questions contained in the letter from Chairman Hardy and the replies of the Board of Governors. The comments of the President of the Council on questions 1 and 2, contained in his letter of October 8, 1960, to the Chairman of the Board of Governors, are approved by the Council.

The Council believes the Board should have the right to exercise the customary prerogatives, including the right to use its discretion in determining the propriety of its expenses and especially the compensation of its staff. Furthermore, the Council strongly urges that consideration be given to a generally higher scale of salaries for members of the staff in responsible positions. These individuals discharge responsibilities of great importance, and it is essential that the System attract and retain highly qualified personnel.

Governor Mills referred to the comments that President Livingston had submitted in writing with reference to the question of a possible change to a single Federal Reserve note issue and inquired whether he correctly interpreted those comments as reflecting apprehension that a cloud would be cast on a symbolism of a decentralized Federal Reserve System.

President Livingston replied in the affirmative, stating that he believed strongly in the virtues of a decentralized Federal Reserve System. He regarded the note issue proposal as one step in derogation of that general principle, and he would deplore any tinkering with the present organization of the System.
In response to a question by Governor Mills concerning the import of his written comments regarding the question of a possible increase in the maximum deferment provided under the Reserve Bank check collection schedules, President Livingston said he felt it would be a mistake to make a change at the present time. However, as the processing of checks reached a greater degree of perfection, he thought the question should be studied again to determine whether the procedures adopted a number of years ago continued to be suitable.

Mr. Hays commented to the effect that a principal reason for the introduction of the deferred availability schedules was to reduce sorting requirements. Under present conditions, the Federal Reserve System had become a more attractive mechanism for the collection of checks, and the System should avoid any change that would represent a step backward. While a substantial amount of float results from time to time under present procedures, this should tend to correct itself gradually as further advances were made in expediting the check collection process.
5. Comments on the balance of payments.

On various occasions in the past, the Board and the Council have discussed the relationship between monetary and credit policy and the balance-of-payments deficit. The members of the Council recognize the difficulty of formulating monetary policy which meets the requirements of the domestic economy and at the same time does not aggravate the problem of the balance of payments.

It is not possible within the scope of this memorandum fully to discuss and evaluate the numerous proposals which have been advanced to ameliorate this vexing problem. Some of these proposals, such as a reduction in overseas military expenditures and the extent of foreign aid, are clearly outside the authority and responsibility of the Board of Governors.

The members of the Council do not believe that such suggestions as a general increase in tariffs, the imposition of quotas, the curtailment of tourist expenditures and U.S. investments overseas, or the embargo of gold provide real solutions to our balance-of-payments problem. The devaluation of the dollar, which undoubtedly would not be unilateral, would be repugnant at best and also would not be a solution.

In substance, the Council does not believe there is any single, easy, quick solution to this complex problem.

The Council believes that the first and essential step in solving the balance-of-payments problem is responsible fiscal policy and public support of sound monetary and credit policies. Under such conditions, even a moderate but progressive decline in the deficit would clearly demonstrate to the world the determination of the United States to redress the balance-of-payments deficit and to maintain the value of the dollar.

A downward trend in the deficit might be established by a series of steps including, for example, a more equitable sharing of the costs of aid to the underdeveloped nations, some reductions in overseas military outlays for dependents, and the elimination of any remaining discrimination against dollar goods.
President Livingston indicated that the Council had considered it desirable to place its views on record because of the importance of the problem and in order that the record might reflect the further discussion of the matter by the Council.

Mr. McCloy then made a statement in which he expressed the view that unless the country furnished evidences that it was prepared to take such steps as might be necessary to keep its house in order and maintain the confidence of other nations, a situation would be created that would be detrimental to the long-range interests of the United States. There were a number of steps that might be taken but none of them would be easy, and these steps must strike at the roots of the problem, rather than the manifestations of it, such as the recent rise in the price of gold in the London market. In this connection, he expressed doubt whether the solution was to be found in a substantial further increase of exports, and he questioned whether a trade surplus larger than $4 billion annually would have desirable results in the longer run.

Mr. McCloy referred to discussion at earlier dates concerning the possibility of increasing the maximum rate of interest payable by member banks on foreign-owned time deposits. He suggested that this might be an opportune time for such a move because American banks would be able to compete better for deposits in the international market and thereby draw funds back to the United States.

Chairman Martin indicated that the whole question of maximum permissible rates of interest on time and savings deposits continued to be discussed regularly by the Board.
Mr. McCloy then inquired whether it appeared that an increase in the maximum rate applicable to foreign time deposits only would require legislation, and Governor Robertson indicated that in his opinion legislation would be necessary.

Chairman Martin continued the discussion by expressing the view that one of the basic problems in a democracy is that of obtaining general debate of fundamental questions in an objective manner before urgent situations arise and irresponsible statements are made. By way of illustration, he referred to several problems that were allowed to persist until such time as the situation became serious and pressing, in which circumstances it was difficult to keep the discussion in proper perspective. He suggested that the balance-of-payments problem, which had been developing over a period of years, was of such a nature.

President Livingston indicated that, in view of the tendency of the average person to associate a loss of gold with lack of strength of the banking system, he was somewhat concerned about the possibility of withdrawals of funds from the banks, particularly in view of the illiquidity of the banking system to which he had referred previously. As to the balance of payments, Mr. Livingston pointed out that the difficulty of achieving public understanding was enhanced by apprehensions concerning the effect of adjustments on the national security.

Chairman Martin then commented that it had always been his position that the Federal Reserve should not become involved in politics.
On the other hand, he felt that the Federal Reserve, working with the Treasury, had a responsibility to point out what was involved, from the standpoint of the banking system and the credit of the country, in the problem of the balance of payments. While he did not believe that the Federal Reserve should attempt to prescribe a choice among alternative courses of corrective action, the problem of the preservation of the currency must be kept before the people. In a sense, the same question was involved in determining the proper role of the Federal Reserve in relation to the Federal budget. It should not detail what ought to be done, but it had a responsibility to declare itself on broad principles insofar as they related to the strength of the currency.

Mr. Sienkiewicz raised a question with respect to the desirability of arranging for the appropriate committee of the American Bankers Association to produce literature for public distribution relative to balance of payments, and neither President Livingston nor Chairman Martin indicated that he would see any objection. The former stated that his concern was not about the issuance of educational literature but about irresponsible articles or statements appearing in public print, while the latter reiterated his view that more, rather than less, discussion of basic problems was needed. He felt that the more irresponsible parties tended to do the bulk of the talking or writing, while responsible parties tended to be apprehensive about exposing major problems to general discussion.
Absorption of exchange charges. Although this topic was not among those listed for discussion at this meeting, President Livingston made the comment that the Council supported the recent action of the Board in restoring temporarily the rule permitting member banks to absorb exchange charges up to $2 per month for any one account, pending completion of a survey bearing on the relationship of absorption of exchange charges to payment of interest on deposits. The Council felt that the restoration of the $2 rule was a satisfactory temporary disposition of the problem and that the forthcoming study, to be made in cooperation with the other Federal bank supervisory agencies and leading banking organizations, would produce information that would be valuable in reaching a determination of the matter.

Next meeting of Council. It was agreed to schedule the next meeting of the Federal Advisory Council for February 20-21, 1961, with a joint meeting of the Board and the Council on the latter date.

The meeting then adjourned.