

Minutes for June 21, 1966


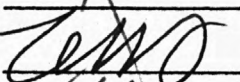
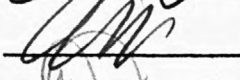
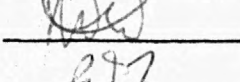
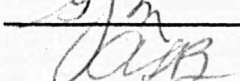
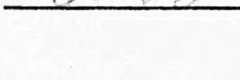
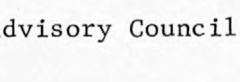
To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date. 1/

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin	<u></u>
Gov. Robertson	<u></u>
Gov. Shepardson	<u></u>
Gov. Mitchell	<u></u>
Gov. Daane	<u></u>
Gov. Maisel	<u></u>
Gov. Brimmer	<u></u>

1/ Meeting with the Federal Advisory Council.

A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the Board Room of the Federal Reserve Building in Washington, D. C., at 10:30 a.m. on Tuesday, June 21, 1966.

PRESENT: Mr. Martin, Chairman
Mr. Robertson, Vice Chairman
Mr. Maisel
Mr. Brimmer

Mr. Sherman, Secretary
Mr. Bakke, Assistant Secretary

Messrs. Simmen, Moore, Day, Stoner, Watlington, Fleming, Bodman, Brinkley, Moorhead, Knight, and Stewart, Members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, and Eleventh Federal Reserve Districts, respectively

Mr. Frank L. King, Chairman of the Board, United California Bank, Los Angeles, California, representing the Twelfth Federal Reserve District in the absence of Mr. Cook

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

There had been distributed a memorandum listing the topics to be discussed at this meeting, together with the statement of the Council on each. The topics, the Council's statement on each topic, and a summary of the discussion at this meeting follow.

1. Economic conditions and prospects:

- A. How does the Council appraise prospects for consumer spending and for consumer and industrial prices at mid-1966?

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The Council anticipates that consumer spending will continue to rise, reflecting present high levels of employment and the continued upward trend of personal income. There is evidence that the rate of rise has moderated slightly from the very rapid pace that characterized the early part of the year. While numerous factors may be contributing to this development, it is possible that the increase in the Social Security tax that became effective January 1, together with the reimposition of excise taxes, and the accelerated tax collection program effective May 1, may have caused some reappraisal of consumer savings-spending patterns.

Although consumer prices probably will continue to edge up, the rise may be affected somewhat by lower food prices at the retail level. Food prices at the wholesale level showed a modest decline between February and May. Most members of the Council anticipate that industrial prices will be under increasing upward pressure.

At President Moorhead's invitation, Mr. Bodman commented that the previous week Henry Ford II had expressed the opinion that recent publicity given to the question of automotive safety had caused potential car buyers to feel 1967 designs might be radically different in terms of safety features and equipment and, therefore, to defer purchases pending appearance of the new models. While no other industry spokesmen had echoed this sentiment, there seemed to be general concurrence on the part of dealers, who had been experiencing a large inventory buildup of the 1966 models. In response to a question from Chairman Martin, Mr. Bodman noted that he had heard the 1967 model cars would be introduced to the market two to three weeks earlier than had been the case last year, but that he had no information concerning design or equipment changes.

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Mr. Bodman then suggested that the drop in automobile sales, plus the decrease that had been observed in housing starts, might portend a lower level in overall consumer spending for durable goods during the third quarter of 1966.

- B. Have Council members observed any significant recent changes in business plans for capital expenditures in response to the President's request or in response to tighter conditions in markets for labor, materials, and credit? Have there been any significant changes in inventory policies?

The members of the Council have not observed any significant change in business expenditures in response to the President's request. There is some fragmentary evidence that tighter conditions in the markets for labor, materials, and credit and the resulting increases in costs may tend to slow the rate of rise in capital expenditures. It is difficult to detect any important change in inventory policies. On the other hand, the recent slight decline in retail sales and, in particular, automobiles, may cause businessmen to be less aggressive in building inventories.

Mr. Moore observed that in his opinion there had not been much direct response by business to the President's request for a slowdown in capital investment. In the Second Federal Reserve District, the industries tended to have long-lead programs and any curtailment in spending plans had been based more on a review of their own estimates of what might happen in the economy, especially with respect to the labor situation and cost factors. It appeared to him that there would continue to be a high rate of business investment through 1966 and that the President's plea for a voluntary cutback was not a very workable solution for mitigating the inflationary pressures in our economy.

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Mr. Day commented that, with respect to inventory policies, while the recent slight decline in retail sales might possibly cause businessmen to be less aggressive in building inventories during the balance of the year, it should be borne in mind that such sales still showed an upward trend on an annual basis, although at a lesser rate than that experienced during 1965.

2. Banking developments.

- A. What does the Council anticipate as to near-term business demands for bank credit? Do the members expect banks to have difficulty in meeting such demands?

The members of the Council anticipate a continued strong demand for bank credit. To an increasing extent, banks have been rationing credit in recent months and will have difficulty in meeting the expected strong demand for credit in the remaining months of the year.

- B. How much tightening of bank lending policies has taken place since last winter? Has the ABA checklist to guide selection of loans been effective in this regard?

Bank lending policies are considerably tighter than they were last winter. The ABA checklist has been helpful. Moreover, because the period of tight money and higher interest rates has continued for several months, some would-be borrowers may have been discouraged from making loan requests other than those which they believed would receive favorable consideration.

- C. How have recent developments affected the ability and willingness of banks to attract funds through issuance of large-denomination negotiable CD's? Through issuance of small-denomination consumer-type CD's?

Despite the pressures in the credit markets, the banks in the money centers have been able to attract a slowly rising volume of funds through the issuance of negotiable CD's. To obtain the funds, however, banks have had to step up the rates and/or shorten

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the maturities. Members of the Council believe that the small-denomination consumer-type CD's have been helpful in enabling the banks to attract and retain bank passbook-type savings funds. There has been only a relatively small increase in total consumer savings.

- D. What are the views of Council members regarding the desirability, and the possible effects, of various recent legislative proposals for limiting CD issuance by reducing time deposit interest rate ceilings applicable to certificates below certain maturities or denominations?

The members of the Council do not look with favor on recent legislative proposals for limiting the issuance of CD's by reducing interest rate ceilings. The Council knows of no persuasive evidence that a substantial volume of savings has flowed into the commercial banks from other financial institutions. On the contrary, there are indications that savings have been attracted to equities and higher yielding, fixed income obligations such as those issued by the Federal agencies.

- E. How would the Council appraise the current state of the mortgage and consumer credit markets?

The Council believes that restrictive monetary policy, with the resulting rise in interest rates, has had an important impact on the mortgage credit markets. There is less indication so far of any significant direct effect on consumer credit markets. However, recent increases in instalment credit rates may have a more far-reaching impact on consumer credit markets. To the extent that demand has moderated as a result of these developments, and the pressures on the relatively limited supply of resources eased, monetary policy will succeed in achieving one of its objectives.

President Moorhead stated that, in his opinion, banks had generally reached levels close to the reasonable utilization limits of available lending capital, and that more demand for credit could be accommodated only with great difficulty. In most cases substantially greater demand could only be met through the liquidation of portfolio assets.

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In response to a question from Governor Maisel, President Moorhead expressed the feeling that continuing strong demand for bank credit was general and that still higher levels could be anticipated with respect to business borrowing in particular. Any near-term lessening of demand for credit could be expected only with respect to marginal and speculative types of activity.

Mr. Watlington concurred, stating that a high level of hard-core demand for bank loans would be left even in the face of some slowdown in demand from marginal or speculative borrowers.

President Moorhead added that an important factor in the current demand for bank credit was the relationship between long-term money market rates and bank rates. He stated that a director of his bank who owns an office building had recently expressed reluctance to go into the mortgage market now, because of the rate structure; it was better to borrow from banks at this point, since the bank rate was still a bargain in relation to long-term money market rates. He commented further that banks had many good customers with whom relations over a long period of time had been established, and there was a strong tendency not to turn down credit requests from these sources.

Mr. Moore agreed that while bank lending rates had increased, they were still attractive enough that there was a strong demand for credit, although perhaps customers were borrowing with the hope that refunding could be accomplished later on at a lower rate of interest.

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Governor Brimmer observed that a paradox seemed to have been presented in the foregoing discussion. The present level of bank lending rates did not seem to be discouraging applications for credit, old customers were coming to banks with increased demands for loans, and the country's money supply was increasing; thus, he didn't get the impression that many good borrowers were being turned away. Under these circumstances, he wondered whether the strain on banks was as serious as it was represented to be.

Discussion of this question by the Council developed a consensus that some good borrowers were being turned away as a result of the overall increase in demand for credit and the banks' inability to meet all legitimate requests.

In support of this observation, Mr. Day noted that the ratio of gross loans to deposits for most banks in the Third District was over 70 per cent, and a large proportion of their secondary reserves were pledged.

Mr. Fleming added that pressure was being exerted because of the Federal Reserve's restrictive policy in administering the discount window; this led banks to realize that their only readily available source of funds for lending purposes would be either the Federal funds market or issuance of certificates of deposit. These sources were costly, and this fact tended to discourage banks from turning in this direction for funds to the full extent of loan demands.

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Mr. King stated that banks in the Twelfth District did not seem to be issuing negotiable certificates of deposit aggressively because of the feeling that in doing so they would be borrowing short and lending long. Much of the CD business in that District appeared to have come from transfer of passbook savings to smaller consumer-type certificates. With respect to complaints from the savings and loan industry about loss of share accounts due to the structure of bank rates on deposits, he felt that most withdrawals from Twelfth District institutions were not going into commercial banks but were being transferred to the East, where much of the money had come from because of the higher returns that had been offered by West Coast savings and loans.

Mr. Day noted that his bank had started issuing consumer-type certificates of deposit last August, and use of these instruments had been important in the Philadelphia area for retaining and increasing funds for bank lending. These banks had attracted an aggregate of about \$250 million in this fashion, while overall savings had remained approximately on an even keel. Thus, any supervisory action that would cause a runoff of certificate of deposit funds would present a real problem.

Governor Maisel noted that there had been an upward movement recently in bank rates on consumer-type certificates of deposit; he inquired whether in the Council's view this constituted a money market problem.

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President Moorhead noted that there was considerable variation among Federal Reserve Districts and localities within the Districts in the structure of rates on certificates of deposit, and he then called for comments by individual Council members.

Mr. Stewart said that in the Dallas District rates on these CD's were still in the vicinity of 4-1/2 per cent and had not been moving up very fast.

Mr. Brinkley said that banks in the Eighth District had not led the upward trend in rates but, rather, had tended to lag the country as a whole. Increases that had taken place were defensive in nature.

Mr. Knight observed that the situation in the Tenth District was spotty. In Omaha the prevailing rate on CD's was 5 per cent; it had not attracted much in new deposits, although there had been transfers from demand and passbook savings accounts. On the other hand, in Denver the prevailing 5 per cent rate had attracted a considerable amount of new money, which had led to an easing of bank lending conditions in that city.

Governor Maisel then inquired whether, if California savings and loan share account rates were moved up to 5-1/4 per cent, banks would also move up to that level.

Mr. King stated that banks might well raise their consumer CD rates to 5-1/4 per cent as a defensive move. Some small banks already were issuing such CD's at rates above 5 per cent, although the large banks in California were still holding to 5 per cent.

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Mr. Day noted that in Philadelphia there was a traditional 1/4 to 1/2 per cent spread between the rates paid by mutual savings institutions on share accounts and the rates paid on bank passbook savings. There was some evidence that the mutuals were holding to a maximum 1/2 per cent differential, because of fear that they might otherwise become overextended. Therefore, they had not generally moved to the 5 per cent rate on share accounts that would make them competitive with consumer CD's issued by banks.

Mr. Watlington said that in the Fifth District savings and loans appeared to be more prudent in their rate offerings, and rate competition on the part of commercial banks was not so acute. While some of the larger banks were offering 5 per cent on consumer CD's, this was by no means a general pattern. At his bank the emphasis in advertising was on passbook savings. If sophisticated depositors wished to explore the alternative of purchasing CD's, the contract rate was based upon negotiation rather than on a firm advertised amount.

President Moorhead commented that the same situation generally prevailed in the Ninth District. Both savings and loan share accounts and bank CD's were, by and large, at the 4-1/2 per cent level. While commercial banks could move higher, the mutuals could not; therefore, the banks were exercising forbearance with respect to their deposit rate structures.

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Governor Robertson inquired whether the apprehension being expressed by the savings and loan industry about a runoff in share accounts following second quarter dividend credits warranted serious attention.

The Council's consensus was that this indeed could be a problem, and Governor Robertson then inquired what might be done to forestall a crisis in the industry.

Mr. King replied that, in approaching this question, it was important to consider where the outflow of savings and loan share accounts had gone to date, since withdrawals following June dividends would undoubtedly follow the same course. For the country as a whole, the flow seemed to have been into other market instruments and the stock market, rather than to banks. Therefore, restrictive measures aimed at banks could hardly remedy the problem.

President Moorhead said that this was the unanimous view of the Council. While there had undoubtedly been some flow from savings and loans to banks, the bulk of withdrawals had gone into other types of equities and fixed income obligations.

Mr. Moore expressed the view that restricting the issuance of CD's would be injurious to banks and not particularly beneficial to savings and loan institutions. With respect both to large negotiable CD's and the smaller consumer-type certificates, the real problem lay not in competition for funds by the savings and loan industry but in the issuance of marketable obligations by Federal agencies.

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In response to a question from Governor Maisel, President Moorhead commented that if there were to be any restrictive legislation regarding the issuance of CD's by banks, it was the unanimous view of the Council that the Board should be given complete discretion over both interest rates and maturities in constructing the regulatory limitations.

Mr. Moore added, with respect to this point, that if anything were to be done to restrict issuance of CD's, the most appropriate approach would be to aim at consumer-type instruments, with a premium interest rate differential allowed on certificates of \$100,000 and over. These generally represented a different kind of money than that represented by smaller denomination certificates; therefore, there was some logic for establishing different rates for these large instruments.

Governor Brimmer then inquired what effect the establishment of higher reserves against negotiable CD's might have on the banking industry.

Mr. Moore said that this would not be a major deterrent. His bank was only moving into issuance of these premium certificates to have money to lend, and while they didn't like the added cost, they felt it a competitive necessity to enable the bank to take care of certain customers.

Returning to the question of interest rate differentials, Mr. Brinkley noted that if a restrictive rate of interest were imposed on consumer-type CD's, the result could well be that money would be pulled

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out of interior banks and serious dislocation of resources could result. In his view, banks should not be taken out of competition for funds in the marketplace.

Governor Maisel said that he had gathered the impression that small banks were generally in favor of lower interest rate ceilings on CD's, and a number of Council members indicated that this was probably correct. Mr. Brinkley added the comment that such banks would also feel that savings and loans should likewise be subject to ceiling rates on dividends on share accounts.

President Moorhead commented that in his observation the overwhelming majority of the 14,000 commercial banks of the country would like ceilings on rates they might pay on deposits, and they would like to have them set at low levels. The small country bank was usually not too much concerned with competition from savings and loan associations--such bankers often thought they had a monopoly in their towns, and they might not be aware of how much was flowing out to other areas.

Mr. Watlington thought that in most cases small town bankers were in fact faced with competition from savings and loan associations.

Concerning proposals to restrict interest rates on certificates of deposit on the basis of maturities, Mr. Day noted that his bank issued certificates bearing maturities of from 6 to 24 months, but with a provision for redemption quarterly at a penalty. To the extent that other banks were also doing this, he felt the establishment of

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rate differentials on certificates of deposit based on maturity would not be particularly effective.

Mr. Bodman said that the public generally did not understand the distinction between a share account at a savings and loan or a mutual and a deposit at a commercial bank. The common view was that the debtor-creditor relationship at savings and loans was the same as that that existed between a commercial bank and its depositor. Also, the insurance protection afforded shareholders in savings and loan institutions was not as comprehensive as that applicable to bank depositors. If the public were made to realize the difference between a deposit in a commercial bank and a share in a savings institution, there might well be a considerable exodus of accounts from the latter.

Turning to another aspect of the subject, Chairman Martin suggested that the real problem facing the nation was that demand for credit was substantially in excess of aggregate savings of business and individuals. With industrial activity pushing against manpower ceilings and productive capacity, and with business seeking aggressively to expand, there just was not enough savings to meet the demand for funds to expand productive capacity. If the Federal Reserve were to create money for such expansion, it would only accelerate price rises.

Members of the Council expressed complete agreement with this point of view. Mr. Watlington observed, however, that under economic conditions calling for a restrictive monetary policy, if banks were

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required to keep their interest rates on deposits unrealistically low, they would suffer a competitive disadvantage in seeking available funds. Mr. Fleming added, with reference to Chairman Martin's comment concerning demand for funds in excess of savings, that reducing interest rate ceilings of banks would have a tendency to channel funds out of banks but not necessarily into savings and loan associations; money undoubtedly would move away from such institutions and into the capital market; for example, into issues of the Federal Home Loan Banks, which recently had been offered at 5-3/4 per cent.

Chairman Martin noted that these were all factors to be taken into account. If the economic situation were one of substantial unemployment or unutilized plant capacity, the System could act to mitigate imbalances between savings and investment by allowing the money supply to increase. However, different groups were now struggling to obtain the inadequate volume of savings, and in some way there would have to be a slowdown in both the public and the private sector of expenditure.

Mr. Watlington expressed the opinion that this was the crux of the matter; at the present time the Government should be curtailing its own expenditures rather than seeking to place the whole burden of slowdown on the private sector of the economy.

Governor Brimmer referred to comments previously made by Messrs. Moore and King to the effect that there was an inherent reluctance on

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the part of banks to borrow short and lend long. He noted, however, that banks were still issuing large quantities of CD's in order to obtain loanable funds.

Mr. Moore responded that a dramatic change had taken place in New York with regard to the relation of demand deposits to loans. Demand deposits had not increased at anything like the rate of increase in demand for loans by customers to whom the banks were committed for extensions of credit. Funds to meet these commitments had to be obtained wherever they could be found, and this meant moving into CD's. Nevertheless, the banks were attempting to get the longest maturities possible and to space them out. If banks were not allowed to compete in the marketplace for available funds they would be in trouble, because in order to meet commitments to their customers it would be necessary to dip into secondary reserves. Further, he noted that the problem with which banks were now faced could be attributed directly to the Administration policy that had prevailed until recently to encourage stimulation of economic activity in the public sector. The psychological effects of this policy would be slow to diminish, and any attempt to impose a sudden braking on economic activity could have far-reaching and adverse consequences.

President Moorhead also observed that many banks were obtaining money through the issuance of CD's at 5-1/2 per cent and relending these funds at the same rate to established business clients, just to protect customer relations with a view to the future.

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Chairman Martin then returned to the subject of pending legislative proposals, noting that an alternative to imposing limits on rates or maturities would be a restriction on the aggregate amounts of CD's outstanding. He inquired whether this approach would be feasible.

Mr. King expressed the opinion that banks had been trying to keep the volume of money market CD's down, but at present they were under tremendous pressure to maintain their inflow of lendable funds, for reasons previously cited.

Chairman Martin suggested that a combination of factors was putting banks under considerable pressure and that, under present economic circumstances, this was the time for them to exercise great prudence in credit extensions.

Mr. Day replied that while banks were not unmindful of the necessity for prudent operating policies, practical business considerations, coupled with the fact that credit demands were exceeding the level of savings, made it necessary for them to compete vigorously for such funds as were available within the economy.

Mr. Watlington added that a major factor contributing to present circumstances was the competition that had developed among banks for customers, and given the prevailing tight credit situation banks were willing to lose money now to retain customer relations that could be profitable at a later date.

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Mr. Moore concurred, noting that this was a very important consideration. He cited the example of a customer that had found that demand for a new product far exceeded expectations, thereby putting the company into a liquidity squeeze to meet production demands. In the past, this customer had been a major source of placement for his bank's CD's; now, it needed bank credit. As a matter of good customer relations, it was an almost essential business judgment that his bank respond to this need, notwithstanding that the net result would be adding to the economy's production base at a time when a slowdown in this sector was clearly indicated.

Mr. Day felt that banks had been exercising a lot more restraint in their lending than was generally recognized. However, a problem was presented by the fact that there had been so much economic stimulation for so long that it was both difficult and undesirable to effect an abrupt turnaround.

Governor Robertson then returned to the possible outflow from savings and loans following the payment of quarterly dividends at the end of June. If this went far enough it could affect the entire banking system, and he wondered what the members of the Council would suggest to deal with such a situation.

President Moorhead suggested that some easing of the pressure on banks might be called for, although the first need would be to use the resources of the Federal Home Loan Banks.

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Several members of the Council commented on steps that might be taken, including the possibility of requiring a notice period on withdrawals from savings and loans, which in turn could have serious repercussions upon commercial banks. The consensus of the Council was that in such an event there would be a general effort on the part of the banking community to provide assistance, that this would call for some temporary easing of monetary policy, and that this would no doubt require a willingness on the part of the Federal Reserve to provide greatly increased access to funds through the discount window during the crisis.

In response to a question from President Moorhead, Governor Robertson expressed the view that the resources of the Federal Home Loan Bank System, as the institution set up to deal with problems in the savings and loan area, should be relied upon before any move by the commercial banking community to enter the picture; however, he felt that the commercial banks as well as the Federal Reserve should be giving careful thought to the potential problem.

President Moorhead then turned to the Board's question 2.E. on today's agenda regarding the current state of the mortgage and consumer credit markets. As indicated in the Council's written response, he said that the members generally agreed that the mortgage market had become extremely tight and that this was having an effect on housing plans and sales. In President Moorhead's opinion, this

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was an appropriate place for such an effect if the objective was to slow down the economy. In sum, housing had a special significance, including a particular political significance, and there was no question but that monetary policy was having a real impact in this sector. As for consumer credit, President Moorhead said that ample amounts were still readily available at banks, although some had raised their rates.

Governor Maisel referred to criticism that he had heard of banks and insurance companies for pushing ahead with commercial construction loans while funds for residential housing were increasingly difficult to come by. He inquired whether contraction in housing starts in the various Federal Reserve Districts was felt to be a social problem at this point.

President Moorhead stated that in the Ninth District housing construction seemed to be proceeding apace on the basis of prior mortgage commitments. The third quarter of the year might well see a substantial decrease, resulting in some problems.

Mr. Watlington suggested that a slowdown in housing construction was almost inevitable because of the increase in building costs under current economic conditions; a question of economic feasibility was involved.

Mr. King commented that in the Twelfth District there were a great many unsold new single-family dwellings. The ability to keep

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the housing industry employed depended partly on the overall need for new houses in the country as a whole.

Governor Maisel responded that he felt a requirement of 1.4 to 1.5 million units on an annual basis was needed country-wide. Governor Brimmer added that seasonally adjusted figures for May showed an annual rate of 1.3 million, and estimates for the third and fourth quarters indicated a probable drop in the rate to 1.2 million units.

Mr. Fleming observed that in the Sixth District a lot of residential building appeared to be speculative in nature, with land costs being bid up to unrealistic levels and passed on in the form of inflated prices. This had resulted in some slowdown in sales, unrelated to mortgage market conditions.

Mr. Watlington suggested, and Mr. Fleming agreed, that in the construction industry there was no widespread unemployment problem. Workers engaged in building residential housing were badly needed on commercial construction projects, and therefore the cutback in residential housing starts could not yet be regarded as having an adverse employment effect overall on the construction industry.

Mr. Day commented that discussions of current mortgage market conditions often overlooked the fact that life insurance companies were being called upon to make a heavy volume of policy loans, thus curtailing the amounts they might otherwise have had available for mortgage loans.

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Chairman Martin noted that there appeared to be cases of unnecessary building, for example, expansion projects by educational institutions. Many such projects were forging ahead with construction plans, despite present and prospective shortages of labor and materials, because of the feeling that costs would be even higher at a later time. In his opinion, consideration should be given to postponing deferrable construction of this type to help bring balance to the present state of economic affairs.

3. Balance of Payments.

- A. Does the Council believe that the reduction in foreign lending by U.S. banks is due mainly to (a) general monetary conditions, (b) the voluntary foreign credit restraint program, or (c) other factors?

The Council believes that the reduction in foreign lending by U.S. banks largely reflects general monetary conditions including the pressure of domestic demand, and to some extent, the voluntary foreign credit restraint program.

The slowing in the pace of economic activity in Japan, for example, was one of the other factors accounting for some reduction in foreign lending by U.S. banks.

- B. Does the Council believe that any significant amount of export financing is being refused because of the voluntary foreign credit restraint program or because of general monetary conditions?

The members of the Council are not aware that any significant amount of export financing is being refused either because of the voluntary foreign credit restraint program or because of general monetary conditions.

- C. What is the Council's view regarding the outlook for foreign lending by banks during the remainder of 1966?

The Council does not anticipate any substantial increase in foreign lending by banks during the remainder of 1966.

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President Moorhead emphasized that the consensus of the Council quoted under agenda topic 3.A. was not intended to suggest that the voluntary foreign credit restraint program was no longer an important factor in reduction of foreign lending by U.S. banks; however, at the present time the general tightness of money within the economy was perhaps the most significant consideration.

Mr. Moore concurred, noting that the voluntary foreign credit restraint program had been very effective at first, but that now a more immediate influence was the level of domestic demand for credit.

Mr. Day stated that while this might generally be true, it should be noted that a number of banks in the Third District had fully utilized their targets for foreign lending, and Mr. King added that this situation also applied at some Twelfth District banks.

Further discussion of this topic developed agreement among the Council members that were it not for the current level of domestic credit demands, banks undoubtedly would be showing greater aggressiveness with respect to foreign credit activities.

Governor Brimmer stated his impression that some banks had shifted foreign lending activities to the Export-Import Bank when, under normal circumstances, they themselves would have made the loans. Indeed, he was aware of some cases where credit lines had been transferred after the loan had already been made and equipment put in place.

Mr. King said that this was true with respect to some banks in the Twelfth District, because retaining credits would have put them

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over their guideline targets; in such cases, there had been shifting of part of the line, dictated by a desire to stay within the Board's guidelines. He felt that perhaps some banks in the District had lost a measure of export business or other foreign lending opportunities because of the guidelines.

Mr. Moore noted that another factor in the shift of certain credit lines to the Export-Import Bank was that cases arose where a good customer of the bank wanted the loan, but because of political risks in the country involved the bank preferred to have an instrumentality of the United States Government in the picture.

4. What are the Council's views on monetary and credit policy under current circumstances?

The members of the Council believe that the gradually increasing restraint that has characterized credit and monetary policy in the recent past should be continued. Although there are indications that economic activity seems to have moderated somewhat from the pace of the early months of the year, it is not clear that demand has slowed sufficiently to moderate the pressures on resources and on the price level in general. Accordingly, a continuation of the policy of gradually increasing restraint is warranted. However, the approaching July 1 savings interest period may be marked by unusual activity and shifts of funds requiring temporary policy adjustments over this period.

To deal effectively with inflationary pressures in an economy, it is necessary to pursue a policy not only of monetary restraint but also of fiscal restraint.

President Moorhead said that if a crisis were to develop in the savings and loan industry following the end of June payment of dividends, the impact could spill over into the banking system. He

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personally was concerned about the period July 1 through 15; if in addition to savings and loan withdrawals there were to be a shift of funds out of bank deposits into other forms of investment, it was his opinion that monetary policy should be eased to help take up the strain until the crisis was passed. He realized that if such easing took place, it would be hard to get back to the present posture, but perhaps this disadvantage could be outweighed if the potential pressures were to develop.

Governor Maisel suggested that too much attention was being paid by the banking industry to the net borrowed reserve figure. If the July strains were to materialize, banks could be slightly more welcome at the discount window and some additional reserves might be put into the market. However, he would not like to see an increase in the money supply.

Chairman Martin said that any development of the sort President Moorhead had suggested should be very temporary; in his judgment any easing of monetary policy that resulted in an increased flow of funds would only compound present difficulties. He recognized the danger of a crisis that would have to be met, but this should not be used as a basis for subverting overall monetary objectives.

Mr. Moore commented that perhaps the apprehension expressed by the savings and loan industry was being overemphasized. Even if the circumstances anticipated were to materialize, it would be a mistake to let this situation determine monetary policy action. The primary

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concern was to dampen overheating of the economy. Under these circumstances, it was necessary to keep a tight rein on reserves of the banking system and immediately distasteful consequences had to be accepted in the interest of the long-run good. Although the possible crisis in the savings and loan industry anticipated during July had to be handled in some way, there should be continuing restraint in the economy. While it was his hope that help in this direction might be forthcoming in terms of the Administration's fiscal policies, he recognized that this was probably an unrealistic hope.

Governor Brimmer then inquired regarding the prospect for an increase in the bank prime rate.

Mr. Moore noted that both the prime rate and the discount rate were out of line with the market. Interest rates on bank deposits were rising, and the higher rates along with higher balances meant that the cost of deposit money was going up. He commented that there were political implications with respect to changes in the prime rate, and banks were, therefore, sensitive to adjustments in this area. Nevertheless, apart from the published level of the prime rate, actual lending rates even to prime borrowers were tending to increase within the banking community.

Mr. Watlington remarked that bank lending rates had been relatively low before the previous prime rate increase, and even now bank rates in the United States were not high in relation to those in other countries.

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Mr. Watlington expressed concern that under present conditions of monetary restraint, there might be a reluctance on the part of the Federal Reserve Banks to allow adequate use of the discount window during periods of pressure on a bank's reserve position. He cited the case of his own bank, where there was a seasonal peak need for borrowing that extended over a period of about six weeks beginning toward the end of July, and he wondered whether he could count on availability of the Federal Reserve discount facility throughout this period, notwithstanding the present posture of monetary policy.

Chairman Martin responded that questions of this nature should be discussed frankly with the President of the Federal Reserve Bank of the District concerned. The Reserve Banks were the ones who applied the rules, and while the Board had overall supervisory authority with respect to the provisions set forth in Regulation A (Advances and Discounts by Federal Reserve Banks), the regional Reserve Banks were closer to the local situation insofar as concerned conditions imposed upon use of the discount window. Thus, he felt that member banks should keep in close contact with the Reserve Bank Presidents in their Districts for guidance with respect to use of the discount facility.

Mr. King observed that, while he could concur generally in this regional administration of the discount facility, it had been his observation that there might be quite a variation in administration of the discount window among the several Federal Reserve Banks.

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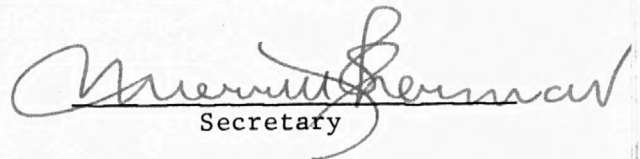
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Governor Robertson responded that this might be a legitimate point, and one purpose of the comprehensive reevaluation of the discount mechanism that was currently being carried on within the System was to see whether more uniformity could not be developed among the Districts.

Chairman Martin concluded the discussion with the comment that this was a matter that could not be reduced to a simple rule, that there was some misunderstanding as to matters of degree and perhaps in views in different parts of the System, but that the Board appreciated receiving the frank views of the members of the Council.

It was agreed that the next meeting of the Council would be held September 19-20, 1966.

The meeting then adjourned.


Secretary