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Minutes for February 20, 1962

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 WM

Gov. Mills

Gov. Robertson R

Gov. Balderston CCB

Gov. Shepardson

Gov. King

Gov. Mitchell

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, February 20, 1962, at 10:30 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Enders, Murphy, Petersen, Hays, Hobbs, McRae, Zwiener, Maestre, Moorhead, Breidenthal, Betts, and McAllister, 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

Mr. Prochnow, Secretary of the Federal Advisory Council
Mr. Korsvik, Assistant Secretary of the Federal Advisory Council

The results of the election of officers of the Federal Advisory Council for the current year had been as follows:

President	George A. Murphy
Vice President	Reuben B. Hays
Executive Committee	George A. Murphy, ex officio
	Reuben B. Hays, ex officio
	Ostrom Enders
	Robert B. Hobbs
	Kenneth V. Zwiener
Secretary	Herbert V. Prochnow
Assistant Secretary	William J. Korsvik

The following newly appointed members were attending their first meeting of the Federal Advisory Council:

J. Finley McRae, President, Merchants National Bank, Mobile, Alabama;
Kenneth V. Zwiener, President, Harris Trust and Savings Bank, Chicago, Illinois;
Sidney Maestre, Chairman of the Executive Committee, Mercentile Trust Company, St. Louis, Missouri;
John A. Moorhead, President, Northwestern National Bank of Minneapolis, Minneapolis, Minnesota;
M. L. Breidenthal, Chairman of the Board, Security National Bank of Kansas City, Kansas City, Kansas; and
Elliott McAllister, Chairman of the Board, The Bank of California National Association, San Francisco, California.

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 at this meeting were as follows:

1. What are the observations of the Council regarding the current business situation, the prevailing sentiment of the business community, and the general outlook for the next six months? What indications does the Council have on current trends in consumer credit, residential mortgage credit, and business loans? Are there indications of stockpiling of steel and steel products as protection against a strike or price increases?

The members of the Council report that the current business situation is generally good. The sentiment of the business community is one of cautious optimism. Businessmen anticipate a moderate rise in the over-all level of economic activity in the next six months, but they are not certain that the expansion in sales will be accompanied by a corresponding improvement in profits.

The Council has observed few indications of any significant change in the current trends in consumer, residential mortgage, and business loans. However, the anticipated increase in automobile sales should result in some expansion in consumer credit. Furthermore, the flow of savings funds into the commercial banks in recent weeks is causing them aggressively to seek additional consumer loans and residential mortgages. The present cost of savings funds is an important factor contributing to these developments. The Council has found comparatively little evidence of the stockpiling of steel and steel products as a hedge against a strike or price increases. As the contract expiration date, June 30, draws nearer, and assuming no accord has been reached, inventory accumulation is likely to accelerate.

In discussion, Mr. Petersen said there was a general sentiment within the Council that there would be no steel strike. The Council's concern, therefore, related more to whether or not the settlement would be inflationary. It appeared from the observations of the members that there would be no significant accumulation of inventories, in the thought that the settlement was not likely to be inflationary.

Mr. Betts reported some inquiries from potential borrowers to take care of stockpiling if it should develop that such stockpiling was thought to be necessary.

President Murphy said that in the Second District there had been little evidence of stockpiling. Further, there was no evidence that such stockpiling as was taking place resulted from concern about price increases; to the extent that stockpiling was occurring, it reflected apprehension about the possibility of a strike. A lot of the stockpiling in 1959 was done as a hedge against possible price increases, and the current situation seemed to be a healthy turnaround.

Mr. Hobbs reported that at the Bethlehem plant in the Baltimore area orders were very brisk. There was little actual inventory accumulation, but users wanted to be sure they could get steel when they wanted it. Therefore, they were putting in orders ahead of time.

Mr. Hays noted an observation by the head of a steel company in the Fourth District that he would regard a noninflationary settlement as far more important than an early settlement.

Inquiry was made as to what significance the Council placed on recent indications of a moderate slackening in business activity, as suggested by the January decline in the Board's index of industrial production, the decline in housing starts, and certain other indexes. It was asked whether those evidences of hesitation might at some point tend to color the thinking of businessmen.

President Murphy commented that the Council, in reviewing the loan figures, was rather surprised that they had not moved up more rapidly. The Council members had noted the evidences of hesitation in economic activity and had discussed the matter to some extent yesterday, but they found it difficult to pinpoint the reasons.

Mr. Petersen noted that demand factors seemed less robust than had been generally anticipated. At its previous meeting the Council had said that it saw little real buoyancy in the recovery movement, and he did not think the Council's view had changed. Recovery had been taking place, but with no signs of great strength.

The comment was made that there seemed to be some evidence that retained earnings had lessened the requirements of many companies for borrowed funds, at least at this stage.

President Murphy responded that there was evidence of a high degree of liquidity on all sides. He then turned to Mr. Zwiener, who summarized a personal survey of several companies in different lines of business, which survey showed that each company was spending more money in 1962 than in 1961, but that all of the companies except one were providing the funds entirely out of cash and liquid assets.

Mr. Hobbs reported that his bank had experienced a gradual change in the composition of its loan portfolio. There had been a falling off in the volume of loans accounted for by "normal lines of borrowing", while construction, consumer, and mortgage lending had increased. He thought that this had been a rather general experience.

Question was raised whether there was evidence of any substantial borrowing in anticipation of going into the capital markets later this year, and President Murphy indicated that this would apply to the utilities. He noted an observation made at the Council meeting yesterday that the old seasonal pattern of borrowing seemed to have changed in many instances. Today there were more so-called "special deals". There was still much seasonal borrowing, but it was not as easy to predict as in the past.

Mr. McAllister reported that West Coast banks had been disappointed in the extent of loan demand during 1961. Budgets and estimates had anticipated a higher volume of loans than actually developed. There had been no great pick-up as yet, but the banks were looking forward to the fall hopefully. The general tenor of the thinking was one of cautious optimism.

President Murphy commented that bankers appeared to be relating the situation to their ability to lend. With new time money, banks were quite liquid; even though loans were higher today than a year ago, the ability of banks to lend was greater. In short, the sentiment was not as optimistic as the loan figures per se would indicate.

Further observations by members of the Council concerning the picture in their respective Districts tended to support these comments. Loans were higher than a year ago, but deposits were up and banks were in a more comfortable position. Thus, there was some disappointment that the demand for loans was not greater.

Question then was raised regarding the sufficiency of motivations for capital investments.

President Murphy commented to the effect that the cost of capital was a principal topic of conversation and study among corporate financial officers as they tried to determine how best to meet the anticipated needs of the future. No outstanding pattern was seen, except that in most instances companies apparently were trying to provide the required funds out of earnings. Some reluctance to issue stock was seen, because it was held that this was the most expensive method of financing. It was thought better to issue bonds, and better still to save the funds out of earnings.

Mr. Zwiener observed that the problem appeared to be tied closely to the prospect of profits. The greatest profit from capital expenditures appeared to result from installation of the cost-cutting type of equipment. As he saw it, the profits squeeze was the most important deterrent to capital investment at the present time.

President Murphy commented on the considerable amount of obsolete and inefficient equipment in use today. Such equipment tended to be used more as production rose closer to capacity, with a resulting squeeze on profits. This made it all the more necessary for management to raise funds for rehabilitating machinery and equipment. In order to remain competitive in world markets, American industry must find ways of becoming more efficient, and this required the availability of capital.

Mr. Zwiener said that he saw more "trouble" types of loans in the banking system than possibly ever before. Most of these related in some way to the fact that the companies were behind the parade in their capital expenditures programs.

Comments followed on the part played by the tax laws in determining business decisions, after which Governor Mills inquired whether it was correct to conclude from the Council's comments that capital expenditures at the present time were aimed more at reducing costs than expanding output and endeavoring to reach new markets.

President Murphy replied that he thought this was probably a fair conclusion. Mr. Hobbs referred to existing over-capacity in almost every segment of industry, and President Murphy observed that this was true when the old was added to the new. Mr. Maestre commented that it seemed to be thought by corporations that interest rates were not going to be any lower and that this was a good time to fund.

Reference was made to the apparent adequacy of plant capacity, the high level of personal incomes, and the increase in savings. In these circumstances, question was raised as to what it was going to take to stimulate the demand that would utilize existing capacity more fully and create a need for additional capacity.

President Murphy said that the answer seemed to lie basically in profits. This tied in with the tax laws. The nation still had its share of entrepreneurs who were willing to take a risk, but time after time it was heard that people had decided to defer taking the risk.

There was an inquiry about the strength of demand for available goods at present price levels, to which President Murphy replied that the customer appeared to be more discriminating than in the past. The company that made a quality product and gave the customer his money's worth could still produce and sell.

With reference to the Council's comment about the greater demand by banks for mortgages, question was raised regarding the influence on mortgage rates.

President Murphy said the Council felt that the immediate effect was going to be a lowering of rates. In his personal opinion, however, that would be only temporary.

Mr. McAllister reported a conversation that had raised the question of a possible broadening of the definition of paper eligible for discount at the Federal Reserve Banks in order to give member banks additional flexibility for mortgage lending in areas where the demand for such credit was great.

2. What evidences are seen of current or prospective improvement in the unemployment situation?

There has been moderate improvement in the unemployment situation, and the Council believes this improvement will continue. The lengthening of the workweek in manufacturing in the past year suggests that the expected expansion in economic activity should be accompanied by further additions to employment. Although unemployment is at present less severe, a persistent problem of structural unemployment remains.

President Murphy commented on the difficulty in obtaining unemployment figures that were fully meaningful. He felt, however, that the trend was in the right direction. There were still well-known distress areas around the country, and they required special attention. On the other hand, the areas that had become distress areas due to the recession seemed to be coming along quite well.

Question was raised regarding retraining programs, and the comments of several Council members indicated a lack of knowledge of such programs in their respective areas. Mr. Hobbs commented that in the Baltimore area employers of labor were constantly complaining about the lack of interest on the part of a certain segment of employees in bettering themselves. He understood that many jobs in the area were unfilled because of that lack of interest. Mr. Moorhead reported some evidence of retraining efforts in the iron range area. However, there was nothing to train people for in that area, and most individuals did not seem to want to move. This included even the younger population.

Chairman Martin suggested that one of the shadows on the unemployment picture was the balance of payments problem. This was not generally recognized, he thought. However, it appeared to be getting more difficult to induce foreigners to invest in this country, for they did not see the opportunities for profit. This was one of the basic problems with which this country must deal.

Mr. Petersen commented that the prospect of a good return on capital was so much greater in the European Common Market area than in this country that it was causing a return flow of capital. President Murphy commented that the Common Market offered safety through diversification. Firms could now go into any member country with the whole Common Market at their doorstep. Entrance by American companies into the Common Market area might be good from the standpoint of the profits of the company concerned, but it increased employment abroad rather than in this country.

3. What are the prospects for demand at banks during the next six months for commercial and industrial loans?

The anticipated expansion in business activity in the next six months suggests a moderate rise in the demand for commercial and industrial loans. This demand is likely to strengthen further if inventory accumulation accelerates.

President Murphy said he found it rather difficult to make up his mind as to the possibility of substantial inventory accumulation.

A new pattern of inventory controls seemed to be developing. He was not sure that businesses were going to accumulate inventories in the future to the same extent as in the past, for reasons discussed several times at recent meetings of the Board and the Council.

Reference was made to substantial loans by United States banks to foreigners in the fourth quarter of 1961, and question was raised as to whether this type of lending was likely to accelerate.

President Murphy replied that the demand was accelerating but the availability of money was not. There were not too many areas of the world where American banks were willing to invest their funds at the moment, and it seemed doubtful to him whether the over-all volume of overseas lending would increase a great deal. Most banks had a limited proportion of funds that they were willing to expose abroad, with rather nebulous quotas for particular countries.

4. What has been the reaction of banks to the recent increase in the maximum permissible rates of interest on time and savings deposits? What structure of rates on different types of time and savings accounts, including certificates of deposit, is developing in various areas of the country? What is the Council's impression as to the origin of the funds being added to savings accounts and time accounts, including certificates of deposit? How will the higher rates of interest paid by banks affect their lending and investment policies?

A substantial proportion of the nation's banks have raised rates on time and savings deposits, with many banks having increased their rates to the maximum permissible. Many banks raised rates reluctantly and under competitive pressures. Savings rates in a number of areas were immediately increased to the maximum. This has created problems in making the required adjustments in bank earning assets.

There is little uniformity across the country in the structure of rates on different types of time and savings accounts. The rates on negotiable certificates of deposit are running somewhat higher than on Treasury bills but tend to be lower than the 3-1/2 and 4 per cent maximums permitted on savings deposits.

Several members reported on surveys that various institutions have made in an effort to determine the origin of the funds flowing to their savings accounts. The results have suggested that no one source seems dominant. Some of the funds are undoubtedly coming from demand accounts. However, the members of the Council believe that a considerable portion of the new savings and time deposits represent funds that heretofore had flowed to competitive institutions other than banks.

While banks will aggressively seek to augment their earnings in an effort to offset the increase in their interest costs, the members of the Council believe it is premature to generalize about possible significant changes in bank lending and investment policies. Some institutions have indicated that they will seek to expand their residential mortgage activities, and to increase their consumer credit loans. The recent strengthening of the price of municipals is likewise attributed to an increased demand by commercial banks. The need to increase income will probably result in the lengthening of maturities in mortgage and municipal portfolios.

President Murphy reported that the Council had spent a great deal of time discussing this subject and that a variety of opinions had been expressed. The banks were going through a reaction period after the change in the maximum permissible rates of interest. It was a period of adjustment, and personally he thought the adjustment was a healthy one. In his opinion, commercial banking would emerge as a stronger industry. Banks would be forced to exercise ingenuity in cutting costs; they would have to be run more efficiently. Thus, the banks were on their mettle. There was a challenge, and he welcomed it. In the past, bankers had been prone to lean on the fact that they were not permitted to pay a higher rate of interest, and as a result they may have gotten a little soft. At present the New York State Bankers Association was working diligently on a method of analyzing costs. Questionnaires were being sent to the banks asking them to tabulate and code expenses; and the State Banking Department was going to analyze this information so that the banks could have a standard for different types of costs. This was a healthy sign. There was hardly a bank that could not do a better job on cost control.

President Murphy went on to say that the scramble for higher rates was bound to cause some difficulty. In the process, however, he felt that banks were going to become stronger institutions. Customers were entitled to the market price for their money. If the banks did not pay the market price, people would be justified in taking their money some place else.

Mr. McRae commented that in the Sixth District some banks had said at first that they were not going to raise their interest rates. In most cases, however, that situation did not last very long. He was inclined to think that increases had usually been made because some bank started the move and others followed for competitive reasons. Thus, most banks had probably now gone to the ceiling. As to his bank's experience, savings deposits increased about 10 per cent in 1961. From the end of the year through mid-February, they rose about 3 per cent further, with about half of the money coming out of checking accounts and a small amount from savings and loan associations. The associations promptly increased their rates by 1/2 per cent.

Mr. McRae expressed concern about the ultimate effect on bank liquidity. He felt that banks were going to reach for more income. Those having the major part of the assets of the banking system were not going to lower the standards of quality for loans and investments or stretch maturities too far. However, he had reservations about the applicability of this statement to the many thousands of smaller banks.

Mr. Hobbs said his bank had experienced quite an increase in savings deposits in January, continuing the trend that began in 1961 at midyear. An analysis of deposits of $5,000 or more from the first of January through the first of February showed that 40 per cent of the deposits came from checking accounts. Other money came from savings banks and from savings and loan associations. There had been a large increase in the number of new savings accounts, indicating that the 3-1/2 per cent rate was attracting customers. Whether this situation was typical throughout the country, he did not know, but he thought it was fairly typical in Baltimore.

President Murphy commented that today's depositor was very rate conscious. Some years ago it had been felt that location might be more important than the rate of interest, within certain limitations, but that was not true today. The scramble for funds had started with the savings banks and the savings and loan associations. If the banks were not able to meet that competition, they would have to sit back and watch a further attrition in a very important area. In his opinion, the banks could compete in this field. They would not have to pay exactly as much as savings and loan associations and savings banks; they could compete with some differential. As of today the competitive factor was running in the favor of the commercial banks, whereas they had previously been on the defensive since World War II. He had a great deal of respect for the ability of the commercial banker to do a job, and he felt that the commercial banker would do a job in this area. The banker would buy mortgages to the extent that they were offset by savings deposits, he would buy some municipals, and there would be some lengthening of maturities. To President Murphy's way of thinking, however, these things would not be harmful as long as they were done with a high degree of good judgment. If the banks had not been given their present opportunity, he would have been worried.

Mr. McRae said he hoped that mortgages would not be made eligible for discounting at Reserve Banks because their ineligibility would serve as a brake against loading up too much with such loans. He felt, however, that in the course of time the Federal Reserve was going to have to do something with respect to mortgages because the liquidity of many banks would be weakened. He hoped, of course, that his fears were unfounded.

Mr. Betts agreed with President Murphy that the commercial banks had not been getting their share of the savings dollar, that they should be able to compete, and that they were now on their mettle. Nevertheless, the amendment of Regulation Q had created problems in the Eleventh District, where about 70 per cent of the banks had gone to the ceiling. The split rate on savings accounts was in his opinion a mistake. The theory apparently had been to give a little elbow room, but in the minds of the public 4 per cent became the rate that commercial banks should and would pay. The majority of banks had gone to that rate because their competitors were doing it. Rural banks in the area were now faced with a real operating problem. All of the bankers were talking about what they could do and were trying to increase their earnings in ways that had been mentioned previously, along with higher service charges. In his opinion, the banks would have to streamline their operations and become more efficient. Be that as it may, however, the banks were greatly disturbed, and in his opinion the repurcussions were going to be rather widespread. For example, there might be a substantial move out of U. S. Savings Bonds. In summary, the banks were going to have to do the things that would offset the increased cost of doing business. They would probably reach for mortgages and long-term municipal bonds. Liquidity would be affected, and in some instances, he thought, the quality of assets.

Mr. Hays agreed with President Murphy that the banks should be in a position to compete. He was not concerned about the large banks, which had management with broad perspective, but about the thousands of little banks. In the Fourth District he had found 104 out of about 900 banks that had increased their rates. He had sent a questionnaire to those 104 banks, and 86 had replied. Most of the banks that replied expressed displeasure about the change in Regulation Q, but most of them had gone to the maximum rate. The majority expected checking accounts to be the principal source of new savings deposits. Many planned to raise the rates charged on loans and to increase their mortgage and consumer loans and their holdings of municipals. A substantial number planned to lengthen the maturities of their investment portfolios. The banks generally objected to the split rate on savings accounts, feeling that it would be difficult to explain the matter satisfactorily to customers and that there would be difficulties of rate computation. 1/

Mr. Moorhead said he would be more impressed by the arguments against the change in maximum rates if he had not heard them given before when the maximum rate was increased to 3 per cent at the beginning of 1957. He was inclined toward President Murphy's view. Bankers, he felt, were really worried about profits rather than liquidity. It would be a sad commentary if banks were to pay interest rates that they could not afford to pay, but competition was a strong factor. Personally, he welcomed the opportunity to meet competition. There would be a burden, admittedly, on small banks; they would have to adjust by improving their earnings or else not pay high interest rates.

1/ Copies of Mr. Hays' summary of the replies to his questionnaire were distributed to the members of the Board following the meeting.

Mr. Zwiener commented that the change in Regulation Q probably would have the effect of slowing down applications for new bank charters in Illinois, because earnings prospects would not be as favorable.

Mr. Petersen said that the change in Regulation Q was not a popular move in the Third District. Only about 20 per cent of the banks had changed their rates. In Pennsylvania the State authorities had ruled that banks could not pay a rate higher than 3-1/2 per cent without a commitment that the money would be in the bank for 12 months.

Mr. Breidenthal commented that in its statement the Council had been attempting to do an effective reporting job on the sentiment in the respective Districts. The statement might not reflect in all cases the way the members felt themselves. In the Tenth District the first reaction was one of resentment, but he thought that was beginning to die down a little. Many country banks had stayed at 3 per cent on savings accounts and had gone to 4 per cent on time certificates, and in January they reported a large amount of transfers from checking accounts to certificates of deposit. They immediately assumed that they were now paying 4 per cent on funds that were formerly interest-free. Every January, however, there had been funds transferred from checking accounts to other financial institutions. Therefore, the funds left the communities, and in his opinion those communities had use for the funds. He could not help but feel that this was another change in the constantly changing image of commercial banking. The banks must be competitive if they wanted to stay in the savings business. Further, the maximum rates did not reflect a hard-and-fast rule. If at some time in the future interest rates should go down, the banks were probably going to adjust their rates downward on savings and time deposits. To him it was a management proposition, and the commercial banks were capable of doing the job.

Mr. Breidenthal said he thought the most unsatisfactory aspect of the problem was the matter of split rates, for this was going to present difficulties from the public relations standpoint. Interest should be figured the same way in all banks, and he did not know how the banks were going to make a satisfactory explanation to their customers when they came in to have interest entered in their pass books. In a concluding comment, Mr. Breidenthal said that he thought practically all banks during the past several years had told their savings and time depositors that they would like to pay more interest but were limited, and that if the time came when banks could be more competitive they would be more competitive. Therefore, he was not going to worry. The banks would do the job.

5. Does the Council detect any change in public concern about the persisting deficit in the United States balance of payments?

The members of the Council believe there is an increasing concern by the informed public about the persisting deficit in the United States balance of payments. A still greater public awareness is necessary if we are to have the policy changes required to eliminate the deficit. Such changes would include sound fiscal policies, a critical reappraisal of our military and aid expenditures overseas, and a level of costs which would make American products and services competitive in world markets.

Mr. Petersen commented that the concern of the general public tends to increase when there are gold losses. The Council had phrased its statement in terms of the reaction of the informed public. Personally, he was greatly concerned about the balance of payments problem, which he thought would be a persistent one. The fact that 1961 was a relatively better year than 1960 was a welcome development but did not solve the problem, and he did not see any solution right around the corner. In his opinion, the current tariff debate would serve as an educational medium, probably causing the balance of payments problem to be presented to the public on a much broader basis than heretofore. This would be all to the good. Also, he felt that banks had an obligation to have their officers well informed in this area in order to be of some assistance to the general public, particularly the business community. By and large, he would guess that this was being done in the larger banks.

President Murphy said he felt that the average businessman was better informed than in the past. He also noted that gold movements could arouse public feelings quickly, to which he added that foreign bankers without exception were looking at developments closely. He had detected an undertone of encouragement because foreign bankers seemed to feel that the United States had recognized the problem, and when a problem is recognized a solution is more likely to be in prospect. With the problem receiving so much attention, he felt that the authorities were in a better position to obtain cooperation from the business community in doing what was necessary. In his opinion, the balance of payments was perhaps the major problem of the country at the present time, and he felt that a lot of things were being done to solve it.

Question was raised with regard to the role of monetary policy in relation to the balance of payments problem, and the views expressed by members of the Council were to the effect that the maintenance of a sound monetary policy was one of the aspects of an over-all discipline that would be necessary in working toward a solution of the problem. This was not to imply, however, a criticism of current monetary policy. Further, it was not felt that monetary policy could correct deficiencies in other areas, such as inadequate fiscal policies. The Council felt that sound policies to control expenditures at home and abroad were necessary, along with a balanced budget.

Mr. Hays reported that discussions with businessmen in his area revealed some difficulty in connecting the balance of payments problem with their own businesses. There was a gap, he thought, that was not bridged in the minds of most people. However, there was considerable concern about tariff policies, and a strong sentiment that the budget should be balanced by whatever means were necessary.

In reply to a question concerning the outlook for agricultural exports to the countries comprising the European Common Market, Mr. Petersen reviewed various aspects of the situation, including the difficulties involved in conducting negotiations in view, particularly, of the heavy agricultural trade balance running in favor of the United States. While there were some factors that seemed heartening, in general he was not inclined to be too optimistic.

Mr. Petersen withdrew from the meeting at this point in order to keep another engagement.

6. What are the views of the Council regarding the impact of current monetary and credit policy?

The members of the Council believe that current monetary and credit policy has been appropriate and is having a desirable impact on business activity.

Chairman Martin inquired whether there were any members of the Council who felt that monetary policy had been too easy, having in mind particularly the relationship to the balance of payments problem.

Mr. Hobbs noted that at the time of its meeting in November 1961 the Council had been rather evenly divided, with some members inclined to feel that a slight tightening of policy might be in order if there was continued improvement in the domestic business situation. There was still some feeling within the Council, he thought, that perhaps a little tightening of policy would be in order before the time of the next meeting of the Council. The situation might be getting closer and closer to that point. Perhaps, however, this reflected no more than his personal opinion.

President Murphy said the Council had noted some of the little dips in economic activity that had occurred recently. He was not so convinced of future trends as to feel that much if any tightening was needed at the present time. In his opinion, an ample availability of funds was quite important at this stage.

Chairman Martin then inquired whether it was the judgment of the Council that the level of short-term rates was having an effect in relation to the balance of payments problem.

President Murphy replied that in his opinion the level of short-term interest rates had had a considerable effect. He added that American banks were finding today, with the rates they were able to pay, that they could attract money in international markets. They were getting a healthy volume of dollars at current rates, and if necessary they could step up the rates in order to protect their balances.

Chairman Martin inquired how the American public might be expected to react to any further substantial losses of gold, and President Murphy commented that much would depend, in his opinion, on how the matter was reported in the press. The average reader tended to look at the headlines and not go into the fine print. People could get excited again, as they did with respect to the Multer bill to remove the gold cover. He thought there was a somewhat better understanding of the balance of payments situation than in the past, but a few articles of a certain type in the press could get people stirred up.

Chairman Martin asked about the thinking of the Council concerning removal of the gold cover, and several members indicated that they thought such a move would be ill advised. The factor of public misunderstanding of such a proposal was mentioned.

President Murphy said that he would personally favor removing the gold cover. However, he gathered there was a lot of opinion against it. Within the Council it was apparent that he was in the minority.

This concluded the discussion of the questions that had been included on the agenda for this meeting.

System foreign currency operations. Chairman Martin commented that the Federal Open Market Committee had recently authorized a program of System operations in foreign currencies. The Treasury, through its Stabilization Fund, had already done some pioneering work in this area, and the Open Market Committee felt that the System should also work in this field and see whether there was a role for it to play. In his view, Chairman Martin said, operations in foreign exchange probably could serve a useful purpose. No one in the System would want to take a strong position at this time, but it seemed desirable for the System to obtain some experience. The System would have to move forward gradually, much in the same way as when open market operations in the Government securities market were first undertaken many years ago, with a minimum objective of dealing with temporary disequalibria in the exchange markets and with the idea of working cooperatively with other central banks to determine what might be done in the exchange field without changing basic flows. Therefore, the Open Market Committee had authorized the Federal Reserve Bank of New York to operate on behalf of all of the Reserve Banks in conducting operations for the System Open Market Account. Before the next meeting of the Council there might be some transactions, but it should be emphasized that the program was very much on an experimental basis.

In this connection, Chairman Martin noted that President Hayes of the New York Reserve Bank had made a speech on this general subject on January 22, and that he (Chairman Martin) had discussed the subject in his testimony on January 30 before the Joint Economic Committee in connection with hearings on the President's Economic Report. He noted that there had been relatively little comment to date.

President Murphy commented that this seemed to be a realistic move in the light of world developments. It was essential for the nations of the free world to work closely together, and he assumed that in conducting foreign exchange operations there would be close relations between the Federal Reserve and foreign central banks.

In reply to a question as to why the Federal Reserve had not conducted such operations previously, Chairman Martin said the basic reason was an absence of pressure. At the present time, however, the United States was an international borrower instead of the world's chief lender. He added that the principal danger in these operations was quite clear. It might be thought that things could be accomplished through them that were not possible. There might be an inclination to temporize with essential disciplines.

The Chairman also said that the Open Market Committee and the Board of Governors had looked at the matter carefully in terms of the System's legal authority. An opinion had been obtained from the General Counsel of the Committee that authority existed to conduct foreign currency operations, and the General Counsel of the Treasury had concurred, along with the Attorney General. However, there was no authority, for example, to buy foreign bills. This might be wanted at some point, and the System might decide to seek additional legislation. On the other hand, it seemed doubtful to most of the members of the Federal Open Market Committee that it would be advisable to request additional legislation at this time. Without any experience in actual operations, the System was hardly in a position to know exactly what kind of legislation might be needed.

In a further comment, Chairman Martin noted that there might be some question regarding the possible magnitude of the operations. However, this was a rather pointless question. The System was not going to risk its resources unduly, but the operations would have to be sufficient to deal effectively with speculative disturbances. For this reason the establishment of any specified maximum limits would be inappropriate. Further, if the System were successful in its operations, it might be that the Stabilization Fund would want to cease its operations in this area, but obviously that would be some time ahead.

President Murphy stated that an international monetary conference in Rome was scheduled at the time that the next meeting of the Federal Advisory Council ordinarily would have been held. The Council therefore would like to suggest that, if agreeable to the Board, the next meeting be held April 30-May 1, 1962.

There being no objection, it was understood that the next meeting of the Council would be held on those dates.

The meeting then adjourned.

Secretary