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Minutes for May 21, 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 offices of the Board of Governors in Washington on Tuesday, May 21, 1963, 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. Spencer, General Assistant, Office of the Secretary

Messrs. Murphy, Stoner, Hobbs, McRae, Zwiener, Moorhead, Breidenthal, and McAllister, Members of the Federal Advisory Council from the Second, Fourth, Fifth, Sixth, Seventh, Ninth, Tenth, and Twelfth Federal Reserve Districts, respectively

Mr. Geoffrey S. Smith, Chairman of the Board, Girard Trust Corn Exchange Bank, Philadelphia, Pennsylvania
Mr. John Fox, President, Mercantile Trust Company, St. Louis, Missouri
Mr. I. F. Betts, President, American National Bank of Beaumont, Beaumont, Texas

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

In the absence of Messrs. Petersen, Maestre, and Aston, Members of the Federal Advisory Council from the Third, Eighth, and Eleventh Districts, respectively, Messrs. Smith, Fox, and Betts represented those Districts at this meeting. In the absence of Mr. Martin, Member of the Council from the First District, that District was not represented.

Before this meeting there had been distributed a memorandum listing the topics that had been 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. How do the members of the Council appraise current business developments and economic prospects for the remainder of the year? What factors are most important in influencing the Council's judgment about the economic outlook? Does the Council anticipate a substantial reduction in unemployment in the near-term future?

Business is generally good and the improvement since the last meeting of the Council has been widespread. Retail sales and the purchase of new automobiles indicate a continued high volume of consumer buying. Orders for machine tools, and durable goods in general, suggest some further increase in business investment. The members of the Council believe that the economic prospects for the remainder of the year point to a continuation of the present moderately rising trend in business activity.

In the Council's opinion, the most important factors in the economic outlook are the expansion in consumer buying, business investment, and government spending. The accumulation of inventories in anticipation of an interruption in steel production also is contributing to the current level of business activity. The liquidation of these inventories later in the year, however, may offset to some extent the rising trend of business.

The Council does not anticipate a sufficiently sharp rise in business activity to result in a substantial reduction in unemployment in the near future.

President Murphy reported a unanimous impression on the part of the members of the Council that business was good and that the degree of optimism had strengthened. The possibility of a tax reduction, about which there had been a great deal of discussion when the Council last met, was still discussed actively in business circles.

It was believed, however, that this would be a good year regardless of the outcome of the proposed tax legislation. While there was little indication of an economic boom, the Council considered the economy solidly based, with the upward trend likely to continue at a gradually accelerating pace.

Question was raised with respect to inventory accumulation, and the Council noted the apparent extent of accumulation of steel inventories in anticipation of a possible interruption of steel production. Even here, however, the increased pace of manufacturing activity, as for example in the automobile industry, appeared to provide an offsetting influence. Aside from the steel situation, the Council saw little evidence of excessive inventory accumulation, particularly in relation to new orders and shipments of durable goods manufacturers. In fact, inventories seemed somewhat on the low side, affording a plus factor. In total, the inventory situation was felt to add up to a rather favorable picture.

2. In the Council's opinion, should the scattered price increases reported in recent weeks be regarded as forerunners of a broad upward movement in commodity prices and wages, or are they more in the nature of selective adjustments to changing demand and supply relationships? Reports of significant instances of price decreases or cost reductions would be of interest to the Board.

The Council believes that the scattered price increases reported in recent weeks could be the forerunner of a somewhat broader upward movement in commodity prices and wages. However, the competitive pressures resulting from unused domestic capacity, as well as from manufacturers abroad, will tend to be sufficient to discourage broad price rises in the relatively near future. Members of the Council reported some instances of price reductions, particularly in the chemical industry.

President Murphy said the Council felt that prices were generally stable. The wholesale price index seemed to be at about the 1957-1959 level; prices of sensitive raw materials appeared to be almost at the lowest point in the past five years; and consumer prices continued to inch upward a little. As indicated in its statement, however, the Council was uncertain as to the full effect of the recent steel price adjustments. These adjustments might sift through and cause a modest rise in price levels of affected products, but probably not enough to qualify as inflationary. Much was dependent on the course of events in the steel industry. If labor were to strike, the ensuing wage settlement might absorb the increased price benefits the steel companies were now experiencing, resulting in a situation that might afford an invitation for a further rise in steel prices. This possibility was viewed with concern by the Council, which felt that there was a delicate balance in prices at the moment.

In response to a question, President Murphy said he saw no great harm in price increases so long as they were in reasonable proportions. American industry should be entitled to make a fair profit. Competition from abroad, however, was a force that American manufacturers were having to deal with increasingly, and it would help to hold prices of American products in line. This situation was exemplified by the competition from foreign steel, which militated against further price increases in that area, but foreign competition was becoming an increasingly important factor for many American industries, including the chemical industry and the electrical field, with the competition of goods from Japan and Germany particularly severe. Little comfort could be taken from the fact that labor costs abroad had been increasing, for it was not known whether this trend would continue.

There followed comments concerning the evidence of keen price competition among U. S. companies, as in steel, reinforced by the pressure of competition from foreign companies. Question was raised as to evidence of "dumping" by foreign steel companies, and it was pointed out that proof of such practices was difficult.

Mr. McAllister called attention to the fact that the existence of unused capacity was a key factor limiting domestic price increases, as suggested by the second sentence of the Council's statement. Such unused capacity existed in practically every important industry.

There was general agreement with Mr. McAllister's comments, although the comment was made that much of the unused capacity was relatively inefficient because it was accounted for by obsolete plants. The discussion of this topic concluded with reports of certain substantial expenditures for new and improved facilities, even in the face of unused capacity, in order to remain competitive in domestic and world markets.

3. Has the Council observed a general movement toward increased business investment in plant and equipment? If so, do the increases seem likely to result in greater actual spending for such purposes this year than indicated by recent surveys? Are the tax credit and liberalized depreciation rules, made effective in 1962, now regarded in business and

financial circles as more stimulative to investment in plant and equipment than was thought earlier?

While there is some evidence of individual upward adjustments in business investment plans, the Council is reluctant to interpret it as a general movement toward a significant expansion of this type of spending. However, business investment in plant and equipment may be moderately above that indicated by recent surveys.

The Council believes that a growing number in business and financial circles now regard the tax credit and liberalized depreciation rules as more of a stimulant to investment in plant and equipment in certain industries than was thought earlier.

Comments in supplementation of the Council's statement emphasized the view that the tax credit and liberalized depreciation rules were proving more stimulative than had originally been envisaged. The Council had not endeavored to distinguish in its discussion between the effect of the one and of the other, but presumably the emphasis varied according to different situations. In any event, some current surveys projected a substantial increase in plant and equipment expenditures, and it might be that the tax credit and liberalized depreciation rules were entitled to considerable credit.

4. Does the Council now regard early tax reduction as essential to sustained business expansion this year?

The Council does not regard early tax reduction as essential to sustained business expansion this year, but a reduction in the tax burden is essential to the longer-term growth of the economy.

Commenting upon the Council's statement, President Murphy indicated there was some difference of opinion within the Council as to whether there should be a tax reduction without a reduction in Federal expenditures. He felt, however, that the majority of the Council saw a need for tax reduction. In his own thinking, it was needed to oil the economy. More jobs could be created and more income could be provided, which would eventually mean more revenue for the Government.

President Murphy went on to say that there was disappointment in the business community over the extensive debate that had taken place with respect to the proposed tax legislation. The average businessman had now discounted the possibility of a tax reduction this year. Nevertheless, business was good: the base seemed to be solid enough, and the economy seemed to be moving in the right direction. It was difficult to see how 1963 could be anything but a good year, even without the benefit of a tax reduction. The Council had also discussed the question of the effect on business sentiment if Congress failed to enact some form of tax legislation. It was the view of the Council that, if there were no legislation in this area after all the debate in Congress, the psychological impact would be adverse. This would be reflected in business sentiment.

During the discussion that followed, other members of the Council concurred in the view that there had been a certain psychological buildup that would turn into a letdown because of the disappointment that would result in the event no tax legislation were enacted this year. Anticipation of a tax cut had already provided a definite stimulus, and it seemed rather doubtful that actual tax legislation could accomplish a great deal as far as the economy was concerned in 1963. On the other hand, passage this year of satisfactory tax legislation should have a real influence on the course of business in 1964.

Two Council members reported that a number of persons with whom they had talked believed that a tax cut would be undesirable unless accompanied by some corresponding reduction in Government expenditures. One of these members felt that this probably reflected the point of view of a rather strong segment of the business population in his area. One also stated, however, that personally he would be agreeable to risking a tax reduction without a corresponding reduction in expenditures if the tax cut could be worked out in such a way as to provide substantial added incentives.

President Murphy observed that for many individuals the underlying desire for improvement in the tax setup and the appropriate timing for such action was tempered by other thoughts. The average American was quite confused by all that he read and heard concerning the balance of payments problem. He understood the principle of a balanced budget, however, and he reasoned that the Federal budget position would be worsened at least immediately by a reduction in taxes. It was difficult for him to look ahead and see a corrective effect: what he saw in prospect was a larger budget deficit, which he naturally assumed would be bad for the country. President Murphy expressed the personal view, however, that if a tax reduction were deferred until a time when it was clear that the country could afford it, there probably would never be such a reduction.

Discussion then turned to the unemployment problem. With particular reference to the effect of a reduction in Government expenditures, it was generally agreed that this would have some adverse effect on employment. However, the feeling was expressed that the level of business plant and investment was a key to the unemployment problem, that there was not enough incentive to invest at the present time, and that it was difficult to get away from the profit motive. Anything that could be done to work out a tax program that would improve incentives should go a long way toward taking care of the unemployment problem. In this connection, President Murphy also commented on the effects of automation on employment, citing the situation within his bank where automation had resulted in more jobs being available rather than fewer. He went on to call attention to the fact that the economy was moving into a period when there would be a large number of younger persons entering the labor market, more than offsetting retirements. Not only were tax incentives important but other remedies also would be needed to deal with the accentuated employment problem in the next five to ten years.

There followed comments by Governor Mitchell on the importance of the rate of economic growth and on factors in the economy at the present time that caused him concern from the standpoint of whether the current economic expansion might be expected to continue at a satisfactory pace. There were also comments by Governor Balderston focusing on the opinion that the rise in wage rates had resulted in inexperienced and unskilled workers, particularly younger persons, being priced out of jobs. Several members of the Council cited instances in which this had occurred. It was noted, at the same time, that the market for skilled workers appeared to be relatively tight.

Summarizing the discussion, President Murphy noted that the rate of economic growth was important and expressed the view that a tax program providing increased incentives could play a significant role in sustaining the growth rate. While he had no doubt but that the economy could pull itself up to a 4 or 5 per cent growth rate, this could not be achieved merely by saying that growth should occur at such a level. It was important to make the businessman find it advantageous, from a profit standpoint, to contribute to economic growth.

5. What are the prospects for loan demand at banks during the next several months, including demand in various loan categories?

The Council believes that the anticipated expansion in the economy will be reflected in a rise in the over-all credit demands of business. However, the large volume of corporate cash flows is likely to moderate the demand for commercial loans from banks. It is expected that the increase in the major loan categories will be somewhat above the normal seasonal pattern.

Commenting in amplification of the Council's statement, President Murphy said that it was the general view that no major push upward in loan demand was to be expected, although the present record loan levels would inch upward during the remainder of the year. The Council felt that the typical American corporation was fairly liquid; there were many cases of corporations being liquid beyond their immediate needs.

Mr. Zwiener anticipated relatively little rise in aggregate loan volume because of seasonal borrowing. The typical corporate borrower was now fairly well financed so far as loan requirements were concerned. In the Seventh District a number of companies had put themselves in comfortable position by going into the long-term market, and private placements were significant. Also, there seemed to be adequate money available in the mortgage field, with the majority of banks eager to make real estate mortgage loans. Further, there was some steadying in interest rates charged in the field of instalment credit. For these reasons, he foresaw no great increase in loan demand.

During further discussion, it was observed that many banks now had a high ratio of time deposits as compared with past experience. If interest rates were less attractive, time deposits would probably decrease. The liquidity picture could change rather quickly depending upon the interest rate structure.

Mr. Betts, commenting with reference to the Eleventh District, said that net loans were about 10 per cent higher than a year ago and that the volume of free reserves had decreased, indicating a less liquid banking position. Inquiries that he had made concerning loan prospects suggested a continuation of moderately strong demand during the next several months. With respect to interest rates on time deposits, there was now a trend toward consideration of interest rate reductions, and there had been a decrease in the rate of time deposit growth in the District compared with a year ago.

Mr. Fox noted that loan demand seemed to be holding up well in the St. Louis area. He had observed some change in the lending philosophy of banks: bankers now made a loan if it appeared all right creditwise, even though the chances of also signing up deposits might be slim.

Mr. Hobbs remarked that he felt bankers had learned to merchandise not only loans but deposits. In some areas savings institutions were losing accounts, whereas commercial banks were gaining. Commercial banks apparently had learned to sell savings.

President Murphy said 1962 could be viewed as a year when the full impact of additional costs had hit commercial banks because of higher interest rates paid on time deposits. However, the commercial banks had ended the year with fairly good earnings. He, too, felt that bankers from coast to coast had changed somewhat their attitudes toward the customer.

President Murphy went on to observe that a collateral question was whether lending standards had been altered. He felt that they had been altered somewhat, but not to a point of concern. It was possible, of course, that aggressive banking institutions were making loans that occasionally might result in a loss. However, as long as banks could go on year after year with losses kept relatively small, it seemed reasonable to think things were satisfactorily in hand. Staffs of banks today were better qualified than ever; to the extent there was exposure, there was also an awareness of it. Loans that required attention were carefully watched.

6. What are the Council's observations regarding current attitudes in the business and financial community toward U. S. balance of payments developments?

The Council has noted a growing concern among informed persons in the business and financial community regarding the persistence of the deficit in our international payments. Although the problem is exceedingly complex and difficult, increasing numbers of persons believe that more determined and positive corrective steps must be taken if the continuing large deficits are to be eliminated.

In discussion, President Murphy observed that the balance of payments was an area difficult for many persons to comprehend, there not being an understanding of all the forces bearing upon this problem. However, it was felt that more and more people were becoming aware that there was a problem, and there was some increase in understanding of it. President Murphy also observed that export trade was an important facet of the balance of payments problem. American industry was trying hard to compete in world markets but finding it difficult because foreign competitors could quote prices below those of certain American products. Following the settlement of the recent dock strike, there had been a drastic increase in shipping rates to Central and South America, and those were passed along to the shipper. This was a case of saying "do more business overseas" but at the same time sanctioning a wage increase that had resulted in making competition more difficult.

Mr. McAllister expressed the view that the balance of payments problem was of a greater degree of gravity than the domestic unemployment problem. A reduction in foreign aid might help the payments problem; a higher interest rate structure also might contribute to its solution, partly by making the American capital market less attractive for foreign borrowers.

7. How does the Council evaluate the impact of current monetary and credit policy?

The Council believes that current monetary and credit policy has had a favorable impact on the economy. However, the persistent deficit in our international payments, against the background of a rising level of domestic business activity, suggests the appropriateness of a gradually more restrictive monetary and credit policy.

President Murphy indicated that it was the view of the Council that a modest move in the direction of a more restrictive monetary policy could be absorbed without injuring the budding buildup of the domestic economy. This might be achieved through a reduction of reserve availability or an increase in interest rates, or a combination of the two. The Council felt there was substantial liquidity in the economy; also, that the economy was moving in the right direction. Against this background a modest move in the direction of restraint might be salutary, and the Council believed such a move would not slow down the domestic economy. Further, more and more requests were being received from abroad for loans, and foreign borrowers were active in the capital market. One turn of the monetary screw in this country might be beneficial in its over-all effects. The stage was being set whereby this country might look with more hope toward correcting its balance of payments position without risk of upsetting the domestic economy.

In response to a question as to whether the commercial banking system would be in a position to accommodate anticipated loan demand in the event of a reduction of the supply of reserves, President Murphy expressed the view that business loans would not suffer. He referred to the last period of credit tightness, recalling that at that time his bank had made it a point to take care of its regular customers. In addition, it had attempted to take care of other worthy credit demands. If there were some degree of credit tightness later this year, requests for loans from abroad would be likely to feel the effect first, since the banks would be obligated to take care of their domestic customers.

Asked whether it was felt that direct capital controls would be effective in dealing with the balance of payments problem, members of the Council expressed the view that they probably would not be practical at this point.

Asked how much additional stimulus would be provided the domestic economy by a reduction in interest rates, the Council expressed the view that there would be little, if any, stimulus.

In further discussion, Mr. Hobbs commented on the serious nature of the balance of payments problem and expressed the view that it would be difficult for monetary policy alone to correct the situation. Large amounts of funds were moving abroad because of military and foreign aid expenditures, and any program should include a review of foreign aid with the thought that adjustments could be made there, especially in areas where the funds were not being well administered or where the program was not accomplishing its purpose. Second, consideration might be given to making trade regulations tighter. Third, as suggested earlier, the American market should be made less attractive to foreign borrowers to cut down on capital outflows. A combination of these three approaches might help in tackling the problem.

Further comments on the problem were along the general lines of the foregoing discussion, with some suggestions that both rate differentials and availability of funds domestically had a part to play in relation to the balance of payments difficulty, but that monetary measures should not be expected to offer a complete solution.

It was agreed that the next meeting of the Federal Advisory Council would be held on September 16-17, 1963.

The meeting then adjourned.

Secretary