Minutes for April 23, 1964.

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

Gov. Daane

1/ Meeting with the Federal Advisory Council.

Minutes of a meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council that was held in the Board Room of the Federal Reserve Building in Washington, D. C., at 10:30 a.m. on Thursday, April 23, 1964.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Martin, Moore, Day, Stoner, Watlington, McRae, Smith, Hickok, Breidenthal, Aston, and Cook, Members of the Federal Advisory Council from First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively

Mr. Henry T. Rutledge, Executive Vice President, Northwestern National Bank of Minneapolis, Minneapolis, Minnesota

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

Mr. Wayne, President, Federal Reserve Bank of Richmond

In the absence of Mr. Moorhead, President of the Council and Member representing the Ninth Federal Reserve District, Mr. Rutledge represented that District at this meeting.

Mr. Wayne was present as Chairman of the Committee on Fiscal Agency Operations of the Conference of Presidents of the Federal Reserve Banks to participate in the discussion of the proposal currently under consideration to substitute a book-entry procedure for the procedure currently followed by the Federal Reserve Banks in holding Government securities in safekeeping or as collateral. The Board had requested the views of the members of the Council on this proposal in a letter dated April 10, 1964. With its letter, the Board transmitted to the Council members as background information a statement entitled "Concept of the Proposed Procedure," which presented the substance of the plan. There had also been transmitted to the Council copies of a letter from President Wayne to Mr. Carlock, Fiscal Assistant Secretary of the Treasury, dated September 26, 1963, in which certain questions were mentioned concerning the proposal and apparent advantages were outlined.

In the memorandum that it had distributed to the Board relative to the topics on the agenda for today's joint meeting, the Federal Advisory Council stated that it believed "that bankers generally favor the proposal of substituting a book-entry procedure for the procedure currently followed by the Reserve Banks in holding Government securities in safekeeping or as collateral."

Vice President Aston commented that the members of the Council did not feel sufficiently versed in the operating details to go into the mechanics of the proposal. As a basic proposition, however, they felt that the proposed procedure was satisfactory. It should save money for the Federal Reserve Banks and the Treasury, and it would provide protection against loss of securities. Each member of the Council had studied the material received from the Board and had gone over the proposal with members of his staff. As a result there were a few suggestions or questions on technical matters. In his own bank, for example, it was noted that there might be a problem with regard to the identification of particular securities for tax purposes.

Mr. Smith said that he had polled other Chicago member banks and found them favorable to the proposal. The main benefit apparently would come by way of saving money for the Treasury, and the banks were anxious to cooperate. Obviously, it was important to keep adequate records for tax purposes.

Mr. Watlington brought out that when a securities dealer was short of bonds he had to cover, it was customary to lend him that specific issue temporarily. There would have to be some way that this type of transaction could be handled. Also, political entities might require that bonds actually be issued, and in such a case it apparently would be necessary to bow to the request.

Mr. Martin commented that there was a question of the timeliness that could be expected in issuing securities when they were needed. It was supposed that this factor would be present under the proposed procedure. There were also questions as to whether the Federal Reserve would extend the new procedure to securities dealers; whether, when one member bank borrowed from another, a hold could be placed on the accounting records of the Federal Reserve; and whether it would be possible for the proposal to be extended to include securities now held by member banks in safekeeping for nonmember banks.

On the question whether there would be a problem under the proposed procedure in identifying particular issues for tax purposes, President Wayne said that this matter had been discussed with the Treasury and in turn with the Internal Revenue Service. There would, of course, have to be a ruling from Internal Revenue before any program was adopted, but he understood informally that the Service saw no reason why this could not be worked out. On the question of loans of securities to a dealer, Mr. Wayne said he could not give a definite answer at this point. It might be found that for the time being it would be necessary actually to issue securities to the dealer. Likewise, the question of extension of the book-entry procedure to securities dealers had not yet been resolved. However, as to the question of timeliness, it was anticipated that any request for an issue could be accommodated the same day.

Commenting more generally, President Wayne said it was contemplated that the System would move into the proposed procedure experimentally. It would be offered simply as an option. It was hoped that the System would be able to expand the service eventually, particularly since the question of vault space was not involved. As to the question of public entities, it would be proposed to adjust the procedure in accordance with the wishes of the public body concerned. As to the question whether a hold could be placed against the account of a borrowing bank, the answer was in the affirmative. As to the question whether the Federal Reserve procedure would cover securities held by member banks for nonmember banks, Mr. Wayne was not prepared to answer at this point. In general terms, he hoped that the Federal Reserve would be able to enlarge the new procedure to the widest possible extent because it was simple and economical, represented a distinct saving in terms of time and space, and because it provided assurance against loss of securities.

President Wayne then inquired whether the members of the Council felt that the availability of this procedure would have any adverse effect on correspondent bank relationships. It was known that New York banks held in safekeeping substantial amounts of securities for correspondent banks. If the proposed procedure was placed in effect, they might hold considerably less. The question, with which the Board and the Treasury were concerned, was whether this would have an effect on correspondent relationships such as to generate any significant questions.

Mr. Moore said that he would prefer to look into the matter further rather than to answer the question at this time. In some respects the procedure would be of advantage to the New York banks, who went to considerable expense in holding securities in safekeeping for correspondent banks, but it was difficult to appraise the psychological aspects.

> Secretary's Note: Under date of May 1, 1964, Mr. Moore addressed a letter to President Wayne containing the following paragraphs:

> It is our feeling that there might be a loss of correspondent bank custodian business but the loss would be minimal unless the Reserve Banks actively encourage member banks to keep their portfolios at the Reserve Banks. As you know, we are faced with this competitive factor today and, occasionally, we lose an account to a Reserve Bank.

> Since New York is the major Government bond market, there are definite advantages for an actively trading correspondent bank to keep its securities with a New York bank. We have no reason to believe that the book-entry procedure would eliminate these advantages.

You might be interested in knowing that the general reaction within the bank to the book-entry procedure was favorable.

In further discussion Mr. Day inquired whether, before such a plan was implemented, operating personnel would be brought in for discussion to be sure that various details of the new procedure were clear.

President Wayne replied that if certain questions presently of concern to the Treasury and the Federal Reserve were resolved satisfactorily, the Federal Reserve could bring together a prospectus of operational techniques. It was contemplated that representatives of the Federal Reserve Bank of New York would then be asked to contact operating personnel at New York City banks for discussion, because problems likely to arise anywhere probably would arise at the New York banks. If, on the basis of such discussion, the scheme made sense, steps would be taken to make the procedure available to member banks around the country. The Federal Reserve Banks would contemplate dealing with specific inquiries by sitting down with operating personnel of the banks concerned.

President Wayne again emphasized that member banks would not have to accept the option of the book-entry procedure. The Reserve Banks would move gradually through personal contact with the member banks of their districts, and it was not anticipated that the book-entry procedure would be instituted on a widespread basis overnight. The Federal Reserve would hope to expand the procedure in due course, but at the beginning it was thinking in terms only of the handling of securities owned by member banks.

President Wayne then withdrew from the meeting.

Before this meeting there had been distributed a memorandum from the Federal Advisory Council setting forth the topics suggested for consideration at this meeting and the views of the Council concerning them. The text of the memorandum was as follows:

1. Economic conditions and prospects.

A. What are the views of the Council on the economic outlook for the remainder of this year? Have the members observed as yet any significant effects of the recently enacted tax cut on consumer spending and attitudes or on business fixed investment spending or plans? To what extent does it appear that the stimulative effect of the tax cut is likely to be offset by tax increases at the State and local levels?

The Council anticipates that economic activity during the remainder of the year will continue to expand strongly. The members have not yet observed any significant effect, other than psychological, from the recently enacted tax cut. While consumer attitudes continue favorable, spending has not shown any unusual spurt. The members of the Council have likewise not detected a step-up in business fixed investment plans. Tax increases on the State and local levels will only slightly offset the stimulative effect of the tax cut.

B. How does the Council view the prospects for continuing price stability? Are there signs of speculative tendencies in credit markets, land, common stocks, and other capital assets, or in commodities?

The Council believes that some upward pressure on prices is developing. As a consequence, it is doubtful that the relative price stability of the past several years will continue. The outcome of the forthcoming wage negotiations will have an important bearing on these trends. Although there are no indications of widespread speculative tendencies, there are some evidences of speculative activity and the excessive use of credit, particularly in land and certain types of construction in various areas.

C. Does ample capacity appear still to be available in most major industries? Are there indications of inventory overbuilding in anticipation of higher prices and/or supply interruptions because of strikes?

The members of the Council believe there is capacity available in most major industries that will permit some additional increase in output, but probably only at higher unit costs. The gap between output and capacity is narrowing. Other than the build-up of automobile inventories, the reasons for which are variously interpreted, the members of the Council so far have observed few signs of inventory overbuilding in anticipation of higher prices and/or interruptions because of strikes. However, an acceleration in the accumulation of inventories will occur if businessmen anticipate rising prices in the months immediately ahead.

2. Banking developments.

A. What is the Council's judgment regarding domestic and foreign loan demands over the rest of this year?

Although the domestic loan demand is currently somewhat below expectations, the Council believes that future demand will reflect the rising level of business activity that is now anticipated. The demand for foreign loans continues strong, especially for loans with a maturity of 2 years and 11 months. With the expected expansion in domestic loan demand and with the reserve position of the commercial banks less easy than it was last year, the banks may find it more difficult to accommodate foreign borrowers.

B. Have Council members observed any changes in customer demands for term loans, or in the willingness of banks to grant such loans?

The demand for term loans continues. The members of the Council have not observed any change in the willingness of banks to grant such credits. In fact, some members report that the competition for these credits has become more intense with some tendency for rates and terms to soften.

C. What are the Council's observations regarding the likely trend of interest rates during the rest of 1964?

The members of the Council anticipate that interest rates will drift upward in the months ahead. However, if the tax cut does sharply stimulate consumer demand, inventory accumulation will be accelerated, production schedules stepped up, and capital investment expanded. In these circumstances, credit demand would increase sharply and the interest rate structure would be under upward pressure.

D. Do Council members have comments on recent developments in regard to the issuance of negotiable certificates of deposit?

Since the last meeting of the Board and the Council the interest rates paid on negotiable certificates of deposit are pressing the 4 per cent ceiling. Although there is some concern about the impact on the volume of negotiable certificates of deposit if the yield on Treasury bills and other short-term interest rates should move up further, the consensus of the members of the Council is that the ceiling should not be raised at this time.

3. What is the current status of the exchange absorption problem?

The members of the Council strongly favor a continuation of the Federal Reserve interpretation that the absorption of exchange charges is, in fact, a payment of interest on demand deposits and therefore should be prohibited. The Council is aware of the awkwardness of the present situation but believes abandonment by the Federal Reserve of its long-held position would not be in the best interests of the banking system or of the public at large.

4. What are the Council's views regarding the appropriateness of recent monetary and credit policy?

The Council believes recent monetary and credit policy has been a major factor in the expansion of the economy to its present high level. However, in view of the current volume of business activity, and the anticipated additional stimulation from the tax cut, the possibility of a renewal of wage-cost increases, and the probable pressures on prices, the Council believes that monetary and credit policy should now move gradually in the direction of restraint.

Vice President Aston stated that the Council proposed a modification of the procedure that had customarily been followed for discussion of the various agenda topics. Under the modified procedure, he would read all of the topics and the statements of the Council with respect to them. Then the Council would invite questions from members of the Board. Members of the Council felt that often they were reciting statistics and data as to which the members of the Board were already fully informed. They felt, therefore, that the discussion might be more productive from the Board's standpoint if the members of the Board were to ask such questions as they wished based on the statements in the Council's memorandum.

The Board having indicated that it was agreeable to the revised procedure, Vice President Aston read the agenda topics and the statements of the Council with respect thereto.

The round of questions by members of the Board began with an inquiry by Governor Daane, who referred to the statement of the Council (topic 1A) that "tax increases on the State and local levels will only slightly offset the stimulative effect of the tax cut." He asked whether the members of the Council could be somewhat more specific as to developments that were occurring at the State and local levels.

Vice President Aston replied that in suburban areas, in particular, utilities, schools, and similar necessities were requiring heavy investments and additional municipal bond issues. As an offset, these expenditures were generating economic gains. It would hardly be proper to say that these additional local taxes were in direct offset to the Federal tax cut.

Mr. Day said that a local newspaper had recently carried a full page devoted to tax developments in the areas around Philadelphia. Without exception the tax rates were moving up, due to expenditures on schools, libraries, and the like. One observer felt that the situation was rapidly getting to the point of real taxpayer resistance. It was a fact that local taxes were going up generally, and rather sharply in suburban areas.

Mr. Watlington reported being informed that a tax increase in the State of Maryland could considerably offset the Federal tax reduction beginning in 1965. In other States of the District, except perhaps West Virginia, the situation was not so apparent.

Mr. Cook commented that the Council in its statement had been trying to say that local taxes were coming along at a galloping rate, but that the Council did not relate this specifically to the Federal tax cut. The States also were willing to take all of the tax dollar that they could get.

Mr. Breidenthal agreed. He added that demands on local governmental units were tremendous, and the States and localities were trying to find every possible source of increased income. There was resistance at the local level to increased taxes, but apparently nothing could be done about it because of the pressures for expenditures for such things as schools and the maintenance of utilities. He illustrated by referring to conditions in the Kansas City area. Local tax increases would offset some of the savings people would derive from the Federal tax cut, but the local increases would not necessarily be made by reason of the Federal tax cut. However, the increasing local taxes constituted another reason why the over-all effect of the Federal tax cut seemed questionable.

Governor Daane then asked for additional background on the view expressed by the Council (topic 1B) that some upward pressure on prices was developing and that as a consequence it was doubtful whether the relative price stability of the past several years would continue. He also inquired what was behind the statement of the Council that there were some evidences of speculative activity and excessive use of credit, particularly in land and certain types of construction in various areas.

Mr. Martin replied that there had been price increases in the metals field, including steel products, aluminum, and copper, and also in chemicals to a minor degree. The increases were not too significant, but there was a slight upward movement. There were slight declines in other commodities, to be sure, but over all there was evidence of some upward price tendency. In some sectors, this tendency was being exhibited for the first time in quite a long period.

Mr. Cook noted that the cost of services was going up. On the question of speculative tendencies, they were observed mainly in the real estate area, where there was still an upward push in prices. Business occupancy costs were rising because of the increasing cost of land and construction.

Mr. Breidenthal commented that he would like to see a little upward pressure on cattle prices, for this was needed. Wheat production was going to be greater than last year, but producers would get less for their crop even though they went along with the new legislation.

Mr. Smith commented that in his area fewer discounts were being granted than formerly. This did not show up readily in the price index, but it was part of the overtone of inflationary feeling.

Mr. Watlington said that the passage of the cotton bill had had a stimulating effect on the textile industry by substantially eliminating the differential between the cost of cotton at manufacturing points in the southeast and on the world market. The textile industry would be working at an accelerated rate, and this should help the profit picture. If so, pressure for higher wages would come into the picture quickly, and probably something would be done about it.

Governor Shepardson noted that pessimistic comment had been made about the prospects for agricultural income. Nevertheless, he continued to read reports of farm land prices rising further around the country. Only one or two States failed to show continuing increases.

Mr. Breidenthal replied that this was true in his area, and that the trend was hard to reconcile with agricultural conditions. A contributing factor was the easiness of credit. There seemed to be no difficulty in financing the purchase of farm land even at higher prices.

Mr. Day reported an overbuilt situation in the Philadelphia area in terms of multi-family houses and apartments, but evidence of some speculation in land in parts of the Third District.

Mr. McRae said he did not believe that there had been any appreciable speculation in land in the Sixth District. If there was, he was not familiar with it.

Governor Mitchell commented that he did not think it unusual that land prices should be rising, because of the population trend. There was a fixed amount of land, and it followed that if the world became richer there would inevitably be a trend toward higher land prices. But when it came to the question of improvements, he would be interested in knowing whether the members of the Council found numerous cases of overbuilding in their respective areas or whether the instances of overbuilding were in anticipation of a rate of growth that would shortly be realized. There was apparently some overbuilding in Manhattan, but for a particular reason related to zoning regulations. California was growing so fast that it should catch up shortly with any overbuilding. These types of excesses should be temporary in character because the population movement had not caught up with the facilities provided. In those instances he would not be so much concerned about overbuilding as if it was occurring in more static areas. So far as he was able to gather from the information available to him, most of the excesses tended to be localized.

Mr. Moore said that in New York City building, and plans for building, were still going ahead although vacancies in office buildings were increasing. The problem seemed to lie in the fact that if a high-rise office building could be about 50 per cent rented it was worthwhile to go ahead because the financing was available. Another problem lay in the builders that were public companies and sold stock, for they had to continue to generate income.

Mr. Day said an artificial factor that had entered into the picture was the granting of FHA insurance. A trick of the builders was to get that insurance. If they had it, it was hard to say that they were actually speculating. He was sure that many builders would not have gone ahead otherwise, and mortgagees were willing to take the chance with that insurance in effect.

Mr. Cook said that over a period of time California could absorb anything that was on the drawing boards. The apartment house building situation was the main problem, particularly the high-priced construction.

Mr. Aston reported that in his part of the country farm and range lands were priced beyond the point of reasonable economic investment. If this situation was to continue, it meant that the land owner had to find someone else to buy from him, or at some point someone was in trouble. It was not possible to borrow at current levels and get a reasonable return from the investment.

Mr. Smith commented that the basic answer was that it was easy to finance all of these things.

Governor Shepardson then turned to the question of absorption of exchange charges (topic 3) and said he understood that in some areas the situation was becoming more aggravated.

Vice President Aston replied that while this was a subject of active discussion, he was not aware that the situation was becoming more aggravated.

Mr. Watlington commented that the problem had been before the American Bankers Association for many years, but the Association had not heretofore come to grips with it because it had a mixed group of members. At the spring Executive Council meeting, however, the Association had come out with a stronger attitude than ever before. The statement of the Executive Council was not as definite as it could have been, but the recommendation was that this matter be given careful attention by the members and that the problem be eliminated by pressure rather than by legislation. The Association did not feel that the goal of elimination of nonpar banking could be accomplished at this time through legislation. But it did feel that if all the regulatory agencies could be persuaded to look at the exchange absorption problem in the same light as the Federal Reserve, that would be beneficial.

Mr. Watlington noted that the problem had existed in the Fifth District for a long time and said that it was being gradually solved. The first means was by the merger of par banks with smaller nonpar banks. The second factor was that the State member banks, by not being able to absorb exchange, passed it back to their customers, who went to local banks and protested. There were inequities in the situation, to be sure. The State member bank could not absorb exchange, but the nonmember bank could. Also, the Comptroller of the Currency was overlooking the problem at national banks. Despite this fact, many national banks were going ahead and charging back exchange, realizing that otherwise the nonpar situation never would be eliminated because there would be no pressure, and also realizing that the absorption of exchange would have a substantial effect on their earnings. In his opinion, those banks that had stayed away from the absorption of exchange would continue to do so. Those who were going to absorb exchange had long since made that decision. He had seen no change in the status for some time.

Governor Shepardson commented that the national figures failed to show much reduction in the number of nonpar banks, to which Mr. Watlington replied that in North Carolina and South Carolina the number of banking points going on the par list has been substantial, and he knew of no banks going on a nonpar basis for the past several years. The number of nonpar banks had been diminishing substantially in his area.

Mr. Rutledge commented that there were many small unit banks in Minnesota, most of which were nonpar banks. There was no pressure on them to move away from nonpar status. He foresaw no significant change in the situation in the Ninth District.

Mr. Rutledge expressed himself as favoring strongly the position taken by the Council in its statement on this topic. So far as he knew, the par banks in his area were almost without exception complying with the present rule against exchange absorption.

Mr. McRae reported a small reduction in the number of nonpar banks in the State of Florida. Several banks with whom he had communicated believed there was less exchange absorption than had been the case in the past in that area.

Governor Shepardson said he had heard recently of some areas where banks had stated that they could not live with the present situation any longer and that they were going to start absorbing exchange to meet competition.

Mr. Day commented that the problem was a difficult one for many member banks in the Third District. They were forced to make charge-backs on small items, and this was costly.

Governor Shepardson inquired if he was correct in his recollection from the last meeting of the Council that the Association of Reserve City Bankers was about ready for a session on the problem.

Mr. Watlington replied that such a session had been held and the Association was very strong on the matter of leaving the present situation as it stood. He had talked with a number of members of the Executive Committee. They had had a number of sessions on the problem and were anxious that the present situation be maintained without change.

Governor Robertson inquired whether there was any way of implementing the action taken at the recent meeting of the American Bankers Association, and Mr. Watlington replied that if the Federal Deposit Insurance Corporation would see eye to eye with the Board of Governors, that would help the situation. Representatives of the Association had talked with Chairman Barr of the Corporation, but it was too early as yet to tell what the Corporation might do. The attitude of the American Bankers Association was to use substantial pressure with the Corporation, and also with the Comptroller of the Currency to see whether he could be persuaded to adopt a firmer approach. A bank could hardly go to another bank, Mr. Watlington said, and persuade it not to absorb exchange, but if customers went to a nonpar bank and complained, that was a different matter. He added that practically every one of the nonpar banks in his area maintained two separate lists. If a customer exerted pressure, the bank would handle his items at par. He went on to say that if all banks were allowed to absorb exchange, then the par banks would have nothing to stand on if they went to the national companies. The cost to his bank in absorbing exchange would be substantial, and he understood from Mr. Rutledge that in the case of the latter's bank the cost might be as much as $1 million a year.

Mr. Hickok inquired if the Board was being pressured by member banks to change its present interpretation, and Governor Shepardson replied that there was some pressure to eliminate the competitive inequity. Governor Robertson added that the pressure was for some change, either a change in the position of the Federal Deposit Insurance Corporation, a change by way of the Comptroller's requiring compliance by national banks with the prohibition against exchange absorption, or else a change in the Board's position. Mr. Watlington inquired if the banks were relatively small that were exerting such pressure, to which Governor Robertson replied that they were not little banks. The words "relatively small" would have to be defined. Mr. Watlington commented that if banks had to absorb exchange this would hurt them considerably, to which Governor Robertson replied that even so they felt this would be better than to lose accounts. Mr. Watlington said he did not know of any account that his bank had lost in the past two or three years because of the fact that it did not absorb exchange, despite the fact that one competing bank had built itself up on absorption and despite the fact that the Comptroller was not enforcing the exchange absorption rule in respect to national banks. Some years ago his bank lost some business, but not in the past two or three years.

Governor Mitchell asked for any information about the relative percentages of items handled at par and not at par by nonpar banks, and Mr. Rutledge said it was his experience that a nonpar bank in his area was essentially a nonpar bank, except for amounts they might handle at par in their own communities.

There followed comments on studies made by the American Bankers Association in the past regarding the point at which it was costly to a member bank to charge back exchange. There was also comment by Vice President Aston that from 1958 to 1963 there was a net reduction of 138 in the number of nonpar banks. Of this reduction, 101 was accounted for in the Richmond District. In the Ninth District there had been a small increase in the number of nonpar banks.

Vice President Aston also said that in his opinion the vast majority of bankers felt that it was in the best interest of banking to "stay where we are." It was felt within the Association of Reserve City Bankers and the American Bankers Association that another effort should be made to try to get the Federal Deposit Insurance Corporation to adopt the same position as the Board of Governors. Otherwise, the objective of having all banks in the United States eventually on a par basis was likely to be lost. If the Board were to hold the line, he felt that more pressure would be exerted through the bankers associations to bring about the desired objective.

Mr. Watlington said he thought that the bankers associations were more interested today than they ever had been, that their attitude was firmer, and that concerted action was developing.

Governor Shepardson asked why, if this was so, the bankers associations had shied away from a legal requirement for par banking, and Mr. Watlington replied that State legislation could not be achieved in North Carolina because the number of small nonpar banks was still rather substantial, and they could exert considerable influence on legislators. An effort had been made in North Carolina, but unsuccessfully. As to Federal legislation, there were not too many areas of the country directly affected.

Governor Shepardson inquired as to the reason for so much concern about the Board's reversing its position, and Mr. Watlington said this would play havoc with the member banks that were principally concerned.

Governor Robertson said that the impression given in the press release issued following the recent meeting of the American Bankers Association was that the Association was opposed to seeking correction through legislation. Perhaps the Association had been thinking in terms of State legislation, but if, as a condition of deposit insurance, a bank had to be on the par list, that would be a different matter.

Mr. Martin noted that the statement made by the American Bankers Association was that legislation should not be sought "at this time." Those were the key words. It must be remembered that the Association is a heterogeneous organization. It was a considerable advance to have the Association take a position such as had been expressed, and the management was seriously interested in the problem. He thought the responsibility implicit in having made the statement that was issued was fully realized, and that the Association proposed to stand up and be counted wherever it possibly could. There undoubtedly was a stronger feeling of responsibility than had existed before. A first approach to Chairman Barr had been made early in his tenure of office, and he had said that he could not at that time give a definitive answer. Within thirty days, representatives of the American Bankers Association expected to try to talk to him further, and the outcome remained to be seen. There was also the matter of leadership on the part of correspondent banks, and it might be that something could be worked out in this regard. There was likewise the question to what extent business and trade organizations could be encouraged to exert additional pressure, and the management of the Association was going to try to do something in that regard. Without any doubt, there was a seriousness of purpose.

Mr. Hickok commented that in the Eighth District a number of banks had withdrawn from membership in the Federal Reserve System, but he knew of no instance where the withdrawing bank had gone nonpar. From a psychological standpoint, he felt that the Board would be letting down the member banks if it changed the rules of the game at this stage, for the ultimate objective was the elimination of nonpar banking.

Mr. Watlington said that ten years ago when his bank was losing accounts to nonpar banks, there would have been much more reason for changing the rules of the game than now. Nonpar banking was being licked in the Fifth District, with over 100 nonpar banks having been eliminated in the past several years.

Mr. Watlington also said he suspected that the banks referred to as having complained recently to the Board that they were being forced by competitive pressure to absorb exchange might be relatively small banks, and he was sure there were many others that would stand up to the competition. Bankers who lost accounts naturally tended to get upset, and sometimes they blamed the loss on absorption of exchange when such was not the cause. Accounts move for many reasons.

Governor Robertson asked for any additional comments the Council might wish to offer in elaboration of its view (topic 2A) regarding the expected trend of domestic loan demand.

Mr. Day said the consensus in the Third District was that on a daily average basis, and taking all categories of loans into account, there would be an increase of 4 to 4-1/2 per cent from the first quarter to the fourth quarter of this year. This was the expectation of the larger banks in the area. Up to this point, loan demand had been less than seasonal.

Mr. Moore concurred that thus far this year business loan demand had not been as strong as anticipated. Loans to sales finance companies and certain other categories of loans had increased, but business loans in the Second District were nowhere as robust as had been anticipated.

Governor Mills noted that the Council had indicated in its memorandum that it saw some evidence of the tax reduction being followed up in additional capital investment, and later the Council had made a comment about a rather strong demand for term loans. He asked whether the term loans were financing business expansion programs.

Vice President Aston said that in his judgment the increase in term loan demand was in the capital area. He thought it was due in part to the borrower's ability to trade with the lender on terms and rates. Until a few years ago, commercial borrowers would hardly have thought of coming to a bank for a long-term loan, but now the over-five-year loan was considered practically a current loan. The pressure was from the "unregulated lenders"; insurance companies, pension funds, and other sources were forcing the commercial banks into term loans.

Governor Mills indicated that he would have some concern if the banks felt that they were being pressured into extending long-maturity loans that were not for the ordinary purposes that one would identify with commercial bank lending. If the banks, with their already reduced liquidity ratios, felt that the demands of their borrowers were such that they were compelled to make long term loans, that was a matter of some concern to him.

Vice President Aston replied that his bank was reluctant, but it was a matter of self-preservation. While it did not necessarily bear on the soundness of the credit, it did bear upon liquidity, and there was even some softening of rates.

Mr. Moore said that the competition was not only from other banks. Some insurance companies were actually lending in the short-term area. If the banks let such loans go, they would lose a position with a particular borrower. But they could not even compete ratewise with the insurance companies, because the latter had been lending at 4-1/4 per cent or something of that order. A downward pull on credit standards was being exerted instead of a stiffening of requirements. So much money was around awaiting suitable investment that insurance companies and other nonbank sources were hard pressed to find places for their funds.

Governor Balderston noted that Chairman Martin had begun raising questions about the quality of credit some time ago. The Board was always challenged to cite evidence, and this was not too easy. But he had been wondering whether the normal rates of lending had not in effect been lowered by relaxation of quality standards. Insurance executives had told him that this trend was going on in their industry, and he wondered to what extent commercial banks were taking on loans that they would not have touched previously.

Mr. Moore replied that things were well over on that side because there was so much nonbank money around. He observed that in lending to foreign subsidiaries of domestic customers the terms and requirements showed a tendency to be less rigid.

Mr. Smith expressed the view that the situation was getting worse. It was the feeling of banks in his area that loan requests were becoming more complicated and difficult. The stronger banks were not making too many of these loans, but a lot were being made by weaker banks. It was a dangerous trend. The basic reason for it was the volume of money around.

Governor Shepardson inquired to what extent standards were changing on the construction-type loan. He had heard, in some areas, of a lengthening of terms through the use of balloon-type provisions.

Mr. Cook said that the expansion of leasing business was having an effect. Terms were liberal, based on credit rather than normal production considerations. Loan delinquencies and losses had not risen particularly sharply, but that was usually the case when business was good. The margin of protection was nonexistent in much of the present financing.

Mr. Watlington said that automobile financing terms had gone through a period of extension of maturities and had since been shortened somewhat. The situation was spotty. He knew of no significant use of balloon-type financing in his area.

Chairman Martin inquired whether there was an implication in the Council's statement (topic 4) that recent monetary and credit policy had been too easy, and the replies by members of the Council were in the negative.

Vice President Aston commented that Council members saw a few storm clouds ahead, which suggested that the Federal Reserve should perhaps consider moving gradually in the direction of a neutral monetary policy. At least, this reflected the consensus of opinion. As in all of the Council's statements, there were shadings of opinion. Some of the members of the Council had expressed concern that the factors arguing in favor of a gradual move in the direction of restraint were not quite as clear as others believed. In his own view, this was a period of optimism and confidence that he felt contained some dangers; it was time for a little thought.

Mr. Moore saw the real estate situation as potentially dangerous, although possibly spotty, and there was at least the chance of higher prices generally. Raw materials prices were already moving higher, and this trend might show up next in wholesale prices. He thought there definitely were elements of boom psychology around, and there was a chance of the economy overheating. Anything that would cool things off a little, certainly in the real estate area, might permit sustaining the kind of growth that had been occurring rather than cause the balloon to burst too soon. Some further facts would be needed to reach a complete judgment, such as the results of the forthcoming wage negotiations in the auto industry, but at present everything in the economy seemed to be moving forward, with no offsetting factors.

Governor Mitchell observed that the purpose of the tax cut was to encourage the rate of economic growth and stimulate the economy to move forward more rapidly so as to reduce the level of unemployment of resources. He inquired whether the Council was saying that the tax cut was considered too stimulative and therefore monetary policy should be somewhat more restrictive.

Mr. Watlington commented that he would favor a more restrictive policy if certain things materialized about which the Council was apprehensive.

Asked by Governor Mitchell whether the Council saw them materializing, Vice President Aston said he did not see them in clear focus. However, he felt that there was a latent force in the tax cut and that the psychological effect in terms of consumer spending and business investment was yet to be measured statistically in terms of its influence. In the circumstances, it might be well to begin to apply the brakes promptly.

Governor Shepardson commented that the matter of timing was a vital question. Should inflation burst out, everyone would want to have something done about it. The question was whether this was the time, before the evidence was fully at hand, to start doing something.

Vice President Aston said this was the consensus within the Council, although there were differences of degree.

Mr. Breidenthal commented that he found it rather difficult to reconcile the observations of the Council as set forth in its statement on economic conditions and prospects (topic 1A) with the statement (topic 4) that monetary and credit policy should move gradually in the direction of restraint. Care should be exercised not to try to put out the fire until it got a start, and apparently the Council members had not thus far even seen smoke. To him, "gradually" meant that the Federal Reserve should begin to move in the direction of restraint when it began to see smoke.

Chairman Martin said he understood that some of the Council members thought there was now a little smoke, and there were several affirmative indications.

Mr. Day said it was hard to deny that there was a boom psychology developing, even though the available statistics might not seem to support it. The Board's economists had suggested to the Council yesterday that there did not appear to be strong upward price pressures at present, but he sensed that the psychology was developing in that direction.

Mr. McRae noted that although most of the bankers he had contacted before this meeting reported that they had not seen too much buying yet as a result of the tax cut, nevertheless they believed that without any doubt the public was assuming a buying mood.

It was agreed that the next meeting of the Federal Advisory Council would be scheduled for September 21-22, 1964.

The meeting then adjourned.

Secretary