MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

November 18, 1963

The fourth statutory meeting of the Federal Advisory Council for 1963 was convened in Room 932 of the Mayflower Hotel, Washington, D.C. on November 18, 1963 at 9:30 A.M.

Present:

Lawrence H. Martin	District No. 1
George A. Murphy	District No. 2
Howard C. Petersen	District No. 3
L. A. Stoner	District No. 4
Robert B. Hobbs	District No. 5
Wallace M. Davis, Alternate	District No. 6
Kenneth V. Zwiener	District No. 7
Sidney Maestre	District No. 8
John A. Moorhead	District No. 9
Maurice L. Breidenthal	District No. 10
James W. Aston	District No. 11
Elliott McAllister	District No. 12
Herbert V. Prochnow	Secretary
William J. Korsvik	Assistant Secretary

Absent:

J. Finley McRae	District No. 6

On motion duly made and seconded, the mimeographed notes of the meeting of the Council held on September 16–17, 1963, copies of which had been sent previously to the members of the Council, were approved.

A complete list of the items on the agenda 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 32, 33 and 34 of these minutes.

The meeting adjourned at 12:50 P.M.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

November 18, 1963

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. Lawrence H. Martin, Howard C. Petersen, L. A. Stoner, Robert B. Hobbs, Wallace M. Davis, Alternate for Mr. J. Finley McRae; Messrs. Kenneth V. Zwiener, Sidney Maestre, John A. Moorhead, Maurice L. Breidenthal, James W. Aston, and Elliott McAllister.

Mr. Louis Weiner, member of the Board's staff, Division of Research and Statistics, presented his "Views on Economic Developments in 1964." A copy of his remarks was sent to each member of the Council.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

November 18, 1963

At 9:00 P.M., the Federal Advisory Council reconvened in Room 932 of the Mayflower Hotel, Washington, D. C.

Present: Mr. George A. Murphy, President; Messrs. Lawrence H. Martin, L. A. Stoner, Robert B. Hobbs, Wallace M. Davis, Alternate for Mr. J. Finley McRae, Messrs. Kenneth V. Zwiener, Sidney Maestre, John A. Moorhead, Maurice L. Breidenthal, James W. Aston, Elliott McAllister, Herbert V. Prochnow, Secretary, and William J. Korsvik, Assistant Secretary.

Absent: Messrs. Howard C. Petersen and J. Finley McRae.

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 32, 33 and 34, listing the agenda items with conclusions reached by the Council. The *Memorandum* was delivered to the Federal Reserve Building at 10:00 P.M. on November 18, 1963.

The meeting adjourned at 9:25 P.M.

HERBERT V. PROCHNOW
Secretary

WILLIAM J. KORSVIK
Assistant Secretary

MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL ADVISORY COUNCIL RELATIVE TO THE AGENDA FOR THE JOINT MEETING ON NOVEMBER 19, 1963

1. Domestic economic conditions and prospects.

   A. What are the views of Council members about the business outlook on the assumption that the proposed tax cut will be passed? On the assumption that it will not? To what extent does it appear to members that anticipations of a tax cut are already reflected in current levels of consumer and business spending, and in reports of spending plans?

   B. Does an accumulative rise in prices appear to be developing, or are price increases expected to remain selective, with decreases continuing generally to offset increases in the over-all averages?

   C. What are the views of the Council members regarding the quality of consumer and business credit? Are repayments on mortgage and consumer instalment credit at unduly burdensome levels?

A. The members of the Council believe that the outlook for business for the months ahead is favorable, even without a tax cut. Underlying this opinion, however, is the widely held view that Federal taxes on corporate profits and personal income will be reduced some time next year. Tax reduction would have some stimulating effect on the economy. If the Congress should not pass the tax bill, it probably would have some unfavorable psychological consequences both on business expectations and consumer attitudes.

The Council believes that the anticipation of a tax cut has contributed to the prevailing confidence in the business outlook. This in turn has been reflected in current levels of consumer and business spending and in reports of spending plans.

B. The members of the Council do not believe that an over-all accumulative rise in prices is developing. A reduction in taxes next year, coming at a time when economic activity is already at a high level, might create some inflationary pressures which would be reflected in the price indices.

C. There has been some deterioration in the quality of consumer and business credit but the quality of the over-all loan portfolio is generally satisfactory. Repayments of mortgage and consumer instalment credit represent an unusually high level of disposable income. Although the rate on delinquencies to date does not indicate that repayments have reached burdensome levels, there is a risk in a continuation of the present trend.

2. Banking developments.

A. What is the Council's judgment as to business needs for bank financing over the next several months?

B. In the opinion of the Council members, have commercial banks recently become somewhat more selective in granting business or consumer loans?

C. What are the members' views as to likely developments over coming months with respect to volume and rates on time certificates of deposit? What are their views as to the implications of the recent sharp growth in time certificates of deposit for bank liquidity needs?

A. Most members of the Council believe that commercial and industrial loans will continue to show a more than seasonal rise following the customary decline after the first of the year.

B. The members of the Council believe that commercial banks have become somewhat more selective in granting business and consumer loans in recent months as the reserve position of the banks has become less easy.

C. The Council believes that the growth of time certificates of deposit will continue and that the rates on these deposits in the coming months will tend to remain near present levels. Concern has been expressed that banks may be unable to offer the competitive rates necessary to retain these funds. The growth in the volume of interest-bearing time certificates of deposit and savings is resulting in the acquisition by banks of higher yielding, longer-term assets with a consequent decline in liquidity.

3. Absorption of exchange charges.

What are the views of Council members on the position the Board has consistently followed that absorption of exchange charges by member banks involves an indirect payment of interest on demand deposits? In view of the widespread evasions of the Board's ruling by member banks, the difficulties of effective enforcement, and the inequities to member banks resulting from the fact that the Federal Deposit Insurance Corporation interprets exchange absorption differently, does the Council believe that Regulation Q should be amended to provide that exchange absorption will not be considered a payment of interest on demand deposits?

The Council believes that the regulation should be enforced. Although the regulation may be difficult to enforce effectively, the members of the Council continue to believe that no change should be made in the present regulation covering the absorption of exchange charges by member banks.

4. The U. S. balance of payments.

   A. What are the views of Council members as to prospects for further improvement in our balance of payments position. To what extent, if any, do members believe that monetary policy has contributed to the recent improvement in our balance of payments?

   B. In the opinions of Council members, has there been any recent change in the strength of demand for bank loans by foreign customers?

   C. Do members observe any indications of significant improvement in the competitive position of the United States in world trade?

A. The members of the Council believe that monetary policy has contributed to the recent improvement and to the somewhat more favorable short-term outlook on the balance of payments.

B. The members of the Council have not detected any recent significant change in the strength of demand for bank loans by foreign customers.

C. Although underlying trends in wages, prices, and productivity here and abroad tend to be helpful to the United States, the members of the Council have not observed any real improvement in the competitive position of the United States in world trade.

5. Monetary policy.

How do Council members evaluate recent monetary and credit policy?

The members of the Council believe that recent monetary and credit policy has been most appropriate. Domestic business activity has had sufficient strength to accommodate itself to the somewhat less easy credit position and the firming of rates. At the same time, monetary and credit policy has been helpful to our international payments position.

The Council believes the increase in the margin requirements on stock purchases was desirable and timely.

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

November 19, 1963

At 10:30 A.M., a joint conference of the Federal Advisory Council and the Board of Governors of the Federal Reserve System was held in the Board Room of 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, Chas. N. Shepardson, and George W. Mitchell; also Mr. Merritt Sherman, Secretary, and Mr. Kenneth A. Kenyon, Assistant Secretary of the Board of Governors. Also present was Mr. Howard H. Hackley, General Counsel.

Present: Members of the Federal Advisory Council:

Mr. George A. Murphy, President; Messrs. Lawrence H. Martin, Howard C. Petersen, L. A. Stoner, Robert B. Hobbs, Wallace M. Davis, Alternate for Mr. J. Finley McRae; Messrs. Kenneth V. Zwiener, Sidney Maestre, John A. Moorhead, Maurice L. Breidenthal, James W. Aston, Elliott McAllister, Herbert V. Prochnow, Secretary, and William J. Korsvik, Assistant Secretary.

Absent: Mr. J. Finley McRae.

President Murphy 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 32, 33 and 34. An extended discussion followed in which the members of the Council described developments in their respective districts.

Governor Mills stated that there had been some suggestion that the quality of bank credit had deteriorated. If this was true, he continued, was there evidence of any movement within the commercial banking system to require that higher credit standards be applied by loan officers. In the ensuing discussion, several members of the Council emphasized that bank managements and loan officers were aggressively seeking loans and spending more time than formerly tailoring credits to meet the requirements of borrowers. They contended that as a result, more time was being spent on special situations to keep them moving in the right direction.

The President then read the second item and the Council's conclusions. There followed considerable discussion on the volume of negotiable certificates of deposit in the banking system. Concern was expressed by several members that the rates paid by commercial banks for such funds were approaching the Regulation Q ceiling. In view of the volume of such funds in the banking system, they urged that the authorities consider raising the ceiling at some appropriate time in the future.

Governor Mills observed that funds obtained by banks when they issue negotiable certificates of deposit apparently do not find their way into the ordinary run of bank loans and investments. To the extent that this was the case, were the certificates doing any good or simply bringing up bank totals out of competitive pride.

In the discussion which followed, it was acknowledged that there was some justification for the Governor's observation. On the other hand, a number of members argued that funds obtained from the use of these certificates enabled them to expand their traditional banking activities that would not have been possible had such funds not been obtained.

The third item and the conclusions of the Council were then read by President Murphy. He added that to say now, that the absorption of exchange charges was not an indirect payment of interest on demand deposits, would be a move backwards.

Chairman Martin noted that the Board's purpose in bringing up this subject was that it continued to be a very serious problem for the Board of Governors and that the Board had an obligation to keep the matter in front of the banking community.

The President then read the fourth and fifth items and the conclusions of the Council. A brief discussion followed.

The meeting adjourned at 12:40 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 November 18, 1963, at 9:30 a.m. in Room 932 of the Mayflower Hotel, Washington, D. C. All members of the Council were present except Mr. McRae. Mr. Wallace M. Davis, President, Hibernia National Bank, New Orleans, Louisiana, attended as Alternate for Mr. McRae.

The Council approved the Secretary's notes for the meeting of September 16-17, 1963.

ITEM I

DOMESTIC ECONOMIC CONDITIONS AND PROSPECTS.

A. WHAT ARE THE VIEWS OF COUNCIL MEMBERS ABOUT THE BUSINESS OUTLOOK ON THE ASSUMPTION THAT THE PROPOSED TAX CUT WILL BE PASSED? ON THE ASSUMPTION THAT IT WILL NOT? TO WHAT EXTENT DOES IT APPEAR TO MEMBERS THAT ANTICIPATIONS OF A TAX CUT ARE ALREADY REFLECTED IN CURRENT LEVELS OF CONSUMER AND BUSINESS SPENDING, AND IN REPORTS OF SPENDING PLANS?

B. DOES AN ACCUMULATIVE RISE IN PRICES APPEAR TO BE DEVELOPING, OR ARE PRICE INCREASES EXPECTED TO REMAIN SELECTIVE, WITH DECREASES CONTINUING GENERALLY TO OFFSET INCREASES IN THE OVER-ALL AVERAGES?

C. WHAT ARE THE VIEWS OF THE COUNCIL MEMBERS REGARDING THE QUALITY OF CONSUMER AND BUSINESS CREDIT? ARE REPAYMENTS ON MORTGAGE AND CONSUMER INSTALMENT CREDIT AT UNDULY BURDENSOME LEVELS?

President Murphy read Item I and asked members of the Council for their views. The ensuing discussion disclosed fairly wide agreement that the outlook for business for the months ahead is favorable even without a tax cut. The members also stated that it is generally believed that federal taxes on corporate profits and personal income will be reduced some time next year. A tax reduction is likely to have a stimulating effect on the economy. If the Congress should not pass the tax bill, it probably would have some unfavorable psychological consequences both on business expectations and consumer attitudes. The comments also disclosed that the Council believes that the anticipation of a tax cut has contributed to the prevailing confidence in the business outlook. This in turn has been reflected in current levels of consumer and business spending and in reports of spending plans.

The members do not believe that an over-all accumulative rise in prices is developing, but rather that increases are tending to be offset by declines. A reduction in taxes next year coming at a time when economic activity is already at a high level might create some inflationary pressures which would be reflected in the price indices.

There was an extended discussion about the quality of bank credit. While it was widely acknowledged that consumer and business credit had deteriorated somewhat in quality, the over-all loan portfolios are generally satisfactory. Repayments of mortgage and consumer instalment credit represents an unusually high level of disposable income, although the rate on delinquencies to date does not indicate that repayments have reached burdensome levels. There is a risk, the members acknowledged, in a continuation of the present rising trend in the proportion of consumer credit to income.

ITEM II

BANKING DEVELOPMENTS.

A. WHAT IS THE COUNCIL'S JUDGMENT AS TO BUSINESS NEEDS FOR BANK FINANCING OVER THE NEXT SEVERAL MONTHS?

B. IN THE OPINION OF COUNCIL MEMBERS, HAVE COMMERCIAL BANKS RECENTLY BECOME SOMEWHAT MORE SELECTIVE IN GRANTING BUSINESS OR CONSUMER LOANS?

C. WHAT ARE THE MEMBERS' VIEWS AS TO LIKELY DEVELOPMENTS OVER COMING MONTHS WITH RESPECT TO VOLUME AND RATES ON TIME CERTIFICATES OF DEPOSIT? WHAT ARE THEIR VIEWS AS TO THE IMPLICATIONS OF THE RECENT SHARP GROWTH IN TIME CERTIFICATES OF DEPOSIT FOR BANK LIQUIDITY NEEDS?

President Murphy read Item II on banking developments. In the discussion which followed, the members reported a fairly strong demand for commercial and industrial loans which they expect will continue. They also anticipate a more than seasonal rise following the customary decline after the first of the year. The brisk loan demand, together with the somewhat less easy reserve positions have caused banks to be somewhat more selective in granting business and consumer loans in recent months.

The discussion on the growth of time certificates of deposit, which the Council anticipates will continue, found several members expressing considerable concern about the ability of banks to retain these deposits should interest rates move higher. Currently, rates are virtually at the Regulation Q ceiling and the ability of banks to remain competitive with other money market instruments requires the ceiling to be raised should the rate structure move higher. The growth in the volume of interest-bearing time certificates of deposit and savings is resulting in the acquisition by banks of higher yielding, longer-term assets with a consequent decline in liquidity.

ITEM III

ABSORPTION OF EXCHANGE CHARGES.

WHAT ARE THE VIEWS OF COUNCIL MEMBERS ON THE POSITION THE BOARD HAS CONSISTENTLY FOLLOWED THAT ABSORPTION OF EXCHANGE CHARGES BY MEMBER BANKS INVOLVES AN INDIRECT PAYMENT OF INTEREST ON DEMAND DEPOSITS? IN VIEW OF THE WIDESPREAD EVASIONS OF THE BOARD'S RULING BY MEMBER BANKS, THE DIFFICULTIES OF EFFECTIVE ENFORCEMENT, AND THE INEQUITIES TO MEMBER BANKS RESULTING FROM THE FACT THAT THE FEDERAL DEPOSIT INSURANCE CORPORATION INTERPRETS EXCHANGE ABSORPTION DIFFERENTLY, DOES THE COUNCIL BELIEVE THAT REGULATION Q SHOULD BE AMENDED TO PROVIDE THAT EXCHANGE ABSORPTION WILL NOT BE CONSIDERED A PAYMENT OF INTEREST ON DEMAND DEPOSITS?

President Murphy read Item III.

Since the non-par banks tend to be concentrated in the 9th, 5th, and 6th districts, President Murphy invited comments from Messrs. Moorhead, Hobbs and Davis. As in the past when this subject was discussed, the members of the Council were unanimous in their belief that the statute, as interpreted by the Federal Reserve Board, is correct and that it should be enforced. While acknowledging the difficulty of enforcing it effectively, the members of the Council continue to believe that no change should be made in the present regulation covering the absorption of exchange charges by member banks. It was agreed to informally discuss with the Board the possibility of establishing a committee of bankers -- perhaps through the National Bank Division of the ABA, or the Association of Reserve City Bankers -- to study this matter.

ITEM IV

THE U. S. BALANCE OF PAYMENTS

A. WHAT ARE THE VIEWS OF COUNCIL MEMBERS AS TO PROSPECTS FOR FURTHER IMPROVEMENT IN OUR BALANCE OF PAYMENTS POSITION? TO WHAT EXTENT, IF ANY, DO MEMBERS BELIEVE THAT MONETARY POLICY HAS CONTRIBUTED TO THE RECENT IMPROVEMENT IN OUR BALANCE OF PAYMENTS?

B. IN THE OPINIONS OF COUNCIL MEMBERS, HAS THERE BEEN ANY RECENT CHANGE IN THE STRENGTH OF DEMAND FOR BANK LOANS BY FOREIGN CUSTOMERS?

C. DO MEMBERS OBSERVE ANY INDICATIONS OF SIGNIFICANT IMPROVEMENT IN THE COMPETITIVE POSITION OF THE UNITED STATES IN WORLD TRADE?

President Murphy read Item IV and asked Mr. Petersen to comment.

Petersen reported that he thought the third quarter figures on our balance of payments clearly indicated that monetary policy had been helpful in reducing the deficit. The equalization tax also has contributed to the improvement. He added, however, that the developments in the third quarter should not be interpreted as indicating that our balance of payments problem was solved. He doubted that U. S. exports could be increased, but instead, stated that we will be doing very well if we just maintain our present excellent trade surplus.

A brief discussion followed. It was agreed that the short-term outlook was somewhat more favorable than in the past. The members of the Council did not report any recent significant change in the strength of demand for bank loans by foreign customers. No one was aware of any real improvement in the competitive position of the United States in world trade.

ITEM V

MONETARY POLICY

HOW DO COUNCIL MEMBERS EVALUATE RECENT MONETARY AND CREDIT POLICY?

President Murphy read Item V. A brief discussion followed in which it was unanimously agreed that the recent monetary and credit policy had been most appropriate. Domestic business has readily accommodated itself to the somewhat less easy credit position and to the firming of rates. At the same time monetary and credit policy had been helpful to our international payments position. It was also decided to acknowledge that the increase in margin requirements on stock purchases had been desirable and timely.

The meeting adjourned at 12:50 p.m.

THE COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING, WASHINGTON, D. C. AT 2:30 P.M. ON NOVEMBER 18, 1963. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MESSRS. PETERSEN AND MC RAE. MR. WALLACE M. DAVIS, PRESIDENT, HIBERNIA NATIONAL BANK, NEW ORLEANS, LOUISIANA, ATTENDED AS ALTERNATE FOR MR. MC RAE.

Mr. Louis Weiner, member of the Board's staff, Division of Research and Statistics, presented his "Views on Economic Developments in 1964." A copy of his remarks is attached.

* * * *

THE COUNCIL RECONVENED AT 9:00 P.M. ON NOVEMBER 18, 1963, IN ROOM 932 OF THE MAYFLOWER HOTEL. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MESSRS. PETERSEN AND MC RAE. MR. WALLACE M. DAVIS, PRESIDENT, HIBERNIA NATIONAL BANK, NEW ORLEANS, LOUISIANA, ATTENDED AS ALTERNATE FOR MR. MC RAE.

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 November 19, 1963. The Memorandum was delivered to the Federal Reserve Building at 10:00 p.m. on November 18, 1963.

The meeting adjourned at 9:25 p.m.

November 18, 1963

Views on Economic Developments in 1964

Remarks to the Federal Advisory Committee

by
Louis Weiner

My remarks today will be primarily oriented to summarizing alternative views on economic prospects for 1964. But I shall begin with a little perspective on the current expansion period as a whole, which does have some relevance for next year.

In many ways, this expansion has been the most gratifying of the postwar period, certainly of the post-Korean period. In mid-November we are 33 months from the early 1961 cyclical low, and prospects are for further expansion in the months immediately ahead. The preceding expansion, from April 1958 to May 1960, lasted only 25 months. Perhaps our most publicized postwar expansion, from May 1954 to August 1957, lasted 39 months. Clearly, the chances are good for equaling or exceeding this latter duration.

It is especially gratifying that the rate of increase in output now compares favorably indeed to that in the two preceding expansions. If we measure from the preceding cyclical peak, in this case from the second quarter 1960 to the third quarter 1963, we find that real GNP has increased at an annual rate of 3.6 per cent and industrial production at an annual rate of 4.6 per cent. The advances were 2.4 and 2.2 per cent, respectively, in the 1953-57 cycle. Another gratifying feature of this expansion has been the continuing stability in over-all measures of commodity prices. Notwithstanding a flurry of price advances in the spring and summer of this year, in steel, aluminum, lead, some types of machinery, sugar, etc., the wholesale index has hardly budged, and remains well within the narrow range that has persisted for the past five years. We tend to forget that prices for many commodities, some of considerable importance, such as automobiles, have not changed. We forget also, that some important prices have declined in recent months; for example, gasoline, hides, and lumber. In our concern with inflation possibilities, we forget also that the classical view on price stability is not that all prices be unchanged, but rather that the allocative process of a free market economy achieves stability through diversity of price behavior.

Reasonable stability of prices has been achieved in large part because resource utilization -- manpower and industrial capacity -- has not been as intense as earlier in the postwar period. This has also been reflected in the fact that increases in wages in manufacturing, including fringe benefits, have been smaller in recent years than earlier. By and large, increases have about matched productivity gains. Thus, unit labor costs in manufacturing are not much different than they were about five years ago. This, too, is a source of gratification, and a basic element in our continuing attempt to cope successfully with the balance of payments problem. At the same time, in recent years we have witnessed -- if anything -- a pickup in the rate of productivity gain.

Another feature of this expansion, often overlooked, has been the behavior of corporate profits. According to preliminary estimates, corporate profits before tax rose to a new high in the third quarter, at an annual rate of $52 billion. Perhaps more significant is the fact that profits have increased -- even though irregularly -- throughout this expansion period; in previous expansions profits reached a high much earlier and then tended to decline.

So far, so good. Nonetheless, experience of recent years has not been satisfactory on at least two major counts:

(1) Resource utilization has just not come up to rates achieved earlier in the postwar period, or to what our society, by and large, has come to accept as a desirable level. The unemployment rate in October was still 5-1/2 per cent rather than the 4 per cent target. In manufacturing industries, operations in October were in the vicinity of 86 per cent of capacity, as compared to the preferred operating rates of 90-92 per cent.

(2) The balance of payments problem has been a continuing one; it is encouraging to report, however, that the deficit in the third quarter was very sharply reduced. But one quarter will not of itself win the war.

On the demand side, the <u>differentiating</u> features of the present expansion have been numerous. For one thing, the continued advance in Federal purchases of goods and services <u>has</u> contributed significantly to our over-all expansion; this has been the first such sustained rise in Federal purchases since the Korean War.

While consumers have continued to spend some 93 per cent of their incomes on consumption, a somewhat unusual feature has been the well-publicized fact that both 1962 and 1963 were "good" auto years. Now the widespread judgment is that 1964 will also be a good auto year, and certainly sales in October and early November support this view. Another factor has been the sustained high volume of housing starts for three years in a row. Certainly the large flow of savings and also monetary policy have contributed to this. Apart from ups and downs associated with hedging against possible steel strikes, inventory policy by and large has been cautious and accumulation has been modest. Indeed, stocks-sales ratios continue on the low side, especially for so far along in a cyclical expansion period.

On the other hand, business outlays for fixed capital, while rising, have proved disappointing and especially so in view of profits performance and the record volume of internal funds.

Right now, we are still expanding. GNP in the third quarter was at an annual rate of $589 billion, 5.7 per cent above a year ago, with the bulk of the rise in physical volume. Industrial production in October was at a new high, just barely, it is true, but nonetheless a high. Retail sales were strong in October and in early November continued strong. Sale of domestic autos in October were at an annual rate of 7.6 million units; with imports included, the total would approach 8 million. (I must add, however, that early November auto sales did not appear quite that strong.)

The McGraw-Hill Survey on business plans to spend on fixed capital next year, however, was disappointing to many. A rise of 4 per cent suggests a level of capital outlays for 1964 below that at which we may be currently spending. On the other hand, as everyone in this business probably knows, the survey may well underestimate the actual increase if demands elsewhere continue strong next year.

In the closing quarter of the year, we may look forward to a gross national product of perhaps $597 billion -- obviously approaching the magic 600 billion. At the same time it is unlikely the unemployment rate will be much, if any, improved by December from the current 5-1/2 per cent level.

This brings us to the year 1964 and the various views that are now being voiced about it.

There are lots of views about prospects for 1964. I won't pretend to have reviewed them all, but some positions have emerged clearly. The standard way of looking at 1964 is to postulate what would happen in the absence of a tax cut and then to see what difference a tax cut would make.

If we assume that there is not to be a tax cut we find two major views:

(1) Those who think that the momentum of the present expansion, together with some obvious plusses, such as State and local spending and consumer services, will see us through 1964 without recession. However, it is hard to see where any big "oomph" would come from. Expansion would be modest and unemployment would remain high or would rise. Under these circumstances we would get GNP's centering, say, at the $610 billion level, give or take a few billion; and

(2) Those who believe that an upper turning point is likely to come next spring or summer. The rationalization for this point of view, which is widespread enough, is that the present expansion will be getting old and tired. Consumer demands for autos and other durables are seen as weakening some. Plant and equipment outlays, without the stimulus of rising demands from other sectors, are seen as peaking in the first half of 1964 and then declining. With some weakness in

demands for goods in these areas, inventory investment is seen as declining and possibly turning to liquidation. This is certainly a standard view of how recessions come about; the big question, as always, is when.

The Administration has been ambivalent in its official statements on prospects for 1964. An effort has been made to generate pressure behind the tax bill by mentioning the possibility of recession without a tax cut; at the same time, however, the Administration, to the best of my knowledge, has never stated clearly that recession is inevitable without tax reduction. Secretary Dillon in recent testimony presented a pattern of GNP through the first half of next year with and without tax reduction. Without tax reduction the figures run $596 billion in the current quarter, $603 billion in the first quarter of 1964, and $608.5 billion in the second quarter.

On the whole it appears to me that without tax reduction, forces now making for expansion or contraction in 1964 are fairly evenly balanced, and that one cannot assert with great certainty a high probability for either of the two possibilities mentioned above.

However, when observers begin to assume a tax cut of the general sort enacted recently by the House, the great preponderance of judgment is that expansion will continue throughout 1964. Differences relate primarily to the amount of expansion. Parenthetically, President Kennedy in his radio and TV remarks of a month or so ago in effect remarked, in a not sufficiently-quoted statement, that recession is not inevitable without tax cut nor does a tax cut guarantee that there will be no recession.

I may remind you that the tax measure enacted by the House, and now under consideration in the Senate Finance Committee, reduces taxes by a total of about $11 billion as of January 1, 1965; about 2/3 of the reduction would be effective on January 1, 1964, with a reduction of some $6 billion in individual income taxes and $1 billion in corporate income taxes. It has become doubtful indeed that Congress will enact tax legislation by the end of this year and most observers now see passage as probably deferred until, say next April, give or take a month. But most models have been predicated on a January 1 effective date and it is this type of model that I shall discuss.

With a tax cut, the bulk of estimates for 1964 probably range between $615 and $630 billion for GNP, a not inconsiderable range, particularly in its implications for the fourth quarter of next year and for the unemployment rate. The Administration, to the best of my knowledge, has not yet released any estimate for the year and indeed is undoubtedly now busily engaged in coming up with figures for the Budget Message. However, Secretary Dillon in his recent testimony, already referred to, used a figure of $608 billion for the first quarter with tax cut (as compared to $603 without) and a figure of $620 for the second quarter (as compared to $608.5 without). By and large his figures for the first half of the year seem consistent with a $625 billion figure for the year as a whole.

At a recent meeting of Treasury consultants, several views as to 1964 were produced. One of these, carefully thought out on an internal basis, and on the whole fairly representative of other views there, came up with a GNP of $624 billion for the year, with the further assumption that the GNP deflator would rise 1-1/2 per cent, about the same as in other recent years. A GNP of $624 billion would represent an increase of 40 billion, or 7 per cent, from the $584 billion estimate for this year.

Perhaps even more interesting is that the $624 billion GNP for the year 1964 involved an annual rate of $642 billion for the fourth quarter. It is instructive to s e what this would mean in the way of private demands. In general, all of these models assume that in the first year, after the tax cut, the bulk of expansion must come from stepped-up consumer outlays; investment expanditures are viewed as responding, with some lag, to increased consumer demands. In this particular model, consumer purchases of goods and services rise $30 billion, or 8 per cent, from the fourth quarter of 1963 to the fourth quarter of 1964. Over the past year, the increase is estimated at only $17 billion, or so. All types of consumer spending are viewed as being favorably affected, with large increases indeed for durable and nondurable goods. For durable goods the rise is approximately 15 per cent, implying a substantially better auto year in 1964 than in 1963. Residential construction activity is assumed to hold at this year's advanced level.

This particular model has an increase of 12 per cent in spending for fixed capital from 1963 to 1964. (Many observers are talking of 10 per cent, notwithstanding the McGraw-Hill 4 per cent.) Inventory accumulation is only moderately higher than this year; presumably partly on the assumption that a really big inventory run-up might not be consistent with continued growth. Corporate profits would, of course, rise substantially in this sort of climate.

Clearly the run-up underway in late 1964 is envisioned as continuing into 1965. By late 1964, the unemployment rate would be below 5 per cent.

This particular model is internally consistent and is not implausible. It could be that a tax cut effective January 1 would produce this sort of expansion. The most important question in my mind, however, is whether the rise in consumption would be as large as envisioned. If not, the over-all picture would be less expansive, but even a smaller expansion in over-all demands would make a tax cut decidedly worthwhile.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON NOVEMBER 19, 1963

1. Domestic economic conditions and prospects.

   A. What are the views of Council members about the business outlook on the assumption that the proposed tax cut will be passed? On the assumption that it will not? To what extent does it appear to members that anticipations of a tax cut are already reflected in current levels of consumer and business spending, and in reports of spending plans?

   B. Does an accumulative rise in prices appear to be developing, or are price increases expected to remain selective, with decreases continuing generally to offset increases in the over-all averages?

   C. What are the views of the Council members regarding the quality of consumer and business credit? Are repayments on mortgage and consumer instalment credit at unduly burdensome levels?

A. The members of the Council believe that the outlook for business for the months ahead is favorable, even without a tax cut. Underlying this opinion, however, is the widely held view that Federal taxes on corporate profits and personal income will be reduced some time next year. Tax reduction would have some stimulating effect on the economy. If the Congress should not pass the tax bill, it probably would have some unfavorable psychological consequences both on business expectations and consumer attitudes.

The Council believes that the anticipation of a tax cut has contributed to the prevailing confidence in the business outlook. This in turn has been reflected in current levels of consumer and business spending and in reports of spending plans.

B. The members of the Council do not believe that an over-all accumulative rise in prices is developing. A reduction in taxes next year, coming at a time when economic activity is already at a high level, might create some inflationary pressures which would be reflected in the price indices.

C. There has been some deterioration in the quality of consumer and business credit but the quality of the over-all loan portfolio is generally satisfactory. Repayments of mortgage and consumer instalment credit represent an unusually high level of disposable income. Although the rate on delinquencies to date does not indicate that repayments have reached burdensome levels, there is a risk in a continuation of the present trend.

2. Banking developments.

A. What is the Council's judgment as to business needs for bank financing over the next several months?

B. In the opinion of Council members, have commercial banks recently become somewhat more selective in granting business or consumer loans?

C. What are the members' views as to likely developments over coming months with respect to volume and rates on time certificates of deposit? What are their views as to the implications of the recent sharp growth in time certificates of deposit for bank liquidity needs?

A. Most members of the Council believe that commercial and industrial loans will continue to show a more than seasonal rise following the customary decline after the first of the year.

B. The members of the Council believe that commercial banks have become somewhat more selective in granting business and consumer loans in recent months as the reserve position of the banks has become less easy.

C. The Council believes that the growth of time certificates of deposit will continue and that the rates on these deposits in the coming months will tend to remain near present levels. Concern has been expressed that banks may be unable to offer the competitive rates necessary to retain these funds. The growth in the volume of interest-bearing time certificates of deposit and savings is resulting in the acquisition by banks of higher yielding, longer-term assets with a consequent decline in liquidity.

3. Absorption of exchange charges.

What are the views of Council members on the position the Board has consistently followed that absorption of exchange charges by member banks involves an indirect payment of interest on demand deposits? In view of the widespread evasions of the Board's ruling by member banks, the difficulties of effective enforcement, and the inequities to member banks resulting from the fact that the Federal Deposit Insurance Corporation interprets exchange absorption differently, does the Council believe that Regulation Q should be amended to provide that exchange absorption will not be considered a payment of interest on demand deposits?

The Council believes that the regulation should be enforced. Although the regulation may be difficult to enforce effectively, the members of the Council continue to believe that no change should be made in the present regulation covering the absorption of exchange charges by member banks.

4. The U. S. balance of payments.

A. What are the views of Council members as to prospects for further improvement in our balance of payments position. To what extent, if any, do members believe that monetary policy has contributed to the recent improvement in our balance of payments?

B. In the opinions of Council members, has there been any recent change in the strength of demand for bank loans by foreign customers?

C. Do members observe any indications of significant improvement in the competitive position of the United States in world trade?

A. The members of the Council believe that monetary policy has contributed to the recent improvement and to the somewhat more favorable short-term outlook on the balance of payments.

B. The members of the Council have not detected any recent significant change in the strength of demand for bank loans by foreign customers.

C. Although underlying trends in wages, prices, and productivity here and abroad tend to be helpful to the United States, the members of the Council have not observed any real improvement in the competitive position of the United States in world trade.

5. Monetary policy.

How do Council members evaluate recent monetary and credit policy?

The members of the Council believe that recent monetary and credit policy has been most appropriate. Domestic business activity has had sufficient strength to accommodate itself to the somewhat less easy credit position and the firming of rates. At the same time, monetary and credit policy has been helpful to our international payments position.

The Council believes the increase in the margin requirements on stock purchases was desirable and timely.

ON NOVEMBER 19, 1963, AT 10:30 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 MR. MC RAE. MR. WALLACE M. DAVIS, PRESIDENT, HIBERNIA NATIONAL BANK, NEW ORLEANS, LOUISIANA, ATTENDED AS ALTERNATE FOR MR. MC RAE.

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

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 12:40 p.m.

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The next meeting of the Council will be held February 17-18, 1964.