MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

April 30, 1962

The second statutory meeting of the Federal Advisory Council for 1962 was convened in the Potomac Room of the Mayflower Hotel, Washington, D. C., on April 30, 1962, at 9:35 A.M.

Present:

Ostrom Enders	District No. 1
George A. Murphy	District No. 2
Howard C. Petersen	District No. 3
Reuben B. Hays	District No. 4
Robert B. Hobbs	District No. 5
J. Finley McRae	District No. 6
Kenneth V. Zwiener	District No. 7
Sidney Maestre	District No. 8
Henry T. Rutledge, Alternate	District No. 9
Maurice L. Breidenthal	District No. 10
I. F. Betts	District No. 11
Elliott McAllister	District No. 12
Herbert V. Prochnow	Secretary
William J. Korsvik	Assistant Secretary

Absent:

John A. Moorhead	District No. 9

On motion duly made and seconded, the mimeographed notes of the meeting held on February 19-20, 1962 were approved.

A complete list of the items on the agenda for the meeting, and the conclusions of the Council are to be found in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council,* which follows on pages 27, 28, and 29.

The meeting adjourned at 12:40 P.M.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

April 30, 1962

At 2:30 P.M., the Federal Advisory Council convened in the Board Room of the Federal Reserve Building, Washington, D. C.

Present: Mr. George A. Murphy, President; Messrs. Ostrom Enders, Reuben B. Hays, Robert B. Hobbs, J. Finley McRae, Kenneth V. Zwiener, Sidney Maestre, Henry T. Rutledge, Alternate for Mr. John A. Moorhead; Messrs. Maurice L. Breidenthal, I. F. Betts, and Elliott McAllister.

Absent: Messrs. Howard C. Petersen and John A. Moorhead.

Mr. Guy E. Noyes, Director, Division of Research and Statistics, and members of the Board's staff, participated in a presentation on "Alternative Patterns of Economic Developments in 1962." Copies of their remarks were distributed to members of the Council.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

April 30, 1962

At 8:45 P.M., the Federal Advisory Council reconvened in the Potomac Room of the Mayflower Hotel, Washington, D. C.

Present: Mr. George A. Murphy, President; Messrs. Ostrom Enders, Reuben B. Hays, Robert B. Hobbs, J. Finley McRae, Kenneth V. Zwiener, Sidney Maestre, Henry T. Rutledge, Alternate for Mr. John A. Moorhead; Messrs. Maurice L. Breidenthal, I. F. Betts, Elliott McAllister, Herbert V. Prochnow, Secretary, and William J. Korsvik, Assistant Secretary.

Absent: Messrs. Howard C. Petersen and John A. Moorhead.

The Council reviewed its conclusions regarding the items on the agenda, and sent to the office of the Secretary of the Board of Governors the *Confidential Memorandum* which follows on pages 27, 28, and 29, listing the agenda items with the conclusions reached by the Council. The *Memorandum* was delivered to the Federal Reserve Building at 10:30 P.M. on April 30, 1962.

The meeting adjourned at 9:45 P.M.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS

FROM THE

FEDERAL ADVISORY COUNCIL

RELATIVE TO THE AGENDA FOR THE JOINT MEETING

ON MAY 1, 1962

1. What are the observations of the Council regarding the performance of the economy in recent months, the sentiment of the business community, and the general outlook for the remainder of the year? Have the Council's estimates of over-all business activity for the year been revised appreciably since the date of the Council's meeting in February? How does the Council appraise the effects of the steel wage settlement and the subsequent increase in steel prices?

The performance of the economy early this year was somewhat below expectations. However, recent increases in the volume of consumer spending, as reflected, for example, by the sale of new automobiles, indicate that the moderate upward trend in business has been resumed. The sentiment of the business community might be characterized as one of cautious optimism. The general outlook for the remainder of the year is for a moderate rise in the level of business activity.

The Council has not revised appreciably its estimate of over-all business activity for the year.

The full consequences of the steel price incident are difficult to appraise. The decision to raise prices may have been poorly timed, but the conditions under which the companies reversed their decision have caused concern in the business community and may tend to delay future capital investment.

2. Does the Council see indications of current or prospective improvement in the unemployment situation?

While the published figures on employment and unemployment reveal a moderately encouraging trend, which the Council believes will continue, the members of the Council see little indication of any significant prospective improvement in the hard core long-term unemployment situation. The statistics on employment and unemployment need further amplification and refinement if the problem is to be accurately appraised and steps taken to solve it.

3. What interpretation does the Council place on developments in the housing and construction area?

The recent rise in housing starts and also in FHA and VA applications and appraisal requests indicate a further rise in home building at a time when family formations are at a relatively low level. In addition, the construction of apartments in the larger cities is continuing despite comparatively high vacancy rates in many areas. In the opinion of the Council, these trends reflect in part a plethora of funds seeking investment in the mortgage market and an effort to meet the rising interest costs of these funds. The Council believes these conditions are accentuating the overbuilding of certain types of housing facilities in some communities.

4. What are the prospects for loan demand at banks during the next several months, including the demand for real estate and consumer loans?

The Council anticipates that loan demand in banks during the next several months will expand moderately with the expected rise in business activity. The over-all demand for real estate loans is likely to rise somewhat in view of the upward trend in construction. The Council also believes that consumer loans will expand more this year than in 1961. Inasmuch as commercial banks in general are seeking higher earning assets aggressively, a somewhat larger proportion of the over-all increases in mortgage and consumer loans may find their way into commercial bank loan portfolios than previously.

5. The Board would welcome comments as to recent developments resulting from the increased maximum permissible rates of interest on time and savings deposits, including the effects of higher interest rates on portfolio management. Are there recent developments of significance in connection with negotiable certificates of deposit or longer-term savings instruments?

The members of the Council report that a substantial volume of savings has flowed into the commercial banks as a result of the increase in the maximum permissible rates of interest on time and savings deposits. This flow of funds, together with the increase in interest costs, is causing the managements of commercial banks to seek ways of augmenting their income.

The Council noted at its February meeting that "it is premature to generalize about possible significant changes in bank lending and investment policies." There is now persuasive evidence that many commercial banks are expanding their mortgage lending activities and are increasing their purchases of tax-exempt obligations. They are also lengthening the maturities of these obligations and of other investments.

The members of the Council report an increased use by commercial customers of the negotiable certificates of deposit and a more active market for these obligations.

6. What are the views of the Council regarding the impact of current monetary and credit policy? Would the Council be inclined to place relatively more weight on domestic considerations or on international considerations?

The members of the Council believe that current monetary and credit policy has had a desirable impact on business activity. However, the economy has been expanding, at least moderately, for over a year and the outlook is for a continuation of this trend. On the other hand, the deficit in the balance of payments of the United States, which has persisted for many years, continues with no definite assurance of correction. The Council is therefore inclined to place relatively more weight on international considerations in view of the serious implications of a continuing balance-of-payments deficit, possible further withdrawals of gold and the threat confronting the dollar. The Council continues to recognize that there are other important factors, such as sound fiscal policy, which are vital to the maintenance of the integrity of the dollar.

MINUTES OF JOINT CONFERENCE OF THE FEDERAL ADVISORY COUNCIL AND THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

May 1, 1962

At 10:25 A.M., the Federal Advisory Council held a joint meeting with the Board of Governors of the Federal Reserve System in the Federal Reserve Building, Washington, D. C.

Present: Members of the Board of Governors of the Federal Reserve System:

Chairman Wm. McC. Martin, Jr.; Vice Chairman C. Canby Balderston; Governors A. L. Mills, Jr., J. L. Robertson and Chas. N. Shepardson; also Mr. Merritt Sherman, Secretary, and Mr. Kenneth A. Kenyon, Assistant Secretary of the Board of Governors.

Present: Members of the Federal Advisory Council.

Mr. George A. Murphy, President; Messrs. Ostrom Enders, Howard C. Petersen, Reuben B. Hays, Robert B. Hobbs, J. Finley McRae, Sidney Maestre, Henry T. Rutledge, Alternate for Mr. John A. Moorhead; Messrs. Maurice L. Breidenthal, I. F. Betts, Elliott McAllister, Herbert V. Prochnow, Secretary, and William J. Korsvik, Assistant Secretary.

Absent: Messrs. Kenneth V. Zwiener and John A. Moorhead.

The President read the first item on the Agenda and the conclusions of the Council as given in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council*, as printed on pages 27, 28, and 29. A brief discussion followed. Comments by members of the Council were directed principally toward the recent steel price increases, their subsequent recision and the possible effect on business conditions and expectations. While there was little evidence of any change in businessmen's investment plans, several members confirmed that various firms were reviewing their capital spending programs.

President Murphy read the second item. The ensuing discussion included a brief report on retraining programs.

The third item and the conclusions were read by President Murphy. In the discussion which followed, the thought was repeated that the ready availability of financing was contributing to the volume of current construction.

The fourth item on the Agenda and the conclusions of the Council were then read by the President.

The fifth item, and the Council's conclusions were then read by the President. The comments of several members of the Council reflected a degree of apprehension about what appeared to be a tendency on the part of some banks to lengthen substantially the average maturity of their investment portfolios. There seemed to be general agreement that the banking system had moved too fast and too indiscriminately to the new maximum rates.

The sixth item on the Agenda and the conclusions of the Council were then read by the President.

Various members of the Council and the Board then participated in a general discussion. Chairman Martin observed that he found it difficult to assign priorities to unemployment, economic growth, and the balance of payments because the problems were interrelated.

Governor Balderston commented that the Federal Reserve had made a substantial amount of reserves available in the past year and that if these funds "seeped" out of the country, foreign claims against the United States would increase and could lead to a further gold outlay. Thus, he continued, by attempting to fortify the domestic economy, the Federal Reserve could be magnifying the balance of payments problem.

There followed at this point a brief discussion of the absorption of exchange charges, the subject of the joint meeting of the Board and the Council on April 4, 1962. The Chairman added that he hoped it would be possible to work something out.

The meeting adjourned at 12:45 P.M.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

NOTE: This transcript of the Secretary's notes is not to be regarded as complete or necessarily entirely accurate. The transcript is for the sole use of the members of the Federal Advisory Council. The concise official minutes for the entire year are printed and distributed later.

H.V.P.
W.J.K.

The Secretary's notes of the meeting of the Federal Advisory Council on April 30, 1962 at 9:35 A.M. in the Potomac Room of the Mayflower Hotel, Washington, D. C. All members of the Federal Advisory Council were present except Mr. Moorhead. Mr. Henry T. Rutledge, Executive Vice President, Northwestern National Bank, Minneapolis, Minnesota, attended as an Alternate.

The Council approved the Secretary's notes for the meeting of February 19-20, 1962.

ITEM I

WHAT ARE THE OBSERVATIONS OF THE COUNCIL REGARDING THE PERFORMANCE OF THE ECONOMY IN RECENT MONTHS, THE SENTIMENT OF THE BUSINESS COMMUNITY, AND THE GENERAL OUTLOOK FOR THE REMAINDER OF THE YEAR? HAVE THE COUNCIL'S ESTIMATES OF OVER-ALL BUSINESS ACTIVITY FOR THE YEAR BEEN REVISED APPRECIABLY SINCE THE DATE OF THE COUNCIL'S MEETING IN FEBRUARY? HOW DOES THE COUNCIL APPRAISE THE EFFECTS OF THE STEEL WAGE SETTLEMENT AND THE SUBSEQUENT INCREASE IN STEEL PRICES?

President Murphy read Item I and invited the members of the Council to comment. The ensuing discussion disclosed that there was wide agreement among the members of the Council that business was moving moderately upward. A number of members suggested that the performance of business early this year was somewhat below expectations but that recent increases in the volume of consumer spending, as reflected for example by the sale of new automobiles, was encouraging. The members of the Council characterized the sentiment of the business community as one of cautious optimism. The general outlook for the remainder of the year is for a moderate rise in the level of business activity. The Council has not revised appreciably its estimate of over-all business activity for the year.

There was an extended discussion about the steel price incident and its possible consequences. The Council concluded that it is difficult to appraise its full impact at this time. While the decision to raise prices may have been poorly timed, the conditions under which the companies reversed their decisions has caused concern in the business community. This, the Council observed, may tend to delay future capital investment.

ITEM II

DOES THE COUNCIL SEE INDICATIONS OF CURRENT OR PROSPECTIVE IMPROVEMENT IN THE UNEMPLOYMENT SITUATION?

President Murphy read Item II. The members of the Council reported on the employment situation in their respective districts. These, together with the published figures on employment and unemployment, reveal a moderately encouraging trend which the Council believes will continue. However, the members see little indication of any significant improvement in the hard core long-term employment situation. A number of members stated that additional information and figures on employment and job opportunities are needed if the problem is to be accurately appraised and steps taken to solve it.

ITEM III

WHAT INTERPRETATION DOES THE COUNCIL PLACE ON DEVELOPMENTS IN THE HOUSING AND CONSTRUCTION AREA?

Murphy read Item III and asked members of the Council for their observations. Several reported over-building of certain types of housing facilities in some communities in their districts. Building continues, however, particularly the construction of apartments in the larger cities, despite the fact that family formations are at a relatively low level and vacancy rates in many areas are comparatively high. A number of members felt that these trends reflect, in part, a plethora of funds seeking investment in the mortgage market and an effort to meet the rising interest costs of these funds. The Council believes that these conditions are accentuating the over-building that has taken place in some communities.

ITEM IV

WHAT ARE THE PROSPECTS FOR LOAN DEMAND AT BANKS DURING THE NEXT SEVERAL MONTHS, INCLUDING THE DEMAND FOR REAL ESTATE AND CONSUMER LOANS?

President Murphy read Item IV. There was fairly wide agreement among the members of the Council that loan demand in banks during the next several months will expand moderately with the expected rise in business activity. Real estate and consumer loans are also likely to increase. The Council concluded that inasmuch as commercial banks in general are seeking higher earning assets aggressively, a somewhat larger proportion of the over-all increases in mortgage and consumer loans may find their way into commercial bank loan portfolios than previously.

ITEM V

THE BOARD WOULD WELCOME COMMENTS AS TO RECENT DEVELOPMENTS RESULTING FROM THE INCREASED MAXIMUM PERMISSIBLE RATES OF INTEREST ON TIME AND SAVINGS DEPOSITS, INCLUDING THE EFFECTS OF HIGHER INTEREST RATES ON PORTFOLIO MANAGEMENT. ARE THERE RECENT DEVELOPMENTS OF SIGNIFICANCE IN CONNECTION WITH NEGOTIABLE CERTIFICATES OF DEPOSIT OR LONGER-TERM SAVINGS INSTRUMENTS?

President Murphy read Item V. The members of the Council reported that a substantial volume of savings has flowed into the commercial banks since interest rates on time and savings deposits had been increased. This flow of funds, together with the rise in interest costs, is causing the managements of commercial banks to seek ways to augment their income. The members of the Council reported that many commercial banks are expanding their mortgage lending activities and increasing their purchases of tax-exempt obligations. They also reported some lengthening of maturities of these obligations and of other investments.

Several members reported a greater use by commercial customers of negotiable certificates of deposits and a more active market for these obligations.

ITEM VI

WHAT ARE THE VIEWS OF THE COUNCIL REGARDING THE IMPACT OF CURRENT MONETARY AND CREDIT POLICY? WOULD THE COUNCIL BE INCLINED TO PLACE RELATIVELY MORE WEIGHT ON DOMESTIC CONSIDERATIONS OR ON INTERNATIONAL CONSIDERATIONS?

President Murphy read Item VI. It was subsequently agreed that the Council would state that it believed current monetary and credit policy has had a desirable impact on business activity. However the economy has been expanding, at least moderately, for over a year and the outlook is for a continuation of this trend. On the other hand, the deficit and the balance of payments in the United States, which has persisted for many years, continues with no definite assurance of correction. In these circumstances the Council is inclined to place relatively more weight on international considerations in view of the serious implications of a continuing balance of payments deficit, possible further withdrawals of gold, and the threat confronting the dollar.

There was considerable discussion on the importance of a sound fiscal policy in order to maintain confidence in the dollar. Although the Council is aware that this is outside the responsibilities of the Board of Governors of the Federal Reserve System, it nevertheless decided to include a statement to this effect in its Memorandum to the Board.

The meeting adjourned at 12:40 P.M.

THE COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING, WASHINGTON, D. C., AT 2:30 P.M., ON APRIL 30, 1962. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MESSRS. PETERSEN AND MOORHEAD. MR. RUTLEDGE ATTENDED AS AN ALTERNATE FOR MR. MOORHEAD.

Mr. Guy E. Noyes, Director, Division of Research and Statistics, and members of the Board's staff, participated in a presentation on "Alternative Patterns of Economic Developments in 1962." A resume of their remarks is attached.

* * * * *

THE COUNCIL CONVENED AT 8:45 P.M. ON APRIL 30, 1962, IN THE POTOMAC ROOM OF THE MAYFLOWER HOTEL. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MESSRS. PETERSEN AND MOORHEAD. MR. RUTLEDGE ATTENDED AS AN ALTERNATE FOR MR. MOORHEAD.

The Council prepared and approved the attached Confidential Memorandum to be sent to the Board of Governors relative to the Agenda for the joint meeting of the Council and the Board on May 1, 1962. The Memorandum was delivered to the Federal Reserve Building at 10:30 P.M. on April 30, 1962.

The meeting adjourned at 9:45 P.M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON MAY 1, 1962

1. What are the observations of the Council regarding the performance of the economy in recent months, the sentiment of the business community, and the general outlook for the remainder of the year? Have the Council's estimates of over-all business activity for the year been revised appreciably since the date of the Council's meeting in February? How does the Council appraise the effects of the steel wage settlement and the subsequent increase in steel prices?

The performance of the economy early this year was somewhat below expectations. However, recent increases in the volume of consumer spending, as reflected, for example, by the sale of new automobiles, indicate that the moderate upward trend in business has been resumed. The sentiment of the business community might be characterized as one of cautious optimism. The general outlook for the remainder of the year is for a moderate rise in the level of business activity.

The Council has not revised appreciably its estimate of over-all business activity for the year.

The full consequences of the steel price incident are difficult to appraise. The decision to raise prices may have been poorly timed, but the conditions under which the companies reversed their decision have caused concern in the business community and may tend to delay future capital investment.

2. Does the Council see indications of current or prospective improvement in the unemployment situation?

While the published figures on employment and unemployment reveal a moderately encouraging trend, which the Council believes will continue, the members of the Council see little indication of any significant prospective improvement in the hard core long-term unemployment situation. The statistics on employment and unemployment need further amplification and refinement if the problem is to be accurately appraised and steps taken to solve it.

3. What interpretation does the Council place on developments in the housing and construction area?

The recent rise in housing starts and also in FHA and VA applications and appraisal requests indicate a further rise in home building at a time when family formations are at a relatively low level. In addition, the construction of apartments in the larger cities is continuing despite comparatively high vacancy rates in many areas. In the opinion of the Council, these trends reflect in part a plethora of funds seeking investment in the mortgage market and an effort to meet the rising interest costs of these funds. The Council believes these conditions are accentuating the overbuilding of certain types of housing facilities in some communities.

4. What are the prospects for loan demand at banks during the next several months, including the demand for real estate and consumer loans?

The Council anticipates that loan demand in banks during the next several months will expand moderately with the expected rise in business activity. The over-all demand for real estate loans is likely to rise somewhat in view of the upward trend in construction. The Council also believes that consumer loans will expand more this year than in 1961. Inasmuch as commercial banks in general are seeking higher earning assets aggressively, a somewhat larger proportion of the over-all increases in mortgage and consumer loans may find their way into commercial bank loan portfolios than previously.

5. The Board would welcome comments as to recent developments resulting from the increased maximum permissible rates of interest on time and savings deposits, including the effects of higher interest rates on portfolio management. Are there recent developments of significance in connection with negotiable certificates of deposit or longer-term savings instruments?

The members of the Council report that a substantial volume of savings has flowed into the commercial banks as a result of the increase in the maximum permissible rates of interest on time and savings deposits. This flow of funds, together with the increase in interest costs, is causing the managements of commercial banks to seek ways of augmenting their income.

The Council noted at its February meeting that "it is premature to generalize about possible significant changes in bank lending and investment policies." There is now persuasive evidence that many commercial banks are expanding their mortgage lending activities and are increasing their purchases of tax-exempt obligations. They are also lengthening the maturities of these obligations and of other investments.

The members of the Council report an increased use by commercial customers of the negotiable certificates of deposit and a more active market for these obligations.

6. What are the views of the Council regarding the impact of current monetary and credit policy? Would the Council be inclined to place relatively more weight on domestic considerations or on international considerations?

The members of the Council believe that current monetary and credit policy has had a desirable impact on business activity. However, the economy has been expanding, at least moderately, for over a year and the outlook is for a continuation of this trend. On the other hand, the deficit in the balance of payments of the United States, which has persisted for many years, continues with no definite assurance of correction. The Council is therefore inclined to place relatively more weight on international considerations in view of the serious implications of a continuing balance-of-payments deficit, possible further withdrawals of gold and the threat confronting the dollar. The Council continues to recognize that there are other important factors, such as sound fiscal policy, which are vital to the maintenance of the integrity of the dollar.

CONFIDENTIAL (F.R.)

Alternative Patterns of Economic Developments in 1962

April 27, 1962
Division of Research and Statistics
Board of Governors of the
Federal Reserve System

Mr. Brill

Chart 1073
GNP - old
proj. &
QI62

Last fall my colleagues and I had the opportunity of presenting to the Board a picture of prospective economic developments in 1962 consistent with the pattern then foreseen by Administration economists preparing the autumn Budget review. The pattern of economic developments then projected for 1962 was one of continued rapid expansion in output through the middle of this year, with some slowing up thereafter. Despite this slowing, the gains in activity were to be impressive, estimated at close to an 8 per cent increase in gross national product from year end to year end, with little or no rise in commodity prices.

This projection of economic activity proved to be exceptionally accurate in the near term. Output in the fourth quarter of 1961 was exactly what had been anticipated by the technicians preparing the projection.

Emboldened by their success, this group used substantially the same economic outlook in preparing estimates of Government revenues and expenditures for the fiscal 1963 Budget. It was on the basis of a pattern of developments substantially the same as those described to the Board in the fall that the Administration arrived at its estimate of a gross national product of $570 billion in 1962, leading to a balanced budget in fiscal 1963.

In the early months of 1962, however, the economy--or perhaps it was the projection--went off track. Activity continued to increase but at a substantially slower rate than had been projected. While businessmen accumulated inventories at even a faster clip than had been projected, their spending for new plant and equipment increased more slowly than expected, and consumer spending for durable goods and housing declined. The sizable shortfall in private spending was accompanied by a slight shortfall in Federal Government outlays. Over all, the increase in GNP from the fourth quarter of 1961 to the first quarter of 1962 was at a rate less than half that stipulated in the earlier projection.

Chart 1827A
Funds
Raised -
Old proj.
QI62
Actual
QI62

Credit market flows were also below earlier projections. Declining rates did induce a greater volume of State and local borrowing than anticipated, but other private borrowing fell somewhat short of expectations.

Chart 1073
GNP - 3
projec-
tions

This brings us to the usual dilemma confronting economists trying to assess trends. Does one assume that recent experience represents the most likely course in the near future, or is there some basis for assuming that the recent experience was due to transitory phenomena, i.e., that the economy will return to the path projected earlier? For this we have the usual economist's answer--we can attribute evidence in support of either position, and at best can only rule out extremes, but not choose among likely, close alternatives.

Not that extreme movements are inconceivable. Any one of us could spin together a conjunction of events which would lead to recession or inflation this year. At the moment, however, the probability of either development does not seem high. Abstracting from international military crises, the two courses of events which seem to carry the highest probability factors are, on the one hand, a further expansion but at the moderate rate of recent months and, on the other, a resumption of the rapid expansion anticipated last fall.

What we would like to do this morning is to review briefly the evidence in support of each of these alternatives, and to describe the pattern and composition of activity in financial and goods markets that would be consistent with each.

It must be recognized that the time period ahead at which we are looking is relatively short. Therefore widely different rates of increase from here on out would not necessarily produce widely different aggregates of economic activity by the end of this year. A highly significant difference, however, is what the alternatives portend for the sustainability of expansion going into next year. We will begin with a discussion by Mr. Weiner of current developments in some of the critical demand factors that could determine the rate of economic expansion over the balance of the year.

* * * * *

Mr. Weiner

Chart 1068
Real GNP
in 3 Recoveries

Developments this year have been mixed, but on net they have practically eliminated the likelihood of reaching the Budget Message estimate of $570 billion GNP for the full year 1962. As may be seen in this chart, the first quarter showed a significant shortfall--some $5 billion or 1 per cent--from the official projection, shown by the dot above the line. Growth from the cyclical low a year earlier is thus about in line with--rather than greater than--expansion in the first year of recovery of the two preceding cycles.

Chart 1074
Postwar
Expansions

The key areas of uncertainty for the balance of this year center about the strength of demands for plant and equipment, housing, and consumer durables--and on business inventory policy, which will be largely influenced by the actual course of such spending. Recent developments are subject to more than one interpretation in regard to their bearing on prospects. This 4-panel chart--in which for each cycle the preceding cyclical peak is shown as 100--indicates the diverse patterns from cycle to cycle in these key demand areas.

The first quarter shortfall from last autumn's projection was concentrated mainly in consumer buying of durable goods and in residential construction activity. As is shown in the two bottom panels of this chart, both of these categories declined in the first quarter, and these declines are in marked contrast to behavior at the comparable stage of the two preceding cyclical expansions. We now know, of course, that the showing for the quarter as a whole gives an exaggerated impression of weakness in these two areas. The declines occurred in January and February and apparently reflected in part unusually severe weather conditions. Since February, both housing starts and auto sales have increased sharply. Despite these and other shortfalls, total GNP in constant dollars--shown in the upper left-hand panel--was almost 6 per cent above the previous cyclical high in the first quarter--as good a performance as in the past two expansions.

Chart 0722
Housing
Permits &
Starts

The outlook for housing has been difficult to assess from the beginning of the current recovery period. The initial recovery in housing starts last year was marked, but the rise slowed after midyear and ended in October--for a total gain strikingly below earlier periods of cyclical recovery. Between October and February housing starts declined sharply, but residential building permits continued to rise, suggesting the possibility of a reversal in starts such as actually occurred in March. The abrupt March recovery brought housing starts back close to the 1.4 million rate reached last October. Whether this rate can be sustained is another question.

Chart 1401
New Car
Sales

Large variations in auto sales have accounted for the rather jerky pattern of changes in consumer buying of durable goods during this recovery period--including the decline in the first quarter. As with housing, auto sales in March--the first dot--were well above January and February, and in the first 20 days of April--the second dot--sales rose considerably further.

Chart 1346
Capacity &
Output

Turning to business demands, and for the moment viewing these apart from recent intentions surveys, the current rate of capacity utilization is not high. Manufacturing output in the first quarter is estimated at 85 per cent of capacity--about the same as in the comparable stage of the 1958-59 expansion, but well below rates achieved in mid-1953 and late 1955. Another set of data--that for major industrial materials--would give the same impression of a first quarter utilization rate similar to the last expansion but below earlier ones.

The need for additional industrial capacity at the present time, accordingly, is not large. On the other hand, there exists a fairly steady growth in the need for replacement of depreciated or retired capital goods. Moreover, additional tax incentives and accelerated depreciation allowances could boost business demands beyond present indications.

Chart 1073
GNP - Low
and old

In the first of our projections to be presented this morning--the "low-track" model--we have generally resolved questions relating to vigor of demands in key areas on the side of moderation. Moderation, in this context, would mean a rise in GNP of less than 5 per cent annual rate over the balance of the year. By the fourth quarter, it would bring total GNP to $570 billion.

Chart 1067
Cyclical
Components
Low only

The key elements contributing to the moderateness of this rise--consumer and business investment--are summarized in this chart. Consumer durable goods and housing, taken together, are projected as rising in the current quarter and then changing little in the second half of the year, at a level not much different from that reached in the fourth quarter of 1961. Purchases of new domestic autos would total 6.5 million for the year, a rather strong pace. On the other hand, private nonfarm housing starts are projected at only 1,275 thousand, a poor showing in comparison with earlier postwar experience.

Business spending for fixed capital in the low-track projection follows closely the indication of the March Commerce-SEC Survey, i.e., an increase of 8 per cent from the year 1961, with larger increases in the second half of this year than in the first. Adherence to this survey for the low projection rests heavily on the sort of capacity utilization considerations described earlier, as well as on the downdrift in profits and profit margins that might be expected with the modest rate of increase in economic activity.

If this reading of demand strength is correct, inventory accumulation may well be smaller than usual for this stage of the cycle. Capacity would generally be ample, supplies potentially large here and abroad, and price incentives for accumulation would be weaker than earlier in the postwar period; also, the rate of change in steel inventories--currently a down influence--would be less disruptive than at other times.

In line with the Budget Document, Federal purchases of goods and services are projected as rising throughout calendar 1962. This would represent the longest sustained rise in Federal spending since the Korean War and, in constant dollars, would bring these outlays to the highest levels since early 1954.

Chart 1149
Output &
Labor Re-
sources -
Low only

Even with this prospective rise in Federal spending, if private investment should be as sluggish as is suggested by the low alternative, fourth quarter GNP would be almost 5 per cent below the Council of Economic Advisers' estimate of full employment potential. Allowing for growth in the civilian labor force at a rate somewhat below trend and for a further--but reduced--rate of productivity gain, nonfarm employment would show but a moderate further rise, and the unemployment rate--now at about 5-1/2 per cent--would drift up to the vicinity of 6 per cent by year end.

Mr. Taylor will now discuss the financial implications of the slow growth model.

* * * * *

Mr. Taylor

Chart 1827A Funds Raised - Low only

If the economy follows the lower projection just described by Mr. Weiner, total credit demands have already passed their peak for this year and--with some fluctuation in Federal borrowing--are likely to tend somewhat downward from now on. For the year as a whole, borrowing would total about $56 billion--$4 billion above 1961 but in about the same relation to GNP as last year.

Chart 1824A Funds Raised by Type - Low only

The indicated borrowing rate of $56 billion for the year is not exceptionally high relative to spending--as a proportion of GNP it was equaled or exceeded in four of the last eight years. Apart from Federal borrowing, which would total about $8 billion for the calendar year, such strength as exists in credit demands would be mainly in private short-term credit to consumers and business. Long-term private borrowing--which is far more stable cyclically than short-term in any case--would be more or less static in the low projection.

In short-term markets, the main source of growth would be the slow upward movement in consumer spending on durables, which could be expected to sustain consumer credit demand at around a $5 billion rate for the rest of the year; this would be considerably above 1961 and above the last two quarters as well. Offsetting this consumer demand, however, would be a marked downdrift in business short-term borrowing associated with the drop in inventory growth included in the low projection. The combined effect is a probable peak in private borrowing--both short-term and total--in the current quarter and a slow drift downward in following periods.

Chart 1072B
Business
Finance
Long-term
Low only

Business demand for long-term funds is restrained relative to fixed investment, mainly by the high level of internal funds indicated by the projection. On the assumption of no change from current monetary policies--an assumption we have adopted as a starting point in constructing both the low and high models--there could of course be some tendency for corporations to shift from banks to security markets as a source of funds in order to take advantage of the relatively more favorable rates available on security flotations. New issues were high last year, however, and are not likely to be matched by the total offered this year.

Chart 1079A
Consumer
Finance -
Low only

Consumers are probably a stronger source of credit demand for the rest of the year than business. As I noted earlier, spending for durables this year at the pace of the low model could reasonably produce a $5 billion growth in consumer credit, a relatively large increase but one that would not raise significantly the ratio of debt repayments to income. Housing demands are rather weak in the low projection, but mortgage funds are currently in large supply and will probably continue so for the rest of the year. Mortgage borrowing could therefore be fairly high relative to home buying and could probably match the volume of mortgage lending in the high year 1959. Taken together, therefore, consumer mortgages and instalment credit could be strong enough, even in the low projection, to produce a volume of consumer borrowing on the scale of 1955 and 1959.

Chart 1836
Flow of
Funds -
Low only

Cyclical movements in demand for funds are mirrored with considerable accuracy in corresponding changes in the volume of funds consumers, business, and State and local governments put into cash, savings accounts, and securities. Private investment in these forms is the most volatile and sensitive element of funds supplied to credit markets, and the primary question in projecting supply is the division of this total flow between institutional deposits and direct security purchases.

Chart 1835
Private
Financial
Invest-
ment -
Low only

Basic to projecting this division of financial flows is the assumption that monetary ease would prevail over the rest of this year. Last year, with the development of the CD instrument, and more recently, with higher rates offered on time deposits, we have seen a large share of private funds flowing into institutions and relatively little going directly into security markets. If yields on Governments and corporate securities were to remain for the rest of the year at approximately their current levels, private investors would probably continue to be strongly attracted into time deposits at commercial banks. The flow into savings banks and savings and loan associations would also be large, since these institutions have responded vigorously to the competition from commercial banks. Hence the outstanding characteristic of credit supplies this year, as compared with other years, should be a large volume of credit flows passing through banks and other deposit institutions rather than entering security markets directly.

The first-quarter peak in deposit flows, shown in the upper panel of the chart, reflects the extraordinary demand in January for commercial bank time deposits. For the rest of this year the flow into time and savings accounts is projected below the first quarter but somewhat above last year's rate.

Purchases of Government securities by the private sectors--consumers, business and State and local governments--are projected to be low for the year--virtually no net flow of such funds either into or out of Government securities. This is in contrast to 1960 and 1961, when private investors were reducing their holdings of Governments by substantial amounts.

Net issues of corporate and municipal securities are low in the low model, while institutional demand for them appears strong. In these circumstances, private investors are no more likely to be attracted into these securities than into Governments.

In summary, the low GNP indicates a total flow into deposits about $6 billion higher than last year--roughly the same increase as in total borrowing--while private purchases of securities would be of negligible proportions.

Chart 1834
Private
Domestic
Liquidity
Low only

While the flow into deposit claims would be exceptionally high as projected here, the effect on liquidity positions would be only slight--a gradual updrift in the ratio of total private liquid assets to total economic activity. At the end of the year the ratio still stands below the level at the end of 1959, when total borrowing most recently approached the level projected here.

As indicated in the lower part of the chart, demand for money relative to GNP is projected to continue to decline, reflecting the continued attractiveness of other liquid instruments. The projection here represents a money supply growth of $2 billion over the year, an increase of about 1-1/2 per cent.

Chart 0230
Commercial
Banks -
Low only

On the basis of projected loan demands, flows into time deposits, and monetary policy assumed, total credit at commercial banks would increase over the rest of this year at approximately the rate prevailing since late last year. The reserve expansion needed to accommodate the projected growth in demand and time deposits is about $800 million for the year.

Chart 0108
Bank Credit
Low only

Bank loans to consumers and business would be up from 1961 but only moderately compared to preceding expansions. Paralleling the time deposit flow projected is a continued strong demand by banks for mortgages and municipals. Funds available for investment in Government securities would be substantially less than last year, but on net commercial banks might absorb $2 billion of Federal financing. New Treasury issues tailored to bank needs may, however, divert bank funds from alternative investments. With this combination of credit flows, loan-deposit ratios would be up about one percentage point over the year, and would end the year at a postwar high level of over 55 per cent.

Chart 1759
Balance of
Payments
Low

Major elements of the balance of payments would not, in the low projection, differ greatly from 1961. Imports would likely increase somewhat, along with economic activity, but so would our exports under conditions of domestic price stability and the expected further expansion abroad. Our colleagues in the International

Finance Division also advise us that net military payments abroad are likely to decline a little, while net Federal economic aid increases, the latter reflecting in part smaller debt prepayments than were received last year.

Unless U.S. interest rates were to decline sharply--a development which in this exercise has been ruled out at least by assumption if not by the economics of the situation--there would not likely be much change in the flow of long-term private capital.

Taking the current account, Government aid, and long-term capital flows together, the deficit in the basic balance might be somewhat larger than in 1961--primarily because of the special debt prepayments last year--although it would likely be less than in the preceding three years. There is some possibility, however, that foreign credit demands might be met increasingly from foreign sources or that such demands for funds will not continue at the exceptionally high rate of the past two years. A decline in short-term capital outflows and in unidentified transactions could--and we emphasize the uncertainty--offset the rise in outflow on other accounts.

* * * * *

Mr. Weiner will now review developments as they might appear if rapid rather than slow growth should be our good fortune from here on out.

Mr. Weiner

Chart 1067 Cyclical Components High and low

As we noted earlier, the most recent developments could be interpreted to suggest more expansive vigor in the economy than has been pictured in the "low-track" projection. Since essentially the same projection of public spending was used in both the low and high models, a more rapid rise in output would have to reflect greater strength in consumer and business investment demands.

In the critical area of business fixed capital, one can note that businessmen have customarily tended to underestimate spending during expansion periods. In this connection, the McGraw-Hill survey last fall indicated a rise of 4 per cent this year; in late winter, the Commerce-SEC Survey upped the sights to 8 per cent. The spring McGraw-Hill survey--released today--indicates a rise of some 11 per cent. Passage of the investment-tax credit bill, as well as revisions of depreciation schedules, could have a further stimulating effect on business outlays, particularly in the second half of the year. The rise in spending shown in the "high-track" projection turns out to be in line with the latest McGraw-Hill survey.

Chart 1401 New Car Sales

In auto markets, March and April developments raise the possibility that consumer demands for durable goods broadly may be significantly higher than might have been judged from the perspective of mid-winter snows and floods. Sales for the year of 6.8 million domestically produced cars would not be inconsistent with the recent vigor of consumer demands. Indeed for the first 20 days of April, sales were at an annual rate in excess of 7 million units, shown in the last dot.

Chart 0722
Housing
Starts &
Permits

Similarly, March housing starts may be viewed as only a partial adjustment or "catching-up" to the rise in permits over the preceding months. In this hypothesis, the drop in activity in winter months reflected principally adverse weather, and prospects for a fairly good housing year are bright--not as high as the 1.5 million units started in 1959 but significantly better than last year or the low projection for this year. Adding support to this view is the intensive competition among mortgage-lending institutions.

Chart 1067
Cyclical
Components
High and
low

The generally higher personal incomes associated with this higher level of economic activity should provide some additional stimulus to consumer spending for nondurable goods and perhaps for services. Accepting such a concatenation of higher private demands, business inventory requirements would be larger than in the low track model. Price developments and supply availabilities would not be such as to stimulate speculative inventory additions, but the higher level of final sales should encourage continued moderate accumulation over the balance of the year.

One note of caution is appropriate. While the most recent data on activity and intentions suggest considerable vigor in private demands, all of us are aware of the dangers of extrapolating from so short a base, just as it would have been dangerous to have taken January and February as conclusive of the trend for the year.

Chart 1149
Output &
Labor Re-
sources
High and
low

Summarizing the economic situation under the more favorable set of possibilities described above, GNP would rise at an annual rate of 7-1/2 per cent over the rest of the year. It would reach a rate of $580 billion in the fourth quarter, only two billion less than was projected in the Administration's model last fall. Capacity utilization would be rising throughout the period, and even after allowing for resumption of labor force growth and continued moderate gains in productivity, the unemployment rate would probably edge down to between 5 and 5-1/2 per cent by year end.

* * * * *

Mr. Taylor will now examine the financial implications of the high-track model.

Mr. Taylor

Chart 1824A Funds Raised by Type - High and low

The higher rates of spending just described by Mr. Weiner would probably generate about $4 billion more borrowing this year than the low projection indicated. The total would approach $60 billion for the year, with the total flow expanding gradually through the fourth quarter. The higher borrowing rate originates entirely from the business and consumer demand considerations just discussed, which could add about $3 billion to short-term demands and something over $1 billion to long-term borrowing. Federal borrowing would be somewhat lower than in the low projection, since tax receipts would be somewhat higher.

Chart 1835 Private Financial Investment High and low

The supply projection for the high GNP is predicated on the same assumption with respect to monetary policy as in the low projection. We would therefore expect in the high projection as large a flow of funds into time and savings accounts as in the low. Purchases of securities by noninstitutional investors would be correspondingly small.

Chart 1834 Private Domestic Liquidity High and low

The single most important difference between the high and low financial projections is in money supply expansion. In the low model money supply was projected to grow by a modest $2 billion over the year, taking into account transactions needs and the attractiveness of other liquidity instruments. With the higher GNP, the corresponding demand for money might amount to $4 billion for the year. Demands for cash balances could be larger than this, however, if the shift from demand into time deposits has about run its course.

Chart 0108
Bank Credit
High and
low

Reflecting the higher credit demands expected with a higher spending total, bank credit growth in the high projection is $2 billion more than in the low. With more short-term borrowing by consumers and business, bank loans would be $3 billion above the low projection and investment in Government securities $1 billion less. Total purchases of Governments would be below $1 billion for the year. Loan-deposit ratios would rise to 56 per cent in the high projection, up a point and a half over the year. The ratio would be one point above the preceding postwar high of 55 per cent at the end of 1960.

* * * * *

Mr. Brill will now conclude the presentation.

Mr. Brill

Chart 1503 Prices

In summarizing our presentation this morning, I would like to focus on the implications of the alternative patterns Mr. Weiner and Mr. Taylor have been describing. First, perhaps, I should emphasize the common elements. In neither model does the rate of resource utilization suggest upward price pressure in commodity markets this year. Also common to both patterns is the assumption that savings flows, coupled with the assumed continuance of current monetary policy, would permit the financing of consumer and business outlays on terms and conditions no more restrictive than those now prevailing.

Chart 1149 Output & Labor Resources

The principal nonfinancial difference between the alternative tracks lies in the degree of resource utilization achieved by the end of the year and what this may suggest for 1963. The high model, in which GNP reaches a rate of about $580 billion in the fourth quarter, suggests an economy making inroads into the problem of adequate resource utilization.

Chart 0430 Profits & Margins

In this model, manufacturing plant would be increasingly brought into production. While output would still be requiring the use of less than 90 per cent of capacity, the trend would be upward. Incentives would exist for further plant expansion and further moderate inventory accumulation. Profits would be rising and margins holding at levels which, while not historically high, would be well above recession lows.

Similarly, the rising demands pictured in this model suggest employment increasing slightly faster than the labor force, with the result that the unemployment rate would be creeping down.

Chart 1827A
Funds
Raised

Credit demands would be fairly strong, with the total of funds raised in credit and equity markets almost as large as in the peak year of 1959. Stability of interest rates in this demand situation would reflect the large volume of savings channeled through intermediaries, particularly the commercial banks, as well as the assumed continuance of monetary ease.

Chart 1149
Output &
Resources

In contrast, a sluggish recovery such as is pictured in the low model suggests that by year end 15 per cent of industrial capacity and 6 per cent of the labor force would still be unutilized. Profits would be declining and profit margins narrowing. While personal incomes would still be rising, the rate of increase would be diminishing. With financing needs somewhat less intense than in the high model, and supplies of funds ample--particularly for long-term investment--interest rates would likely be under some downward pressure. An economy thus characterized does not suggest one likely to sustain expansion in private demands for long.

Such developments would also appear to doom the Administration's efforts to match income and outgo at high levels of economic activity. The Board will recall that the official Administration projection suggested the possibility, for fiscal 1963, of a balanced Administrative Budget and a surplus in the cash budget of about $2 billion. Considering the shortfall in the economy in the first quarter of this year, it is likely that, even if rapid expansion is resumed over the balance of the year, Federal revenues will fall short of the earlier target by perhaps $2-3 billion. The low projection suggests a much greater shortfall in revenues--on the order of $4-5 billion--and higher Federal outlays for unemployment benefits and other transfer payments. Thus, the low track, which some observers have taken complacently as a reasonable target for the economy in 1962, would actually leave us with a large margin of unutilized capacity, high unemployment, slack private credit demands, and the prospect of a large Federal deficit in fiscal 1963.

ON MAY 1, 1962, AT 10:25 A.M., THE FEDERAL ADVISORY COUNCIL HELD A JOINT MEETING WITH THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM IN THE FEDERAL RESERVE BUILDING, WASHINGTON, D. C. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MESSRS. ZWIENER AND MOORHEAD. MR. RUTLEDGE ATTENDED AS AN ALTERNATE FOR MR. MOORHEAD.

THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: CHAIRMAN MARTIN, VICE CHAIRMAN BALDERSTON, GOVERNORS MILLS, ROBERTSON AND SHEPARDSON. MR. SHERMAN, SECRETARY, AND MR. KENYON, ASSISTANT SECRETARY, OF THE BOARD OF GOVERNORS, ALSO WERE PRESENT.

The minutes of the joint meeting are being prepared in the office of the Secretary of the Board of Governors of the Federal Reserve System. Their content will be compared with the notes of the Secretary of the Council. Assuming they are in substantial agreement, they will be distributed to the members of the Council.

The meeting adjourned at 12:45 P.M.

* * * * *

The next meeting of the Council will be held September 17-18, 1962.