Minutes for **February 19, 1963**

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 Board Room of the Federal Reserve Building in Washington, D. C., on Tuesday, February 19, 1963, at 10:30 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Martin, Murphy, Petersen, Stoner, Hobbs, McRae, Zwiener, Maestre, Moorhead, Breidenthal, Aston, and McAllister, Members of the Federal Advisory Council from the First through the Twelfth Federal Reserve Districts

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

The following officers had been elected by the Federal Advisory Council for the year 1963:

President	George A. Murphy
Vice President	Robert B. Hobbs
Secretary	Herbert V. Prochnow
Assistant Secretary	William J. Korsvik

The following had been elected by the Federal Advisory Council as members of the Council's Executive Committee for the year 1963:

George A. Murphy, ex officio
Howard C. Petersen
Robert B. Hobbs, ex officio
J. Finley McRae
Kenneth V. Zwiener

This being the first meeting of the Board and the Council in 1963, Chairman Martin welcomed the new members of the Council (Messrs. Martin, Stoner, and Aston) and expressed appreciation on behalf of the Board for the work done by the Council. In doing so, he referred particularly to those persons who had served as President of the Council during his tenure as a member of the Board of Governors and also noted the service rendered over a period of time by Messrs. Prochnow and Korsvik as Secretary and Assistant Secretary, respectively, of the Council.

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

1. What are the observations of the Council regarding (a) recent domestic economic developments, and (b) the business outlook for the first half of 1963 and the year as a whole? (c) Do the members of the Council believe that the improvement in business psychology reported at the November meeting with the Board has strengthened further since that time, remained about the same, or receded?

(a) Recent domestic economic developments indicate a continuation of the mixed trends that have prevailed the past several months. While the spending behavior of consumers, as evidenced by retail sales and in particular by the volume of new model automobiles sold, has been encouraging, the decline in new orders for durable goods, the failure of industrial production to rise, and the uncertainty created by the Budget Message, together with the discussion of a possible tax cut, have clouded the immediate outlook.

(b) Despite these imponderables, however, the Council anticipates that business in the first half of 1963 will continue to show the moderate improvement that characterized the last six months of 1962. The outlook for the last half of 1963 is less certain.

(c) The Council believes that the improvement in business psychology reported at the November meeting has receded somewhat since that time. Developments in Europe, Canada, and Cuba, together with the problems associated with the balance of payments, budget deficits, and especially the proposed tax legislation, have lessened the favorable sentiment in the business community.

In comments supplementing the statement by the Council, President Murphy noted that the various yardsticks of business activity looked quite good at the present time. He thought it could be said that the typical businessman was cautiously optimistic. Seldom, however, had he seen a time when there were more questions in the businessman's mind. There was confusion with regard to the Cuban situation, and the French veto of British entry into the European Common Market was a matter of concern to businessmen doing an international business. Many companies had been set to move forward with expansion or new installations in Great Britain to cover the Common Market area, but those plans were now being held in abeyance. In addition, there had developed a series of misunderstandings between the Government and the business community, with the result that the typical businessman had become unusually concerned about political factors and their potential impact on the economic picture.

There followed a series of comments by the other members of the Council with regard to developments in their respective districts. While there were minor variations in the reports from district to district, in general the comments reflected an opinion that business conditions were currently quite good, with an expectation that this situation would continue to prevail at least through the first half of 1963. Among the favorable factors cited by members of the Council were the volume of retail trade, including automobile sales, the comparatively low levels of inventories, corporate profits, and agricultural conditions. At the same time, business psychology was judged to be affected adversely by numerous uncertainties in both the domestic and international areas. Items referred to frequently as being of an unsettling or troublesome nature were the developments in connection with the current tax proposals, rejection of the British bid for entry into the Common Market, pending or prospective wage negotiations, particularly in light of the terms of the recent dock strike settlement, and the trend of relationships between the Government and private business. The recent statement by the President putting the need for a tax cut in terms of forestalling a possible recession was said to have been surprising and disconcerting. Against this background, it was suggested that business optimism tended to be more restrained than might otherwise be the case.

Question was raised as to the general reaction to the Administration's program of tax reduction and reform, in reply to which President Murphy stated that the reaction was one of disappointment. The average businessman was worried about the continued unbalanced Federal budget and the further deficit that the proposed tax reduction program would create. The businessman had hoped for tax reduction in areas that would tend to promote additional capital spending, but he did not find that incentive in the current proposals. Analysis indicated that these proposals would take a substantial group of people off the tax rolls and reduce the tax obligations of another sizable group. However, when it came to the middle income class, no substantial improvement was seen. There was almost a feeling that the benefits would be so modest as to cast doubt on whether the whole program was worth pushing. As far as corporate taxes were concerned, the improvements were regarded as modest, but to the good. There appeared to be a great deal of concern with respect to the provisions of the tax program that would in effect place a 5 per cent floor under itemized deductions, it being felt that this would have severe repercussions on the financing of private charitable and educational institutions.

Inquiry was made as to whether it seemed to be the judgment of the business community that the tax bill was not of an incentive nature, and there appeared to be unanimous concurrence by members of the Council in a comment by President Murphy to the effect that an adverse reaction was almost universal. Remarks by individual members of the Council centered generally around the view that the current tax program, if enacted, would be unsuccessful in removing disincentives in the present tax structure in such manner as to promote better business psychology, encourage greater productivity, and lead to more business investment. It was felt that the tax program would not provide immediate stimulation to the economy, the advantages contained therein being projected too far into the future. The view also was expressed that the resulting budget deficits, at least in the near run, might run the risk of criticism by foreigners on the ground of fiscal irresponsibility.

Asked whether it could be inferred from the foregoing remarks that the tax proposals were believed to constitute a psychological deterrent from the standpoint of the business community, President Murphy indicated that this was the widespread reaction. Businessmen were almost unanimously disappointed. Although it was recognized the tax program provided distinct improvement in some respects, the general sentiment with regard to the program was not good.

In reply to a question concerning the reaction from the budget standpoint, President Murphy commented that the average businessman was accustomed to operating within his budget. This was sometimes difficult, but there were penalties involved if this principle was not observed. To the typical businessman there was not much difference between the principles that must be observed by his company and the principles that should be observed by the Government. There was believed to be a general feeling on the part of businessmen throughout the country that a better job should be done with the Federal budget.

There followed comments by other members of the Council along the same lines, and the discussion of this topic concluded with remarks by President Murphy on the implications of the Cuban problem from the standpoint of hemispheric vulnerability to Communistic infiltration and the substantial financial burden that might be involved for the United States over a period of time.

2. In the opinion of the Council, what factors in the current economic picture suggest the most strength or encouragement? Conversely, what factors appear to be of greatest concern?

In the opinion of the Council, the persistent strength of consumer buying is a major source of encouragement in the current economic picture. This factor and the absence of growth in inventories suggest that new orders and production will probably rise, resulting in some improvement in employment, income, and over-all economic activity. A build-up of inventories by steel users in anticipation of a strike could also contribute to a rise in business in the months immediately ahead.

Excess productive capacity, the lack of vigor in capital expenditures, the relatively high level of unemployment, and recent developments in labor negotiations, such as the newspaper strikes and the departure from the guidelines in the dock strike settlement, are currently matters of economic concern.

It was noted that the foregoing questions had been dealt with rather fully in connection with the discussion of the preceding topic. In reply to a question as to whether it seemed likely that there would be economic distortions within the current calendar year due to anticipation of a steel strike, Mr. Zwiener commented that until the terms of settlement of the dock strike were announced the steel industry had seemed relatively confident. Now, however, the outlook appeared somewhat more ominous. Discussion following the publication of the General Motors financial report for 1962 also portended an element of unrest that was not previously in the picture. Further, the recent announcement by the same firm of its intention to build inventories substantially during the next few months suggested some resultant adverse effect during the second half of the year.

3. What are the prospects for loan demand at banks during the next several months, including demand in various loan categories? Is the liquidity of the banking system considered ample to accommodate the present and foreseeable volume of credit demands?

The members of the Council anticipate a moderate increase in loan demand during the next several months. Some increase in loans is likely to occur in the durable goods sector, especially if steel users add to their inventories because of the possible reopening of the steel labor contract. The members of the Council believe that the liquidity of the banking system is adequate to accommodate the present and foreseeable volume of credit demands.

In comments supplementing the Council's statement, President Murphy noted that the volume of loans was reasonably high at present but that the banking system had been able to take care of credit demands without difficulty. In fact, competition for loans was intense, especially in the area of construction loans and mortgages. In that area there had been some signs of softening of rates, reflecting the competition attendant upon the effort of the banking industry to put available money to work. Liquidity yardsticks suggested that the banking system was in a fairly comfortable position and that it should be able to take care of any foreseeable increase in loan demand. Loan-deposit ratios of New York City banks at present were slightly under 60 per cent, while across the country the average was about 57 per cent, these figures reflecting no substantial change over the past several years. In the Second District it was being estimated that loan volume would step up somewhat in the period until the end of June; prospects beyond that date were not clear.

Comments by other members of the Council were generally along the same lines. Mr. Hobbs foresaw no appreciable change in loan demand in the Fifth District, although it seemed likely that any change would be on the up side rather than otherwise. Mr. McAllister commented that his view regarding the ability of West Coast banks to take care of prospective loan demand was based on an assumption that approximately the same monetary policy as now prevailed would be continued. Mr. Petersen noted that a significant longer run problem involved the ability to retain in the banking system the present volume of time deposits.

There followed a discussion emanating from a question regarding the status of the secondary market for negotiable certificates of deposit. Comments by some members of the Council suggested improvement in the secondary market for certificates issued by banks outside New York City. In this connection, it was noted that the most recent figures showed the volume of outstanding certificates issued by New York City banks to be about $2.2 billion, with a rough estimate that there might be outstanding around $4 billion of such certificates issued by other banks. Inquiry was made whether it might be reasonable to suppose that one-third of the certificates that were issued subsequently appeared in the secondary market, and a view was expressed that this percentage might be on the high side. President Murphy observed that there appeared to be a tendency on the part of corporate treasurers to place in negotiable certificates funds for which there was no foreseeable need for periods of, say, six to nine months. He felt that in these circumstances the certificates usually would not be sold, although occasionally corporations might sell a certificate and use the proceeds to buy another certificate at a higher interest rate. Mr. Hobbs mentioned that his bank had recently purchased a quantity of certificates for its portfolio, having found that a better yield was available than on Treasury bills. These certificates were purchased in the secondary market, it was brought out; banks were not known to have issued certificates to other banks.

4. Does the Council detect any symptoms of deterioration in lending standards, particularly in the field of real estate credit?

The Council has observed some deterioration in lending standards, particularly in the field of real estate credit. There has also been some pressure to lengthen the maturities of term loans. However, lending standards generally are consistent with sound banking practices.

During a general discussion of this subject, in which all of the members of the Council participated, some of the members expressed the view that a deterioration of lending standards had occurred. This was traceable, they suggested, to factors such as the intense competition for loans, the continuation over an extended period of time of a relatively easy monetary policy, and the necessity to provide for interest payments on a large volume of time money. Other members of the Council were less disposed to use the word deterioration. They conceded that in response to changing conditions there had been changes in lending practices, which might be spoken of as in the area of liberalization. At the same time it was contended that there had been offsetting factors, such as the introduction of more scientific management of loan portfolios, and that the modifications in lending practices had in numerous instances contributed to meeting community needs in a manner that reflected credit on the banking system. It was contended that liberalization of credit terms, by lengthening of maturities for example, did not necessarily mean a lowering of quality standards. While there were scattered references to the possibility of imprudent lending practices at smaller banks in an effort to improve earnings, and also to the longer run import of trends that might be developing, it was the general sentiment that such changes as had occurred to date in lending practices had not created a problem of substantial concern at this time.

In the course of the discussion, President Murphy referred to the recent approval of a rather substantial number of new banking offices in one part of the Second District and the tendency toward extension of less sound credits that might result from an overbanked situation.

Reference was made by a member of the Board to expressions of concern about a deterioration of consumer loan standards, particularly in the case of auto loans, that had been made by a group of consumer bankers who recently visited the Board's offices. The comments made in response indicated that in some scattered instances auto loans of 42-month maturity were beginning to be offered. This development was regarded as rather disturbing. In general, however, it was not felt that the consumer loan situation presented problems of particular concern at present from the standpoint of the commercial banking system. It was noted that the volume of consumer loans outstanding did not appear unreasonably high in relation to the level of personal income.

Question was also raised whether concern was felt about the continuing rise in the level of farm land prices. Mr. Breidenthal indicated that he sensed considerable concern about this trend. He noted, however, that in the Tenth District this trend was particularly noticeable in the case of irrigated land. Mr. Aston observed that in the Eleventh District prices had risen most where the land was located close to the larger cities. At some point, he suggested, the rate of return available from such land should tend to bring the price to a plateau. Mr. Zwiener brought out that the small farmer could not afford to mechanize to the extent he desired. Therefore, he was willing to pay a high price for additional land so as to increase his acreage to the point that such mechanization would be economically feasible. Mr. Moorhead commented that the large farmer was at present prosperous, whereas the small farmer was gradually disappearing from the scene. The large farmer was willing to pay a relatively high cost per acre for additional land; he would be able to obtain a reasonable rate of return whereas the small farmer could not.

5. (a) The Board would appreciate comments with respect to developments in the area of time and savings deposits, including the trend of such deposits, the cost burden of higher interest rate levels, and whether the uses made by banks of funds represented by such deposits have been consistent with accepted standards of bank liquidity and asset quality.
(b) Does the Council believe that competitive abuses are likely to arise from the rapidly expanding use of negotiable corporate certificates of deposit or that unsound banking conditions might arise from widespread reliance on deposits of this type? How would the Council regard an increase to 3-1/2 per cent in the maximum permissible interest rate payable under Regulation Q on time deposits having a maturity of less than six months?

(a) Although time and savings deposits continue to expand, the rate of increase has slowed considerably and is substantially less than it was a year ago. Furthermore, because of shifts in the distribution of bank assets that were effected last year, the squeeze on bank profits currently is less than it was a year ago. Accordingly, the pressure to extend maturities and to buy higher yielding assets has lessened somewhat. As the Council has observed, there has been some liberalization in credit standards, but in general the lending and investment policies have been consistent with accepted standards of bank liquidity and asset quality.

(b) The Council does not believe that significant competitive abuses have arisen from the rapidly expanding use of negotiable corporate certificates of deposit or that unsound banking conditions have arisen from widespread reliance on deposits of this type. However, the growth of negotiable corporate certificates of deposit has resulted in important shifts in the types of bank assets. A continuing expansion in the use of these certificates of deposit will tend to lessen the liquidity of the banking system because of the pressure to use these funds profitably.

The Council believes that bankers generally would not presently favor an increase to 3-1/2 per cent in the maximum permissible interest rate payable under Regulation Q on time deposits having a maturity of less than six months.

President Murphy noted that there was some difference of opinion within the Council with regard to the desirability of an increase to 3-1/2 per cent in the maximum interest rate payable on time deposits having a maturity of less than six months. Some members would like to see the regulation of interest rates on time deposits eliminated entirely, but the majority would not. As to the banking fraternity as a whole, he thought it safe to say that a large majority of bankers would favor the retention of Regulation Q and retention of the present maximum permissible rates.

President Murphy referred, in this connection, to the developments that had occurred after the maximum rates were adjusted to their present levels. There was a general tendency to go to the new ceiling rates immediately, and that could occur again. If the restrictions were eliminated entirely, he was inclined to feel that the banks might proceed somewhat more cautiously. In respect to negotiable certificates of deposit, he noted that the issuing banks had spread out the maturities fairly scientifically. At his bank there were fairly even maturities over a period of months, with a scale of rates designed to produce this result. If there should be a relaxation of maximum rates in the short-term time deposit area to the extent suggested by the Board's question, conceivably the end result could be a concentration of time money on a very short-term basis.

Mr. Petersen observed that the action of the banking system following the relaxation of Regulation Q rates had tended to increase bank demand for mortgages and longer-term investments, and also to assist in the maintenance of short-term rates. From this standpoint, he judged that the Board should have been pleased with what had developed. As to a possible further relaxation of

Regulation Q, Mr. Petersen said he was one of those who felt that it would be preferable if the maximum rate limitations were eliminated. This view, he added, was not in accord with the view of most bankers in the Third District. Basically, the majority of bankers wanted to be protected against the foolishness of the fellow across the street, particularly where a large proportion of bank assets was represented by savings funds. Turning to the discussion that had taken place during the past several months regarding the consequences of the movement to a 4 per cent maximum rate, Mr. Petersen noted that it had developed that the earnings of banks, at least the larger banks, were good in 1962. In his opinion, the principles involved in the question now presented by the Board were essentially the same as those that had been involved earlier in deciding whether to increase the maximum rates to their present levels. The question of protectionism again was involved.

Mr. Zwiener said he supposed an overwhelming majority of the bankers in the Seventh District would say that they did not want the present ceilings changed. However, he also supposed that those bankers issuing negotiable certificates of deposit would like to have enough flexibility to protect their position in the event of a further increase in the Treasury bill rate. Generally speaking, the banks operating in the money market probably would prefer to see Regulation Q provide such a wide range of latitude as to minimize the temptation for everyone to go to the maximum. He doubted that bankers would move quickly to a rate of 3-1/2 per cent on time deposits under six months. In summary, the money market banks probably would favor the suggested change while other banks probably would be opposed to it.

Mr. McAllister expressed the view that most bankers in the Twelfth District would be opposed to the suggested change. Corporate treasurers might be tempted to take more of their demand money and seek to put it into time deposits of short maturity at rates up to 3-1/2 per cent. This would amount to a step in the direction of paying interest on demand deposits.

Mr. Maestre expressed the view that the suggested change would be a mistake at this time. He asked how far banks could go in taking short-term money and lending on a long-term basis in order to make a profit.

After Mr. McRae had expressed himself adversely with respect to the suggested change, a member of the Council asked for background information and inquired whether there was pressure for such a move. Chairman Martin replied that there was no great pressure at the moment; the question had been raised for the purpose of discussion. In general, the principles involved were much the same as those involved in consideration of the most recent increase in Regulation Q maximum rates. Somewhat more specifically, however, there was the tie-in with the balance of payments problem and the effect on that problem of the movement of short-term funds. The Chairman added that personally he did not look with too much favor on the separation of domestic and foreign time deposits from the standpoint of interest rate limitations.

As the discussion continued, Mr. Stoner remarked that he would not like to see the suggested change made, although at present there appeared to be an element of inconsistency. He added that banks in part of the Fourth District had retained a maximum rate of 3 per cent on savings deposits, yet showed a good gain in such deposits.

Mr. Hobbs said he was one of those who favored the elimination of all restrictions. He inquired whether in actuality the Board's suggestion was not directed at time deposits with maturities from 90 to 180 days, and response was made to the effect that the question had not been phrased in precise terms.

Mr. Aston indicated that he would not favor the suggested change at this time, although his view might be different in the event of an upward movement in the general structure of interest rates. He felt that the banking system was able to live satisfactorily at present under the existing provisions of Regulation Q and that adoption of a change such as suggested would get closer to the point of paying interest on demand deposits. If the change were made, he was apprehensive of a repetition of developments such as occurred when Regulation Q was last revised. This might have serious implications because he did not know how, given the present rate structure, banks could use more short-term deposits and break even on them. Some banks might get hurt.

Mr. Moorhead expressed himself in favor of the suggested change. The banks had created a new money market instrument that was now important in the deposit picture. Within this setting, he felt that any restrictive ceiling on rates was dangerous, more so than borrowing short and lending long. He would feel more secure if there was fairly good assurance that the banks would be able to keep the deposits they had gained.

President Murphy indicated that he would be more in favor of eliminating all limitations on the payment of interest on time deposits than increasing the maximum rate on short-term time certificates. If the latter course were followed, he was fearful of a mass movement to the new maximum rate. In this connection, he referred to the repeal of the rate limitation on certain classes of foreign time deposits and expressed the view that the situation had been working out well, with the banks bidding for the foreign funds as needed. If the rate limitations on all time deposits were eliminated, he would hope for a similar approach.

Inquiry was made as to whether the Board had authority to eliminate maximum rates on time deposits, and the answer was in the negative. Chairman Martin noted that there was some feeling that it would be permissible under the statute to fix a maximum rate so high as not to represent any real restriction. On the other hand, there was also some feeling that this would violate the spirit of the law.

The discussion of this topic concluded with comments by President Murphy on certain longer run projections indicating a substantial further increase in the aggregate of savings funds held at commercial banks, mutual savings banks, and savings and loan associations. There was also a brief discussion of the possible effects on competition for savings funds if the insurance of deposits and of share accounts should be increased beyond the present maximum figure.

6. Has the Council noted any tendency toward heightened concern on the part of the business and financial community with respect to U. S. balance of payments developments? Are the difficult negotiations going on within the European Economic Community a factor to be taken into account and a subject of concern to bank customers?

The Council has noticed increasing concern on the part of the business and financial community with respect to the U. S. balance of payments. Customers who have international investment and/or trade interests are particularly concerned not only with balance of payments developments, but also with the difficult negotiations going on within the European Economic Community.

The discussion began with comments by some members of the Council to the effect that the balance of payments problem was becoming increasingly a matter of concern to businessmen and a topic of general conversation. This did not mean, however, that all those who were becoming more familiar with the terminology of the balance of payments understood the full implications of the problem or the measures that might be required to cope with it.

Mr. Martin suggested that the prospect of a heavily unbalanced budget was an unfavorable psychological factor. While the average businessman was becoming more familiar with the language of the balance of payments, his understanding of developments was limited. There seemed to be a feeling of concern about the fact that foreign countries were being importuned to make advanced debt repayments to the United States; such prepayments seemed to represent a borrowing against the future. In general, the businessman felt that the current business situation was quite favorable, with good profits being recorded, but he foresaw constantly increasing pressure for taxes to cover domestic and world-wide Governmental programs, all of which would enable the Government to bring more and more areas of the economy under its control. Feelings of uncertainty and anxiety were being created.

Chairman Martin commented at this point that the discussion was now beginning to touch upon a problem of much concern to the Board; namely, whether the domestic economy would be stimulated by a further easing of money. The related question involved the extent to which the balance of payments was affected by interest rate differentials. The problem went to both the cost and the availability of money. If an effort was made to reduce interest rates by one-half per cent, for example, the availability of money would have to be increased substantially. This in turn involved the problem of interest rate relationships internationally. As he had said on a number of occasions, it was his view that the domestic and international problems could not be separated.

President Murphy expressed the view that if money should be made substantially easier, the Council would be likely to report a deterioration of lending standards at its next meeting with the Board, because the banks would be under real pressure to put the additional funds to work. The Council members saw no evidence that legitimate demands for credit were going unsatisfied. The banks were trying hard to find ways to make loans. If more funds were available, he found it difficult to foresee how they would be used.

President Murphy noted that United States banks doing an international business were making more and more commitments abroad, indicating that their reserve positions were not uncomfortable. The foreign commitments that he knew about were sound, but he did not know how far the banking system should go in that direction. Part of this foreign lending reflected interest rate differentials; foreign companies could come into the U. S. market and borrow at rates that were attractive by standards in their own countries. If money were eased further, he felt that the banking community might be forced into doing some things that the best judgment of bankers would lead them to question. He felt confident that the balance of payments would be affected adversely.

Chairman Martin then commented that although loan demand had been quite good during the past year, the conventionally-defined money supply had begun to contract again recently. Business activity appeared quite good. However, there were those who maintained that the Federal Reserve had been following too restrictive a monetary policy because of the failure of the money supply to increase more rapidly.

The members of the Council having indicated that they did not agree, Chairman Martin turned to the substantial growth of time and savings deposits over the past year and raised the question whether there was agreement with his conclusion that a substantial portion of such deposits might be regarded as virtually the equivalent of demand deposits.

President Murphy expressed the view that much of the increase in time deposits represented money that had come out of the bill market and the commercial paper market. Today's corporate treasurer was a sophisticated businessman who knew to the dollar how much money needed to be kept on demand deposit. Even in the absence of the increase in time deposits, President Murphy felt that the demand deposit picture would have been roughly the same because the corporate treasurers would have found other avenues of investment for their funds.

Mr. Aston observed that reference frequently was made to a so-called hard core of time and savings money. In his judgment, however, there was no hard core of negotiable certificates of deposit. As he saw it, they reflected purely a switch in form of investment for the purpose of seeking a rate of interest. He went on to say that in the Eleventh District time and savings deposits traditionally had been low in relation to demand deposits until recently. He felt that a large proportion of the recent increase in such deposits actually represented investment money rather than what might be called true savings. In his opinion, under certain conditions the negotiable certificates of deposit might dry up as fast as maturities occurred, with greater activity in the secondary market as more favorable rates became available from other forms of investment. This money, he thought, would be available to the banking system only as long as the rate was favorable in comparison with the return from other forms of investment.

In further discussion, Mr. Petersen referred to balance of payments developments and pointed out that around the middle of 1962 official statements and estimates had given rise to a considerable degree of optimism. However, when the figures for the third quarter became available, the situation was seen to have deteriorated and the feeling of optimism was replaced by one of disappointment. The Canadian dollar crisis admittedly had introduced an extraordinary factor into the picture, but he felt there may have been a tendency for official statements to go too far in the direction of suggesting that the problem was moving toward a solution. This made it all the more disconcerting when statistics released later showed that the trend was not favorable.

Mr. Breidenthal addressed himself to the question whether some portion of time and savings deposits should not be considered as part of the money supply. He had always felt that a part of such deposits should be included, although he was not prepared to say what percentage would be appropriate. There were economists who would say that commercial banks should not hold time and savings deposits, that they did not add anything to the money supply. Nevertheless, looking at the recent trend of demand deposits as compared with the growth of time deposits, it was his view that some portion of the latter could reasonably be included.

Governor Balderston pointed out that prior to the change in Regulation Q time and savings deposits had been growing at an annual rate of about 12 per cent. Subsequently, they had grown at an annual rate of 18 per cent, reflecting in part the issuance of negotiable certificates of deposit. Having in mind Mr. Aston's comments, he wondered how much of the increment could justifiably be thought of as part of the money supply.

President Murphy expressed the view that this type of money might be considered fairly secure if the banks had the necessary rate flexibility. It had been said by some that time deposits of foreign central banks could not be counted upon because they would shift according to rate differentials. Now that the interest rate limitation on such deposits had been removed, however, he felt rather confident that this money was more secure. By the same token, he felt a little more complacent about the negotiable certificates than some of the other members of the Council, since corporations should continue to be in a fairly liquid position for the foreseeable future. If the banks had leeway to compete ratewise, they should be able to retain these funds. In 1962, he noted, the banks enjoyed their second best year in history from the standpoint of earnings, showing that the funds obtained by offering higher rates of interest had been put to work. He continued to feel that the savings dollar held in a bank was worth more to the community than the savings dollar held in other financial institutions. Therefore, he concluded that recent developments had been constructive.

Chairman Martin then presented a hypothetical question involving the possibility of an international payments crisis and inquired whether it was felt by the Council that an increase in the discount rate would be effective in such circumstances. If one argued that capital movements were not affected substantially by interest rate differentials, one might also argue that an increase in the discount rate at such a time would have little effect.

In the discussion that ensued, President Murphy suggested that the problem seemed to boil down largely to a question of confidence. As exemplified by the experience after World War II, people were not likely to transfer money to a country unless they thought it would be safe. If foreigners were to lose confidence in the fiscal responsibility of the United

States, he doubted whether this could be corrected simply by an increase in the discount rate.

Mr. Petersen expressed a somewhat different view, saying that it seemed evident that short-term capital, at least, was influenced by interest rate differentials. In a situation such as suggested, it seemed to him that it would be logical to use indirect controls first and see whether they were effective. Before turning to alternatives such as exchange controls, it would appear reasonable to try to curb claims against the dollar by endeavoring to make it attractive on a rate basis to transfer funds to this country.

Chairman Martin noted the results of increasing the British Bank Rate and suggested it seemed to have had an impact from the standpoint of improving confidence in the pound sterling.

President Murphy agreed, adding that his previous remarks had been directed more toward developments that might ensue as the result of skepticism about the ability of this country to keep its financial house in order. In an actual crisis, the natural move would be to attempt to deal with it by an increase in the discount rate. He hoped that such a step would be effective, although he entertained some doubt.

7. The Board would appreciate the Council's comments on effects observed thus far from the depreciation and tax credit provisions adopted in 1962.

With the exception of certain industries, the Council has observed few effects that it would attribute to the depreciation and tax credit provisions adopted in 1962.

The Council's statement was noted, and there was no substantive discussion of this topic.

8. What are the Council's views regarding the impact of monetary and credit policy under current conditions?

The Council believes that current monetary and credit policy has had a generally favorable impact on the economy. This policy has been a constructive factor in the domestic economy and at the same time has been helpful to the balance of payments.

This topic having been covered quite fully in previous discussion, there were no further comments at this point.

Having been invited by the Board to comment on the proposed Regulation M, Foreign Branches of National Banks, which had been published in the Federal Register as a notice of proposed rule making, the Council presented the following statement:

The Council favors the revision of Regulation M intended to carry out the purposes of P. L. 87-588, "To improve the usefulness of national bank branches in foreign countries." In considering the Board's proposed revision, members of the Council have reviewed the comments of certain national banks with branches abroad. The Council believes that their suggestions merit consideration by the Board.

Three of the members of the Council indicated that certain national banks in their respective districts were of the opinion that the proposed regulation did not go far enough in the direction of providing latitude for foreign branch operations. Their attitude toward the points made by those banks was generally sympathetic. They understood that the banks were communicating with the Board.

It was understood that the next meeting of the Federal Advisory Council would be held May 20-21, 1963.

The meeting then adjourned.

Secretary