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Minutes for September 20, 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	WM
Gov. Robertson	A
Gov. Shepardson	[illegible]
Gov. Mitchell	GM
Gov. Daane	[illegible]
Gov. Maisel	[illegible]
Gov. Brimmer	AFB

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, September 20, 1966.

PRESENT: Mr. Martin, Chairman
Mr. Robertson, Vice Chairman
Mr. Shepardson
Mr. Mitchell
Mr. Daane
Mr. Maisel
Mr. Brimmer

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

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

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 business costs and prices during the remainder of 1966?

The Council anticipates that upward pressures on business costs and prices will intensify during the remainder of 1966.

This will reflect a continuation of expanding demands as well as an exceedingly tight labor situation and the probability of increasing wage costs.

President Moorhead said there were no significant differences of opinion within the Council in this regard.

B. Have Council members observed any significant recent changes in business expenditures or expenditure plans 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 recent changes in either business expenditures or plans. However, tighter conditions in the markets for labor, materials, and credit, together with the proposed suspension of (1) the 7 per cent investment tax credit, and (2) the liberalized depreciation allowances, may result in some moderation in business investment plans and outlays in the months ahead.

The members of the Council are not aware of any significant change in inventory policies. While there have been substantial additions to inventories, the inventory-sales ratio has not changed appreciably.

President Moorhead said that although in isolated cases there had been some changes in expenditure plans, perhaps for reasons peculiar to the given industry or company, in general businesses seemed to be going right ahead.

Mr. Day commented that it should not be overlooked that in the housing field monetary policy obviously had had a drastic effect.

Asked whether the situation of overbuilding appeared to have been fairly well corrected, Mr. Day said that it had in his area. Mr. Cook observed that in the Twelfth District there was quite a bit of feeling that it was a good thing to slow down until inventories had

been worked out. The apartment house situation was clearing up gradually, and the office building situation was not critical, but in several areas there was still a good deal of residential property overhanging the market. Also, there was quite a lot of subdivision property, partly or fairly fully developed, where building had not been started, in some cases apparently due to the inability of the parties concerned to carry out their commitments. A certain amount of liquidation probably had to go on anyway; the situation was already turning down before the tight money situation developed. In some agricultural areas, particularly where growth had been fast, there were reports of what was said to amount almost to a recession, with carpenters not working, but retail stores in those areas were not complaining.

2. Banking developments.

A. By how much, if at all, does the Council expect the fall demand for business loans to exceed normal seasonal projections? Do the members expect banks to have difficulty in raising funds to meet such demands? If so, to what extent are banks resorting to refusals or discouragement of business loan requests?

A number of members of the Council report that in addition to loan requests from regular borrowers they are receiving loan applications from customers with excellent credit standings who have maintained good balances for years but have never previously borrowed, and who feel they are entitled to credit. The Council expects the fall demand for business loans to exceed normal seasonal expectations.

Bankers expect to have considerable difficulty in raising funds to meet the credit demands of the economy. Some bankers are not at all certain that they will be able

to meet adequately the seasonal requirements of their customers or commitments already existing. As a consequence, there is wide expectation that banks will continue to be obliged to refuse or discourage a growing volume of business loan requests.

Mr. Bodman said a feeling was expressed at the Council's meeting yesterday that banks were so tight, generally speaking, that if any substantial percentage of customers with existing commitments came in at one time the strain on the banking system would be tremendous. It was well known in banking circles that the number of loan applications turned down had increased materially, and at an accelerated rate. Many banks in his area were making every effort to avoid granting loans except where there were commitments or where customer relationships of long standing made the banks feel that the customers were entitled to some part of the credit they requested.

President Moorhead said the Council believed that the banks were doing about as much as they could to discourage loan requests. However, the practicalities of the American banking system made it extremely difficult to turn down certain requests, as indicated in the Council's statement. Furthermore, the sale of securities was almost foreclosed, with virtually all Governments pledged, and the municipal market could become demoralized rapidly in the event of any substantial selling of municipals by banks.

Mr. Watlington commented that banks outside the money centers were feeling the impact keenly. When borrowers went to the money centers they were discouraged; and to the degree possible they were spreading

their borrowings at other banks throughout the country. Therefore, banks outside the money centers were experiencing a degree of pressure from national and regional companies that had not been felt in a long time. Many of the requests could be turned down, but in other cases that was difficult. His bank was recently approached by a customer of many years' standing that had maintained good balances. This national company pointed out that it had not called on the bank for credit previously and that it needed credit now for what it considered legitimate purposes. If the request was not granted, the customer's confidence in the bank would be lost.

Chairman Martin inquired whether it was fair to say that the possibilities for corporate financing of expansion from retained earnings and depreciation had been fairly well exhausted, and there was general agreement that this was correct. Mention was made of the names of several prominent companies now coming into the banks that had not sought bank financing for years.

Governor Maisel inquired about the extent of anticipatory borrowing, and President Moorhead said many companies were trying to firm up credit arrangements, and were willing to pay commitment fees, to be sure that money would be available when needed.

Mr. Fleming noted that commercial banking practices emphasized the element of mutual confidence and respect between the customer and the bank. Nowhere was the unwritten word more powerful than in the banking business. Small companies that a bank had helped to get started

looked to that bank to take care of their reasonable and legitimate banking needs. Also, many banks had worked hard to maintain connections with national corporations that carried good balances and usually asked for no credit accommodation. However, the relationship implied that if the corporation needed credit at some stage the bank would respond. Now the banking industry was experiencing calls for credit far greater than anticipated from customers in all size brackets. In a number of cases it was not feasible for larger companies to go to the capital market, and they were being discouraged by the life insurance companies, many of which had experienced a large growth in policy loans or were fully committed for a year or more ahead. Smaller companies were finding their business expanding and needed credit on that account. In one instance with which he was familiar the company had Government contracts to provide clothing for Vietnam but could not obtain financing. When all of these factors were put together in a package, the burden on the banking system was great, both in terms of immediate credit demands and calls that might come from all types of customers, including non-member banks who felt that their city correspondent banks must take care of them if they got into tight straits. Further, the banks' sources of funds were being cut away by prevailing high money market rates. In some areas the banks were faced with potential demands that could hardly be estimated, at a time when their sources of funds were being curtailed. While the banks might try hard to discourage loan

requests, they could not destroy relationships with those who had depended on them over a period of many years.

Mr. Watlington said that recently his bank was approached by a nonmember bank that had not borrowed in a generation. The nonmember bank indicated that it would have to do some borrowing next February, according to its projections, and asked whether it could count on accommodation for about 60 days. The nonmember bank was simply trying to plan to take care of legitimate demands in a seasonal peak period.

Mr. Fleming commented that if a bank began to turn down what were considered to be legitimate requests, rumors would spread that the bank was in such a situation that it could not take care of its customers. He thought it was necessary to guard against a whispering campaign against any segment of the banking industry.

Governor Robertson said he gathered from the foregoing remarks that the policy of monetary restraint was becoming effective. With that effectiveness came difficulties. However, the question was whether the difficulties would be solved by easing the impact of monetary policy.

President Moorhead commented that the Council members were aware of the objective of monetary policy and the fact that monetary policy was beginning to bite. While they agreed with the objective, they were pointing out that it could not be accomplished without difficulty in some places. The Council was suggesting, in connection

with another topic on the agenda, that perhaps some adjustment might be required over the next two or three critical months.

Mr. Brinkley said that banks in his area that had been trying to operate conservatively felt they were victims, to a certain extent, of an economic situation they did not create and could not control. Given time, they could restrain credit demands further, but during the period immediately ahead they were concerned about being able to take care of necessary requirements. Some loan requests had been coming into his area from national corporations because of the pressure on the New York banks; what helped in one place might simply create distortions in another place. Further, correspondent banks were coming in for loans secured by Government bonds, with the alternative of selling Governments or municipals. Such banks were relatively unsophisticated and depended on their city banks; if they lost confidence, there could be trouble in rural areas. The concern was whether the city banks could depend on the Federal Reserve if they needed money in a situation such as seemed likely to occur in the next few months. Reassurance was needed.

Mr. Watlington said that his bank had made it a rule not to lend to other member banks, and instead advised them to go to the Federal Reserve.

Mr. Day commented that within the past few weeks several national corporations had indicated to his bank that between now and the end of the year they would want to use part of their credit

lines. One national corporation in Philadelphia that had not borrowed for years had now set up a multi-million dollar line of credit with a number of banks, and had scheduled demands on the banks through the next 18 months. The present situation was forcing corporations to plan further ahead, and they wanted definite commitments that the banks would stand behind them at specified times.

Mr. Cook referred to the voluntary credit restraint program that was in effect during the Korean War period. He noted that such a program would not be feasible at this time, in the absence of special legislation, because of antitrust implications. However, a waiver was obtained from the Congress in the case of the current voluntary foreign credit restraint program, which seemed to have helped in one area. The banks were now moving into a critical period without the ability to act en masse. If a program similar to the voluntary foreign credit restraint program had been instituted a year ago, perhaps that might have helped to prevent some of the increase in interest rates by slowing down the output of money. As long as each bank was competing for its share of business, it was difficult to achieve a united effort. It would seem reasonable if the banks could move together in a body according to certain understandings that the banks would all be expected to observe.

Mr. Cook asked whether it was really feasible to use general monetary policy to try to correct excessive demands for facilities. There had been criticism of the banks for the sharp increase in business loans, as against other types. However, people were borrowing

to take care of the demands that had been created in the economy, partly due to expansive fiscal policies. The question was how, in such circumstances, judgments on the extension of credit for various purposes could properly be made by individual banks.

Mr. Cook also commented that at most California banks about half of the loans were real estate loans. The banks were definitely interested in making those loans. In analyzing their portfolios, they tried to determine what adjustments would be in the best interest of the over-all economy and also in the bank's best interest. It was known that mortgage loans required more cash per job than some others and that they did not turn over so fast. While the banks regretted not being able to make mortgage loans at higher rates, such loans were deferrable as opposed to other categories. If it were possible for the banks to move as a body, subject to an understanding that could be worked out as to which types of loans were or were not suitable, that might be constructive.

Mr. Cook added that the Council had never advocated that the discount window be used simply to provide money to banks as desired. The central bank was thought of as a lender of last resort, and it should remain that way. However, the Council members were concerned about lack of uniformity at the windows of the various Federal Reserve Banks. There was a certain uneasiness because the banks were not sure just what discount window policy presently existed, except that it was thought that a curtailment of business loans was desired.

The question was whether it was really prudent to curtail business loans to the extent that seemed to be indicated. Criticism perhaps was appropriate in regard to some loans made a year or so ago, but he doubted whether the same criticism was valid today.

Governor Mitchell observed that business loans rose in June and July at an annual rate of about 26 per cent, which could hardly be called a moderate increase. The September 1 letter from the Reserve Banks to member banks made it quite clear that there was no disposition to try to curb all further expansion. It was recognized that allowance should be made for seasonal requirements.

Governor Mitchell added that he had participated yesterday in a meeting of the Reserve Bank discount officers in New York, which meeting was primarily for the purpose of discussing specific cases and issues. It was probably true that there had been some differences of understanding among the discount officers, but he believed they were being worked out in a reasonable way.

Governor Mitchell observed that no one had in mind trying to do more than to tranquilize the rate of growth of the economy. In the absence of effective fiscal action, however, monetary policy was about all that was available to deal with inflationary pressures. He felt sure that the discount window would take care of the banks in a reasonable way, and he believed that the discount officers were becoming well equipped to deal with problems of the kind that had been discussed. It was recognized that difficult questions were

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presented for the banks in a period when demands were so heavy as at present, but the pressure probably would continue until effective fiscal action was taken or until activities in Vietnam abated.

On the subject of corporate liquidity, Mr. Moore commented that in the June-August period it became apparent that a number of large corporations had about run out of money. They began borrowing heavily, with the result that the amount of dollars borrowed grew disproportionately to the number of borrowers involved. Many of the corporations also went to the public market. Corporate demand deposit balances did not decline greatly from the first of the year to midyear; certificates of deposit ran off more than demand balances. But corporate excess funds and short portfolio investments ran off substantially. In view of the demands upon facilities, to which Mr. Cook had alluded, and in light of increased operating costs, the plans of corporations had to be reviewed, and the companies found that they would need a great deal more money than they had thought.

Mr. Fleming observed that payments on military contracts tended to be slow, thus making it necessary for contractors to obtain bank financing in the interim.

Asked whether it was known how much of the June-July rise in business loans involved lending for purposes associated with the Vietnam conflict, Governor Mitchell said that he thought borrowing for such purposes probably was significant and that a lot of the

July borrowing was for tax purposes. August figures showed the rate of loan expansion down substantially.

Mr. Cook said he had confidence in the willingness of the Federal Reserve to open the discount window for proper purposes. Nevertheless, the banks did have some qualms. Perhaps recent reactions at the discount window had been a little more extreme than usual, reflecting a desire to curb the rate of loan expansion to which Governor Mitchell had referred.

Governor Mitchell said that he thought some good results were being obtained. One factor that had been quite disconcerting was the state of the municipal market. Something had to be done; otherwise it might have been necessary to intervene in direct fashion. He was inclined to feel, however, that the situation had improved.

Governor Shepardson commented that in recent years some city banks had been quite active in suggesting that smaller banks withdraw from System membership. He wondered how much demand such city banks were now receiving from the banks that had withdrawn from membership, with assurances that they would be taken care of.

Mr. Watlington replied that in his area there were relatively few member banks. His bank had encouraged nonmembers to apply for Federal Reserve membership, but without great success.

Governor Shepardson said he was satisfied that that was correct. However, there were known situations where member banks had urged country banks to withdraw from membership.

Mr. Watlington said he felt that it was to a bank's advantage to have System membership, whether the bank was large or small, and that he had expressed such a view to banks in his area. Traditionally, his bank had lent to nonmembers at the Federal Reserve discount rate, but recently it was charging 3/4 per cent above the discount rate, and had indicated that it might go higher, in order to discourage borrowing for inappropriate purposes.

One of the Council members then summarized a meeting with officers of the Reserve Bank in his district from which it was understood that the Reserve Bank had developed certain groundrules or conditions with respect to borrowing. First, a member bank should come to the Federal Reserve only after exhausting every other avenue of borrowing. Second, the member bank should not be lending to other banks while borrowing from the Reserve Bank. Third, the bank should make a relatively drastic portfolio adjustment in order to get out of the window. The first condition seemed quite logical, but the second condition would be difficult to meet in view of correspondent banking relationships of long standing. Of most concern, however, was the indication that the Reserve Bank was going to "sit on you" until adjustment was made in the member bank's portfolio to enable it to discontinue its borrowing. The first indication was that the Reserve Bank had in mind a relatively short adjustment period, say, five or six days; subsequently a period as long as three or four weeks was mentioned. In any event, that would force the borrowing

bank to sell off municipals, if it had them, or else to engage in a drastic refusal of new loans or refusal to renew loans as they matured. The Reserve Bank indicated that it would expect the borrowing bank to meet normal seasonal demands; however, the member bank was expecting a greater than seasonal demand.

Governor Mitchell commented that a purpose of the September 1 letter was to offer assurance to member banks. He thought the prevailing interpretation of the letter among the discount officers was that if a member bank chose to reduce the rate of growth of its business loans it would be given a little time to accomplish that objective. During the adjustment period the bank could rely on the discount window for accommodation. He felt that there might be some changes in administration at some of the Reserve Banks as a result of the discount officers' meeting being held currently. Various kinds of issues were being discussed in as much detail as possible.

Governor Brimmer suggested that the concern of the aforementioned Reserve Bank on the question of lending by member banks to nonmembers might be related to the recent record of withdrawals from membership in the area concerned. He had received the impression that withdrawing banks had been assured by city banks that they could rely on them to obtain accommodation as needed.

The Council member who had spoken agreed that the country banks probably would not have withdrawn from membership unless they had received assurances from some large source of funds. To that extent

the posture of the Reserve Bank might have validity and might lend some justification to the imposition of the particular condition.

In further discussion, question was raised whether there was a rationale that member banks, if they borrowed from the Federal Reserve, should borrow all of their requirements from that source. While the answer was in the negative, Governor Shepardson commented that a member bank should not be borrowing from the Federal Reserve simply to lend to nonmember banks. He added that it amounted to a difficult problem for the System when banks were encouraged to withdraw from membership upon assurance that they would be taken care of by their correspondent banks. Governor Maisel cited provisions of section 19 of the Federal Reserve Act to the effect that a member bank shall not act as a medium or agent for a nonmember bank in applying for or receiving discounts from a Federal Reserve Bank, except by permission of the Board of Governors.

Governor Mitchell said he assumed that if a nonmember bank came to a member bank for accommodation it should have as strong a case for borrowing from the member bank as a customer seeking accommodation.

Mr. Fleming observed that seasonal needs, such as the moving of crops, sometimes required special assistance, and Mr. Stewart said that his bank was charging the Federal funds rate on loans to nonmember banks.

Mr. Watlington noted that Governor Mitchell had intimated earlier that the threat of crisis in the municipal market might have subsided. However, his bank, as an example, had some municipals that might have to be liquidated in order to weather the anticipated demand for funds in the forthcoming period. If the same situation prevailed at other banks, a crisis in the municipal market might develop before the end of the year.

Governor Daane agreed that the municipal market continued in a delicate situation, and Governor Mitchell commented that a purpose of the September 1 letter was to express the hope that banks would hold on to their municipals to the extent possible.

B. 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? What is the prospect for renewed emphasis on sales of consumer-type CD's?

The rise in interest rates in recent weeks which has lifted yields on prime short-term investments above the Regulation Q ceiling has limited the ability of banks in the money centers to maintain their volume of large-denomination negotiable CD's. Although there is no evidence of unwillingness of the money center banks to continue to bid for these funds, the ceiling has substantially curtailed their competitive ability. The present tendency to shorter maturities for CD's further aggravates the practice of borrowing short and lending long.

Banks generally continue to find the small denomination consumer-type CD a helpful instrument in competing for individual savings. However, some banks are experiencing a net decline in consumer-type savings despite the use of CD's. The persistence of a strong demand for credit and the present high interest rate structure suggest the continued reliance on consumer-type CD's

to help retain deposits. The ability to do so will depend to a great extent on any regulations which may be issued under the new legislation.

President Moorhead commented that the banks, as indicated in the Council's statement, were now priced out of the market for large CD's, which were running off at a rather alarming rate. It was even difficult to maintain consumer-type CD's at present levels. Much would depend, of course, on the regulations issued pursuant to the recently enacted legislation granting additional authority to regulate rates of interest on deposits and share accounts.

Governor Brimmer asked if the Council could be more precise as to experience in attrition of CD's. It was known that a large volume of CD's was scheduled to mature in September and October, but information on attrition rates varied. He understood that some corporations were being told by banks that their prospects for loan accommodation were likely to be enhanced if CD's were renewed.

President Moorhead said some corporate treasurers were indicating that while they could do better elsewhere from an income standpoint they would stick with the banks. He added that his bank had experienced a rate of attrition of about 7 per cent of total CD's, but 25 per cent for CD's maturing in September.

Mr. Moore said his bank had a maximum of $950 million of CD's outstanding around the beginning of July. Now it had about $820 million, and the figure probably would decline to about $700 million by the end of the year. He added that the situation of

the New York City banks was critical in many ways. They were not able to attract new CD's and were able to renew only perhaps a third to a half of maturing CD's. The banks were also losing savings deposits steadily because of the 1 per cent interest rate differential in favor of mutual savings banks. That was why the banks were borrowing funds from abroad. His guess was that most of the New York City banks were having approximately the same experience as his own in terms of CD's, although some had sold more smaller-denomination CD's and might experience a somewhat more gradual decline.

Mr. Day said the Council had tried to reach some consensus yesterday as to how many of the outstanding negotiable CD's would run off. The Council found it hard to come to a conclusion, but the feeling was that by year end perhaps 35 or 40 per cent would run off. Some of the funds might be converted to demand deposits, but the problem of immediate dislocation and necessary readjustment was important.

Mr. Fleming noted that many CD's were being retained only by renewing them on a 30-day basis, which made them almost demand deposits.

Mr. Moore said a lot of CD's were being renewed solely on the basis of bank-customer relationships. He could not emphasize too strongly that there had been an abrupt change of policy on the part of the Federal Reserve affecting the CD area, and there had not been time to effect orderly adjustment. The banks had been encouraged in the past three or four years to bid for this type of money; now

they were out of business almost over night. In New York demand deposits had been flat for years, and the commercial banks also were losing savings deposits. The only place they could get funds, other than through the Federal funds market, was the Euro-dollar market, in order to keep the deposit level anywhere near even. He did not see how there could be even a modest increase in business loans at New York banks given present and prospective circumstances in the deposit area.

President Moorhead inquired whether it was anticipated that Board regulations issued pursuant to the new interest rate legislation would be compatible with the regulations issued by the Home Loan Bank Board, and Governor Robertson replied that the new regulations should be issued by all of the agencies within a day or two. One of the provisions of the statute required each agency to formulate its regulations after consultation with the other agencies. It was not necessary, however, that all of the agencies agree.

Chairman Martin commented at this point that there was a fundamental problem that deserved everyone's thought. When the savings of businesses and individuals were inadequate to accommodate credit demands, when there was full employment, when there was virtually full utilization of plant capacity, and when everybody was competing for money, the creation by the central bank of additional money could do nothing but depreciate the currency.

While there was admittedly a structural problem, one must not lose sight of the fundamental fact. This was the first time since 1950-51 that anything like the present circumstances had occurred. The authorities might have been mistaken in their original attitude toward the issuance of negotiable CD's, but it should be remembered that the CD's were initially used in an entirely different set of economic circumstances from those now prevailing.

Mr. Moore asked what was wrong with the theory of combatting inflation through creating additional productive capacity. Many business loans were for the purpose of plant improvement. There was admittedly the question Chairman Martin had mentioned: whether the savings of the country were sufficient to sustain the flow of business. But could not the System perhaps designate types of loans that were less essential than loans to enlarge productive capacity?

Chairman Martin commented that that went to the matter of expenditures generally, including Government expenditures, so a broad problem was presented. Different people might feel that different segments of the economy should be favored. In his view, Vietnam was the most critical factor at present in terms of the financing picture. He did not know the full extent of defense expenditures or exactly what impact they might be having on various segments of the community, but the ramifications were apparent.

Mr. Moore commented that question might be raised about using selective controls in the private financial area and not in the

Government area. While the latter was not a problem within the purview of the Board's authority, it was creating imbalances in the economy.

Mr. Fleming noted that at present the principal competitors for the savings dollar were Government bonds and Federal agency issues.

Governor Brimmer inquired about the outlook for consumer-type CD's, and Mr. Stewart said they were the lifeblood of the Dallas banks. His bank's savings deposits were off about 15 per cent, and the bank was paying around 5-1/4 per cent for CD's of $100,000 and under. Large CD's were difficult to place in Dallas, although the banks were getting some on the basis of customer relations. His bank would be willing to go higher, if it were permitted, just to retain its CD's. Most of the large savings and loan associations in the area were paying 5 per cent, and some were paying more.

President Moorhead said that in his case consumer-type CD's were declining slightly, and Mr. Moore said New York banks were generally paying 4-1/2 per cent, with some going a little over that rate. Mr. Cook reported that San Francisco and Los Angeles banks were paying 5 and 5-1/4 per cent, with savings and loans offering dividends up to 5-3/4 per cent, or more under certain conditions. Mr. Bodman said Detroit area banks were generally paying 5 per cent on consumer-type CD's, except that two institutions were gaining rapidly at 5-1/2 per cent. Those institutions paying 5 per cent

were experiencing a loss of growth rate. Mr. Prochnow said his bank was paying 4-1/2 per cent on small CD's and 4-3/4 per cent on $25,000 to $100,000 CD's, with negotiated rates over $100,000. During the past few weeks his bank had been gaining passbook savings, for unexplained reasons, after having lost previously. Mr. Bodman cited a similar experience. Mr. Prochnow also said his bank was showing only a modest gain in consumer-type CD's. Mr. Day reported mutual savings banks in his area offering savings certificates at 5 per cent, with the commercial banks suffering attrition in CD's at the same rate. Mr. Cook pointed to the differences in rates around the country as suggestive of the disruptions that could be created by the imposition of a uniform ceiling under the new legislation. Mr. Moore alluded to the variations in savings habits, with mutual savings banks strongly competitive in the New York area and savings and loans in other sections.

C. How does the Council appraise the current and prospective state of the market for municipal securities and for Federal agency issues?

The Council is not certain that the recent modest improvement in the market for municipal securities and for Federal agency issues will persist. The present yields on these investments have made them attractive to certain institutional and private investors. However, the possibility of further sales by banks as they seek additional funds to meet seasonal loan requirements poses a threat that overhangs the market.

It was noted that this topic had been covered in earlier discussion, and there was no further discussion at this point.

D. How does the Council appraise the prospect of continued intensive competition for savings among banks, savings and loan associations, mutual savings banks, and market borrowers?

The Council anticipates continued intensive competition for savings among banks, savings and loan associations, mutual savings banks, and market borrowers. The ability to compete also depends on any regulations which may be issued under the new legislation.

Governor Brimmer inquired about expectations in the financial community in light of the proposals for the regulation of interest rates that had been under debate in the Congress, and members of the Council indicated that they had not heard a great deal of speculation. One member noted that banks could not discuss the matter very specifically with their competitors in view of the antitrust laws. Mr. Cook said banks understood generally that the Congress was definitely interested in seeing that funds were channeled into the housing industry. If that should occur, however, it might create more problems than were corrected. Mr. Fleming cited possible impairment of the ability of the banks to finance needs incident to the Vietnam conflict.

Mr. Knight mentioned that in his area several building and loan associations had announced an intention to go into the instalment credit business. While they were subsequently ordered to desist by the State authorities, it was interesting to note that they apparently had enough money to try to go into instalment credit.

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Mr. Day said the hope was that regulations implementing the new legislation would apply equitably to commercial banks and savings and loan associations. Banks could live with the situation if the cost of money to the two types of institutions was equalized to a certain extent, but if there was a significant differential in favor of the savings and loans the banks would be in the same unfavorable competitive position as a year ago.

3. Balance of payments.

A. Are outstanding U.S. bank loans to foreigners likely to decline substantially further during the next six months?

The Council does not anticipate that outstanding U.S. bank loans to foreigners will decline substantially further during the next six months. However, the continued tightness of credit suggests that there will be no important increase in foreign lending by U.S. banks in the months immediately ahead.

There was no discussion of this topic.

B. Would the Council expect any significant easing of domestic credit conditions during the course of 1967 to be followed fairly promptly by renewed expansion of U.S. bank loans to foreigners?

Although it is difficult at present to see any significant easing of domestic credit conditions during the course of 1967, such a development is possible if restrictive fiscal policies are employed. In these circumstances, U.S. bank loans to foreigners might expand, although there is no assurance that this would take place.

With domestic credit demands tending to limit U.S. bank loans to foreigners, it might be appropriate now to consider the repeal of the present voluntary foreign credit restraint program.

In reply to a request for the Board's views on the Council's suggestion, Governor Robertson said he thought it would be unwise to terminate the voluntary foreign credit restraint program at this time, not so much because it was needed for the banking system but because it was needed in other areas. This year the banks had shown a substantial inflow through July, and he thought there might be a further inflow by the end of this year. However, termination of the bank program could provide a psychological impetus for capital outflows. In any event it appeared that the impact of the program on the banks would not be severe, particularly in view of the tightness of credit conditions domestically.

Mr. Moore said his theory was that the job had been done so far as the banking system was concerned. Therefore, one might ask why the banks should not be released from the program. That would not mean that the total balance of payments problem had improved; in fact, it appeared to have worsened.

Governor Robertson commented that if a different solution appeared for the balance of payments problem he would want to get rid of the voluntary program, but not until that time arrived.

President Moorhead inquired whether the Council was correct in its feeling that the voluntary program had worked well in the banking sector but not in the corporate sector.

Governor Brimmer commented that the balance of payments problem thus far this year had centered on the deterioration in the

trade balance. The Commerce Department program, he noted, had two objectives, one being to moderate the outflow of corporate capital funds and the second being to encourage the raising of funds abroad to pay for direct investments. The target for reduction of direct investments was about $2-1/2 billion for the year as a whole, and for the first six months that was about the way things appeared to be going, with the decline in direct investments offset by the larger amount of funds borrowed abroad.

President Moorhead remarked that the Council members had not observed that many corporations had changed their plans for investment abroad as a result of the program, and Governor Brimmer said he felt that the large amount of borrowing abroad could be traced to the program. A program of this kind could not be expected to stick together indefinitely, but thus far it seemed to have had an impact. Like Governor Robertson, he believed this would be a poor time to terminate the program. Even now, Government statisticians were trying to unravel the impact of the Commerce Department program on the balance of payments, and it was hoped that that could be determined within the next few weeks. In the meantime, he felt that judgment should be reserved.

There ensued some discussion of a suggestion that had been heard that the voluntary program be terminated except in its application to Western Europe, following which Mr. Cook observed that the time might be appropriate to consider further adjustments in the

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targets applicable to the bank program similar to those that became effective at the beginning of 1966, so that the program would not appear to be frozen.

Governor Brimmer pointed out that while the banks as a group had considerable head room under the program, some banks were pressing against their ceilings. If the over-all target should be increased, additional credit might be extended by the banks now at their ceilings to offset some of the improvement on capital account.

C. Have Council members observed any significant recent changes in U.S. business plans to expand their operations abroad through foreign branches and subsidiaries?

The Council members have not observed any significant recent changes in U.S. business plans to expand their operations abroad through foreign branches and subsidiaries. Presumably some plans may have been delayed or postponed because of the strength of the domestic demands and also the difficulty of obtaining funds both here and abroad.

There was no discussion of this topic.

D. To what extent would the Council judge that U.S. merchandise exports are being hampered by supply bottlenecks and delivery delays or by limited availability of export financing?

The Council is not aware that U.S. merchandise exports are being materially hampered by supply bottlenecks, delivery delays, or by limited availability of export financing. This is not to say, however, that exports could not be larger if domestic demand were less strong.

Governor Brimmer noted that through July there was a drop in shipments abroad and a substantial increase in imports. A shift

of the magnitude that had occurred might seem to imply supply bottlenecks and difficulties in obtaining export credit, especially with some revival having occurred in markets abroad.

Council members commented that while there might be some bottlenecks and delays, the banks represented on the Council had not heard of such experiences from their customers.

E. How does the Council appraise the effects on the balance of payments of U.S. bank borrowing from the Euro-dollar market?

It is difficult to appraise the effects on the balance of payments of U.S. bank borrowing from the Euro-dollar market without determining the use to which the funds are put. For example, if the funds are used to finance domestic transactions, the effect on our balance of payments may be different than if the funds are used to pay for imports. On the other hand, to the extent that U.S. bank borrowing in the Euro-dollar market reduces the supply of funds available to finance foreign buying of U.S. goods, our exports and the balance of payments may presumably be adversely affected.

Governor Brimmer said that this question was directed toward the phenomenon whereby some banks in the money market centers were drawing funds from their foreign branches and using them in lending at home. The Board wondered to what extent that might be having an impact on the balance of payments.

Mr. Prochnow said that his bank had tried to trace a number of transactions to ascertain the impact. He then outlined several types of transactions, some of which appeared to have an adverse impact on the balance of payments, some of which appeared neutral, and others of which seemed to have a favorable impact. He concluded

that it was necessary to analyze each kind of transaction, and that in some cases a transaction might have different short-run and longer-run effects.

It was the general view of the Council that the question was one of considerable complexity and not susceptible of easy explanation.

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

In general, the Council approves the continuation of a policy of monetary restraint in the critical period ahead. This policy implies (1) sufficient flexibility to meet seasonal demands and an orderly growth in the economy, and (2) time to make adjustments that may prove necessary in the banks' assets and liabilities.

The members of the Council are apprehensive about the impact on the credit and financial markets and the resulting distortions in the economy if monetary policy alone is to continue to be relied on to restrain demand. As a consequence, the members of the Council and bankers generally approve the recently expressed intent of the Administration to use fiscal policy and are greatly hopeful that fiscal policy will be employed to an increasing degree to restrain the economy. Such a program would include a reduction in Federal expenditures and, if necessary, an increase in taxes.

Chairman Martin asked for the Council's judgment about monetary policy if it developed that no help was forthcoming from fiscal measures to restrain demand, and President Moorhead said that in such event the Council was inclined to feel there would have to be a little easing of monetary policy.

Mr. Day commented that the critical period was ahead for the banks, not behind. Even if the banks held half of their CD's and if they had already experienced the major impact of credit demand, it appeared that the period ahead would be a difficult one.

Mr. Fleming suggested that it was highly important that monetary policy be formulated in a sufficiently flexible manner to provide the necessary time for the banks to make adjustments.

Governor Maisel said that these views seemed to coincide with the intent of the September 1 letter, which was to offer assurance that the discount window would be kept open in the normal way to meet emergency situations. In addition, whereas under normal circumstances banks might have been asked to get out of the window through adjusting their investment portfolios, now they could be given a longer time to effect adjustment through their loan portfolios if they agreed to follow that course. This all carried the implication of more flexibility, and probably more discounting.

Mr. Fleming said he thought the banks had gotten the word. However, they were worried about questions of interpretation. There was a need at this time for mutual confidence between the Federal Reserve System and the banks of the country. The banks wanted to be sure, in a period when they were trying to get their houses in order and trying to finance the war effort, that they would not run into a stone wall on the part of the Federal Reserve. He added that his bank had sent a representative to the Federal Reserve Bank of Atlanta for discussion, after receiving the September 1 letter, in order to ascertain the ground rules and open up lines of communication. If other banks followed the same procedure, there might be a better understanding.

Mr. Brinkley remarked that he had been unable to locate the September 1 letter and that his bank had not been contacted by the Reserve Bank. On the other hand, he felt that the discount people in his District had been understanding and sympathetic. Up to this time there had not been any problem, and he was rather reassured by what the members of the Board were saying today.

Members of the Council suggested that in the future it would be helpful if such letters were addressed specifically to the chief executive officer of each member bank. A few indicated that the Reserve Bank of their district had followed up the September 1 letter with member bank contact; others had heard of no such effort.

Mr. Fleming asked whether, if his bank lent a half million dollars to a nonmember bank to help move the tobacco crop, it would be precluded from going to the discount window. Asked whether the nonmember bank in the hypothetical case had been a normal seasonal borrower, Mr. Fleming said probably not, because it had not been faced with conditions such as prevailed this fall.

After brief discussion, Governor Robertson commented that the appropriate procedure was for banks with specific problems in mind to go to their Reserve Bank and open up lines of communication. The Board was desirous of achieving as much uniformity of approach as possible, but contacts on individual cases should be made with the respective Reserve Banks.

Governor Robertson also observed that numerous member banks had been lending to correspondent nonmember banks as a regular practice over the years. There was no intent at this time to require changes in interbank relationships of long standing. If the lending went beyond traditional practice, there could be a different question, but no basic change in the rules was intended.

There followed further comments on evidence available to the Board that some member banks had been advised to leave the Federal Reserve System by their correspondent banks. A Council member expressed the thought that in any event this would not seem to be a good time to penalize banks for mistakes in the past, and Governor Maisel commented that the function of a reserve system was to furnish funds, in necessitous circumstances, to member banks. In a critical time such as the present, no institution should go down the drain simply because of lack of liquidity. Governor Shepardson said, however, that he felt a member bank deserved criticism if it came in and stated that it must borrow because it had to take care of many nonmember banks, some of which it had earlier invited to leave the System with the promise that they would be taken care of in event of need.

Mr. Cook again suggested that, in the absence of some change in fiscal policy, a case could be made for some kind of voluntary, cooperative effort aimed at bringing to bear collective judgments to discipline the whole banking structure. Such an arrangement seemed preferable to a multitude of regulations striving to deal with one

point after another. Asked if other members of the Council favored such a program, Mr. Cook said a number of the members were impressed by the results of the voluntary credit restraint program in 1951-52. No one had been discriminated against under that program, nor under the current voluntary foreign credit restraint program.

Governor Mitchell asked Mr. Cook whether he would be so interested in such a program if it was known that fiscal action would be forthcoming by the end of the year, and Mr. Cook replied that he probably would not.

Mr. Moore commented that while the earlier voluntary program had a good effect initially, it rather soon lost momentum. It was necessary to pick a specific period of time when such a program would fit in appropriately. But he agreed with Mr. Cook that many regulatory actions taken during critical periods could be avoided through better communication among the banks. He repeated that a critical period could be approaching in the case of the New York banks. If the banks called loans to brokers--a likely next step--that could mean disruption of the whole marketplace, with attendant serious effects. At present, the banks were not necessarily acting in concert. They had no way to relieve themselves from the pressure of customer relationships. What he had essentially in mind was some kind of policy clearinghouse.

Chairman Martin suggested that the members of the Council could be helpful in encouraging banks in their respective districts to have more contact with the individual Reserve Banks. Reserve

Banks sometimes were remiss in not inviting such contacts, and as a result there was not the desired degree of communication. The Board was seeking uniformity of policy, but uniformity of administrative details was not feasible with 12 Federal Reserve Banks operating in separate districts. However, he had found that people sometimes picked up certain stories and made no effort to ascertain their accuracy by checking at the Reserve Bank. The Council could make a point of encouraging better communication between the Reserve Banks and the member banks.

Mr. Watlington spoke of the high level of communications that existed in the Fifth District, saying that his bank never failed to get a good audience at its Reserve Bank and that frequently the Reserve Bank sought out its member banks. Half a day was spent by his bank at the Reserve Bank discussing the September 1 letter.

President Moorhead said this was true in the Ninth District also. When there was indication of a potentially difficult situation in moving crops, the Reserve Bank called a meeting of the major banks to see how critical the situation was.

Mr. Bodman inquired whether it would be desirable to put machinery in motion so that a voluntary restraint program could be activated quickly in case it was determined to be needed, and Governor Robertson said steps had already been taken so that such a program could be put into effect administratively without too much delay. However, the program could hardly be instituted without

legislation to provide an exemption from the antitrust laws, and he considered it doubtful that the Congress would be willing to pass exemptive legislation for this purpose unless as part of a broader program. He went on to point out the question of instituting voluntary controls had both pros and cons. Significant mistakes could be made. Such a program might prevent a bank from losing a customer to some other bank, but under such a kind of selective regulation banks could no longer make their own rules; there would have to be guidelines.

Mr. Moore then commented further on the question of business loans. Admittedly, they could not continue to rise at the same rate as in recent months, but any program that precluded necessary expenditures in that area had serious long-range implications, more so than in the case of curtailment of certain other types of loans.

Governor Robertson replied that in no area was it advisable to go to extremes. In his judgment, however, some curtailment was called for in the business loan area.

Governor Mitchell suggested reviewing the rate of growth of business spending for plant and equipment in the past three or four years, which was unprecedented for such a sustained period. He considered this a potentially destabilizing influence; the volume of such spending might come down of its own weight at some point, with resultant shock to the economy.

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Governor Maisel commented that spending for plant and equipment and inventories had been critically high compared to total demand. There should be some allowance for further growth, but the rate of spending for such purposes had been proceeding faster than final demand.

It was understood that the next meeting of the Federal Advisory Council would be held on November 14-15, 1966.

The meeting then adjourned.

Secretary