

Minutes for November 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

Gov. Mills

Gov. Robertson

Gov. Balderston

Gov. Shepardson

Gov. King

Gov. Mitchell

RM
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CCB
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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, November 20, 1962, at 10:30 a.m.

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

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

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

1. What are the observations of the Council regarding (a) recent domestic economic developments, and (b) the outlook for the remainder of this year and the first part of 1963?

The members of the Council have observed a more favorable attitude toward the business outlook. The possibility of a tax cut and developments in the Cuban situation may have had an encouraging psychological impact. The continued high volume of automobile sales has also had a beneficial effect on economic activity in general. In addition to the impact on production, the high volume of automobile sales has increased income and has helped to lift retail sales to a record level. Aggregate inventories are probably lower and new orders have risen, both suggestive of

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future business activity.

As a consequence, the Council believes that the outlook for the remainder of this year and for the first part of 1963 is better than it was at the time of the last meeting of the Board and the Council. Most members of the Council anticipate a modest rise in business activity in the months ahead.

President Murphy reported a unanimous feeling on the part of the Council members that business activity was fairly good. While it had not reached the heights some had hoped for, it was quite favorable when measured against the yardstick of the immediate past, and the outlook for the remainder of this year and the early part of 1963 seemed reasonably bright. In almost all conversations with businessmen, the Council members found the discussion turning to two factors: the Cuban crisis and the possibility of a tax cut. Both of these factors had psychological implications, although perhaps the question of a tax reduction had passed the psychological stage. The feeling was being expressed, and strongly, that a tax reduction at this time was needed and that a modification of the tax structure was long overdue. The mere fact that this was a possibility seemed to represent a mild stimulant.

Comments by members of the Council concerning developments in their respective Districts supported the Council's statement on this topic and President Murphy's summary remarks. Although some variations were reported from District to District, the general tenor of the comments was to the effect that while no boom was evident the volume of business activity was at a reasonably high level. It was noted that at the time of the previous meeting of the Council with the Board there appeared to be some tendency for business sentiment to run behind the statistics. Since then, however, the sentiment of the business community had improved

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markedly, or in other words had caught up with the statistics. Fears of recession had now been supplanted in most instances by an expectation that business activity would continue in the foreseeable future at approximately current levels or perhaps increase moderately. The agricultural situation was reported to be highly favorable. While business profit margins continued to present a substantial problem, it appeared that a somewhat improved or more hopeful tone was found in the comments of businessmen in this respect.

Concluding comments by the Council drew attention to the difficulties that the economy had weathered over the past few months, including the stock market break and the Cuban crisis. It was noted that the general attitude of the business community had nevertheless remained fairly optimistic. Further, as indicated by the reports from the various Districts, the tone of optimism had heightened within the past few weeks. In summary, the economy appeared to be moving ahead in rather deliberate fashion and, in all the circumstances, it was the view of the Council that the economy had performed in a reasonably satisfactory manner.

2. Has the Council seen indications of significant increase in consumer or business inventory buying or of price mark-ups as a result of the recent period of international tension? Are businesses tending to increase or to reduce plans for fixed capital investment because of this situation?

The members of the Council have seen few, if any indications of significant increases in consumer or business inventory buying or of price mark-ups that they would attribute to recent international tensions.

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The Council has not observed any tendency for businesses either to increase or to reduce their fixed capital investment plans because of international tensions.

In supplementary comments, President Murphy noted that aside from the Sixth District, where there had been some temporary reaction to the Cuban crisis in terms of consumer buying of certain items, the period of acute tension appeared to have passed without any noticeable reaction in terms of consumer buying or stockpiling of inventories. Perhaps the fact that the period of acute tension passed so rapidly was a contributing factor. Renewed difficulties might, of course, occur. Up to this point, however, the situation seemed to have been taken pretty well in stride.

3. In the light of present circumstances, what are the Council's views with respect to the advisability of substantial tax reduction?

In view of the projected budget deficit for fiscal 1963, the probability of a large deficit in the following year, and a continuing balance of payments deficit, some members of the Council are doubtful about the wisdom of a substantial tax reduction at present unless accompanied by a reduction in expenditures. However, other members of the Council believe that taxes generally should be reduced whether or not accompanied by a simultaneous reduction of expenditures. Irrespective of the differences in viewpoint expressed above, the members of the Council are unanimous in their belief that Government expenditures should be reduced with the ultimate objective of balancing the Federal budget.

President Murphy said the Council members felt that the decisions made in this area would have an important and far-reaching influence on the economy. All of the members agreed that the tax structure needed to be revamped and that this should be a first order of business. In the

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opinion of the Council, one of the reasons for the rather sluggish performance of the economy had been the drag attributable to the repressive effects of the tax structure. The statement of the Council was not intended to reflect a view that the Government should just go ahead and spend money without knowing where the money was going to be obtained. However, some of the members believed that if a tax reduction was to be deferred until the Federal budget was in balance, it would never be accomplished. These members concluded that the best way to proceed would be to work out a logical reduction and hope that the results would afford the necessary discipline to keep Government expenditures in line. The Secretary of the Treasury, they noted, had made the comment that a reduction in taxes as of the first of next year could be regarded as a down payment on future profits, that a revised tax structure should produce more taxes in a more equitable fashion.

In the discussion that followed, a number of the Council members supported the point of view to which reference had been made by President Murphy. They reported that expressions concerning the need for an early tax revision were widespread in their respective District and that the expectation of such action at an early date constituted, in part at least, the foundation for the currently improved tone of business sentiment. According to the point of view expressed by these Council members, the need for tax revision was so urgent in terms of satisfactory economic growth that it would be reasonable to proceed even without assurance of a reduction of Government expenditures. It was considered doubtful

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whether such assurances were likely to be given or whether, if given, they would be too meaningful. It appeared to these members of the Council that a tax reduction would be of considerable stimulation to the economy, with the prospect that over a period of time aggregate Governmental revenues would be increased at lower levels of taxation.

The contrasting point of view, presented by other members of the Council, was to the effect that it would border on fiscal irresponsibility to effect a substantial tax reduction without regard to all related factors and circumstances. Reference was made to the projected budget deficit for the current fiscal year and the magnitude of the deficit that might result if a substantial tax reduction were injected into the picture. According to this point of view, the economic situation was not sufficiently acute to warrant the taking of such a risk in the absence of compensating action to reduce Government expenditures. The suggestion was made that the tax problem could be separated into two parts, one of which involved the level of taxation and the other of which involved a revamping of the tax structure, and that action along the latter lines would have productive results without incurring the same degree of risk. Reference was made in this connection to the international balance of payments situation, and question was raised as to the reaction abroad if measures should be taken in this country that were construed as irresponsible from a fiscal standpoint.

4. What are the impressions of the Council with respect to the underlying strength of real estate markets and construction activity? Does the Council anticipate that the revaluation of stock market prices

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this year will be followed by a similar revaluation of real property values?

The real estate market is somewhat less active, but the volume of construction continues at a high level. Some members of the Council observed that overbuilding of certain types of buildings is evident in their districts. Residential values are below their previous peaks and the sale of such properties is slow in many areas. However, the Council does not anticipate a revaluation of real estate property as drastic as the revaluation of stock prices that occurred earlier this year.

Comments by members of the Council with respect to developments in the real estate market in their particular areas were generally in support of the views expressed in the statement of the Council on this topic.

5. What are the prospects for loan demand at banks during the next several months, including the demand for real estate and consumer loans?

The members of the Council anticipate that the volume of commercial loans will continue to reflect seasonal variations in the next several months. Any change in this pattern will tend to be in the direction of increased loan demand.

In view of the high level of automobile sales, an expanded demand for consumer loans is expected. The banks' real estate loan portfolios are likely to grow as bankers continue to increase their holdings in an effort to compensate for present higher interest costs.

In supplementary comments, President Murphy said the Council members seemed to be reasonably optimistic about the immediate outlook for loan figures. There had been a normal fall buildup, and the general feeling was that there might be a little slackening of demand after the end of the year. However, the views of the Council were mixed in this respect. In the Second District, for example, there was some feeling

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that loans might trend upward in the early part of 1963, but the pattern was not uniform throughout the country.

Mr. Hays expressed some surprise that instalment credit had not expanded further in view of the movement of automobiles. In general, he felt that the trend of loan demand was about sideways, when considered in light of the usual seasonal pattern. Mr. Moorhead spoke of a high level of loan demand at city banks in the Ninth District and referred to the problem of country banks in covering the higher rates of interest now being paid on time and savings deposits. Mr. Betts reported a rather strong continued demand for loans in the Eleventh District and said that the banks had been endeavoring to increase their mortgage loans in the face of strong competition. Mr. Enders likewise reported a strong continued loan demand, which he felt might lessen somewhat after the turn of the year.

6. What are the Council's views regarding the adequacy and trend of bank liquidity?

The Council believes that the liquidity of the banking system continues to be adequate. Several members, however, again expressed concern about the declining trend in bank liquidity. The tendency to lengthen the maturities of term loans, mortgages, and securities continues despite the fact that the rate of increase in time and savings deposits has lessened.

In a discussion of this subject, Mr. McRae expressed some concern about the liquidity of the banking system. He pointed out that the increase in deposits had been principally in time money. If the rate of increase should diminish, he did not think it would take a lot of additional demand to tighten things up to an undesirable extent fairly

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quickly. In the Sixth District, the principal banks were about even with or above previous loan peaks. This was not true, however, in the rural areas, and there was a good deal of pressure from the rural banks for loan participations.

Mr. Maestre said that he saw nothing dangerous in the degree of liquidity of the banking system as of today. The banking system had undergone material change in the last 25 or 30 years. As long as the banks wanted to be competitive for time money they would have to lengthen maturities, and that was what the banks were doing.

President Murphy cited figures indicative of the fact that loan-deposit ratios were now at a rather high level by historical standards. However, he did not think that one could simply look at the ratios and stop. Instead, one must look behind the scenes and also think of the prospective job of the banks in the months ahead. If gross national product were to move substantially higher, the additional business would have to be financed, for the most part through the banking system. He suspected, therefore, that the banks would have to get accustomed to higher loan-deposit ratios. At the same time he felt that bank management had today the best tools ever at its disposal for analyzing loan portfolios. Present-day records enabled management to have a better knowledge of loans than ever before and to spot troubles quickly. Further, the banks were now training as able a group of men as he had ever seen in the banking field. In these circumstances, he felt that bankers would be able to live in comfort with higher loan-deposit ratios

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and that pressures of the economy would, in fact, force them to do so. Although the ratios were trending upward, he did not think there was a sense of alarm in the Council about the degree of liquidity of the banking system.

The observation was made that this year longer-term bank assets had grown at about the same pace as the increase in time and savings deposits, and it was suggested that some of this money might not be as permanent as had been assumed. Question was raised as to what the banks would do in these circumstances in the event of an increased loan demand.

In reply, President Murphy commented that to the extent that banks had extended maturities and gone into municipals, by and large these investments were offset--at least in the minds of the bankers--against their savings deposits and time money. They were not quite sure what would happen to the negotiable certificates of deposit if there should be a period of tightness, but he rather thought that much of the money would tend to be rolled over. Likewise, he felt more comfortable in respect to time deposits of foreign central banks now that the interest rate limitations on such deposits had been removed; he believed the foreign banks would keep a substantial amount of dollar reserves in this market. As to savings deposits, he thought history would show that a hard core of this money tended to remain with the banking system rather consistently. It was his view that this body of deposits would tend to build up in the banking system, as well as in mutual savings banks and savings and loan associations.

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Mr. Hays described portfolio management practices followed by his institution to enable it to take care of increased loan demand, following which Mr. Hobbs stated why he felt that in the Sixth District there was still considerable room for loan expansion. Mr. Breidenthal presented figures showing that the recent increase in deposits of Tenth District member banks had been practically entirely in time and savings deposits, that the banks had extended investment maturities beyond five years to a noticeable extent, and that they had increased their holdings of municipals and real estate loans substantially.

Question was raised as to the effects of a higher interest rate structure, and President Murphy noted that the market values of longer-term securities would move downward. There presumably would be some hesitation on the part of banks to resort to that area of their portfolios to raise funds to make loans. In other words, there might be some lock-in tendency in the longer term portion of bank portfolios. He then referred, however, to current bank management practices with regard to loan portfolios and expressed the view that most prudent bankers would not go so far as to jeopardize liquidity. He did not foresee a serious lock-in problem. As to the possible deterrent effects of a higher interest rate structure on loan demand, he expressed the view that there would be little dampening effect. In his opinion there were few cases where decisions to obtain loans would depend on a difference of, say, one-half per cent in the interest rate. The interest rate might have some effect on construction loans and in the longer term market for funds, but on

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short-term industrial loans he believed that the interest rate was not a determining factor.

7. How does the Council appraise public reaction to latest U. S. balance of payments developments?

The Council believes there has been little reaction on the part of the general public to the latest U. S. balance of payments developments. Informed persons, however, are very much concerned about the increase in the payments deficit.

8. What are the views of the Council with respect to the impact of monetary and credit policy under current conditions?

The Council believes that monetary and credit policy has had a favorable impact under current conditions. The reduction in reserve requirements on time deposits was desirable and well-timed. The Council believes the present degree of ease continues to be appropriate.

These two topics were discussed by the Board and the Council in combination.

With respect to the balance of payments, President Murphy made the observation that the average man on the street read the newspaper headlines but did not really understand the problem. On the other hand, more and more people were beginning to understand it, and those who did understand it regarded the problem very seriously. From the standpoint of foreign observers, this was an area requiring the best thinking that could be brought to bear in this country, particularly in view of the rather discouraging nature of recent balance of payments figures despite the efforts that had been made by the Government. The efforts being undertaken to increase exports were laudable, but it remained to be seen how quickly a solution to the problem would develop through this means.

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Mr. Hays expressed the view that the informed businessman was particularly concerned about the possibility of devaluation of the dollar and about the effects on his company of steps that might be taken by the Government to deal with the balance of payments problem, such as taxation on earnings abroad. Behind all this was the general concern about the effect of the continuing deficit on the value of the dollar and on the position of the United States in the world economy.

Chairman Martin noted that the problem faced by the Federal Reserve System at the present time was whether the prevailing degree of monetary ease continued to be appropriate or whether a shift should be made in the direction of greater or lesser ease. There were differing judgments within the System and within other parts of the Government. Some felt that the Federal Reserve had paid too much attention to the balance of payments in the formulation of monetary policy and not enough to the stimulation of the growth potential of the domestic economy or to reducing the level of unemployment. Others believed that the System had not paid enough attention to the balance of payments problem, that the level of interest rates was so low as to result in consistent pressure toward an outflow of capital. They concluded, in other words, that the availability of money was so great as to lead to a consistent outflow of funds. The question, then, was whether a moderately easier monetary policy would be likely to result in stimulating additional economic growth or whether the Federal Reserve was doing about all at present that could reasonably be

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done through monetary means; and there were those who felt the requirements of the balance of payments situation would be such over a period of time as to necessitate slightly less easier monetary conditions. If so, the question was whether that would retard the economy and lead to recessionary influences.

As to the financing of a Government deficit, Chairman Martin said it was his position that in large measure such a deficit should be financed out of savings. Here also, however, there were different schools of thought. There was some feeling that the country was over-saving and underinvesting. As to the tax problem, the Chairman suggested that the real concern was with incentives. As he saw it, planned deficits had failed in almost every instance when they had been used in an effort to galvanize the economy. In his view the only real basis for tax reduction at the present time was to provide additional incentives to the economy. There was a serious question, in his judgment, whether additional budget deficits--unless linked to the framework of incentives and properly financed--were going to provide the answers to this country's current problems. He was inclined to feel the same way with regard to easier money.

Mr. Zwiener commented that he did not know of any situations at the present time where deserving borrowers were being turned down, or where worthy borrowers were not coming to the banks because of a feeling that interest rates were too high. In his opinion the policy followed by the Federal Reserve had been exceptionally good. If there had been any

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error, he was inclined to think that the error had been in providing slightly too much monetary ease. It was his view that the domestic and international problems could not really be separated. Had there been a greater degree of ease, he did not think the economy would have been stimulated any more than it had been stimulated. The banks presently had money with which to work, and they were busy endeavoring to stir up loans. He was told by officers of corporations that they saw more bankers today with money to lend than in a long time. Lower rates might encourage speculative builders, but even with them he did not feel that the rate factor was too important.

President Murphy also cited the strong competition among banks for loans. At the last meeting of the Council and the Board, he had said that if the banks had more funds at their disposal they might find it difficult to use those funds, and he felt that his observation could be repeated today. He knew of no legitimate potential borrower who had not been able to obtain funds. There had been some softening of rates in the form of making more loans at the prime rate that ordinarily would be made at a somewhat higher rate. He also saw a tendency to upgrade customers, this being noticeable, for example, in the finance company field. He noted that the prime rate in this country was lower than comparable rates in other countries of the world, reflecting partly the requirement that compensating balances be maintained. However, this requirement had been eased somewhat, which also might be regarded as a tendency toward softening of rates.

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Mr. Hobbs expressed the view that the general public was oblivious to the balance of payments problem. Businessmen were apprehensive about the continued loss of gold, but that seemed to be about as far as their interest extended unless they were intimately associated with the export and import business. After referring to periods in the past when the prime rate and the Treasury bill rate were at particularly low levels, Mr. Hobbs made the observation that when interest rates were higher historically, business tended to be better. In his view the greatest contribution that monetary policy could make to economic growth would be to induce a stability of interest rates. He agreed with Messrs. Zweiner and Murphy that few people with legitimate borrowing needs were retarded in any way from borrowing at current interest rate levels. He had never seen a period when bankers were trying so hard to make loans.

Chairman Martin inquired whether members of the Council detected any lowering of lending standards in the real estate field, and some of the members of the Council expressed the view there had been a tendency in that direction. President Murphy noted that the banks had been through a period when real estate loans worked out well and were good income producers. This experience may have created a little too much confidence and complacency. In view of the strong desire of banks to make more real estate loans for income purposes to offset increasing costs, he thought there may have been some easing of lending standards, particularly in the case of loans to newcomers to the real estate field. Mr. Enders expressed the view that at present the underlying strength of the real

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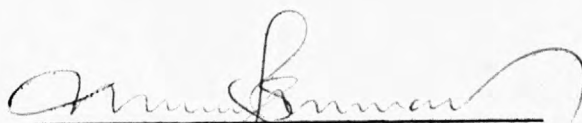
estate market was based on the availability of money rather than the demand factor. Easier money, he felt, would tend toward speculative lending. Mr. McAllister agreed, adding that money now appeared to be available to any borrower who was entitled to credit. Mr. Moorhead agreed with the view that there had been some lowering of lending standards. As reasons, he cited the long period of easy money and the intense competition among banks for loans.

Question was raised whether the members of the Council saw substantial risk in the mortgage loans held at their banks, and the replies were in the negative. The view was expressed that such a risk did not exist at the better managed banks throughout the country.

In a concluding comment, President Murphy said he did not think that any Council members saw danger in the current situation. It might be that in the past the banks had been too stringent in their lending practices. In order to serve their communities well, banks ought to be aggressive and meet the reasonable needs of their customers. For a good many years the banks may have been falling short of that point, but he did think that this reflected the attitude of commercial bankers today.

It was agreed that the next meeting of the Council would be held on February 18-19, 1963.

The meeting then adjourned.


Secretary