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Minutes for September 17, 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. Mitchell

1/ Meeting with 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, September 17, 1963, at 10:30 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

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

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

Before this meeting there had been distributed a memorandum concerning the topics that had been suggested for discussion. The topics, the statement of the Council with respect to each, and a summary of the discussion at this meeting follow:

1. What are the views of the members of the Council as to the probable course of economic activity in the United States during the remainder of 1963 and the early part of 1964? In discussing this general question, the Council may wish to comment on the following items:

   (a) Do recent levels of residential building activity appear to be firmly based, and is further expansion anticipated?

(b) Does the liquidation of steel inventories acquired earlier this year appear to have about run its course, or is further liquidation in prospect?

(c) Has any important change been observed recently in prospects for plant and equipment expenditures?

(d) Does the Council continue of the opinion, expressed at its previous meeting with the Board, that 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?

The members of the Council anticipate that economic activity in the United States during the remainder of 1963 and the early part of 1964 will continue to increase moderately. The persistent deficit in our balance of payments, the reaction which might occur if a tax cut did not materialize, and the fact that the current period of expansion has already run over 2-1/2 years are some uncertainties in the current economic situation.

(a) While certain types of residential construction in particular areas of the country have been overbuilt, most members of the Council believe that the recent building of single-family homes has been relatively firmly based.

One of the facts involved in the strong expansion in apartment building has been the abundance of long-term funds seeking investment. This probably has resulted in some speculative building of multi-family units. On the other hand, in many areas of the country there is a demand for apartments, particularly by the younger and older population groups. In general, residential construction will probably experience a sideways movement with no pronounced upward trend.

(b) The members of the Council are of the opinion that the liquidation of steel inventories acquired earlier this year has about run its course.

(c) The expectations of businessmen have improved since the last meeting with the Board in May. This change in sentiment increases the prospects for an expansion in plant and equipment expenditures in the months ahead.

(d) The Council continues to believe that broad price rises are unlikely in the relatively near future. However, the substantial rise in production since May reduces somewhat the competitive pressures resulting from unused domestic capacity which have discouraged price advances in the past. Recent increases in productivity tend to contribute to price stability.

In comments supplementing the Council's statement, President Murphy said it was the consensus within the Council that business sentiment was good. The typical businessman was moderately optimistic. A good record for 1963 seemed almost assured, even though it might be a bit short of the record for which some had hoped. Looking ahead to 1964, it was believed that the optimistic sentiment could be justified as far ahead as could reasonably be foreseen. One important condition, however, was the enactment of tax reduction legislation. The businessman was expecting the passage of a tax bill, and it seemed imperative to obtain such legislation at this session of Congress. In the opinion of the Council, this had been one of the major factors in developing optimistic sentiment in the business community. Current developments in Washington suggested some difficulty with the tax bill, and the Council would be concerned if the pending legislation were defeated. The psychological impact that would result from failure to enact tax legislation would be substantial.

Mr. Martin said he had little to add from the First District that departed from the general pattern suggested in the Council's statement. However, there was, in addition to what had been mentioned, a little indication of speculative excesses of all kinds. There was a high proportion of defense-related work in the District, he noted, and in this area of activity there were always questions as to what would happen next, but there had been no significant adverse developments thus far.

Mr. Stoner said that the Fourth District was following the general pattern rather closely. The steel industry felt that liquidation of inventories had about run its course, and orders were picking up a bit. There had been some overbuilding in the apartment field, but the economy was generally good. Employment was holding up quite well.

Mr. Hobbs said that steel operations in the Baltimore area had snapped back remarkably well beginning in early August. He sensed a feeling of optimism on the part of the steel industry.

Mr. McRae commented that over-all business conditions in the Sixth District were quite good. The outlook for retail trade was satisfactory. Sentiment in the paper industry was definitely better than it had been for a long time. The volume of business in that industry had been consistently good, but price increases instituted several months ago did not hold up very well. However, recent price increases looked quite firm. As to the price movement generally, he noted that it should be recalled that many of the current increases were actually restorations of previous cuts. The housing market in the Sixth District seemed softer than in many sections of the country, with complaints in Florida particularly.

Mr. Zwiener stated that the business outlook in the Seventh District seemed good. The steel situation had righted itself well. Automobile business was good, with the new models off to a satisfactory start. Prospects were for substantial Holiday trade, and business seemed likely to carry on satisfactorily through the first quarter of next year. Although construction of apartments and multi-family units continued to progress favorably, there were evidences of overbuilding in some areas, and he did not feel that single-family units would show up quite as strongly in the period ahead. Steel inventories were now in reasonably good shape. It appeared that the inventories acquired earlier were substantially against orders, and that there was no unduly large amount of speculative inventorying. If orders continued to be as good as seemed likely in the period ahead, inventories probably would continue in good shape.

Mr. Maestre reported business good in the Eighth District. The District was suffering in spots from overbuilding, particularly of apartments and motels. It seemed likely that parts of the area would be grossly overbuilt in apartments in the next year, and some builders and banks probably were going to get hurt. Outside of that, the District was in prosperous condition.

Mr. Aston reported overbuilding in the Eleventh District, particularly of high-rise apartments, with the principal motivation appearing to be the availability of credit rather than need for the construction. As long as builders could obtain funds and in most cases arrange for 100 per cent financing, they would continue to build. This signaled trouble ahead that would ultimately be reflected in the over-all economy. Otherwise, the pattern described by the Council's statement seemed to fit the District quite well.

Mr. McAllister reported that conditions were generally good in the Twelfth District. The unemployment rate was running a little higher than in the country as a whole. There had been some drop-off in employment in defense industries, which accounted for a substantial percentage of total employment. There had also been an increase, as compared with the first quarter, in the vacancy rate on all types of rental properties. By and large, however, conditions in the District were quite satisfactory.

President Murphy reported that in the Second District construction was running about 12 per cent below 1962 but 13 per cent above 1961. However, it was necessary, in considering these figures, to make adjustments for rather important distortions at particular times, reflecting strikes in up-State New York and, in the lower part of the State, the starting of a large quantity of multi-unit dwellings to get ahead of a zoning law. Adjusting for these factors, construction activity in New York State seemed quite good. As to the labor picture, the Newark and the New Brunswick-Perth Amboy areas had previously been quite bad in terms of unemployment. Both, however, had now been reclassified to moderate from substantial labor surplus areas, due largely to a pick-up in employment in transportation equipment and electrical equipment. A bright spot in up-State New York was the Rochester area, where there was tightness in the employment market, with prospects that the market would get even tighter.

With regard to the tax bill, question was raised as to how much importance the Council attached to sentiment in some areas for reduction, or at least containment, of Federal expenditures.

President Murphy said there was some difference of opinion on that score within the Council, but it was the consensus that a tax bill should be enacted regardless. He felt that if there was a delay until expenditures were adjusted downward, or until the Federal budget was close to being in balance, it was unlikely that there would ever be a tax bill enacted, and the country needed tax relief badly. All manner of things were being done because of the effects taxwise; conversely, some things were not being done.

Mr. Zwiener stated that in his area sentiment seemed to be running more strongly toward the view that the passage of a tax bill should be contingent upon a holding down of Government expenditures, that there should be a more definite commitment toward reduction of expenditures. He thought that this sentiment also was growing among members of the Congress who had talked with their constituents in the area and obtained their views.

Mr. Martin reported quite marked sentiment in the same direction in the First District; people were saying "hold the line."

There also seemed to be some feeling of discouragement with respect to the positive benefits that might eventually come out of the tax program.

2. Does the Council detect any substantial slackening in bank efforts to attract time and savings deposits? Any change in the pattern of bank investment of these savings inflows?

The members of the Council believe that banks are making a somewhat less intensive effort to attract time and savings deposits. However, this has not been reflected in an easing of rates paid for such funds.

The changes in Regulation Q were interpreted by many commercial bankers as an indication that the monetary authorities would permit them to pay competitive rates in the money markets. Those funds sensitive to changes in yields in the money market would therefore be less apt to move out of the banking system. Many bankers felt that their need for liquidity had been lessened somewhat, and they changed their investment policies by adding substantially to their holdings of municipal securities and mortgages. Although the members of the Council believe that time and savings deposits in the future will account for an increasing percentage of total deposits, the rate of increase will not be as sharp as in the past two years. As a consequence, changes in bank investment portfolios will tend to be less marked.

President Murphy said there appeared to be some difference of opinion as to the degree to which commercial banks might be relaxing their efforts to attract time and savings deposits. Efforts were still fairly vigorous in the Second District and had been accelerated by the continuing drive of the mutual savings banks and savings and loan associations, as well as by the fact that the commercial banks saw their demand deposits moving sideways, or in some instances dropping slightly. This sideways movement extended back for some period of time, and it appeared as though it might be projected into the future. Accordingly, the commercial banks had to find new sources of funds, and the savings field looked promising. In his opinion, commercial banks would be remiss if they did not continue their efforts to obtain a fair share of the savings dollar. Further, the banking system had been able to absorb the payment of higher rates of interest. Although bank earnings had not gone up as much as might be liked, earnings of commercial banks were reasonably high last year; this year the records of individual banks would range roughly from a 10 per cent increase to a modest decrease from last year. Commercial banks had been able to weather the storm, and he felt that they should continue their efforts.

President Murphy went on to say that members of the Council had cited some instances where banks were cutting back on their advertising for savings funds, but he saw no cutting back in the desire of commercial banks to continue to develop this type of business. The whole situation touched, of course, on the matter of bank liquidity. Personally he felt that if banks were to serve the nation as they should in terms of economic development, and if there was the expansion of business in the years ahead that was being anticipated and was necessary to provide employment, there must be general expansion in the banking area. Deposits would have to be acquired to provide the ability to lend.

Mr. Aston said there had been no slackening on the part of the Eleventh District banks in seeking time and savings deposits.

While banks may have cut down on their advertising, the reason was that they could get such funds satisfactorily without so much advertising. He knew of no commercial bank that was refusing deposits even when it could not use them profitably. At his own bank, interest-bearing deposits represented 38 per cent of the total, while less than 3 years ago the figure was less than 10 per cent. The bank felt that it was going to have to keep this money in the bank somehow. Commercial banks were experiencing increasing pressure, though, in attracting savings money; for example, Sears was now advertising 4.85 per cent to "members of the Sears family." The banks were going to have to stay in the business, and he hoped the Board of Governors would keep them in a position to be flexible enough to meet competitive rates in view of the change in deposit structure that was taking place, and in order to insure that commercial banks would be able to meet the demands upon them. He suggested that consideration might be given to some reduction in reserve requirements applicable to both demand and time deposits.

Mr. Martin said that First District banks were trying to estimate where they were going and were reappraising their position. The pattern was distinct: a reduction on balance in holdings of Government securities and an increase in holdings of tax-exempt securities and mortgages. There was discussion of increasing installment loans. A markedly lesser degree of liquidity had been accepted as the banks went along, and the current attitude was one of constant reappraisal. First District banks had been increasing their certificates of deposit slightly, but they had done little in their thrift accounts. There had been some advertising of a rather spasmodic nature, but actually the banks had done relatively little to address themselves to the real issue, which was whether they wanted to be in the thrift business or not. They were trying to decide how much strain they could stand. The general feeling was that it would not take too much to get the banks into a little trouble from here on out, subject to monetary policy decisions.

Mr. Maestre said that Eighth District banks were strongly in favor of accepting time deposits at a rate that was competitive. As to portfolios, he had noticed that quite a few banks were lengthening their maturities in municipal bonds, which could affect their capital position in an unfavorable market. He also felt that banks were lowering their investment standards. Banks were forbidden by law to underwrite revenue bonds, but were not forbidden to invest in them after the dealers had underwritten the securities, which to him did not make much sense. It should be the other way around. It should be the policy of the Federal Reserve to keep the banks competitive. The banks had gone so far they could not afford to lose a substantial part of their time money.

Mr. Stoner said he saw no lessening in the efforts of Fourth District banks to obtain time deposits. There were plenty of savings and loan associations competing in the District. Part of the

District was a 3 per cent area, but the banks were still gaining time deposits.

Mr. Moorhead saw no lessening in the advertising appropriations of banks to attract savings deposits. There had been some let-up in reaching for corporate time deposits, where the rates were bumping against the present ceiling.

Mr. McRae said he detected little slackening of efforts on the part of Sixth District banks to attract time and savings deposits. At his own institution, he was much concerned at first by the investment money the bank had to take because of customer relationships. However, during the past six months or a year the amount of such money had been much less. Most of the increase in prospect was in savings accounts. He did not worry too much about paying 4 per cent on money that would be with the bank on average, but the bank could not make money at 4 per cent under its lending and investment policies.

Mr. Breidenthal said the Tenth District conformed to the general pattern. There had been no slackening in the desire of the commercial banks to obtain savings and time deposits despite the fact that the District was a 4 per cent area. Isolated banks had been sending up some trial balloons, cutting the rate of interest by 1/2 per cent to find out what would happen. They seemed to find that they could hold their own and that seemed to satisfy them, but looking at the history of developments in the District and elsewhere, the only increase was in time and savings deposits. If they turned downward, the banks would run out of tools with which to work. In the Tenth District demand deposits were down while time and savings deposits continued upward, so most of the banks were not turning any time and savings deposits away. There had been some advance refunding of municipal securities, including revenue bonds, even seven or eight years in advance of the call date. This meant that higher rates on tax-exempt securities apparently were not going to be available to banks as an offset to higher rates paid on time and savings deposits. In his opinion, however, the banks could ill afford not to attract time and savings money in the face of the trend that was going on. He saw no particular advantage in reducing interest rates if all the banks could do was to hold their own; they must do better than that. Another factor was that public officials were now demanding interest on public funds. Legally or otherwise, a lot of them were investing in bank certificates of deposit and Treasury bills. The theory was that they ought to have the right to employ their surplus funds profitably, but most banks were unhappy about the prospect of paying interest on public funds.

Mr. Hobbs brought out that in his area mutual savings banks played a large role. He had noticed in the past several months that the commercial banks were gaining in numbers of thrift accounts and that the savings banks were losing, indicating that the commercial banks were competing with the mutuals successfully, probably reflecting the full range of banking services provided. He had not noticed any slackening of efforts to attract savings and time deposits, except possibly in the 4 per cent area. His bank was now operating in Montgomery County, where the prevailing rate was 4 per cent, but it had stopped at a 3-1/2 per cent rate and had noticed no penalty. He was encouraged about the future of commercial banks in the thrift field, and thought they could compete with other institutions at a lower rate. Mutual savings banks in Baltimore were paying a higher rate, but the commercial banks were competing successfully.

Mr. McAllister saw no slackening in the efforts of Twelfth District banks to attract time and savings deposits, which in that District traditionally loomed large. At present, 51 per cent of total deposits consisted of time and savings deposits, this figure being up from 45 per cent three years ago. The banks were going more into mortgages and reducing their holdings of Governments. They were also increasing their holdings of municipals.

Mr. Zwiener said that in some isolated instances, say in the case of smaller banks in the outlying Chicago area, there were heavy amounts of savings deposits with no profitable utilization of the funds. Such banks were not sophisticated in municipal investments, or in finding mortgages, so they were feeling a pinch on earnings. At the larger institutions there had been a lessening of advertising for time and savings money, but the money still seemed to be flowing in. This was a period of change, and the banks had yet to run through a complete cycle. While he was aware of the reports of a lengthening of maturities in municipals and the holding of more mortgages, there was still a large segment in the District that felt that the banks had not gone through a complete cycle and were watching the liquidity factor more closely than usual. This was true of many large banks in the District. It was his bank's feeling that only about 60 per cent of the time deposits were hard-core money. The rest was there only because it was more profitable to keep the money in the bank at the present time. There was little corporate loyalty. Money tended to flow fast when the rate changed, particularly in the time certificate of deposit market.

President Murphy spoke of a competitive development in New York. Something over a year ago the State banking authorities removed the interest ceiling on deposits at mutual savings banks of over a year's duration, and just recently the ceiling was removed entirely. Thus, the mutuals were now free to pay whatever rate they liked. This meant that the commercial banks would have to intensify their efforts to obtain their share of the savings dollar. In the small savings account, habit-forming was a factor, unlike the large corporate account. It seemed important for the banks to continue their efforts in the direction of obtaining savings accounts, as an important part of their tool kit for the future.

Asked for an evaluation of the experience in Indiana, where the ceiling on interest-bearing deposits had been retained at 3 per cent, Mr. Zwiener said that apparently the banks, even in the area near Chicago, had not suffered too much. Their growth had not been spectacular, but he did not think that the Indiana banks felt they had suffered with the 3 per cent rate. They had had to forego corporate time deposits, but they could compete reasonably well for thrift accounts even at the prevailing differential.

Governor Mitchell inquired whether the Council had any views as to the possibility of permitting the corporate use of savings accounts up to a figure of, say, $20,000.

Mr. Martin said that First District banks would be against such a move, to which Mr. Maestre added that he did not think corporate money could come properly into the thrift category. Acceptance of corporate funds as savings deposits would border on the paying of interest on demand deposits. Mr. McAllister said that only the larger corporations put money into certificates of deposit. He doubted whether such corporations would be interested in savings accounts. Corporate treasurers were now active in the money market and watched rates all over the country.

Governor Mitchell suggested that such a change would accommodate small corporations; the large ones would not need it. His question stemmed from his view that trustees in bankruptcy ought to be able to use savings accounts.

Mr. Hobbs suggested that banks could take care of small corporations by certificates of deposit of some kind. He had not seen any of this business going to savings and loan associations.

President Murphy expressed the view that the banks must expect more pressure for the payment of interest on deposits; it was in the air. The increased use of Federal funds was the same thing in reverse. A bank picked up the phone and sold idle funds. He did not see much difference in this and the actions of the corporate treasurer who tried to use his money fully.

President Murphy saw a big plus in all this discussion from the standpoint of the national economy, including retail sales and purchasing power. He had recently reviewed estimates of the future growth of savings. The experts were predicting that the present level of approximately $225 billion would be up by 1970 to anywhere from $400 to $475 billion. The present level was an accumulation from all previous times, but in about 7 or 8 years the experts expected the current figure to double. The commercial banks would be shortsighted if they did not interest themselves vitally in fighting to get their share of this money. It represented purchasing power; it meant that many people had pulled their incomes above subsistence levels. From the standpoint of the economy for the next few years, this money represented a tremendous potential for sales. As these funds accumulated, the commercial banks must aggressively compete for them.

Question was raised whether an increase had been noticed in the turnover of savings accounts; whether they were coming, in effect, nearer to use as demand accounts.

Mr. Hobbs reported a definite pick-up in turnover of savings deposits at his bank, and he thought this was also the case at the mutuals in his area. Mr. Zwiener said the same thing was true in Chicago. President Murphy commented that where the use of the passbook had been eliminated, the process was made somewhat easier.

Asked whether, to the extent this took place, it did not have a bearing on the way the banks used the funds, President Murphy suggested that some withdrawals from individual savings accounts reflected the fact that demand balances had been drawn too low. As to the aggregate of savings deposits, however, there was a growth curve that the banks could take into account. Mr. Martin reported some segregation of savings accounts, with isolation from the regular totals. These funds could be labeled as "hot" money, of a type between thrift accounts and certificates of deposit. Mr. Zwiener reiterated that his bank regarded only 60 per cent of savings deposits as hard-core savings. The remainder was treated differently, with ways maintained to pay it out quickly if necessary.

Inquiry was made as to the results of the Board's action in July in raising to 4 per cent the maximum rate payable on time deposits with maturities from 3 months to one year.

President Murphy replied that this action provided more elbow-room. It was a move that he considered essential. Likewise, he felt that the earlier legislative action removing certain foreign-owned time deposits from the purview of the interest rate ceilings was a good move. If the Board had not increased the Regulation Q rates, member banks would not have been able to be as competitive as they had been with mutual savings banks and savings and loan associations. However, the rates actually paid on time deposits were again knocking at the ceiling. Mr. Zwiener added that member banks would have been out of business in the certificate of deposit market if the recent change in Regulation Q had not been made.

Governor Balderston referred to the strong flow of savings through the savings and loan associations, causing them to look around for opportunities to increase their areas of credit activities. He inquired whether the Council had given any attention to whether that would be in the public interest; that is, whether permission should be granted to savings and loan associations to enter what used to be thought of as the field of banking.

On this general subject, President Murphy cited the fact that in New York there was very heated competition between mutuals and savings and loans on the one side and mutuals and commercial banks on the other. Every day there were new signs that the mutuals were inching closer to wanting to do a commercial banking business. He would favor letting them do such things, but making them abide by the same rules as commercial banks. The mutuals in New York were now making personal loans, at low rates, as long as the loan did not exceed the amount on deposit, and there were indications that some mutuals would like to let their depositors use something like checks and have them charged against their accounts, all of which represented inching closer to a commercial banking business. In his opinion the day would come when this type of legislation would be on the books due to the pressure within the mutuals to use their available funds in the most profitable way. He would not object to such a development provided the mutuals had to pay taxes on the same basis as commercial banks and provided they were guided by the same rules, for example as to reserve requirements. If such requirements were not established, the mutuals would be at a competitive advantage vis-a-vis the commercial banks. He continued to feel, however, that there was plenty of room for all kinds of institutions. If the savings field developed as he thought it was certain to develop, there was plenty of room for all institutions.

Mr. Zwiener referred to the financing of automobile purchases by adding to outstanding mortgages. This was being done in the Chicago area in a rather substantial way.

3. As a result of high levels of activity and of changes in business tax laws, the flow of internally generated business funds has increased substantially this year, while dependence on bank and market financing appears to have declined. Do the members of the Council expect business needs for bank financing to continue moderate over the balance of the year or are there signs of significant increase in business loans? Does the Council feel that banks, by and large, are sufficiently liquid to meet a moderate upsurge in credit demands without substantial portfolio rearrangement?

The members of the Council expect business needs for bank financing to increase seasonally over the balance of the year. While the liquidity of the banking system has declined, the Council believes that the commercial banks are in a position to meet a moderate upsurge in credit demands without substantial portfolio rearrangement.

President Murphy said the Council felt that by the end of this year loans were going to be higher than at present, but that the Council did not visualize any strong upward thrust. He had never seen corporations more liquid. Cash flows were tremendous, and the balance sheets of corporate customers showed, in addition to cash, the largest amounts he had ever seen invested in short-term securities. Thus, he could not envisage a vigorous upward push in loans although he felt there would be a general movement upward. At the moment commercial, industrial, and agricultural loans of all reporting member banks were running well ahead of 1962, but he anticipated that the 1963 curve line would move upward at a rate between 1961 and 1962. Turning to the ratio of liquid assets to deposits, banks were now less liquid than since 1960 according to this yardstick and, except for the 1959-60 period, less liquid than at any time going back to 1957. As the situation moved into 1964, and looking ahead the second and third years, it was his opinion that the situation could tighten quite fast. There was not too much slack.

Mr. Moorhead said that Ninth District banks were quite liquid and could finance any foreseeable demand for loans, but only because of the corporate certificates of deposit. The banks did not otherwise generate sufficient deposits to meet loan demand, and the corporate certificates of deposit had introduced a new note. With the current 4 per cent ceiling, however, there was danger in relying too much on the certificates. Thus, liquidity was not something that could be counted upon.

Mr. McRae agreed with the view that the banking system could take care of any increase in loan demand that seemed likely to occur in the next six months. However, he felt substantial discomfort about the decline in liquidity of the banking system as a whole. He was concerned about the lengthening of maturities and increased investments in long-term mortgages and municipal bonds.

Mr. Stoner stated that he looked for only a seasonal increase in loan demand in the Fourth District and that District banks were sufficiently liquid to take care of that demand.

Mr. Hobbs said that Fifth District banks were looking for only a modest seasonal increase. For some period of time the increase had been only almost entirely in mortgage and instalment loans, while business loans had remained about level. He was not concerned about the liquidity of District banks.

Mr. McAllister noted that in the Twelfth District the ratio of loans to deposits was high, running about 65 per cent. This ratio could hardly get too much higher, but member banks had been quite successful in keeping away from the discount window. There was some leeway, but the ratio was getting quite high.

Mr. Maestre reported a similar situation in the Eighth District. However, if there was going to be only a normal seasonal increase in loans he was not concerned, assuming that the Federal Reserve was going to provide reserves to cover seasonal requirements.

Mr. Aston agreed with Mr. Maestre's observation.

Mr. Zwiener said that the composition of loan demand in the Seventh District had changed quite materially over the past year and that he foresaw further change taking place. Because of the financing being done around the banking system, he no longer saw the large bodies of loans coming into the area that formally were seen. A great deal of the loan increase in the Seventh District had been accounted for by what might be called the earning asset type of loan. If banks ceased taking them on, they could build liquidity readily, accommodate a material seasonal increase in loan demand, and take care of requirements quite well.

Mr. Martin reported that First District banks expected only a normal seasonal increase in loans and that they should be able to handle it without difficulty, assuming that monetary policy was of the nature to support the seasonal increase. If loan demand should increase heavily, there could be some volume of member bank borrowing.

Chairman Martin inquired whether any members of the Council anticipated a much larger than seasonal increase in loan demand, and none of the Council members so indicated.

4. What are the Council's observations regarding current attitudes in the business and financial community toward U. S. balance of payments developments? How does the Council appraise the general reception of the recent actions and proposals designed to deal with this problem?

Although the persistent deficit in our international payments and the loss of gold are somewhat remote from the everyday affairs and activities of most businessmen, the Council believes that there is heightened concern in the business and financial community regarding U. S. balance of payments developments.

The actions of the Federal Reserve System designed to deal with this problem have been favorably received, especially the increase in the discount rate. There is some doubt, however, about the merit of the equalization tax proposed by the Treasury, although many persons were encouraged by the fact that specific action was being taken in an effort to cope with our payments difficulties.

As the Council has observed in the past, the solution to our balance of payments problem involves fiscal policy, overseas defense expenditures, and foreign aid outlays, which do not fall within the responsibility of the monetary authorities. Monetary policy alone can therefore not be expected to meet the problem of the deficit in our international payments. Nevertheless, the Council believes some further tightening of monetary policy might be desirable.

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

As suggested in Item IV, the Council believes that current monetary and credit policy has had a favorable impact on the financial and business community.

In discussion of these topics, which were considered together, President Murphy noted that the interest equalization tax proposal had been a subject of much discussion in financial circles. The first reaction was that at least the authorities were trying to do something specific to help solve the balance of payments problem and that the move appeared to be a reasonable one, although some sources regarded this proposal as a forerunner to objectionable direct controls. On the other hand, looking at the likely effect from the balance of payments standpoint, it would not appear to be substantial except in terms of one or two foreign areas. Further, since the proposal was announced, an exemption in respect to Canadian issues had been proposed. A lot of people felt that if the proposal was watered down they would be indifferent as to whether or not it was passed, and it now appeared that the proposal might encounter difficulties in the Congress.

President Murphy went on to say that he detected a great deal of concern regarding the balance of payments. Bankers from abroad invariably brought up the subject, and he saw signs of increased criticism on their part. They were saying, in effect, that this country talked a lot about the problem and yet nothing seemed to happen. Announcement of the disappointing second-quarter balance of payments results highlighted the situation. Efforts were in process to try to build more export business, but the export trade already showed a substantial surplus. Unless this could be preserved and steps could be taken to avoid dissipating the trade surplus, the problem would not be solved.

In summary, President Murphy said, it was his feeling that this was one of the country's most serious problems. The businessman who made it part of his job to know something about the balance of payments was deeply concerned, even worried, and criticism from abroad continued to build up. Some sort of solution needed to be found. While he had mixed feelings about the interest equalization tax, he applauded the fact that someone had come up with something specific to help deal with this problem. He was not prepared to say whether it was the best move.

Mr. Zwiener felt that the equalization tax proposal was a fringe attempt to meet the problem. It dealt with only a fraction of the capital outflows, and taking into account the discretionary authority that would be granted to the President, the extent of this attack on the problem might be further reduced. The only comfort was in knowing that somebody was looking at the various areas where something could be done. The tax implied that there might be moves into controls of different types, which would be unpalatable in the light of American traditions. Further, he doubted whether there would be any significant net favorable effect on the over-all balance of payments because of the uncertainties that the proposal created. For example, one company planning ahead had asked whether it should immediately transfer abroad half of its estimated needs for the next three years. In some instances, therefore, money had already left the country in view of the tax having been proposed. Also, there were several inequities in the proposal from the standpoint of the individual investor, although some of those, he understood, may have been corrected. As a summary statement, he did not think that the tax would contribute very much to solving the balance of payments problem.

Mr. Martin said that well-informed businessmen were beginning to have a depressed reaction to the balance of payments situation. Foreigners had commented constantly over the past several years on the reckless fiscal policies under which this country was operating its affairs. This was an important factor in conditioning the minds of people around the world as to whether the dollar was a good currency in which to have their money.

Mr. Martin also commented that from the presentation yesterday to the Council by the Board's staff, several members of the Council had the impression that some foreign sources were suggesting that the United States embark on a heavy Governmental spending program. President Murphy noted, in this connection, that the observation had been made that some foreign sources felt that one move this country could make to improve its position was to incur a greater budget deficit. It was his feeling, President Murphy added, that the persistent budget deficit had bothered many foreign observers and that this country's determination to come to grips with the balance of payments problem would be indicated to them most impressively by avoidance of a further deficit, except one that might result from the proposed tax reduction program. A stepping up of Government spending here and abroad would not appear to the Council to be a proper method of meeting the balance of payments problem. Mr. Moorhead said he understood the point to be that a further budgetary deficit would spur the domestic economy and therefore make the United States more attractive for foreign investments. As he saw it, the net effect might be additional investment in the United States, but also further investments abroad. Mr. Maestre noted that the suggestion was hedged with the qualification "without inflation." President Murphy, in a further comment, said the members of the Council felt that the balance of payments problem was tied in closely with fiscal policy and that it was difficult to separate them.

Governor Mitchell commented that he thought the prescription this country had been getting from many foreign sources was quite clear. It involved a much larger dose of fiscal policy, including a tax cut, a larger Federal deficit, and increased Government spending, but higher interest rates were also advocated. Such a program would be generally consistent with policies that some foreign countries had pursued in similar circumstances. This was the impression he gathered from the tenor of remarks of foreign central bankers, and it was the type of prescription he understood was being suggested in various official quarters.

President Murphy observed that the Council members would all admit that this was a very complicated area. The problem tied into almost every facet of economic and political life. U. S. Government expenditures abroad were very much a part of the picture, and it was easy to say that they should be cut. However, for the State Department it was no doubt difficult to decide where reductions could best be made.

Chairman Martin commented that Governor Mitchell had stated well one prescription that was being received from abroad. However, those who returned from abroad came back with different accounts as to what people had told them. It was difficult to get accurate reports.

The Chairman went on to say that the problem of real concern to the Federal Reserve was this: leaving aside questions of overseas expenditures and fiscal policy and considering only the area of Federal Reserve action, how much could the System contribute? The Council seemed to endorse the increase in the discount rate. However, there were differences of judgment within the Federal Reserve as to what, if any, influence this had exerted on the balance of payments. The problem was extremely difficult because the flows of funds were difficult to measure. There were no completely satisfactory statistics. It was known, of course, that the Euro-dollar market had become very substantial. There were indications, he believed, that it had reacted somewhat to the change in the discount rate and the slightly higher short-term interest rates that had developed in recent months. Nevertheless, how much, if anything, the System's actions had accomplished remained open to discussion. The question was whether, even assuming no cooperation whatever in terms of fiscal policy or otherwise, there was something the Federal Reserve could do. Some people would feel that it was in the best interest of the national economy to do nothing.

Mr. Breidenthal referred to the part of the Council's statement that expressed the belief that some further tightening of monetary policy might be desirable. He felt strongly that the word should have been "necessary" rather than "desirable." The case should be proved that it was necessary.

Chairman Martin noted that over a long period he had consistently taken the position that interest rates should be as low as possible without producing inflation, because that would induce the largest amount of capital formation. The balance of payments problem was, of course, a complicating factor.

President Murphy said it seemed to the Council that the increase in the discount rate had had beneficial results from the standpoint of the international balance of payments problem without affecting the domestic economy adversely. Whether the domestic economic improvement was in such even balance that a further rise in interest rates would be a deterrent to a continued upward movement, the Council did not know. He felt sure that this was the Board's major problem. In back of it was the question of employment and unemployment, and the Board no doubt was trying to find some happy medium. It could hardly afford to take steps that might tend to aggravate the unemployment problem. It might be that interest rates should rise a little further in the weeks or months ahead, but the problem was more complex than in the case of some of the European countries.

Chairman Martin inquired whether there were any members of the Council who felt that it would be wise to raise the discount rate, and several members, perhaps a majority of the Council, responded affirmatively.

President Murphy related that at a recent meeting attended by representatives of some of the leading industries in the United States he had presented the question whether it was felt that an increase of 1/2 per cent in the discount rate, such as the recent increase, had a deterrent effect on American industries. The replies, without dissent, were in the negative. It was brought out that if a company was considering an addition to its plant, and if the question was so finely drawn that an interest rate differential of 1/2 per cent would mean making or losing money, a decision to go ahead probably would not be made. This was the consensus of those present. It was pointed out, also, that U. S. interest rates were so low relative to those prevailing elsewhere in the world that they constituted an ever present invitation for foreigners to come to this country and seek funds. The net of the remarks was that the recent discount rate increase did not involve much of a risk from the standpoint of deterring further improvement in the domestic business situation.

Governor Mitchell noted that U. S. banks were being importuned to make term loans to foreigners and that there appeared to be accelerated use of acceptances between countries other than the U. S., with a selling of the acceptances to investment organizations in this country. He asked whether any difference in these respects had been noticed since the interest equalization tax was proposed.

Mr. Zwiener responded that up to this point his answer would be in the negative. President Murphy agreed as to acceptances. On requests for foreign loans at New York City banks, he would answer in the affirmative. These frequently involved requests for loans to be repaid over a period of three or four years. In more cases than not, they were guaranteed either by the foreign central bank of the country concerned or a strong commercial bank. Factors underlying the requests included the availability of loanable funds, the willingness of American banks to make such loans, and the attractive interest rate, both to lender and borrower. He anticipated that the volume of loan requests was going to increase rather than decrease. By and large, moreover, the credit risk was minimal; such risk as obtained was of a political nature. The borrowers were some of the best credits in the respective countries, and there was a dearth of capital in most of those countries. On the other hand, there was a surplus here, and with the savings trend upward there would be additional pressure to put the funds to work. Further, the rates on the loans were attractive to the banks; a 6 per cent rate was typical.

> The Board would also like to have any views that the Council may care to express on the legislation that has been recommended to broaden the kinds of security on which credit can be advanced by the Federal Reserve banks. These recommendations

were included in the Board's letter of August 21 to the Chairmen of the Senate and House Banking and Currency Committees.

The members of the Council believe that commercial bankers generally would strongly favor enactment of legislation designed to broaden the kinds of security on which credit can be advanced by the Federal Reserve banks.

In discussion, President Murphy said the Council felt that the legislative proposal was highly constructive. If the economy moved ahead in the next three or five years, this could be very helpful. He would be surprised if the banking community did not take advantage of it. The Council assumed that it was intended that the broadening of the kinds of security on which credit could be advanced by the Federal Reserve Banks would not involve penalty interest rates. However, the Council noted that the legislative proposal provided that different rates might be fixed for different classes of paper, which had raised some question.

The response was in terms that the proposed legislation was designed to assure adequate flexibility. It was contemplated that there would be one rate, but the power would be retained to fix different rates if necessary to curb any possible abuses.

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

The meeting then adjourned.

Secretary