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Minutes for October 31, 1961

To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin

Gov. Mills

Gov. Robertson R.

Gov. Balderston CCB

Gov. Shepardson

Gov. King

Gov. Mitchell

Minutes of the Board of Governors of the Federal Reserve System on Tuesday, October 31, 1961. The Board met in the Board Room at 10:00 a.m.

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

Mr. Kenyon, Assistant Secretary
Mr. Young, Adviser to the Board and Director, Division of International Finance
Mr. Shay, Legislative Counsel
Mr. Molony, Assistant to the Board
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Noyes, Director, Division of Research and Statistics
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Director, Division of Examinations
Mr. Koch, Adviser, Division of Research and Statistics
Mr. Dembitz, Associate Adviser, Division of Research and Statistics
Mr. Furth, Adviser, Division of International Finance
Mr. Conkling, Assistant Director, Division of Bank Operations

Discount rates. The establishment without change by the Federal Reserve Banks of Boston and Atlanta on October 30, 1961, of the rates on discounts and advances in their existing schedules was approved unanimously, with the understanding that appropriate advice would be sent to those Banks.

Maximum rates payable on time and savings deposits. There had been distributed copies of a memorandum from Governor Robertson dated October 25, 1961, resubmitting his memorandum of July 14, 1961, in which he proposed amendment of Regulation Q, Payment of Interest on Deposits, to alter the maximum rates of interest payable on time and savings deposits. There had also been distributed copies of a memorandum from Mr. Noyes dated October 27, 1961, submitting, pursuant to a request by Governor Balderston, a suggestion from the staff as to how a "moderate" upward adjustment of the maximum rates might be implemented.

At the request of the Board, members of the staff presented their views, beginning with Mr. Noyes, who commented that a principal recent development involved the issuance of negotiable time certificates of deposit, a matter with which the Board was familiar. There had been increasing concern expressed in the financial community that if the economy moved into a period of rising short-term interest rates, the banks that had such certificates outstanding would find it difficult to retain the funds should they be prohibited from offering a rate higher than 3 per cent.

Mr. Koch's comments related principally to the question of timing. If action were taken at the present time, he pointed out, it might possibly be interpreted as a first step toward tighter money. However, if announcement of such action included a statement along lines such as Governor Robertson had suggested in his memorandum of July 14 and Mr. Noyes had suggested in his memorandum of October 27, perhaps the action could be accomplished without giving rise to the interpretation he had mentioned.

Mr. Dembitz expressed agreement with the points brought out by Mr. Koch as to the timing and announcement of any action. He also mentioned that under amended regulations of the Home Loan Bank Board that became effective during the past summer, savings and loan associations were now permitted to provide bonus payments on share accounts held for three years or more, with no penalty for earlier withdrawal except loss of the bonus. Although he understood that few associations had as yet taken advantage of this provision, this was another instance where special inducements could be offered for longer-term savings by institutions in competition with commercial banks for such funds.

Mr. Furth commented on the extent of the current interest rate advantage from holding funds abroad, and on the element of potential risk involved for the depositor. To the extent that there was international competition for funds on an interest-rate basis, it appeared to him to relate primarily to the differential between rates in the London and New York markets. At the present time, London market rates provided only a rather small advantage on a covered basis, but the advantage on an uncovered basis was substantial and could not be compensated for by a small increase in United States rates.

Mr. Young noted that, whether right or wrong, there was a good deal of feeling in the European financial community about the inhibiting effects of Regulation Q. Some attention, he suggested, probably ought to be paid to this factor, especially at a time when a developing balance-of-payments problem was in prospect. It appeared that a somewhat larger deficit was likely to develop as a result, among other things, of the movement of short-term capital abroad. The present international relationship of interest rates, particularly between New York and London, was not tenable over any period of time; British rates were going to have to come down, and possibly United States rates were going to have to go up, or there would be an increasing volume of short-term capital movements. If the problem became more acute than it was today, United States banks should be in a position to hold the foreign balances that were already here, and perhaps attract other balances, in order to minimize the impact of this country's balance-of-payments problem on its monetary reserves. This situation was being watched closely by foreign observers; perhaps it was being overrated as a symbol of developing monetary conditions in the United States.

At this point the Chairman called upon Governor Mitchell, who expressed agreement with the thought in Governor Robertson's memorandum of July 14 that an agency that had been a vigorous proponent of free markets and free competition must appear rather strange to outsiders if it administered a regulation in the manner that Regulation Q had been administered. In his opinion the only way the question could be resolved was for the Board to extricate itself as rapidly as possible from the box in which it found itself. Referring, however, to a memorandum from Mr. Thomas, Adviser to the Board, to Governor Balderston dated October 25, 1961, which dealt with the question of timing involved in a change of the maximum rates currently prescribed by Regulation Q, he said that the analysis and judgment of Mr. Thomas seemed irrefutable. A change at the present time possibly would tend to deter spending. There might be a time not too far in the future, however, when the Board would want to encourage savings, and that would be the appropriate time to move.

Governor Mitchell then referred to the subject of banking competition and said he had not been able to locate information that analyzed the competitive position of the commercial banks, either among themselves or with other types of financial institutions. It was frequently alleged, he noted, that the bankers must be protected from themselves, but he had yet to see a memorandum that provided a quantitative analysis of the problem. It should be possible to find out rather easily, he thought, whether the banks that were paying the ceiling rate had different portfolio structures from other banks and whether they had inferior loss records. Also, he would like to know how many banks were now paying the ceiling rate and something about the characteristics of the banks that were not paying the ceiling rate.

Continuing, Governor Mitchell said he supposed his predilections were in the direction of removing the interest rate ceiling as soon as that could appropriately be done. However, he did not think it would be practicable to remove the ceiling rate in one fell swoop, and it might not be practicable to remove it completely in any event. In theory, any move should be made in a period when interest rates were rising, as

Mr. Thomas had suggested, and the extent to which the ceiling was raised should be considered in light of the impact upon the banking system; that is, the degree to which banks took advantage of the opportunity to raise their rates and the extent to which banks followed unsound practices. If information such as he had referred to previously could be made available, he felt that a more intelligent judgment could be made, for the record of discussion of this subject reflected speculation not always based on facts.

In the light of Governor Mitchell's comments, reference was made to data that the Division of Bank Operations had processed from the June 1960 bank condition reports. It was stated that these data were under analysis in the Division of Research and Statistics, and that it was hoped material could be made available to the Board within the near future.

Chairman Martin agreed that as much data as possible should be provided to assist in considering the problem, which had been discussed for a long time and involved differences of judgment. If the country was going to enjoy the growth and development that he confidently expected, he felt personally that at some point it would be necessary to provide a higher maximum rate. The matter of timing was in his opinion the real problem, and he thought the memorandum of Mr. Thomas was quite convincing on that point. Nevertheless, although he would hesitate to make a change at this particular moment, the System must be alert. Much discussion of the balance of payments was taking place, and it apparently was going to increase.

After referring to the current accumulation of dollars by the British, Chairman Martin added that the essential point in his opinion was whether the Board would be forced by the balance-of-payments situation to do something. In his judgment, either British rates would have to go down or United States rates would have to go up; the present structures were not tenable indefinitely. Having gone this long, however, he would hesitate at this juncture to lead the market on interest rates by choosing this particular time to make a change. If the Treasury bill rate rose to 3 per cent or above, the problem would be on the Board's doorstep, but there was no immediate necessity to act.

Governor Mills expressed agreement with the view that the international situation was the crux of the problem. His question was whether it might not be proper for the Board to take the lead, in a moderate way, in view of what seemed to be almost certain developments; otherwise, it might become necessary to take corrective measures on a crash basis. At the present time, he could argue for increasing the ceiling rate as a measure that would be interpreted as an adjustment to national interest rate conditions that had developed and not as an action taken solely because of international considerations. He continued to be seriously concerned about the ability of smaller banks to carry the cost of a heavy burden of time deposits. If the ceiling were raised and they should be forced by competition to raise their rates, that could produce an unhappy situation. However, he thought that that kind of situation probably would develop slowly. In some communities there might be ambitious bankers who would raise their rates and force others to follow, but in most communities this situation probably would not prevail. Another problem he foresaw was that an increase in the ceiling rate to 3-1/2 per cent might set off rate increases on the part of savings and loan associations as a counter-offensive, which could prove to be economically undesirable in the longer run. A further point was that an increase in the ceiling rate might provide an incentive for smaller banks to go into consumer loans excessively for earnings purposes.

Governor Mills then pointed out that there had been comments in the press to the effect that the New York banking authorities had under consideration requests to increase the rates permitted to be paid by mutual savings banks in that State. Action to such effect, he suggested, might be influential on the Board's thinking. If the New York State authorities should act, he questioned whether the Board could any longer keep member banks in the United States bound to a 3 per cent maximum rate if the banks wanted to raise their rates and assume the risk.

Governor Mills also pointed out that the first of December would be a logical date for the Board to announce any action on the maximum rates under Regulation Q in order that banks might make any necessary adjustments before the first of the year.

In reply to a question, Governor Mills said that he would be inclined to raise the maximum rate, particularly if the New York State authorities authorized a higher rate for mutual savings banks. He would be inclined to go to a maximum of 3-1/2 per cent, graduating downward for time deposits of shorter maturities.

Governor Robertson agreed that there was a real question from the standpoint of timing and said that he had not yet seen the memorandum prepared by Mr. Thomas. As to the underlying problem, however, he suggested that the Board think in terms of the situation that existed when the statute was enacted and the Board began operating under it. At that time the Board fixed a higher maximum rate than any bank was then paying. At present, though, the Board had gotten itself into a box because it did not take action earlier in line with the trend of events. What the Board was doing, in effect, in its administration of Regulation Q was to run counter to its general thesis favoring freedom of competition. The question of getting out of the box seemed to involve a matter of judgment as to when to act. His own preference would be to lead rather than to follow; he would hate to see the Board get into a position of following along after other forces made action necessary. If the New York State authorities acted, he felt that the Board would be almost obliged to act. Then, if the Board did take action, it would appear as though the Board was just coming along after the fact and succumbing to the pressure that existed.

The Commission on Money and Credit, Governor Robertson noted, had suggested a standby authority. This would be essentially in line with his own suggestion; that is, to raise the ceiling so high that no bank could touch it. The Board could announce it was doing so purposely in order to create freedom of competition. In terms of the international situation, this would enable United States banks better to retain both foreign deposits and domestic funds that might flow out of the country because of interest rate differentials. Also, he felt that the problem of the negotiable time certificates of deposit would force the Board to take action sooner or later, and again he felt it would be preferable to act sooner rather than later. He did not think that such action, if taken, would have any drastic impact; banks would meet competition as it arose. Therefore, unless there was something in the Thomas memorandum that would change his view, he felt that the Board ought to act. Before acting, however, the Board would have to present the subject to the Federal Deposit Insurance Corporation so that the latter could consider its regulation applicable to nonmember insured banks, and this would be a better time to take this step than after the Board had adopted a position. Before acting, the Board also ought to have such additional pertinent data as could be furnished by the staff. In summary, he hoped that the Board would not act too late, that it would take the lead rather than lag behind.

Chairman Martin said he found much of what Governor Robertson had said quite persuasive. The matter of timing was the real question. Certainly, he would not want to act while the Treasury was in the midst of a financing program. (Governor Robertson expressed agreement.) A further question was whether the New York State authorities would actually take action; after this was known the Board should be prepared to reconsider the pros and cons.

Governor Shepardson said he thought the suggestions that had been made were appropriate. If there was additional information that would be helpful in considering the problem, it should be made available to the Board by the staff. Probably, it would not be opportune to act at the present moment but he would be sympathetically inclined toward taking the lead, provided that could be done without disadvantage. It should be borne in mind, of course, at a time when the System was trying to maintain a relatively stable position, that such action might be taken as an indication of a move on interest rates generally.

Governor King said that he could not conclude that banking was really a business involving free competition. While he was appreciative of banking services, still he could not conclude that free competition existed. If it did, anyone could go into the banking business, which was not the case. In his opinion, therefore, this was a wrong premise from which to start. Further, although the point might not be too important, he felt that an increase of the maximum rate might have the effect of putting additional pressure on smaller banks to merge with larger institutions. Perhaps this trend was inevitable, but the question was whether the System wanted to give the movement more impetus than already existed.

As he understood it, Governor King added, the major question was the one of keeping so-called "hot money" from leaving the country. That was the only strong reason he had heard for taking action now or around the first of December. To him, however, it did not seem reasonable to raise the maximum rate simply to try to hold such funds in this country; the whole problem was deeper and more basic.

Governor King went on to say he was inclined to feel that Regulation Q was a good regulation; he did not believe that it should be removed. Also, he doubted from a legal standpoint whether the Board could properly remove the ceiling rate. A responsibility had been delegated to the Board by the Congress, and he thought the intent was that the Board would provide a working ceiling. Of course, if the Congress wanted to study the matter and eliminate the ceiling, that was its prerogative.[1/]

Governor Balderston said that if the New York State authorities acted on November 8, he felt this would start a train of discussion that could then be followed by action on the part of the Board that might be announced around the first of December. He agreed with the logic of the Thomas suggestion that the Board let economic forces take the lead. However, it takes some time, he noted, for people to arrive at decisions such as the switching of funds from New York to London. If the Board should wait until the rush was actually on, as it might be by the first of December, the Board's action might be too little and too late. If the Board was going to try to do its part to stem an outflow of funds, it ought not wait until the outflow became serious if that could be

1/ Governor King's views were amplified in a memorandum dated November 1, 1961, which was distributed to the other members of the Board subsequent to this meeting.

avoided. On balance, he would wait at least until November 8, however, and then consider announcing some action during the period between November 15 and the first of December.

Governor Balderston stated, in reply to a question, that he would be inclined to favor a moderate approach in making any adjustment of the current ceiling rate and to include some incentive for funds retained on deposit for more than one year.

In further discussion, during which Chairman Martin referred to the confidential character of the subject under consideration, Governor King made the comment that personally he did not feel that any action that might be taken by the New York State banking authorities would oblige the Board to take any action with respect to the maximum rates under Regulation Q.

Governor Robertson expressed the view that an increase of the maximum rate would not constitute an incentive to bank mergers, because the additional competition for savings that would be permitted would be primarily between banks and other types of financial institutions rather than among banks themselves. As to the Congressional intent, which had also been mentioned during the meeting, it seemed to him one ought to weigh carefully the history of the matter, which showed that for years after the statute was enacted the ceiling rates were not "working ceilings." If the Congress had felt that the Board was not doing what the Congress intended, presumably it would have taken occasion to review the administration of the statute.

Chairman Martin then suggested that the subject of the maximum rates of interest on time and savings deposits be carried as "an open item on the Board's agenda." Pending further consideration of the matter by the Board, he suggested that Governor Robertson be requested to contact the board of directors of the Federal Deposit Insurance Corporation for the purpose of discussing the subject in appropriate terms and obtaining the views of the directors. Governor Robertson indicated that he would be agreeable to undertaking the assignment, and it was understood that this procedure would be followed.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board a letter to the Federal Reserve Bank of Richmond (attached Item No. 1) approving the designation of Franklin L. Clark as special assistant examiner.

Kenneth A. Kenyon
Assistant Secretary

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

Item No. 1
10/31/61

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

November 1, 1961

Mr. John C. Horigan,
Chief Examiner,
Federal Reserve Bank of Richmond,
Richmond 13, Virginia.

Dear Mr. Horigan:

In accordance with the request contained in your letter of October 26, 1961, the Board approves the designation of Franklin L. Clark as a special assistant examiner for the Federal Reserve Bank of Richmond for the purpose of participating in examinations of State member banks only. The authorization heretofore given your Bank to designate Mr. Clark as a special assistant examiner is hereby canceled.

Very truly yours,

(Signed) Elizabeth L. Carmichael

Elizabeth L. Carmichael,
Assistant Secretary.