The attached minutes of the meeting of the Board of Governors of the Federal Reserve System on December 3, 1965, which you have previously initialed, have been amended, at the request of Governor Daane, to insert beginning at page 9 the text of the statement made by him at the meeting of the Federal Open Market Committee on November 23, 1965, rather than to incorporate the statement by reference.

If you approve the minutes as amended, please initial below.

Chairman Martin

Governor Robertson

Governor Shepardson

Governor Maisel

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## Minutes for December 3, 1965

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.

It is proposed to place in the record of policy actions required to be kept under the provisions of section 10 of the Federal Reserve Act entries dealing with the subjects referred to below:

Approval of a discount rate of 4-1/2 per cent for the Federal Reserve Banks of New York and Chicago.

Amendment to Supplement to Regulation Q, Payment of Interest on Deposits.

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 to indicate approval of the minutes.

Chm. Martin

Gov. Robertson

Gov. Balderston

Gov. Shepardson

Gov. Mitchell

Gov. Daane

Gov. Maisel

Minutes of the Board of Governors of the Federal Reserve System on Friday, December 3, 1965. The Board met in the Board Room at 1:20 p.m.

PRESENT: Mr. Martin, Chairman

Mr. Balderston, Vice Chairman

Mr. Robertson
Mr. Shepardson
Mr. Mitchell
Mr. Daane
Mr. Maisel

Mr. Sherman, Secretary

Mr. Kenyon, Assistant Secretary

Mr. Young, Senior Adviser to the Board and Director, Division of International Finance

Mr. Holland, Adviser to the Board

Mr. Solomon, Adviser to the Board

Mr. Molony, Assistant to the Board

Mr. Hackley, General Counsel

Mr. Brill, Director, Division of Research and Statistics

Changes in discount rate and Regulation Q. Chairman Martin noted that advice had been received that the directors of the Federal Reserve Banks of New York and Chicago had acted at meetings yesterday to increase the discount rate from 4 per cent to 4-1/2 per cent (with corresponding increases in subsidiary rates on discounts and advances) subject to the approval of the Board of Governors.

In opening remarks the Chairman suggested for the Board's consideration not only the question of approving the discount rate increase but also amending the Supplement to Regulation Q, Payment of Interest on Deposits, to increase to 5 per cent the maximum rate permitted to be paid by member banks on time deposits with maturities

from 30 to 90 days, with a maximum rate of 5-1/2 per cent on time deposits of longer maturities.

The Chairman then requested the views of the other members of the Board.

Governor Robertson, who spoke first, presented a statement as follows:

Changes in monetary policy should not be triggered by fear of prosperity. A prosperous and growing economy has been the goal of public policies, and substantial achievement in that direction in the 1960's should be a cause of gratification rather than concern. It is not inevitable that inflation, boom, and bust must follow from the kind of prosperous performance the United States economy has been giving, and consequently there are no valid grounds for arguing that tightening now is needed to forestall inflationary developments that are sure to come later.

This is not to deny the need for very careful scrutiny of the progress of economic events and a willingness to act to further restrain credit if and as excessive demand pressures actually emerge. I conceive of the present as a time of delicate balance in the economy. Supply and demand forces seem so tentatively poised that abrupt action to change monetary conditions could tip the scales significantly - towards inflation if policy was actively eased, or on the other hand, towards recession if credit availability were sharply tightened.

Financial markets have only recently calmed somewhat after being buffeted by rumors of an impending discount rate change. Such a rate increase now would come as a distinct surprise, with reactions aggravated by the impending seasonal peak of money market pressures. Such action would insure undoubtedly that the heavy volume of Treasury cash borrowing to be done in January would have to be undertaken at substantially higher interest costs to the Government.

If, for whatever reasons, a tightening action is to be initiated, it would be far preferable to use a subtle rather than a slam-bang method. An appropriately mild and indirect line of action might be to (1) dampen bank issuance of promissory notes by defining them as deposits; (2) hold Regulation Q ceilings on time deposit interest rates at existing levels for the time being; and (3) take no action on the discount rate, expecting that banks would undoubtedly have to cover some portion of their net December loss of CD's by substantial temporary resort to the discount window. This combination of steps should serve to moderate somewhat the rate of advance in bank credit, while not triggering immediate expectations of higher interest rates in the market and yet, at the same time, placing banks in a position of dependence on the discount window that could lead fairly naturally to a more overt tightening of monetary policy should inflationary developments begin to appear.

Whether or not a breakout of inflationary pressures will in fact occur cannot now be predicted. Accordingly, the best practical course is to adopt a policy of "watchful waiting", meanwhile continuing to supply a reasonable flow of reserves to finance much-needed economic growth. Despite large and sustained expansion since the last recession in 1961, a small but significant margin of human and real capital resources remains unutilized in this country. Further orderly expansion in aggregate demand can effectively employ some of these resources. The accompanying growth in credit and money during this period has been orderly, and has contributed to overall economic growth. Continued orderly credit expansion is needed if our economy is to move on up to the goal of sustainable full employment of available resources.

The price pressures to date from this economic growth have been small and selective, stemming mostly from world-wide shortages of particular nonferrous metals, temporary scarcities of certain agricultural products, and market-testing mark-ups in a few administered-price industries. These are not the types of price increases appropriately dealt with by a dampening of aggregate domestic demand. The temporary nature of some of the recent increases is indicated by the

fact that the rate of rise in the wholesale price index has already slowed since mid-year from an annual rate of 2 per cent to 1 per cent. Meanwhile, recent successful Administration actions against aluminum and copper prices reduce the likelihood of other administered-price increases.

The U. S. balance of payments performance does not now supply reasonable grounds for further monetary tightening. The chief burden for further improvement in the balance falls on other policies. The allegedly interestsensitive components are already performing very well under the discipline of the voluntary foreign credit restraint program. I see no sign that this program is weakening in so far as its influence on financial institutions is concerned. Corporate direct investment abroad, the category of capital flow that has been least reduced to date, is notoriously insensitive to changing general credit conditions in the United States.

U. S. interest rates are already high by historical standards, and I believe they are generating all the credit restraint that ought to be attempted in the current delicate situation. The Federal fiscal position will be shifting to a somewhat less stimulative policy for a time after the turn of the year, and we should be wary of imposing a coincident restraining influence from additional monetary tightening at this juncture. The appropriate monetary policy for later in 1966 can be best judged after we have the benefit of the official Federal budget message in January and see the public reaction thereto.

Governor Robertson noted that, as indicated by the views he had just expressed, he did not think it would be wise to increase the present Regulation Q ceiling rates. Such action would make more money available to the banks to expand their loans further, and in his opinion that would be the wrong approach. The proper approach would be to retain the present ceilings and force the banks into the discount window. Perhaps there could be a statement by the Board reflecting

realization that in the absence of a change in the Regulation Q ceiling rates and in view of the prospective run-off of CD's, banks would be forced into the discount window, which window would be made available to them. The greater discount volume would enhance the ability of the Federal Reserve to help curb inflationary forces if this became necessary later.

Governor Shepardson commented that as he had listened to the debates over the past several months it seemed to him there was no essential difference of opinion concerning the desire to avoid inflation. As far as he could see, the differences centered largely around the matter of timing and to some extent the method of combating inflationary pressures. Granting that the price indexes might not show rampant inflation as yet, nevertheless he had felt, and continued to feel, that inflationary pressures were generating. The time to make corrective adjustments was before the situation got seriously out of hand. This could be done, in his opinion, through some slowing of the rapid pace of expansion that the economy had been experiencing, and without leading to a downturn. As to the various techniques that might be employed, he had studied the kind of approach mentioned by Governor Robertson that would involve greater use of the discount window. As he remarked at the November 23 meeting of the Open Market Committee, he had thought at that time that an appropriate approach might be to bring about some further tightening of reserve availability. If a change was made in the discount rate, there would be some churning in the markets as a result. But if an increase also was made in the Regulation Q ceiling, this would provide flexibility for adjustment purposes. Then, in the ensuing period of backwash after the turn of the year, there could be a mopping-up of reserves to the extent necessary to validate the rate movement. In his opinion this would be the best course to follow, and he felt it was time to act.

Governor Mitchell said his appraisal of the economic situation had not changed significantly: the economy was showing a little more strength every day, a little more than he would like to see. He would prefer to move into full employment somewhat more slowly.

In his opinion the major problem before the Board at the moment was of a political nature. The Federal Reserve appeared to be on a collision course with the Administration, and this should be avoided if at all possible. He believed such a collision could be avoided if there was a little time to negotiate. The System was moving into a difficult operating period. Things would happen that would be difficult to take care of, and they would tend to convince some people that the rather distorted market relationships must be brought back into a more viable condition. Accordingly, he felt it would be unwise for the System to move until some effort had been made to negotiate with a view to assuring, if possible, that the Administration would not be going in one direction and the Federal Reserve in another. The System's public

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posture at this particular juncture would be a poor one if the System were to say to the Administration, in effect, that it was trying to establish a national policy by means of monetary policy. This would mean that the Administration would not have freedom to make a selection of fiscal and monetary measures within the framework of its economic program for 1966, which would be announced shortly. The total economic program of the Government encompassed spending and taxing policies as well as monetary policy. If the Federal Reserve were to announce a discount rate increase in advance of appropriate consultations, it seemed to him this would be an affront that the Administration could not and would not ignore.

Governor Mitchell went on to say that he believed in the independent status of the Federal Reserve System within the Government. He had said to many people, publicly and privately, that much credit for retaining an appropriate degree of independence was due to the Chairman's skill in handling particular situations. He would be prepared to defend the position of the System to the best of his ability in any event, but he believed this was a defense that it would be difficult to undertake.

On the technical side, Governor Mitchell said, he was not inclined to agree at the moment with Governor Robertson's proposed solution. His preference would be to make a change in Regulation Q, even though he felt, as aforesaid, that a change in the discount rate was largely a matter of negotiation with the Administration. As to Regulation Q, he

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realized that a change such as he would prefer personally -- to move perhaps as high as 6 per cent--might involve more trouble than was warranted. At the same time, he would be prepared to go to 5-1/2 per cent for all deposits with maturities of more than 15 days. This would amount to telling the banks that they were free to go ahead and take money away from somebody else. The banks would, in fact, have to take money from somebody else, and he felt that this was the right way to handle the situation. The reason he was suggesting a high maximum rate on all maturities of 15 days or more at this point was that if banks needed money for some short periods it might be of advantage to have this leeway available. He also had a feeling that it might be well to reduce reserve requirements at this time, in such manner as to release a relatively modest volume of reserves to the small banks; this would fit into a package that seemed appropriate for the occasion. reserves provided might have to be mopped up at some stage through open market operations, but reserves made available to the small banks probably would not be utilized for a while to any great extent. Thus, there would be some time to work out a solution. When reserves were made available to the small banks, one might expect that a substantial part of them would take the form of excess reserves for some time.

Governor Daane asked for a staff view on whether, if Governor Mitchell's proposal were adopted, the discount rate would not inevitably have to be raised, and Mr. Holland replied that he did not think the one

move would compel the other in terms of rate relationships. However, expectations might be generated. Governor Daane asked if the market would not react uneasily to a move on Regulation Q, taken by itself, and Governor Mitchell replied that he thought much would depend on how the situation was handled.

Governor Mitchell then continued by referring to the question whether any discount rate increase should be in the amount of 1/4 per cent or 1/2 per cent. He recalled that at the November 23 Open Market Committee meeting he had said that a 1/4 per cent increase would validate the then existing position of the market while a 1/2 per cent increase would lead the market. Perhaps that was not true today. But if it was true his judgment would be--and here he came back to the political question--that if a 1/2 per cent increase could be negotiated such action might be indicated. If only a 1/4 per cent increase could be negotiated, then he thought it would be better to make such a move.

Governor Daane said he did not have too much to add to the statement he had made at the Open Market Committee meeting on November 23 reading as follows:

Three weeks ago I was pretty well convinced that, once the Treasury financing was out of the way, the time had come for an overt move in System policy involving a change of one-half per cent in the discount rate and in Regulation Q ceilings coupled with some cushioning of the move, similar to last November, in terms of somewhat greater reserve availability initially. My view was premised on both economic and financial grounds. From the standpoint of the economy we had for several years been following, in my judgment appropriately, a relatively easy, or more or less passively accommodative, policy in order

to provide the needed credit stimulus or support to increasing aggregate demand in the interest of achieving full employment and a sustainable expansion within the framework of relative price stability. On the resource utilization side and specifically the employment side, or more accurately unemployment side, I now feel that, as has been publicly acknowledged by top Labor Department officials, we are down to the hard core unemployment, or a composition of unemployment that may be relatively impervious to additions to total aggregate demand. Further credit-stimulated additions to demand in current circumstances of close to capacity operation in terms of utilization of resources must inevitably risk accelerating a price upcreep--perhaps even upsweep--that I sense is already in process.

Continuance of a no-change System policy risks overstimulating an investment boom rather than containing it in the interest of continuing a sustainable expansion. On this score, in reading the Green Book and in following the chart show this morning, I again was particularly impressed by three points which seem to me to be central to a diagnosis of the present situation. First, that business fixed investment plans for 1966, which are already buoyant, at 8 per cent above 1965, are practically certain to be revised upward if the general expansion continues. Second, that if business investment outlays rise considerably faster than they are now projected to rise, we will be likely to have fairly severe pressures on capacity in the machinery industries. And third, that if GNP rises much faster than it is now projected to rise, the "selectivity" that has been characterizing price increases may begin to disappear, if it is not already disappearing.

At some time farther ahead--I would hope a long time ahead-the risks and dangers of a downturn in business investment are
bound to be serious. And the severity of the problem at that
time will depend directly on the degree of disproportion that
will have been allowed to develop in the meantime between the
rate of growth of capital expenditures and the general rate of
growth of the economy. The degree of ease in monetary and
credit policy will certainly be a major determining factor.

Parallel to the need for restraining credit expansion so as to help avoid an unsustainable acceleration in business investment, restraint is needed so as to damp down the growth in consumer expenditure financed by credit. Here again, the need is for maintaining reasonable balance in the economy, and reasonable sustainability of rates of increase in the various flows of expenditure.

Above all, we need to restrain credit expansion so as to hang on to a reasonable degree of price stability. Whatever set of theories of linkages between credit or money and prices you may prefer, the present and prospective situation is certainly one in which too much ease would be likely to contribute, directly or indirectly, to upward pressures on prices. And if prices were to begin rising in a less selective manner than apparent up to now, the price rise in turn would feed the bullishness of the economy, stimulate protective inventory investment, accelerate capital outlays—in short, lead us into a classical boom completely unlike the steady well-balanced expansion we have had for nearly five years now.

Last, but by no means least, on my list of economic reasons for a System policy change is the deterioration in our balance of payments not entirely papered over by changing definitions and strenuous Governmental efforts to achieve postponement of some scheduled outflows into next year's statistics. While the effect of a change may not produce immediately beneficial effects, it would clearly over time be supportive of our current efforts. Most importantly it will contribute to the relative price stability essential to the eventual resolution of our balance of payments problem.

In sum, the case on economic grounds for a discount rate increase this December appears to rest on the following:

- 1. Persisting gradual upward price pressures--with the wholesale price index rising at an annual rate of 1 per cent since June, following a 2 per cent rate of rise over the previous 9 months.
- 2. Continuing rapid expansion of business fixed investment at a pace disproportionate to the rise in final products—in the past 10 months, business equipment production is up 10 per cent; consumer goods production up 2 per cent.
- 3. Shrinking margin of unused resources--average manufacturing output at 90 per cent of capacity (more in lines other than steel) and unemployment down 2.9 per cent of adult males, with signs of a beginning slowdown of productivity and rise in unit labor cost.
- 4. Persisting balance of payments deficit--at a roughly \$400 million per quarter rate on a regular transactions basis.

On the financial side, three weeks ago I found the case for a change even more compelling. Both the demand and supply of funds seemed to be distorted by the continuance of relatively fixed rates in the banking sector and by our own policy of seemingly resisting market forces in the interest of Treasury financing considerations. Today, financial developments still supply support for a rate increase although perhaps somewhat less support than a few weeks ago.

- 1. Credit demands are large and growing; especially business demands for external financing partly to pay for disproportionate expenditures on fixed investment.
- 2. Despite big business capital market flotations, and some bank efforts to push more borrowers into the capital markets, a stable 4-1/2 per cent prime loan rate keeps drawing in business loan demands. To the extent resultant demands tax bank resources, resultant rationing actions press most against newer and smaller borrowers.
- 3. Seasonal pressures will be pushing up bill rates between now and mid-December--perhaps to in the neighborhood of 4.15 per cent on the 3-month bill. An accompanying seasonal tightening of other rates will increase pressures on discount administration and may trigger new disturbing uncertainties concerning discount rate action.
- 4. Higher short-term market rates will squeeze hard on bank ability to sell CD's to replace big December maturities. Such maturities are by now probably as big as September, when the post-tax-date squeeze pinched banks for several weeks and led to sharp rate run-ups.
- 5. Prime-name banks are already being led to merchandise promissory notes at shorter maturities and higher interest rates than allowable on CD's under Regulation Q. Unless Q ceilings are raised, promissory note issuance is likely to balloon in December, pushing up rates and complicating the Treasury's intended turn-of-year bill financing. If promissory notes are redefined as deposits to halt Regulation Q avoidance, Regulation Q ceilings will have to be raised to give banks relief, and thereby will trigger renewed strong expectations of a discount rate increase--expectations that could inhibit market flows.
- 6. Higher interest rates can increase market capacity to handle flows, as happened in the corporate market in the last two weeks. A higher discount rate could clear the air and

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improve the reception for unexpectedly large Treasury financing needs in January. This would be particularly true if at the same time open market operations reduced somewhat the need for member banks to borrow.

While I still feel the case can be made along the lines I have indicated, I am today less certain of the timing and sequence of System actions. It seems to me the market now is poised precariously, having been buffeted by oral suasion and shifting expectations to the point where an overt move in the form of a discount rate change could set off a chain of overreactions that could go far beyond the sort of modest tightening I have had in mind. Thus, where I come out is that we face a choice of two courses: one, we can move back on net borrowed reserves to the high side of the \$150 million mark and accept, not resist, market forces that in all likelihood will produce somewhat higher rates in the days and weeks immediately ahead. Under this course I would at that point consider a change in the discount rate. To be specific, following this particular course at this juncture argues that it would be better for the System to follow than to lead the market. The other alternative course is to go ahead with an overt move on the discount rate as quickly as possible, with the cushioning action on reserves I have already suggested. These two courses may not really be far apart in point of time but my own preference would, I believe, be to follow rather than lead the market.

Governor Daane said the things to which he had been exposed since the November 23 date tended to confirm his opinion that there was a case for a policy change on both economic and financial grounds. While he did not have full information on the forthcoming Federal budget, the outline and shape of that budget seemed quite obvious. In any event, the day-to-day signs of strength in the economy lent weight to the judgment that action should be taken, and evidence of the increasing impact of the Vietnam conflict, which seemed likely to be of rather long duration, reinforced the case for action.

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Governor Daane said that upon reading the memorandum prepared by Governor Maisel under date of November 29, 1965 (which Governor Maisel had distributed to the other members of the Board) he found much in the memorandum with which he could agree. But he did not quite agree with the observation that the credit and financial markets were moving well. Knowledgeable people in the investment banking fraternity with whom he had talked recently held the view that the present market situation was something that was not going to go away and that no amount of talk, such as the recent speech by the Secretary of the Treasury in New Orleans, would really solve the problem. It was felt generally that economic forces were contriving to push market rates up. Thus, there was a clear choice between trying to resist, through an easing of monetary policy, the higher rate levels that were in process of being achieved or to take a policy action and adjust the rates, where there were distortions, so as to improve the flows of funds. All indications were that the situation was getting worse, not better. Therefore, on the financial side he came out, as he had at the November 23 Open Market Committee meeting, that there was a clear case for action in a technical sense to improve the flows of funds.

On the political side, like others he felt most sensitive to the situation. The situation was an awkward one, and he was much concerned

about that aspect of the matter. He felt, however, that the judgment of the Board members must be exercised if the independent status of the Federal Reserve within the Government was to have any real meaning.

As to the amount of a discount rate increase, Governor Daane said he did not think a 1/4 per cent increase would do much more than indicate to the market that the Federal Reserve was likely to take further action and that another 1/4 per cent increase probably would be forthcoming. Therefore, he would prefer a 1/2 per cent increase at this time. As to Regulation Q, he would not want to argue strongly about going to 5 per cent for maturities up to 90 days and to 5-1/2 per cent for longer maturities, as opposed to a move to 5-1/2 per cent for all maturities. However, he would accompany the discount rate and Regulation Q actions with some sort of easing action on the reserve side, as was done following the discount rate increase in November 1964. He was not sure whether the sort of cushioning he had in mind would best be accomplished through open market operations or through some adjustment of reserve requirements, and he would welcome whatever views the staff might have on this subject. Finally, Governor Daane added, he felt there was definitely a relationship between Federal Reserve discount rate and Regulation Q actions and the whole U.S. program in the balance of payments area. There were differences of views in this respect. But in his opinion the Federal Reserve actions could be regarded as supportive of the broad balance of payments effort. (The revised voluntary foreign

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credit restraint program had been discussed by Government officials with the press this morning and was to be publicly released over the week end.)

Governor Maisel noted that, as mentioned by Governor Daane, he had distributed to the Board members a memorandum setting forth reasons why he urged strongly that for the present the existing 4 per cent discount rate not be changed. This memorandum had read as follows:

After a long and arduous climb, aided by the extra kick of Vietnam-induced demand, this country for the first time in eight years is approaching a full-employment economy. An orderly growth in money and credit has helped this expansion. If monetary policy remains supportive, prospects are bright for continued full use of all resources with price stability.

The strains of growth have been severe. A continued full-employment level will bring further pressures. Still, in prices, wages, and credit, increases and distortions have been far less than seemed likely. Price pressures have been small and selective. They are of a type best resisted by a sound incomes policy rather than by a monetary dampening of effective demand.

The credit and financial markets have been buffeted, but they too have come through recent crises admirably. Large needs have been met under conditions of moderate restraint. Most credit categories have expanded simply in line with growth of sales, spending, and investment. Signs of changes in credit quality are few and mixed.

A discount rate increase or a sharp tightening in credit at this time could be interpreted only as a vote of no-confidence by this Board in the national goal of growth at full employment. It would declare our belief that recent Governmental policies had been wrong. It would express our feelings that even to approach full employment carries so many inflationary dangers that a more restrictive monetary policy is necessary.

In addition to threatening further expansion, torpedoing recent policy, and making further wage restraints harder to achieve, more stringent credit would have other unfortunate

long-run effects. Interest rates are near their highest for the past 37 years. The last time the discount rate (New York) was newly set as high as 4-1/2 per cent was on November 15, 1929. Higher interest rates hit long-run investment hardest. They can easily be absorbed by short-term speculators. A current increase would primarily restrict modernization of plant and equipment, growth in housing (a drop of 100,000 starts or more per year would be likely), and the expansion and rebuilding of vitally needed State and local improvements. It would halt the growth of small business and the absorption of marginal groups into the economy.

A change at this time might demoralize and perhaps fatally weaken parts of our financial markets. They have just demonstrated their ability to handle severe pressures. A move by the Board now would appear like a direct attack from an unexpected source.

Some fear that existing pressures cannot be contained. In actuality, inflationary forces do not appear to have increased. Maximum fiscal pressures should slacken within the month. No major wage bargains are in progress. Aluminum, copper, and wheat price policies have been unusually successful. Their impact is spreading. While potential costs of Vietnam are disturbing, unless the Federal budget in January is more inflationary than appears probable, little indication exists for excess demand next year. If further pressures do appear, serious consideration should be given to the longerrun implications of the proper balance of interest rate, incomes, and fiscal policy.

I have already stated my views on the balance of payments argument. We are doing extremely well on the interest-sensitive items through present programs. Further rate increases might simply be matched again overseas. Indeed, higher rates may have a perverse effect. U.S. interest costs would rise immediately. Higher financing costs for exports would make them less competitive. Slower growth in this country might make foreign direct investment—our chief problem area—look even more inviting.

Bank credit expansion has slowed. Rates for the past four months are below the previous period. This deceleration has pulled the year-to-date averages of the majority of the major credit measures down to their 1963 or 1964 levels.

Two other arguments are really counter-arguments to some of the above. Future deflation is feared if investment is too rapid. Such a deflationary danger would be erased by the future release of consumer and Government demands restrained by present policies. Meanwhile, the increased capacity from present investment in plant and equipment will be a welcome aid to combat price and balance of payment pressures.

Another argument states that failure to raise rates causes a distortion of bank lending and also, because of Regulation Q, increases the danger of banks' running short of funds. Clearly, a believer in higher rates should not be concerned if banks are under pressure. Decreasing the rate of bank credit expansion must be the main reason many people suggest a rise in the discount rate. If this is not so, additional funds could easily be supplied without increasing rates.

Lending distortions are possible. However, markets seem to be operating well. There is no sign that a change in policy to distribute less credit at higher rates would bring us any closer to our national goals than present policies.

Arguments for increasing rates will always strengthen as full employment approaches. This is true now. If prosperity is retained, steady pressures will continue. We must recognize this fact. However, we must not give up too easily. We should maintain present policy to continue an orderly expansion. If in the next two months inflationary pressures increase instead of subsiding, a reexamination of this decision will be possible.

Governor Maisel commented that his memorandum had dealt with the traditional effects of credit and demand. Everyone would agree that there was an imperfect sense of knowledge in this area, and the memorandum reflected his own judgment, but he thought that probably the Board members were not too far apart in their analyses of the credit and demand situation. Thus the question came down to whether the situation required action.

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Governor Maisel said he was concerned about the so-called political problem, which he thought was actually economic rather than political. Against the traditional effects of the use of monetary policy to restrain demand must be weighed the announcement effect of a raising of the discount rate. This was an economic, not a political, question. Therefore, he did not think the matter of being independent or not being independent really was involved. As a part of being independent, the Board members had to be careful in their judgment of the economic effects of a direct attack on the President's policy. The announcement effect, then, got into two major areas. First, the Board would be saying that it wanted to be counted out as far as a unified full-employment policy was concerned. It would be saying that it did not want a coordinated monetary-fiscal policy package, a procedure that would seem logical at the time the budget was announced. Beyond that, he felt strongly that by raising the discount rate at this time the System would be attacking the Commander-in-Chief. A situation prevailed where the President had said that for the sake of a country at war a particular type of policy should be followed--a type of policy that involved using wage-price guidelines to hold down inflation. The President had made it clear that this policy applied to the banking community as well as the aluminum, steel, and copper industries.

By raising the discount rate, the Board would be saying that aluminum, steel, and copper were not able to talk back, but that the

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Federal Reserve, because it was independent and had much firmer controls on the banking community, could talk back and was going to do so. This would have an effect on every major wage and price bargain next year. Whenever an attempt was made to reach an agreement under the guidelines, the people involved would say that the Federal Reserve got away with talking back and they could also. That would be the announcement effect, and it could be much more inflationary than deflationary. In other words, raising the discount rate might be as inflationary an action as the Federal Reserve could take because of the announcement effect. He recognized that this was not the traditional way of looking at the matter, but he felt it had validity.

If the majority was convinced that the Board should take a deflationary step, Governor Maisel continued, he felt strongly that raising the discount rate was not the way to go about it. He believed that the period between now and the time of the budget release should be used in an effort to put together a package with the Administration. If the rest of the Board felt that the Federal Reserve should not wait, however, then it seemed to him that holding the line on Regulation Q rates was the most deflationary step the Board could take. This could be accompanied by a statement making it clear that the discount window was open, and the opening of the window could be offset by open market operations. If the Board felt that this was the time to take action, he would urge as strongly as he could that the Board take action in

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some other way than by raising the discount rate. He would leave it to the staff to devise the best technical means.

Governor Daane added to his previous remarks by expressing the view that the desire for a coordinated monetary and fiscal policy, that is, the question of negotiating a package of actions some time in January when the budget figures were at hand, would not really argue against making a discount rate change now. The advantage of monetary policy lay in its flexibility and the ability to act quickly. If, when the budget was fully revealed and the Administration had developed concrete plans, it became clear that the Federal Reserve had acted too strongly or not strongly enough, the Federal Reserve could either reverse what it had done or take some additional step. As he saw it, the likelihood of having to take some further step was greater than the likelihood of reversal in light of what the budget probably would reveal, but this was a question that could not be answered now. In other words, he did not see why Federal Reserve action at this time ruled out a coordination of policy. If the Board took action now, it would merely be saying that it was using an instrument made available by statute that it felt definitely needed to be used in the current context. However, the System would stand ready to change its course if a change seemed necessary at any time.

Governor Mitchell commented that, as he had indicated previously, he felt there would be an advantage in negotiating an economic policy

package that might be made public next month. But there was also the possibility of negotiating on a discount rate action and how it might tie in with the overall policy now being contemplated. He was not fully advised on the extent to which Chairman Martin may have already tried to work this out, but to get into a direct confrontation with the Administration was a serious step.

Governor Shepardson referred to comments that had been made about embarking on a collision course with the Administration and about weakening the opportunity for full employment. On the first point, he did not agree that a comparison could properly be made between interest rates and commodity prices. The raising of the price of money was one of the deterrents to further pressure on commodity prices. On the matter of utilization of resources, he thought the picture had been overdrawn. There was now nearly a full utilization of resources in many sectors, including many critical areas. Where major segments of the economy were overextended and pressures therefore were being created, it seemed incumbent upon the Federal Reserve to take some action, even though there might be small pockets of the economy where some underutilization of resources persisted.

Governor Balderston asked Mr. Hackley whether as a legal matter the Board could fix a single maximum rate of interest on all time deposits, and Mr. Hackley replied that some legal question probably could be raised. He noted that before 1935 the Board had, in fact, fixed a single maximum

rate. But the law was then amended to require the establishment of different maximum rates according to specified criteria. He did not want to suggest that the Board could not adopt a single maximum rate, but there had been an assumption since 1935 that different maximum rates would be fixed.

Governor Balderston then said that he regarded this as a period of crisis for the Federal Reserve System. It concerned him deeply that this crisis should arise at a time when he was about to conclude his service as a member of the Board because to speak out, as he was going to do, was perhaps easier for him than for other members of the Board.

Broadly stated, Governor Balderston continued, the problem under discussion related to protecting the integrity of the dollar, and he would judge that the Board's responsibility was to make the right decision at the right time so far as it was able. Monetary policy being a flexible instrument, the Federal Reserve could act in time, while other policies could not be brought to bear on the problem so readily. He recalled well the Korean episode, when war broke out in June of 1950. By June of 1951 wholesale prices had risen over 14 per cent, construction prices more than 6 per cent, and wage rates 7 per cent. Belatedly, an effort was made to use selective controls. Price controls were instituted in January 1951, but wage controls were not instituted until six months later. In his opinion, action could not be taken effectively after the event, and the situation confronting the Board at this time was one that required

action. He would not repeat what he had said on other occasions recently about the general market problem, except that the interest rate structure was so distorted as to place the banks in a serious bind. He wished the banks had had the courage to increase the prime rate and to use the price mechanism as a deterrent to some of the lending they had been doing. But the banks had not done that. Thus, with the rate structure out of kilter, a problem was created for the banks, particularly since their loan ratios had risen to such a high point. A problem was also presented for the Treasury in its financing next year.

His principal concern about any delay, Governor Balderston said, was that the war in Vietnam was accelerating. The more it accelerated, the greater would be the upward pressure on prices, not only because of economic scarcities but because of expectations created in the minds of businessmen and others. If one went back through the years, it could be seen that historically the major upward price distortions were traceable to wars and their aftermath. Therefore, he thought it would be quite naive on the part of the Board, which supposedly was able to appraise matters of this kind intelligently, to await the announcement of the Federal budget. Even then, one could not know whether the budget would reflect accurately all of the additional expenses that the war would impose on the United States. If one took a realistic view about what was ahead, one could scarcely come to any conclusion other than that the expenditures of the Federal Government would be higher next

year and that this would press on prices, now that the activities of the Government were beginning to impinge even on human resources. Much as he disliked opposing the desires of the President, there were statutory responsibilities that each Board member had sworn to fulfill to the best of his ability. To wait for the release of the budget would mean postponing action in an irresponsible way. Postponement of action until January would involve a conflict with the Treasury financing schedule, probably necessitating still further postponement. It had been suggested earlier that Federal Reserve action should wait until after completion of the Treasury's December financing, but this had now been completed and again objection was being interposed.

Governor Balderston concluded by saying that he would favor a 4-1/2 per cent discount rate and that he had no strong views about the precise maximum rates under Regulation Q. He felt sure, however, that the Board must raise the Regulation Q ceilings.

Governor Robertson asked why it was considered necessary to raise Regulation Q ceilings if the Federal Reserve was trying to tighten, and Chairman Martin replied that such action seemed necessary to him in order to get out of the current bind. He remarked that Governor Robertson had set forth a consistent position, but in his (Chairman Martin's) judgment it was unrealistic in terms of the market. To get out of the current bind, the banks were going to have to attract funds as outstanding certificates of deposit came due. It was also his judgment that action of

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the kind under discussion could result in drawing back a substantial amount of funds from the Euro-dollar market. Absent Regulation Q action, he would hesitate to move the discount rate up now.

Governor Robertson asked the Chairman whether it was the rapid expansion of credit with which he was concerned, and the Chairman said it was the distortions affecting the flows of funds, although the expansion of bank credit was one element in this problem. Governor Robertson suggested that it would not curb the expansion of credit if banks were able to acquire more funds at higher rates, and Governor Mitchell commented that raising the Regulation Q ceiling would bring into the banks funds that would otherwise be employed somewhere else. In contrast, the supplying of additional reserves through the open market process or through accommodation at the discount window would provide new funds. Governor Robertson inquired whether Governor Mitchell desired more expansion of business credit, and the latter replied that he would, as contrasted with certain other uses of funds. Governor Robertson then asked Governor Mitchell whether he would favor further expansion of business loans at the expense of home loans, and Governor Mitchell replied that the strongest credit demand at the moment was from the business sector while the weakest demand was from the homebuilding sector. After further discussion along these lines, Governor Robertson said that his basic question was whether the desire was to permit an expansion in the volume of bank loans through a Regulation Q change. Governor Mitchell responded in the affirmative,

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but he added that this would be at the expense of other sectors of the credit market. Governor Daane agreed, commenting that it would also be at the expense of not adding new reserves.

Chairman Martin, who had been called from the room a few moments earlier, returned and said at this point that he did not look upon the proposed operation as a contractive one. His objective was sustainable expansion. He did not want to see knots develop that might lead to forced liquidation of loans. He did not want to see a situation develop where banks would get panicky about their loan-deposit ratios and dump assets at the slightest waver of the economy. Some banks were close to that point now.

The Chairman then said that he would like to reiterate a comment he had made at the November 23 Open Market Committee meeting. The fine thing about the Federal Reserve System in recent years had been that, despite differences of opinion, no one had questioned another person's motives or integrity. To him this had been a source of great satisfaction. But it was also a matter of concern to him to see things were developing to a point that he had hoped would not come to pass. Speaking as one member of the Board, he found it difficult in good conscience to help create a money pool to sustain a level of rates in a market that was out of touch with reality. As to the expectational element, the Chairman observed that it could work in both directions. Governor Robertson, he noted, felt that the recent market situation reflected

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expectations of Federal Reserve action. However, he (Chairman Martin) thought the opposite was true. Many people in the market with whom he had talked were convinced that the Federal Reserve had been prevented from taking action on the discount rate.

The Chairman added that the Board members should be under no delusions. A decision to move at this time could lead to an important revamping of the Federal Reserve System, including its structure and operation methods. This was a very real possibility, and it was a matter that he had been turning over in his mind for the past several months. With regard to the political problem, he recalled that he had started as early as August to try to negotiate and in September he had gotten more active. He had put into the minutes of the Open Market Committee meeting on October 12 the essence of what transpired at a lengthy session with the President at which he (Chairman Martin) did most of the talking. He had maintained good relations with the Secretary of the Treasury, the Chairman of the Council of Economic Advisers, and the Director of the Budget Bureau. Gradually their views had changed to the point where they now seemed to be saying that if given another month or two, perhaps they could agree with his (Chairman Martin's) position. But there was the question whether the Federal Reserve was to be run by the Administration in office. If that Administration was right, of course, this point did not make so much difference, but after having been through this problem for several years he continued to be concerned.

The Chairman then said that he hoped the Board would act today

to approve the 4-1/2 per cent discount rate established by the New York Digitized for FRASER

http://fraser.stlouisfed.org Eederal Reserve Bank of St. Louis and Chicago Reserve Banks. A System move of this kind was a rather cumbersome operation; if rumors got started, they would feed on themselves, and this could do damage to the posture of the System. Also, there had been so much public discussion about the division of opinion within the System that a lot of people thought the Board could not act. Therefore, he would like to see the Board act today on the discount rate and Regulation Q. If, however, the Board took such action, he would like to defer the announcement until Sunday evening, which was the time set for release of the revised balance of payments program, to see if he could negotiate with the Administration. He would appreciate that much latitude if the Board was prepared to give it to him.

Chairman Martin proposed that a vote be taken, and in response to a question said that he was thinking in terms of a vote on the discount rate and on Regulation Q. He would like to take action on the discount rate and Regulation Q together, because he would be dubious, personally, about approving a discount rate change and doing nothing on Regulation Q.

Governor Mitchell commented, however, that he was prepared to vote one way on the discount rate change and the other way on Regulation Q. Governor Daane also suggested that the votes be taken separately, even though he shared Chairman Martin's feeling. He added that while he was favorably disposed to discount rate action, he felt that a look should be taken on the reserve side at the same time. His thinking in favor of

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the discount rate action was predicated on an assumption that the System would cushion the reserve situation, as it had done following the discount rate increase in November 1964. In his opinion such cushioning could do a great deal to offset any over-reaction to a discount rate change.

Chairman Martin commented that he thought it had been made clear at the November 23 meeting that the Open Market Committee would not propose to tighten the availability of reserves. He added that any action on reserve requirements should be thought through carefully. Governor Mitchell agreed, but said he believed the Board should try to think the matter through to some extent. Chairman Martin responded that, while he would have no objection, he would not like to have the other matters held over.

Governor Daane then said that if the Board did take the proposed actions, with the latitude requested by the Chairman, it would seem reasonable to him to request the Board's staff to consider how best operationally to shield the market from undue impact of a discount rate change, whether through the open market instrument or through reserve requirements. He would not propose to make one action contingent on the other, but he would suggest that staff study be instituted, with the hope that as of next Monday the Board would be prepared to do whatever was needed. There was the possibility, he noted, of taking a step in the direction of graduated reserve requirements.

Mr. Brill commented at this point on two pieces of information that had just come to light, both of which suggested that over-rapid expansion--perhaps in the spring of next year--was more likely than had been apparent at the time of the staff's economic presentation at the November 23 Open Market Committee meeting. First, newly-released figures for the current fiscal year suggested that Government spending would be substantially higher than previously indicated. Second, a clue was available today on prospective business plant and equipment expenditures for 1966, based on the most recent SEC-Commerce survey. The indications were that the SEC-Commerce estimate would be significantly larger than the earlier estimate derived from the McGraw-Hill survey.

A vote was then taken on the question of approving the rates on discounts and advances that had been established by the Federal Reserve Banks of New York and Chicago, as follows: 4-1/2 per cent on discounts for and advances to member banks under sections 13 and 13a of the Federal Reserve Act; 5 per cent on advances to member banks under section 10(b); and 5-1/2 per cent on advances to individuals, partnerships, and corporations (other than member banks) under the last paragraph of section 13.

The rates established by the New York and Chicago Reserve

Banks were approved effective December 6, 1965. Chairman Martin and

Governors Balderston, Shepardson, and Daane voted to approve, while Governors Robertson, Mitchell, and Maisel voted against approval.

Turning to Regulation Q, Governor Mitchell said he saw a need to remove the bind on the ability of the banks to obtain funds, and he thought the bind ought to be removed as effectively as possible. He would like to move to a maximum rate of 5-1/2 per cent on all deposits with maturities of 15 days or more. This would be a strong signal that the Board wanted to give the banks a chance to use their own financial discretion and judgment in committing themselves relative to the price they were willing to pay for funds. He would favor having just one maximum rate for the whole maturity range despite the reservations previously expressed by Mr. Hackley.

Governor Daane expressed doubt whether anyone would challenge the establishment of a single maximum rate, and Chairman Martin agreed. He did feel, however, the Chairman said, that it would be slightly better from a tactical standpoint if the Board fixed one maximum rate for maturities under 90 days and another for maturities of 90 days and over. Governor Mitchell commented that his own thinking was influenced by the fact that he would like to remove all unnecessary restrictions. Governor Maisel inquired about short-term promissory notes, and Chairman Martin commented that he did not think it would be necessary to worry about them so much if Regulation Q action were taken along the lines suggested. The Board could take another look, however, if that seemed desirable at any time.

Mr. Hackley pointed out that in the past, action on Regulation Q rates had customarily been taken after consultation with the Federal Deposit Insurance Corporation, and Chairman Martin said he had discussed the matter with Chairman Randall last week. Mr. Randall therefore was aware of the situation. However, there was a question whether any action could be taken immediately because of the vacancy on the Corporation's Board of Directors and the fact that one director (the Comptroller of the Currency) would not be back in Washington until next week.

Mr. Hackley also observed that the laws of four or five States provided lower maximum rates of interest on time deposits than the maximum rate under Regulation Q now being proposed. He presumed this would have a competitive effect on banks in those States, including national banks unless the Comptroller of the Currency ruled that the national banks were not subject to the State laws.

Chairman Martin then inquired as to the views of the other members of the Board about a single maximum rate for time deposits, as opposed to different maximum rates for different maturities. In reply, Governor Robertson said his basic position was that the present maximum rates should not be changed. In principle, however, he thought it would be a little tidier to maintain one maximum rate for time deposits with maturities of 30 to 90 days and another maximum rate for time deposits with longer maturities. Governor Shepardson said that, like Governor Mitchell, he favored removing unnecessary restrictions. However, the

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proposed maximum rate increase probably would provide adequate leeway. He added that he would be somewhat inclined to maintain a lower maximum rate on 30-90 day maturities.

Mr. Hackley remarked that a maximum rate on time deposits and a different maximum rate on savings deposits probably could be defended. As he had said, however, since 1935 there had always been more than one maximum rate on time deposits.

Mr. Holland commented that as long as the maximum rate on shorter-term time deposits was around 1/2 per cent above the bill rate, there would be sufficient latitude for banks to operate in those maturities. This raised the question, however, whether the Board would want to set a maximum rate high enough to obviate the necessity for considering the matter again in a relatively short time. On the whole he felt that it made good sense to have a flat maximum rate, extending down to maturities of 15 days or more.

Governor Daane said he was somewhat disposed toward Governor Mitchell's suggestion. If the Board was correct in its action today and its assessment of economic and financial conditions, it would otherwise be likely to face again rather soon the need for further action.

Mr. Hackley noted at this point that an amendment to Regulation Q to redefine the term "time deposit" would be required if the Board were to permit the payment of interest on deposits with maturities of less than 30 days.

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In discussion of this point, several members of the Board indicated that they would not be disposed to take an action today that would require such an amendment.

Accordingly, a vote was taken on the question of establishing a maximum rate of 5-1/2 per cent that member banks would be permitted to pay on time deposits with maturities of 30 days or more. The establishment of such a maximum rate was <u>approved</u>, effective December 6, 1965, Governor Robertson dissenting.

In further discussion Governor Daane commented that if the System was going to take cushioning reserve action, the question was whether to assume that this would be done at the initiative of the Open Market Account Manager or whether at some point the Open Market Committee should issue an instruction. Chairman Martin replied that in his opinion the discussion at the November 23 Open Market Committee meeting sufficed to cover the point. In fact, this was the assumption on which various Open Market Committee members approved the directive issued at that meeting to the Federal Reserve Bank of New York.

Following some additional discussion of technical operations that might be undertaken by the Trading Desk, question was raised concerning the handling of the press release on the discount rate and Regulation Q actions, and Chairman Martin said he would like to have authority to work this out in detail with Mr. Molony. He felt that he should have some latitude in this respect if he was going to try to

negotiate. Essentially, however, he believed the press release should place emphasis on improving the flows of funds and on contributing to sustainable expansion of the domestic economy. He also felt that, in view of the disparity of judgments among the members of the Board, the votes on the discount rate and Regulation Q actions should be stated in the press release. He questioned whether it would be appropriate to issue lengthy statements of dissent in advance of publication of the policy record in the Board's Annual Report for 1965, but he felt that the dissenting votes should be announced in the press release, with some phrasing that would indicate that the dissenters regarded the discount rate action as at least premature in the absence of more compelling evidence of inflationary dangers.

Further discussion indicated general agreement with proceeding in the manner the Chairman had proposed. During this discussion Governor Mitchell noted that if Chairman Martin were able to negotiate successfully on the discount rate his disagreement with the discount rate action would be very mild; if not, it would be stronger. There seemed to be no way of spelling that out, however, except through an overall statement somewhat along the lines the Chairman had indicated. Chairman Martin reiterated that in the policy record section of the Board's Annual Report everyone would have an opportunity to include a more complete statement of his position.

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Governor Shepardson inquired whether the intent to negotiate implied an effort to obtain some agreement with the Administration, and Chairman Martin replied that action had already been taken by the Board. The purpose of negotiation was to see whether a means could be found for reducing the area of disagreement.

Governor Daane said this was why he felt that action on the reserve side was needed. If some action such as a move toward graduated reserve requirements should be taken as part of the package, this would be clearly a gesture in the direction of negotiation; or a policy line might be followed, as in November 1964, that reserve availability would remain relatively unchanged. He would like to see if any action on reserve requirements as part of the package could be accomplished. If it could, the System's public position and its position vis-a-vis the Administration would be improved.

Mr. Brill said that the staff had been giving some thought to the reserve requirement feature and that a variety of actions might be possible. One would be an action to reduce reserve requirements for the smallest banks. Such action should not have an immediate market impact, although some of the reserves might get into the Federal funds market fairly quickly.

After additional discussion along these lines, Chairman Martin expressed doubt whether such action could be taken effectively at this

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point. He would prefer to wait and see what happened. He repeated that at the Open Market Committee meeting on November 23 no desire was expressed to contract the level of reserves in the event of a discount rate increase. He doubted if a reserve requirement change could be worked into the present program. Governor Daane said he felt that it could be worked in if the Board really wanted to, and Chairman Martin agreed that it would not be impossible. He felt that it would be unwise, however, and that there should be an Open Market Committee meeting before any action was taken that would deviate from the present policy on reserve availability. The implications were broader than the mere question of reserve requirements.

Governor Balderston recalled that he had promoted the idea of a change in reserve requirements as long ago as August. However, he had since discarded that idea. He did not think that conditions were right at the present time, and he doubted whether the public would understand such a move.

Governor Shepardson agreed. He recognized that the System must ease the transition, but he felt this could be done satisfactorily through the open market process and the leeway being given under Regulation Q. If the Board were to make an announcement of a change in reserve requirements at this time, in his opinion that would be confusing.

Governor Daane commented that the Board was, of course, rectifying the situation that Chairman Martin had described earlier

as far as the larger banks were concerned. However, the increase in the Regulation Q ceiling rate would hardly amount to helping the smaller banks at all. In fact, it might put them in a poorer competitive position. He felt that a move on reserve requirements on behalf of the smaller banks would be supportive of the Board's other actions, and he would not want to dismiss it from consideration. He suggested taking a thorough look at the possibility.

At the conclusion of the discussion it was understood that further consideration would be given by the Board early next week to the possibility of a change in reserve requirements and that the staff would endeavor to provide material bearing on the subject.

Secretary's Note: In view of a subsequent development, namely, the appearance of a story in the Sunday morning edition of a local paper that the Board had taken action on the discount rate and on Regulation Q, the Board's press statement was issued to the press early Sunday afternoon for use in Monday morning's papers. The Federal Reserve Bank Presidents were notified by telephone Sunday afternoon of the essence of the Board's actions and the full text of the press statement was sent to them by wire Monday morning. text of the press statement was also sent by cable Sunday evening to the heads of major foreign central banks and by mail or messenger to various officials of interested Government agencies. Detailed advice on the precise nature of the discount rate action and the Regulation Q action was sent to the Reserve Banks by wire Monday morning,

and arrangements were made for publication of appropriate notices in the Federal Register. A copy of the press release is attached as <a href="Item No. 1">Item No. 1</a>, and a copy of the amended Supplement to Regulation Q is attached as <a href="Item No. 2">Item No. 2</a>. Subsequent to the meeting, Governor Robertson submitted a statement of his reasons for opposing the Regulation Q action. A copy of the statement is attached as <a href="Item No. 2A">Item No. 2A</a>.

Request of Mellon Bank International (Item No. 3). A distributed memorandum from the Division of Examinations and the Legal Division dated December 2, 1965, pointed out that on November 17, 1965, the Board had granted consent to Mellon Bank International, Pittsburgh, Pennsylvania, to purchase and hold three million shares of Bank of London & South America Limited, London, England, at a cost of approximately \$14,700,000, subject to certain conditions. Representatives of Mellon subsequently advised the Board's staff of apprehension that the conditions imposed might necessitate terminating the whole transaction, and they requested an opportunity for discussion. Such discussions were held, and in a letter dated November 24, 1965, Mellon asked in substance that the Board remove from its consent the conditions related to activities of Bank of London & South America in the United States. Representatives of Bank of London & South America who attended the discussions requested among other things that the New York branch of Bank of London & South America be permitted to continue as at present.

In a letter from Mellon dated November 29, 1965, there were indicated various customer relationships that were desirable for the branch but not permissible for an Edge corporation, and clarification Digitized for FRASER

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was requested concerning the appropriateness of certain types of transactions currently carried on by the New York branch. Mellon's letter of November 29 asked that the Board permit the investment in the shares of Bank of London & South America "without the condition imposing Regulation K restrictions on BOLSA New York." The December 2 memorandum pointed out that as the Board would recall, the Legal Division had indicated that this would be permissible under the law, and the Legal Division continued of that view. This would mean that the investment would be subject only to the statutory restriction that Bank of London & South America not be "engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States, and not transacting any business in the United States except such as in the judgment of the Board of Governors of the Federal Reserve System may be incidental to its international or foreign business . . .".

There was submitted with the December 2 memorandum, for the Board's consideration, a draft of letter to Mellon Bank International containing clarification of the Board's letter of November 17, 1965.

After discussion, revision of the draft letter in certain respects was agreed upon, and unanimous <u>approval</u> then was given to a letter to Mellon Bank International in the form attached as  $\underline{\text{Item}}$  No. 3.

International Banking Summer School. Pursuant to the recommendation in a memorandum from Mr. Young dated December 1, 1965, the Board approved the nomination of David G. Hayes, Economist in the Division of International Finance, to participate in the International Banking Summer School to be held in Bergen, Norway, June 20 - July 2, 1966. It was understood that during the actual time of his stay at the school Mr. Hayes would be placed on an actual expense basis to cover any incidental expenditures, but that during the remainder of the time he was in travel status he would receive per diem in lieu of subsistence at rates provided in the Standardized Government Travel Regulations. The Board also authorized an expenditure not exceeding \$100 to cover the pro rata expense incurred by Mr. Hayes if the custom should be followed at the 1966 Summer School of giving a national delegation reception.

The meeting then adjourned.

Secretary's Notes: With the approval of Governor Robertson, acting under the authority vested in him by the Board for administration of Federal Reserve functions related to the conduct of the voluntary foreign credit restraint effort, a part of the President's balance of payments program, there were issued today, for release in morning papers of Monday, December 6, 1965, new guidelines for financial institutions to follow during 1966 in cooperating with the President's program. Attached as Items 4, 5, 6, and 7, respectively, are copies of the press release that was issued, a prefatory statement concerning the 1966 guidelines, the guidelines for banks, and the guidelines for nonbank financial institutions.

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Pursuant to the action taken by the Board at its meeting on November 24, 1965, it had been ascertained that Kenneth S. Pitzer would accept appointment, if tendered, as Class C director of the Federal Reserve Bank of Dallas for the three-year term beginning January 1, 1966, and that Joseph M. Ray would accept appointment, if tendered, as a director of the El Paso Branch for the three-year term beginning January 1, 1966. Accordingly, appointment wires were sent today to Messrs. Pitzer and Ray.

On December 2, 1965, Governor Shepardson approved on behalf of the Board the following items:

Letter to the Federal Reserve Bank of Richmond (attached <a href="Item No. 8">Item No. 8</a>) approving the designation of Antoon M. Arkesteyn, Jr., as special assistant examiner.

Memoranda recommending the following actions relating to the Board's staff:

#### Prevailing Rate Wage Schedule

Revised Prevailing Rate Wage Schedule (attached <u>Item No. 9</u>) and increases in the annual salary rates of the following employees in the Division of Administrative Services under the schedule, effective December 5, 1965:

	Annual sa	alary rate
Name and title	From	To
R. A. Windsor, Assistant Supervisor, Motor Transport Unit	\$6,074	\$6,261
Willard D. Creasey, Chauffeur	5,554	5,741
Carlton C. Poling, Chauffeur	5,554	5,741
Roger M. Painter, Chauffeur	5,283	5,470
Bert Harvey, Chauffeur (Station Wagon)	4,514	4,659
Arthur S. Myers, Mechanical Foreman	8,237	8,486
Karl J. Steger, Steamfitter-Operating Engineer	7,218	7,426
Park O. Showalter, Electrician-Operating Engineer	7,218	7,426

	Annual salary rate	
Name and title	From	To
Gordon M. Davis, Sr., Carpenter-Operating Engineer	\$6,864	\$7,072
Glenn B. Hopkins, Painter	6,594	6,822
Bruce L. Rabbitt, Painter	6,594	6,822
Paul L. Tedrow, Operating Engineer	6,282	6,490
P. D. Maddox, General Mechanic-Operating	6,074	6,261
Engineer William T. Houser, General Mechanic-Operating Engineer	5,782	5,970
Carroll P. Hickman, Supervisory Clerk	5,782	5,970
Saul Clanton, Gardener	5,803	6,011
Henry Edmonds, Grounds Maintenance Worker	4,514	4,659
Charlie H. Ward, Lead Laborer	4,742	4,909
Hampton L. Logan, Window Washer	3,661	3,806

#### Printing Grade Wage Schedule

New Printing Grade Wage Schedule (attached <u>Item No. 10</u>) and increases in the annual salary rates of the following employees in the Division of Administrative Services under the schedule, effective December 5, 1965:

	Annual salary rate	
Name and title	From	<u>To</u>
Franklin Taylor, Supervisor, Duplicating, Mail, Messenger, and Supply Section	\$9,214	\$9,506
Thomas V. Kopfman, Assistant Supervisor, Duplicating, Mail, Messenger, and Supply	8,674	8,902
Section Bruce L. Moffett, Operator (Offset Press)	7,842	8,050
Edward Cross, Photographer (Offset)	7,842	8,050
Nelson S. Dyson, Photographer (Offset)	7,842	8,050
John P. Fling, Sr., Operator (Offset Press)	7,467	7,675
Bishop Hart, Bindery Worker	7,280	7,488
Aaron Dortch, Foreman-Operator	5,886	6,053
Wesley B. Collins, Photographer (Offset)	6,094	6,261
Abner Thompson, Operator (Multilith)	5,907	6,074
Herbert W. Bundy, Bindery Worker	5,907	6,074
James R. Jordan, Operator (Offset Press and Multilith)	5,616	5,782
Charles P. Brown, Operator (Duplicating Devices)	5,346	5,491

	Annual salary rate	
Name and title	From	<u>To</u>
Quincy W. Barnes, Operator (Xerox-Mimeograph)	\$5,096	\$5,221
Abraham Rose, Operator (Mimeograph)	4,826	4,950
Theodore L. Jones, Operator (Duplicating Devices)	4,826	4,950
Charles E. Evans, Operator (Duplicating Devices) (Trainee)	4,784	4,909
James T. Jones, Operator (Mimeograph)	4,555	4,680

Governor Shepardson today <u>approved</u> on behalf of the Board memoranda recommending the following actions relating to the Board's staff:

#### Salary increases, effective December 5, 1965

		Basic annual salary	
Name and title	Division	From	<u>To</u>
<u>B</u>	oard Members' Offices		
Dorothy B. Saunders,	Secretary to Governor Daane	\$10,185	\$10,491
<u>o</u>	ffice of the Secretary		
Edna L. Stoll, Senio	r Records Clerk	5,865	6,036
<u>R</u>	esearch and Statistics		
Ann Roane Clary, Lib	rarian	7,987	8,241
Patricia K. Cook, Statistical Clerk		4,289	4,429
William W. Wiles, Ec		8,961	9,267
	International Finance		
Robert F. Emery, Eco	nomist	12,945	13,380
Rodney H. Mills, Jr.		12,510	12,945
	Examinations		
Att W. Hammons, Jr., Reserve Examiner	Assistant Federal	9,879	10,185

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#### Transfers

Carol Polievka, from the position of Stenographer in the Division of Research and Statistics to the position of Secretary in that Division, with an increase in basic annual salary from \$4,953 to \$5,352, effective upon assuming her new duties.

Hubert L. Steward, from the position of Messenger in the Board Members' Offices to the position of Messenger in the Division of Administrative Services, with an adjustment in basic annual salary from \$3,814 to \$3,864, effective December 6, 1965.

Raphael Wallace, from the position of Messenger in the Division of Administrative Services to the position of Messenger in the Board Members' Offices, with no change in basic annual salary at the rate of \$3,507, effective December 6, 1965.

#### Acceptance of resignations

Sanford Johnson, Guard, Division of Administrative Services, effective November 29, 1965, rather than the close of business December 22, 1965, as previously approved.

James H. Lowden, Messenger, Division of Administrative Services, effective at the close of business December 10, 1965.

Jane Smith Wilson, Payroll Clerk, Office of the Controller, effective at the close of business December 10, 1965.

Daviette H. Stansbury, Digital Computer Programmer, Division of Data Processing, effective at the close of business December 17, 1965.

Judith A. Thomas, Special Assistant Federal Reserve Examiner, Division of Examinations, effective at the close of business December 31, 1965.

Secretary

December 5, 1965.

For release in morning papers of Monday, December 6, 1965.

The Federal Reserve announced today two complementary actions to reinforce efforts to maintain price stability, and thus to foster balance in the economy's continued growth and strength in the dollar's international standing.

The actions, intended not to cut back on the present pace of credit flows but to dampen mounting demands on banks for still further credit extensions that might add to inflationary pressures, were as follows:

- 1. The Board of Governors in Washington approved actions by the directors of the Federal Reserve Banks of New York and Chicago increasing the discount rates of those Banks from 4 to 4-1/2 per cent, effective Monday, December 6, 1965. The discount rate is the interest rate charged member banks for borrowing from their district Federal Reserve Banks.
- 2. Simultaneously, the Board increased the maximum rates that member banks are permitted to pay their depositors to 5-1/2 per cent on all time deposits and certificates of deposit having a maturity of 30 days or more. This change is also effective, Monday, December 6. Previously, the maximum rates payable were 4 per cent for time deposits and certificates of 30 to 90 days and 4-1/2 per cent on those of 90 days or more. No change was made in the rate payable on savings deposits (4 per cent).

The increase in the rates that member banks are permitted to pay their depositors is intended to enable the banks to attract and retain deposits of businesses and individuals and thus to make more effective use of savings funds already available in the economy to finance their loan expansion.

The increase in discount rates is intended to moderate additional bank reliance on short-term borrowings from the Federal Reserve to meet intensifying loan demands.

The action contemplates, however, the continued provision of additional reserves to the banking system, in amounts sufficient to meet seasonal pressures as well as the credit needs of an expanding economy without promoting inflationary excesses, primarily through the Federal Reserve's day-in and day-out purchases of government securities in the open market.

The changes in discount rates and the maximum rates that banks may pay depositors were the first in either respect since November 24, 1964.

Since then, total borrowing by consumers, business, and State and local governments has risen sharply, and interest rates at all maturities from the shortest to the longest have been rising under demand pressures. In these circumstances, the Federal Reserve would be forced to increase bank reserves at an accelerated pace if all demands for borrowing money at present rates were to be satisfied.

With slack in manpower and productive capacity now reduced to narrow proportions, with the economy closer to full potential than at any time in nearly a decade, and with military demands on output and manpower

increasing, it was felt that excessive additions to money and credit availabilities in an effort to hold present levels of interest rates would spill over into further price increases in goods and services. Such price rises would endanger the sustainable nature of the present business expansion. Moreover, increases in costs and prices would make it more difficult for American goods to compete in markets at home and abroad.

In addition, a pattern of interest rates that is accepted by borrowers and lenders as fully reflecting market forces should add assurance of a smooth flow of funds to all sectors of the economy. Discount rate increases in 1963 and 1964 did not stop business or credit growth, but helped to keep the economy within an expansion that was sustainable.

In sum, the actions taken today should have the three-pronged impact of:

- Backing up the Government's efforts to prevent inflationary excesses from damaging an economy now carrying the added burden of military operations in Vietnam;
- Bolstering the Government's programs to overcome persistent deficits in the U.S. balance of payments; and
- 3. Demonstrating anew the United States' determination to maintain the international strength of the dollar.

Governors Robertson, Mitchell, and Maisel dissented from the discount rate action on the ground that it was at least premature in the absence of more compelling evidence of inflationary dangers. Governor Robertson also dissented from the action to increase the maximum rates

#### TITLE 12 - BANKS AND BANKING

Item No. 2 12/3/65

#### CHAPTER II - FEDERAL RESERVE SYSTEM

#### SUBCHAPTER A - BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. Q]

#### PART 217 - PAYMENT OF INTEREST ON DEPOSITS

#### Maximum Rates of Interest

1. Effective December 6, 1965, § 217.6 (Supplement to Regulation Q) is amended to read as follows:

## § 217.6 Maximum rates of interest payable on time and savings deposits by member banks.

Pursuant to the provisions of section 19 of the Federal Reserve Act and §217.3, the Board of Governors of the Federal Reserve 1/System hereby prescribes the following maximum rates of interest payable by member banks of the Federal Reserve System on time and savings deposits:

- (a) Maximum rate of 5-1/2 per cent. No member bank shall pay interest accruing at a rate in excess of 5-1/2 per cent per annum, compounded quarterly, regardless of the basis upon which such interest may be computed, on any time deposit.
- (b) Maximum rate of 4 per cent. No member bank shall pay interest accruing at a rate in excess of 4 per cent per annum, compounded quarterly, regardless of the basis upon which such interest may be computed, on any savings deposit.

<sup>1/</sup> The maximum rates of interest payable by member banks of the Federal Reserve System on time and savings deposits as prescribed herein are not applicable to any deposit which is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia.

<sup>2/</sup> This limitation is not to be interpreted as preventing the compounding of interest at other than quarterly intervals, provided that the aggregate Digitized for FR amount of such interest so compounded does not exceed the aggregate amount of the interest at the rate above prescribed when compounded quarterly.

2a. The purpose of the amendment is to increase the rate of interest that member banks are permitted to pay on time deposits, including certificates of deposit. Formerly, member banks were permitted to pay interest up to 4-1/2 per cent per annum on a time deposit with maturity of 90 days or more and to pay interest up to 4 per cent on any such deposit with maturity of less than 90 days. Member banks are now permitted to pay interest up to 5-1/2 per cent per annum on any time deposit, irrespective of maturity. (A time deposit does not include a deposit contract that provides for payment in less than 30 days § 217.1.)

b. There was no notice and public participation with respect to this amendment, nor is the effective date thereof deferred. In the circumstances, such procedure and delay would prevent the action from becoming effective as promptly as necessary in the public interest.

(See § 262.1(e) of the Board's Rules of Procedure (12 CFR 262.1(e)).)

(12 U.S.C. 248(i) and 371b.)

Dated at Washington, D. C., this 3rd day of December, 1965. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

(SEAL)

(Signed) Merritt Sherman

Merritt Sherman, Secretary. Statement of Governor Robertson's Reasons for Opposing an Increase of the Ceilings on Interest Rates Payable on Time Deposits from 4 and 4-1/2 per cent to 5-1/2 per cent, December 3, 1965

Governor Robertson dissented from this action generally for the same reasons given for his dissent from the action to raise the discount rate. The latter action, he assumed, was designed to tighten credit, in view of the rapid expansion of bank credit; it surely was not designed · simply to raise interest rates. However, in his view, the raising of the ceilings on interest rates payable on time deposits would - in virtually the same breath - enable banks to acquire more funds to expand their lending but at higher rates, and thus not serve to reduce bank credit expansion - if that were the aim. In addition, he felt, the larger banks would be able to attract funds away from smaller financial institutions which did not actively engage in the issuance of time deposits but relied on inflows of savings and demand deposits with which to meet loan demands, or, alternatively, to force those smaller banks to also engage in the risky business of competitively bidding for highly interest-sensitive short-term funds with which to make long-term loans.

# BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Item No. 3 12/3/65



WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE

December 3, 1965.

Mr. John A. Mayer,
President,
Mellon Bank International,
Mellon Square,
Pittsburgh, Pennsylvania.

Dear Mr. Mayer:

This refers to your letters of November 24 and 29, 1965, acknowledging receipt of the Board's letter of November 17, 1965, which granted consent for Mellon Bank International ("MBI"), to purchase and hold 3 million shares of Bank of London & South America Limited ("BOLSA"), London, England, subject to certain conditions. The Board has considered your letters and the information furnished to members of the Board's staff in conferences with representatives of MBI and BOLSA on November 24 and with representatives of MBI, BOLSA, and the Balfour, Williamson group on November 29.

With respect to the condition in the third paragraph of the Board's letter of November 17, 1965, that BOLSA shall not engage in any activity in the United States not permissible for a Corporation organized under Section 25(a) of the Federal Reserve Act engaged in banking, it was intended that this should apply only to the activities of BOLSA in the United States. Moreover, it was not intended that such matters as capital requirements, reserve requirements, or Section 211.9 of Regulation K--Limitations and Restrictions should be applicable to the operations of the New York Branch of BOLSA. Rather, the condition related to the kinds of activities as distinguished from the extent of such activities.

The Board believes that generally foreign corporations, in which Edge Corporations are permitted to invest, should not engage in any activities in the United States not permitted to a corporation organized under Section 25(a) engaged in banking. While the provisions of Regulation K relating to activities permissible in the United States are partly regulatory, they are in large measure interpretative of the words "incidental to its international or foreign business" which Section 25(a) uses with respect to both Edge Corporations and corporations in which they may invest. However, in the letter of consent of November 17, 1965, the Board recognized that there might be certain exceptions to the provisions

in Regulation K and indicated that no objection would be interposed if BOLSA invests temporarily idle funds derived from foreign sources in brokers loans, prime commercial paper, Federal Funds, and short-term obligations of United States banks.

-2-

The Board has again reviewed the matter in the light of information furnished in your letter of November 29, 1965, and in discussions with representatives of MBI and BOLSA and has reached the following conclusions with respect to the seven numbered items mentioned on pages 3-5 of that letter:

Item 1. - No objection will be interposed if savings deposits are received by BOLSA in New York from individuals resident abroad.

Items 2 and 3. - No objection will be interposed to (a) BOLSA's receiving and holding deposits of United States corporations, or (b) BOLSA's making loans to United States corporations at interest rates advantageous to BOLSA, if it can be clearly demonstrated that the deposits or loans, as the case may be, are to compensate BOLSA for facilities provided abroad to the corporations themselves or their subsidiaries and affiliates.

Items 4, 5, and 6. - On the basis of information furnished, the Board believes such transactions would not be inappropriate as long as such banking relationships are not promoted.

Item 7. - This is regarded as merely a fringe benefit for employees incidental to their employment and not banking activities.

With respect to the fifth paragraph of the Board's letter of November 17, 1965, relating to the activities of United States subsidiaries in the Balfour, Williamson group, it is understood that Balfour Poultry Ranches, Inc. and Balfour Chemicals, Inc. have been sold, and that it is the firm intention of Balfour, Guthrie & Co., Limited to sell Balfour-Guthrie Insurance Company as soon as possible. It is further understood that the grain trading and metals warehouse operations of Balfour, Guthrie will be discontinued.

In further reference to the fifth paragraph of the Board's letter of November 17, 1965, and without dealing with other questions relating to activities of other companies listed therein, it is the view of the Board that activities by Balfour, Williamson as agent or broker for foreign clients where there is no market risk on the part of Balfour, Williamson would not cause it to be "engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States . . ." . Moreover, if Balfour, Williamson acts as principal where there are offsetting firm orders for foreign clients, the Board believes that such activity should not be regarded as being covered by the above quotation in this paragraph from Section 25(a) of the Federal Reserve Act.

It is hoped that these clarifications of the Board's earlier letter may be of assistance to you in your further discussions with BOLSA.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman, Secretary.





#### apries sitter e le a s'e

Item No. 4 12/3/65 December 3, 1965.

For release in morning papers of Monday, December 6, 1965.

The Board of Governors of the Federal Reserve System today issued new guidelines for financial institutions to follow during 1966 in cooperating with the President's program to improve the nation's balance of payments.

For the year 1966 the guidelines for both banks and nonbank financial institutions have been revised to suggest limitations on expansion of foreign credits which are comparable to the limitations suggested for 1965, but with variations to remove certain inequities inherent in the 1965 program.

The basic feature of the guidelines for 1965 has been a percentage limitation on increases in foreign credits from the base date of December 31, 1964. In general, each bank was requested to restrict its foreign credits outstanding to an amount not in excess of 105 per cent of the amount outstanding at the end of 1964, and each nonbank financial institution was requested to operate within a framework roughly comparable with that suggested for banks.

Although the banking system as a whole has stayed well under the suggested ceiling for 1965, some further expansion has

been provided for in the 1966 program for two reasons: (1) it is believed that banks will continue to cooperate with the spirit as well as the letter of the program and will utilize the expansion suggested only to the extent needed to meet priority credit requirements; and (2) it is intended to make certain that export financing is available in adequate amounts, and that the bona fide credit needs of less developed countries will continue to be met.

Under the 1966 program, commercial banks are requested to restrain any expansion in foreign credits to such an extent that the amount outstanding does not exceed 109 per cent of the amount outstanding on December 31, 1964. Further, in order to spread throughout the year any outflow necessary to meet priority credit requirements, it is requested that the expansion be utilized at a rate of not more than one per cent per calendar quarter; that is, the target would be 106 per cent of the 1964 base during the first quarter, 107 per cent during the second, 108 per cent during the third, and 109 per cent for the remainder of the year. Special consideration for banks with small bases will add about one per cent to the total, bringing the possible expansion for 1966 for the banking system as a whole to about the same amount as that provided for 1965.

The 1966 guidelines for nonbank financial institutions have been made broadly comparable with those of the bank guidelines.

But the foreign financial assets of such institutions continue to be classified into three groups--liquid funds, investments in credits maturing in 10 years or less and in financial subsidiaries, and long-term investments--each subject in whole or part to a guideline ceiling. In some cases the guidelines for 1966 are based on outstanding amounts at September 30, 1965, where the use of a December 1964 base might be inequitable to individual institutions.

The priorities established by the 1965 guidelines remain in effect; i.e., an absolute priority for <u>bona fide</u> export credits, and highest priority in nonexport loans to credit to less developed countries.

The Board expressed its appreciation for the cooperation of the financial institutions since February 10, 1965, and its confidence in the continued cooperation of the banks and other financial institutions—so essential to the success of the President's balance of payments program.

Copies of the new guidelines are being made available through the Federal Reserve Banks. Banks and other financial institutions having questions concerning their application are urged to consult with the Federal Reserve Bank of their district.

3999 Item No. 5

12/3/65 December 3, 1965.

THE 1966
VOLUNTARY CREDIT RESTRAINT PROGRAM
FOR FINANCIAL INSTITUTIONS

#### Preface

Since inception of the voluntary foreign credit restraint effort, immediately following announcement by the President of his balance of payments program in February 1965, commercial banks and other financial institutions have contributed substantially to the improvement in the nation's payments position. This has been accomplished by the high degree of cooperation and statesmanship exhibited by the financial community in restraining the growth of (and in some instances reducing) claims on foreigners in accordance with guidelines issued by the Board of Governors of the Federal Reserve System.

Although considerable progress has been made and although the voluntary restraint program is temporary in nature, perseverance by financial institutions in the program through 1966 is necessary to attain the goal of equilibrium in the nation's balance of payments and represents the appropriate response to the President's message of February 10, 1965, in which he issued a personal "call on American businessmen and bankers to enter a constructive partnership with their Government to protect and strengthen the position of the dollar in the world today."

The main feature of the guidelines for 1965 has been a percentage limitation on increases in foreign credits from the base date of December 31, 1964. In general, each bank was requested to restrict its foreign credits outstanding to an amount not in excess of 105 per cent of the amount outstanding at the end of 1964, and each nonbank financial institution was requested to operate within a framework roughly similar to that suggested for banks.

For the year 1966 the guidelines for both banks and non-bank financial institutions have been revised to suggest limitations on expansion of foreign credits which are comparable to the limitations suggested for 1965. These will permit some further expansion in such credits, and provide for variations to remove certain inequities inherent in the 1965 program.

Notwithstanding the fact that the banking system as a whole is presently well below the suggested target for 1965, this additional expansion has been allowed for two reasons: (1) it is believed that banks will continue to cooperate with the spirit as well as the letter of the program and will utilize the expansion suggested only to the extent needed to meet priority credit requirements; and (2) it is intended to make certain that export financing is available in adequate amounts, and that the bona fide credit needs of less developed countries will continue to be met.

Continued restraint on the increase in foreign credits is the basic objective of the bank program for 1966. Generally speaking, commercial banks are requested to restrain any expansion in foreign credits to such an extent that the amount outstanding at year-end will not exceed 109 per cent of the amount outstanding on December 31, 1964. Further, in order to spread throughout the year any outflow necessary to meet priority credit requirements, it is requested that the amount outstanding not exceed 106 per cent of the 1964 base during the first quarter, 107 per cent during the second, and 108 per cent during the third quarter. Special consideration for banks with small bases will add one per cent or less to the total, bringing the potential amount outstanding at the end of 1966 for the banking system as a whole to about 110 per cent of the 1964 base as compared with the 105 per cent target for 1965.

The guidelines for 1966 for nonbank financial institutions have been revised to reflect provisions broadly comparable with those of the bank guidelines. Investments of liquid funds abroad are to be held to minimum practicable levels and ordinarily should not be permitted to exceed the reduced September 30, 1965, total. Investments in credits maturing in 10 years or less and in foreign branches and financial subsidiaries are subject to the same ceiling as suggested for the banks. Long-term investments

in developed countries other than Canada and Japan are subject to a ceiling of 105 per cent of the September 30, 1965, amounts during 1966; this base was selected because retroactive use of a 1964 year-end base might have been inequitable for some institutions.

As in 1965, finencial institutions are requested to give priority to export credits and credits to less developed countries. In instances where the special base and ceiling calculations for banks with small bases result in a ceiling in excess of 109 per cent, it is requested that the amount in excess of 109 per cent of a bank's base be used exclusively for such priority credits. The leeway for additional foreign credits provided by the 1966 guidelines plus the funds available from repayments on outstanding credits will provide larger resources than last year to finance an expanded volume of exports and to satisfy credit requirements of less developed countries.

The guidelines for banks and nonbank financial institutions follow.

#### GUIDELINES FOR BANKS

#### (1) Base, ceiling, and reporting

#### (a) Base

1. The base is a bank's total claims on foreigners for own account, including foreign long-term securities, on December 31, 1964, except for the exclusion in (a)3 below.

#### 2. Meaning of terms:

- (A) "Foreigners" include individuals, partnerships, and corporations domiciled outside the United States, irrespective of citizenship, except their agencies or branches within the United States; branches, subsidiaries, and affiliates of United States banks and other United States corporations that are located in foreign countries; and any government of a foreign country or official agency thereof and any official international or regional institution created by treaty, irrespective of location.
- (B) "Long-term securities" are those issued without a contractual maturity or with an original maturity of more than one year from the date of issuance.
- (C) "Other claims" include all long-term claims other than securities, real assets, net investment in and advances to foreign branches and subsidiaries, and all short-term claims (such as deposits, money-market instruments, customers' liability on acceptances, and loans).

#### 3. Specific inclusions and exclusions:

- (A) Claims on foreigners should be included without deduction of any offsets. Foreign customers' liability for acceptances executed should be included whether or not the acceptances are held by the reporting bank. Participations purchased in loans to foreigners (except participations in loans extended by the Export-Import Bank) also should be included.
- (B) Contingent claims, unutilized credits, claims held for account of customers, acceptances executed by other United States banks, and participations in loans arranged by or guaranteed by the Export-Import Bank or insured by the Foreign Credit Insurance Association should be excluded.

#### (b) Ceiling

- 1. The 1966 ceilings with respect to the amount of foreign credits outstanding by a bank with a base of \$5 million or more are as follows:
- (A) In the first calendar quarter, 106 per cent of its base;
- (B) In the second calendar quarter, 107 per cent of its base;
- (C) In the third calendar quarter, 108 per cent of its base;
- (D) In the fourth calendar quarter, 109 per cent of its base.

- 2. In lieu of the ceiling prescribed in (b)1 above, a bank with a base of \$500,000 but less than \$5 million, may use the following special ceiling:
  - (A) In the first calendar half, its base plus \$225,000;
  - (B) In the second calendar half, its base plus \$450,000.
- 3. The ceiling for a bank with a base below \$500,000 is 150 per cent of its base. However, any such bank, or a bank which had no foreign credits outstanding on December 31, 1964, may discuss with the Federal Reserve Bank of the Reserve district in which it is located the possibility of adopting a ceiling that would permit expansion up to \$450,000 above the bank's base.
- 4. In discussing the ceiling of a bank described in Paragraph 3, the Federal Reserve Bank will ascertain the bank's previous history in foreign transactions, including acceptance of foreign deposits or handling foreign collections, and the reasons why the bank considers it should have additional leeway. Prior to a decision, the Federal Reserve Bank will obtain clearance from the Board of Governors.
- 5. Any expansion under paragraphs 2 or 3 that is in excess of 109 per cent of the bank's base should be limited to loans or acceptance credits that finance exports of U.S. goods or services or that represent credit extended to less developed countries. Export credits should be limited to transactions

originated by the bank's regular customers or by residents of its normal trade territory. Such expansion should not involve

(A) participations in loans originated by other banks or purchases of such loans, (B) investments in foreign securities, (C) deposits in foreign banks, or (D) investments in foreign short-term money market instruments.

#### (c) Reporting

- 1. Banks that report on Treasury Foreign Exchange
  Form B-2 or B-3 should file a Monthly Report on Foreign Claims
  (Form F.R. 391) with the Federal Reserve Bank of the Reserve
  district in which the bank is located.
- 2. Banks that have claims on foreigners in an amount of \$100,000 or more and do not report on Treasury Foreign Exchange Form B-2 or B-3 should file a Quarterly Report on Foreign Claims (Form F.R. 391a) with the Federal Reserve Bank of the Reserve district in which the bank is located.
- 3. Copies of Forms F.R. 391 and 391a are available at the Reserve Banks.

#### (2) Loans involving Export-Import Bank

Participations in individual export loans arranged by the Export-Import Bank, loans with Export-Import Bank guarantees

or insurance, and holdings of "Export-Import Portfolio Fund"

participations are excluded from the ceiling. The role of the

Export-Import Bank within the framework of the President's program
is coordinated by the National Advisory Council for International

Monetary and Financial Problems.

#### (3) Credits in excess of ceiling

A bank would not be considered as acting in a manner inconsistent with the program if it at times exceeds its ceiling as a result of the (a) draw-down of binding commitments entered into before February 11, 1965; or (b) extension of priority export credits.

The bank should, however, reduce its claims on foreigners to an amount within the ceiling as quickly as possible. It should also take every opportunity to withdraw or reduce commitments, including credit lines, that are not of a firm nature and to assure that drawings under credit lines are kept to normal levels and usage. At time of renewal, each credit line should be reviewed for consistency with the program.

A bank whose foreign credits are in excess of the ceiling will be invited periodically to discuss with the appropriate Federal Reserve Bank the steps it has taken and proposes to take to reduce its credits to a level within its ceiling.

#### (4) Loan priorities

Within the ceiling, absolute priority should be given to bona fide export credits. Credits that substitute for cash sales or for sales customarily financed out of nonbank or foreign funds are not entitled to priority.

With respect to nonexport credits, banks should give the highest priority to loans to less developed countries and should avoid restrictive policies that would place an undue burden on Canada, Japan, and the United Kingdom.

It is expected that the outstanding amount of nonexport credits to developed countries in Continental Western Europe would not be increased during 1966 but rather would be reduced to the extent needed to meet <u>bona fide</u> requests for priority credits within the overall ceiling.

Without attempting to specify all types of loans that should be restricted, it is obvious that credits to developed countries that can be cut back with benefit to our balance of payments and with the least adverse side-effects include: credits to finance third-country trade; credits to finance local currency expenditures outside the United States; credits to finance fixed or working capital needs; and all other nonexport credits to developed countries that do not suffer from balance of payments difficulties.

### (5) Bankswhose foreign credits consist almost entirely of export credits

A bank whose foreign credits are consistently composed almost entirely of export credits usually should keep its credits within its ceiling. If such a bank exceeds its ceiling from time to time, it would not be considered as acting in a manner inconsistent with the program if the amount of such excess is reasonable and the bank makes every effort to bring the amount of its credits back within the ceiling at the earliest practicable date.

#### (6) Trust departments

Trust departments of commercial banks should follow the guidelines with respect to nonbank financial institutions.

## (7) Transactions for the account of customers

A bank should bear in mind the President's balance of Payments program when acting for the account of a customer.

Although the bank must follow a customer's instructions, it should not encourage customers to place liquid funds outside the United States. A bank should not place with a customer foreign obligations that, in the absence of the voluntary credit restraint Program, it would have acquired or held for its own account.

#### (8) Foreign branches

The voluntary credit restraint program is not designed to restrict the extension of foreign credits by foreign branches if the funds utilized are derived from foreign sources and do not add to the outflow of capital from the United States.

Total claims of a bank's domestic offices on its foreign branches (including permanent capital invested in as well as balances due from such branches) represent bank credit to non-residents for the purposes of the program.

#### (9) "Edge Act" corporations

"Edge Act" and "Agreement" corporations are included in the voluntary credit restraint program. Foreign loans and investments of such corporations may be combined with those of the parent bank or a separate ceiling may be adopted for the parent bank and each such subsidiary corporation. If such corporation is owned by a bank holding company, its foreign loans and investments may be combined for purposes of the program with any one or all of the banks in the holding company group.

An "Edge Act" corporation established before February 10, 1965, that had not made any significant volume of loans and investments before December 31, 1964, may take as a base, alone and not

in combination with its parent, its paid-in capital and surplus, up to \$2.5 million.

## (10) United States branches and agencies of foreign banks

Branches and agencies of foreign banks located in the United States are requested to act in accordance with the spirit of the domestic commercial bank voluntary credit restraint program.

# (11) Loans to United States residents and substitution of domestic credit for credit from foreign sources

There are a number of situations in which loans to domestic customers may be detrimental to the President's balance of payments program. These include:

- (A) Loans to U.S. companies which will aid the borrower in making new foreign loans or investments inconsistent with the President's program. Banks should avoid making new loans that would directly or indirectly enable borrowers to use funds abroad in a manner inconsistent with the Department of Commerce program or with the guidelines for nonbank financial institutions.
- (B) Loans to U.S. subsidiaries and branches of foreign companies which otherwise might have been made by the

bank to the foreign parent or other foreign affiliate of the company, or which normally would have been obtained abroad.

(C) Loans to U.S. companies with foreign activities which take the place of credit normally obtained abroad. Even though such loans are made to domestic firms or those domiciled here, the impact on the U.S. balance of payments is the same as if the bank had made loans to foreigners in the first instance.

To the extent possible, banks should also avoid making losns to domestic borrowers which have an effect similar to that of the losns described in paragraphs (B) and (C).

## (12) Management of a bank's liquid funds

A bank should not place its own funds abroad for shortterm investment purposes, whether such investments are payable in foreign currencies or in United States dollars. This does not, however, call for a reduction in necessary working balances held with foreign correspondents.

#### Guidelines for Nonbank Financial Institutions

Item No. 7 12/3/65

The types of financial institutions to which these guidelines on foreign lending and investing are applicable include domestic
life, fire and casualty insurance companies; corporate noninsured
pension funds and State-local retirement systems; mutual savings banks,
mutual funds and investment companies; consumer sales and commercial
finance companies; college endowment funds and charitable foundations.
Also covered by the program are the United States branches of foreign
insurance companies and of other foreign financial corporations. Trust
companies and trust departments of commercial banks are expected to
observe the guidelines in the investment of funds entrusted to them
or for which they serve as investment advisor. Investment underwriting firms, security brokers and dealers and investment counseling
firms are also covered with respect to foreign assets held for their
own account, and are requested to inform customers of the guidelines
and to enlist their support in cooperating with the President's program.

Any nonbank financial institution holding \$500,000 or more in foreign loans, investments or other foreign financial assets is requested to file a statistical report (Form F.R. 392) at the close of each calendar quarter with the Federal Reserve Bank of the Reserve district in which its principal office is located. Lending institutions not receiving copies of the reporting form may obtain them from the Federal Reserve Bank.

1. Investment of liquid funds abroad should be reduced to minimum practicable levels consistent with the operating needs of the institution. Such holdings ordinarily should not be permitted to exceed the September 30, 1965, total, except for temporary seasonal excesses.

This category includes all deposits held with foreign banks or foreign branches of U.S. banks, whether denominated in U.S. dollars or a foreign currency and regardless of maturity. It also includes all liquid money market claims on foreign obligors with an original maturity of one year or less, whether such claims are denominated in U.S. dollars or a foreign currency. The term "liquid money market claims" is interpreted broadly to include the securities of Governments and their instrumentalities, commercial paper, finance company paper, bankers' acceptances and other readily marketable paper. This guideline is not applicable to short-term business credits that are not readily marketable (covered under guideline 2).

2. Investments and credits maturing in 10 years or

less at date of acquisition are subject to a percentage guideline
based on the total of such holdings at the end of 1964. The
aggregate amount of these investments, and of net financial
investment in foreign branches, financial subsidiaries and
affiliates (described below), should not exceed 105 per cent of

the 1964 base date amount as of the end of 1965, and should not exceed 106 per cent of the base date amount during the first quarter of 1966, 107 per cent during the second quarter, 108 per cent during the third quarter, and 109 per cent in the final quarter of the year.

This category includes all bonds, notes, mortgages, loans and other credits carrying maturities at date of acquisition of 10 years or less. The date of final maturity is to be taken in classifying individual credit transactions, except that a credit transaction should not be classified as "long term" (and hence subject to guideline 3 below) unless 10 per cent or more of the amount to be repaid is scheduled to be repaid after 10 years. Loans guaranteed or arranged by the Export-Import Bank or insured by the Foreign Credit Insurance Association are not to be considered foreign credits for purposes of this program.

Net financial investment in foreign branches, financial subsidiaries and affiliates, if any, is included among the assets subject to the percentage ceilings of this guideline. Such financial investment includes payments into equity and other capital accounts of, and net loans and advances to, foreign corporations engaged principally in finance, insurance or real estate activities, in which the U.S. institution has an ownership interest of 10 per cent or more. Earnings of a foreign

affiliate that are reinvested in the business are not included among assets subject to the guideline ceiling, although institutions are requested to repatriate such earnings to the fullest extent feasible.

In administering restraint in foreign lending and investing, institutions are requested to observe the following priorities or guides: 1) credits and investments that represent bona fide U.S. export financing should receive absolute priority; 2) nonexport credits and investments in the less developed countries, and investments in the securities of international institutions, are to be given priority consideration second only to bona fide export financing; 3) the flow of investment funds to Canada and Japan, which are heavily dependent on U.S. capital markets, need be restricted only to the extent necessary to remain under the guideline ceiling.

It is recognized that some individual institutions may temporarily exceed the guideline ceiling, because of investments made under the first two priorities above, or the taking down of firm commitments to lend or invest entered into prior to June 22, 1965, the effective date of the previous guidelines. In any such case, an institution that exceeds its target should consult with the Federal Reserve Bank of the Reserve district in which it is located regarding a program for moving back within the ceiling in a reasonable period of time.

3. Long-term credits (exceeding 10 years in maturity) and stock investments in foreign companies are not subject to an aggregate ceiling for 1966. This category includes bonds, notes, mortgages, loans and other credits maturing more than 10 years after date of acquisition, as well as preferred and common stocks. (Loans and investment in certain subsidiaries and affiliates, however, are covered by guideline 2.) Term loans and serial-payment notes and bonds are included in this category only if 10 per cent or more of the total amount of the credit is scheduled for repayment to the lender after 10 years beyond date of acquisition.

No percentage ceiling is suggested on long-term credits and investments in the priority categories relating to export financing and to less developed countries (including international institutions) as described in guideline 2. Long-term investment in Canada and Japan also is not subject to a percentage ceiling, in view of inter-Governmental agreements affecting the net amount of financing done by these countries in U.S. financial markets. Lending institutions are requested, however, to limit in 1966 the total of credits and investments in other developed countries to an amount not in excess of 105 per cent of the amount of such holdings on September 30, 1965. Within this category, institutions are expected to avoid any increase in long-term investments in the developed countries of Continental Western Europe.

The attention of lending institutions is directed to the need to refrain from making loans and investments inconsistent with the President's balance of payments program. Among these are the following: 1) long-term credits covered by guideline 3 which substitute for loans that commercial banks would have made in the absence of the voluntary foreign credit restraint effort administered by the Federal Reserve System; 2) credits to U.S. borrowers which would aid in making new foreign loans or investments inconsistent with the voluntary restraint program administered by the Department of Commerce; 3) credits to U.S. subsidiaries and branches of foreign companies which otherwise might have been made to the foreign parent, or which would substitute for funds normally obtained from foreign sources; 4) credits to U.S. companies with foreign activities which would take the place of funds normally obtained abroad. Reasonable efforts should be made to avoid accommodating credit requests of these types, regardless of specific guideline targets detailed in this circular.

Notes - None of the guidelines is this circular is intended to apply to the reinvestment of reserves on insurance policies sold abroad in assets within the country involved, in amounts up to 110 per cent of such reserves.

Developed countries other than Canada and Japan are: Abu Dhabi, Australia, Austria, the Bahamas, Bahrein, Belgium, Bermuda, Denmark, France, Germany (Federal Republic), Hong Kong, Indonesia, Iran, Iraq, Ireland, Italy, Kuwait, Libya, Liechtenstein, Luxembourg, Monaco, Netherlands, Neutral Zone, New Zealand, Norway, Portugal, Qatar, Republic of South Africa, San Marino, Saudi Arabia, Spain, Sweden, Switzerland, and the United Kingdom.

Also to be considered "developed" are the following countries within the Sino-Soviet bloc: Albania, Bulgaria, any part of China which is dominated or controlled by International Communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by International Communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Soviet Zone of Germany and the Soviet sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics, and any part of Viet-Nam which is dominated or controlled by International Communism.



### BOARD OF GOVERNORS

OF THE

Item No. 8 12/3/65

#### FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE

December 3, 1965.

Mr. John L. Nosker, Vice President, Federal Reserve Bank of Richmond, Richmond, Virginia. 23213

Dear Mr. Nosker:

In accordance with the request contained in your letter of November 29, 1965, the Board approves the designation of Antoon M. Arkesteyn, Jr., as a special assistant examiner for the Federal Reserve Bank of Richmond.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon, Assistant Secretary.

#### METROPOLITAN D.C. RATE WAGE SCHEDULE\*

#### December 5, 1965

This schedule applies to manual labor, semi-skilled, and skilled manual labor, trade and craft positions in the Mechanical Force, as well as the Chauffeurs in the Motor Transport Unit of the Division of Administrative Services.

## Basic Hourly and Rounded Annual Wage Rates by Step and Grade

	Step 1		Step 2		Step 3	
	Hourly	Annual	Hourly	Annual	Hourly	Annual
-	1.48	3078	1.56	3245	1.64	3411
	1.74	3619	1.83	3806	1.92	3994
	2.00	4160	2.10	4368	2.21	4597
		4650	2.36	4909	2.48	5158
	2.24	4659	2.63	5470	2.76	5741
	2.50	5200 5429	2.75	5720	2.89	6011
			2.87	5970	3.01	6261
	2.73	5678		6240	3.15	6552
	2.85	5928 6157	3.00 3.12	6490	3.28	6822
	2.90	0157			2.40	7072
	3.08	6406	3.24	6739	3.40	7426
	3.23	6718	3.40	7072	3.57	7779
	3.38	7030	3.56	7405	3.74	1113
	3.54	7363	3.73	7758	3.92	8154
	3.70	7696	3.89	8091	4.08	8486
	3.85	8008	4.05	8424	4.25	8840
				8757	4.42	9194
	4.00	8320	4.21		4.59	9547
	4.15	8632	4.37	9090	4.76	9901
	4.30	8944	4.53	9422	4.70	,,,,,,
			4.70	9776	4.94	10,275
	4.47	9298	4.86	10,109	5.10	10,608
	4.62	9610 9922	5.02	10,442	5.27	10,962
	7.11	,,				

Incumbents of positions subject to this wage schedule are eligible for step increases within particular grades on the following basis:

For advancement to Step 2, after 26 weeks (6 months) satisfactory service in Step 1.

For advancement to Step 3, after 78 weeks (18 months) satisfactory service in Step 2.

<sup>\* (</sup>This schedule supersedes the wage scale effective December 6, 1964)

#### PRINTING GRADE WAGE SCHEDULE \*

December 5, 1965

This schedule applies to those positions in the Duplicating, Mail, and Supply Section that perform the following kinds of lithographic work: Offset Printing, Offset Photography, Photostat and Xerox Operation, Mimeograph Operation, Bindery Operation, and to the Supervisor and Assistant Supervisor of those positions.

Basic Hourly and Rounded Annual Wage Rates by Step and Grade

ing	Ste	Step 1		Step 2		p 3
	Hourly	Annual	Hourly	Annual	Hourly	Annual
	1.64	3411	1.73	3598	1.82	3786
	1.77	3682	1.86	3869	1.95	4056
	1.89	3931	1.99	4139	2.09	4347
	2.01	4181	2.12	4410	2.23	4638
	2.14	4451	2.25	4680	2.36	4909
	2.14	4701	2.38	4950	2.50	5200
	2.38	4950	2.51	5221	2.64	5491
	2.52	5242	2.65	5512	2.78	5782
	2.64	5491	2.78	5782	2.92	6074
	2.76	5741	2.91	6053	3.06	6365
	2.89	6011	3.04	6323	3.19	6635
	3.01	6261	3.17	6594	3.33	6926
	2 14	6531	3.30	6864	3.47	7218
	3.14	6781	3.43	7134	3.60	7488
	3.26 3.38	7030	3.56	7405	3.74	7779
					0.07	0050
	3.51	7301	3.69	7675	3.87	8050
	3.63	7550	3.82	7946	4.01	8341
	3.75	7800	3.95	8216	4.15	8632
				0106	4 20	8902
	3.88	8070	4.08	8486	4.28	9214
	4.01	8341	4.22	8778 9048	4.43	9506

Incumbents of positions subject to this wage schedule are eligible for step increases within particular grades on the following basis:

For advancement to Step 2, after 26 weeks (6 months) satisfactory service in Step 1.

For advancement to Step 3, after 78 weeks (18 months) satisfactory service in Step 2.

<sup>\*(</sup>This schedule supersedes the wage scale effective November 8, 1964)