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 February 20, 1967, at 9:30 A.M. in the Board Room of The Madison, Washington, D.C. All members of the Federal Advisory Council were present except Messrs. R.E. McNeill, Jr. and A.M. Brinkley, Jr. Mr. George A. Murphy, Chairman of the Board, Irving Trust Company, New York City, attended as an Alternate for Mr. McNeill.

The Secretary provided each member with a list of all the members of the Council for the year 1967, officially elected in accordance with communications received from the Federal Reserve banks.

Mr. John A. Moorhead was elected Chairman pro tem and Mr. Herbert V. Prochnow was elected Secretary pro tem.

The following officers were nominated and unanimously elected:

John A. Moorhead, President
Sam M. Fleming, Vice President
John A. Mayer, Director
Roger D. Knight, Jr., Director
Robert H. Stewart, III, Director
Herbert V. Prochnow, Secretary
William J. Korsvik, Assistant Secretary

On motion duly made and seconded, the salary of the Secretary was fixed at $3,000 annually, and that of the Assistant Secretary at $2,000 annually.

The Secretary presented the financial report for the year 1966, which had been audited by Don O. Noren, Assistant Auditor of The First National Bank of Chicago. The report was approved and placed on file. It will be included in the formal printed minutes.

A motion was adopted authorizing the Secretary to draw drafts for $450 upon each Federal Reserve bank for the secretarial and incidental expenses of the Federal Advisory Council for the year 1967.

The by-laws were approved. The Council approved the Secretary's notes for the meeting of November 14-15, 1966. The printed minutes for all of the 1966 meetings of the Council also were approved subject to subsequent review by the members of the Council.

President Moorhead opened the meeting with a brief discussion of the Council's procedures outlining the confidential nature of the Council's Memorandum to the Board of Governors.

ITEM I A, B, C, D AND E

ECONOMIC CONDITIONS AND PROSPECTS.

A. HOW DOES THE COUNCIL APPRAISE THE GENERAL ECONOMIC OUTLOOK FOR THE FIRST HALF OF 1967, AND FOR THE FULL YEAR?

B. WHAT IMPRESSIONS DO COUNCIL MEMBERS HAVE FROM THEIR CUSTOMER CONTACTS WITH RESPECT TO THE OUTLOOK FOR WAGES, PRICES, AND PROFITS in 1967?

C. RECENT SURVEYS POINT TO MARKED SLACKENING IN GROWTH IN BUSINESS OUTLAYS ON PLANT AND EQUIPMENT. WOULD COUNCIL MEMBERS EXPECT THESE OUTLAYS TO RESPOND PROMPTLY AND VIGOROUSLY IF AND AS FINANCING BECOMES MORE READILY AVAILABLE? IF THE INVESTMENT TAX CREDIT WERE TO BE RESTORED?

D. WHAT IS THE COUNCIL'S JUDGMENT ON THE LIKELY COURSE OF BUSINESS INVENTORIES OVER THE NEXT FEW MONTHS? DOES ANY INVOLUNTARY INVENTORY ACCUMULATION APPEAR TO BE REFLECTED IN CURRENT BUSINESS LOAN DEMAND, OR IN CHANGES IN LOAN REPAYMENT PATTERNS?

E. IN THE JUDGMENT OF COUNCIL MEMBERS, HOW LONG WILL IT BE BEFORE HOUSING ACTIVITY REVIVES SIGNIFICANTLY IN THEIR RESPECTIVE REGIONS, GIVEN THE RECENT SIGNS OF ENLARGED FLOWS OF FUNDS TO MAJOR GROUPS OF MORTGAGE LENDERS?

President Moorhead then read Item I and invited members of the Council to report on conditions and the outlook in their respective districts.

There was general agreement of a slight rise in economic activity during the first half of 1967 with some step-up in the latter half of the year. While a number of members anticipate some further softening in the private sector, particularly in the rate of accumulation of inventories, the expected increase in government spending together with some rise in total consumer expenditures are likely to offset these developments. There also was unanimity among the members that wages will be under strong upward pressure during the year. However, several members cautioned that competition is likely to prevent price increases adequate to absorb rising costs fully and as a consequence profit margins would narrow.

Mr. Murphy indicated that he thought pre-tax corporate profits might rise during the year.

Several members of the Council stated that they were doubtful of this developing and as a matter of fact, thought corporate profits would not increase.

A number of members expressed doubt that business outlays in plant and equipment would promptly and vigorously respond to an increased availability of financing and the restoration of the investment tax credit. While acknowledging that these factors would be helpful, several members mentioned that in present circumstances other forces may be more determining. These would include the fact that business investment has been rising for a number of years and is at an exceedingly high level, profit margins are narrowing, and the rate of growth in over-all demand has lessened. In the discussion of inventories, there was general agreement that the rate of accumulation is likely to moderate considerably over the next few months. Several members noted that many businessmen feel no urgency to liquidate inventories in view of rising prices and that this may alter loan repayment patterns.

The discussion of the housing situation and outlook revealed differences among districts. Most members, however, anticipate some revival of housing activities in 1967 in view of the enlarged flows of funds to major groups of mortgage lenders. A few members added that increasing costs of construction may serve as a deterrent.

ITEM II A, B, C, AND D

BANKING DEVELOPMENTS.

A. WHAT ARE THE PRESENT ATTITUDES OF BANKS WITH RESPECT TO THE ADEQUACY OF THEIR LIQUIDITY POSITIONS?

B. WHAT IS THE COUNCIL'S ASSESSMENT OF THE STRENGTH OF BUSINESS LOAN DEMANDS CURRENTLY AND OVER THE NEXT FEW MONTHS?

C. DO COUNCIL MEMBERS EXPECT ANY SIGNIFICANT RELAXATION OF BANK LENDING POLICIES IN THE NEAR FUTURE?

D. HOW WOULD COUNCIL MEMBERS APPRAISE RECENT AND PROSPECTIVE CHANGES IN DEMAND FOR CERTIFICATES OF DEPOSIT ON THE PART OF VARIOUS KINDS OF BANK CUSTOMERS?

President Moorhead read Item II. A brief discussion followed. The Council concluded that most bankers are not satisfied with their liquidity positions and are desirous of improving them as soon as possible. Several members noted, however, that in some districts, particularly in the rural areas, bank liquidity levels are satisfactory and there is no particular pressure to change them. There was a fairly widespread belief that there is a strong underlying demand for business loans and that this will continue over the next few months. This will reflect, in part, borrowings to cover accelerated tax payments.

Because of the liquidity positions in most banks, the Council does not anticipate any significant relaxation in lending policies in the near future.

A discussion on the outlook for certificates of deposit indicated that bankers anticipate an increased demand for C/D's on the part of various kinds of bank customers. The relative increased availability of funds and the fact that rates offered are competitively attractive are factors contributing to this development. It was acknowledged that there has been some shift of funds from passbook savings to higher yielding consumer certificates.

ITEM III A, B, AND C

BALANCE OF PAYMENTS.

A. HOW STRONG AND WIDESPREAD ARE CURRENT FOREIGN DEMANDS FOR TERM LOANS, SHORT-TERM LOANS, AND ACCEPTANCE CREDITS FROM U.S. BANKS? HAVE SUCH DEMANDS SHOWN RECENT SIGNS OF CHANGING SIGNIFICANTLY?

B. HOW FAR TOWARDS THE LEVEL SPECIFIED IN THE 1967 GUIDELINES WOULD THE COUNCIL EXPECT THE BANKING SYSTEM AS A WHOLE TO EXPAND ITS HOLDINGS OF FOREIGN ASSETS?

C. WOULD THE COUNCIL EXPECT U. S. BANK INDEBTEDNESS TO THE EURO-DOLLAR MARKET TO INCREASE, DECLINE, OR REMAIN ABOUT UNCHANGED IN THE MONTHS JUST AHEAD?

The President of the Council then read the third item on the Agenda. The members reported that they believe there is a strong and widespread current foreign demand for all types of credit from U.S. banks and that this demand has not recently changed significantly. In view of the slight easing in domestic demand, the Council anticipates that the foreign asset holdings of the banking system will approach the 1967 guidelines. Moreover, because of the easing in demand pressures, U.S. indebtedness to the Euro-dollar market is likely to decline as these obligations mature in the months ahead. In general, the rates paid for Euro-dollars have been somewhat above prevailing money market rates in the U.S.

ITEM IV

WHAT ARE THE COUNCIL'S VIEWS ON MONETARY AND CREDIT POLICY UNDER CURRENT CIRCUMSTANCES?

President Moorhead read Item IV. In general the Council approves the easing that characterizes current monetary and credit policy. There was some feeling that in view of the anticipated heavy corporate borrowing to cover the accelerated tax payments in the months ahead, monetary policy should not be changed particularly but that a kind of "sit tight" attitude should prevail. It was subsequently decided to include in the Council's response the hope of favorable consideration by the Congress of a more restrictive fiscal policy -- a reduction in nondefense expenditures, or failing that, an increase in taxes. This will permit a more balanced mix of fiscal and monetary policy rather than the undue reliance on credit restriction which marked much of 1966.

The meeting adjourned at 12:20 P.M.

THE COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING, WASHINGTON, D.C., AT 2:30 P.M. ON FEBRUARY 20, 1967. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MESSRS. R.E. MC NEILL, JR. AND A.M. BRINKLEY, JR.

Messrs. Ralph A. Young and Daniel H. Brill, Senior Advisers to the Board, and Robert C. Holland, Adviser to the Board, together with other members of the Board's staff, participated in an audio-visual review of the economic outlook as outlined by the President's Council of Economic Advisers.

THE COUNCIL RECONVENED AT 5:00 P.M. ON FEBRUARY 20, 1967, IN THE BOARD ROOM OF THE MADISON. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MESSRS. R.E. MC NEILL, JR. AND A.M. BRINKLEY, JR.

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 February 21, 1967. The Memorandum was delivered to the Federal Reserve Building at 6:50 P.M. on February 20, 1967.

The meeting adjourned at 6:15 P.M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON FEBRUARY 21, 1967

1. Economic conditions and prospects.

A. How does the Council appraise the general economic outlook for the first half of 1967, and for the full year?

The Council anticipates a moderate rise in general economic activity during the first half of 1967. During the latter half of the year there is some expectation that the rate of rise may increase slightly. While a number of members of the Council anticipate some further softening in the private sector, as certain self-correcting forces assert themselves--a possible topping out of the capital spending boom, some liquidation of inventories, and a slow-down in consumer buying of durable goods--the expected increase in Government spending and some increase in total consumer spending are likely to offset these developments. As a consequence, the Council believes that over-all business and economic activity in 1967 will continue to rise though at a considerably slower and more sustainable pace.

B. What impressions do Council members have from their customer contacts with respect to the outlook for wages, prices, and profits in 1967?

The members of the Council have the general impression from contacts with their customers that wages will be under strong upward pressure in 1967. As competition is likely to prevent price increases adequate to absorb rising costs fully, profit margins will narrow, with little or no increase in total corporate pre-tax profits.

C. Recent surveys point to marked slackening in growth in business outlays on plant and equipment. Would Council members expect these outlays to respond promptly and vigorously if and as financing becomes more readily available? If the investment tax credit were to be restored?

The members of the Council doubt that business outlays on plant and equipment would promptly and vigorously respond to an increased availability of financing and the restoration of the investment tax credit. These factors would be helpful but in present circumstances other forces may be more determining. These forces would include the fact that business investment has been rising rapidly for a number of years and is at an exceedingly high level, profit margins are narrowing, and the rate of growth of over-all demand has lessened.

D. What is the Council's judgment on the likely course of business inventories over the next few months? Does any involuntary inventory accumulation appear to be reflected in current business loan demand, or in changes in loan repayment patterns?

Most members of the Council believe that the rate of inventory accumulation will moderate considerably over the next few months. While there may be some involuntary inventory accumulation, this is not readily documented from a review of current business loan demand. However, several members reported that some businessmen feel no urgency to liquidate inventories in view of rising prices, and that this may be changing loan repayment patterns.

E. In the judgment of Council members, how long will it be before housing activity revives significantly in their respective regions, given the recent signs of enlarged flows of funds to major groups of mortgage lenders?

Although the judgment of Council members varies somewhat by district, most members anticipate some revival of housing activities in 1967, given the recent signs of enlarged flows of funds to major groups of mortgage lenders. However, the increasing costs of construction may serve as a deterrent.

2. Banking developments.

A. What are the present attitudes of banks with respect to the adequacy of their liquidity positions?

The Council believes that most bankers, especially in the larger cities, are not satisfied with their liquidity positions and are desirous of improving them as soon as possible.

B. What is the Council's assessment of the strength of business loan demands currently and over the next few months?

The Council believes there is a strong underlying demand for business loans and that this will continue over the next few months, reflecting in part, borrowings to cover accelerated tax payments. However, the pressure is not as intense as it was in the latter half of last year.

C. Do Council members expect any significant relaxation of bank lending policies in the near future?

The Council members do not expect any significant relaxation of lending policies in the near future, as banks are not yet satisfied with their present liquidity positions.

D. How would Council members appraise recent and prospective changes in demand for certificates of deposit on the part of various kinds of bank customers?

The Council anticipates an increased demand for certificates of deposit on the part of various kinds of bank customers. This reflects some slowing in economic activity and easing of credit policies, which has increased the availability of funds, and forced the structure of interest rates lower, making corporate CD rates competitive with other market instruments. In addition, there has been a step-up in consumer savings and a shift of funds from passbook savings to higher yielding consumer certificates.

3. Balance of payments.

A. How strong and widespread are current foreign demands for term loans, short-term loans, and acceptance credits from U.S. banks? Have such demands shown recent signs of changing significantly?

The members of the Council believe there is a strong and widespread current foreign demand for term loans, short-term loans, and acceptance credits from U.S. banks. The Council is not aware of any recent significant change in the intensity of these demands.

B. How far towards the level specified in the 1967 guidelines would the Council expect the banking system as a whole to expand its holdings of foreign assets?

The members of the Council anticipate that the foreign asset holdings of the banking system as a whole will approach the 1967 guidelines.

C. Would the Council expect U.S. bank indebtedness to the Euro-dollar market to increase, decline, or remain about unchanged in the months just ahead?

The Council anticipates that U.S. indebtedness to the Euro-dollar market is likely to decline as these obligations mature in the months ahead. By and large, the rates paid for Euro-dollars have been somewhat above prevailing money market rates in the U.S. As a consequence, banks are likely to reduce these liabilities in preference to others.

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

The Council in general approves of the easing that characterizes current monetary and credit policy. Moreover, the Council is hopeful of favorable consideration by the Congress of a more restrictive fiscal policy--a reduction in nondefense expenditures, or failing that, an increase in taxes. This will permit a more balanced mix of fiscal and monetary policy rather than the undue reliance on credit restriction which marked much of 1966.

Because of the balance of payments and inflationary problems, any further significant easing of monetary policy should be contingent upon a more balanced mix of fiscal and monetary policy or a further slowing in over-all business activity.

ON FEBRUARY 21, 1967, 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 MESSRS. R.E. MC NEILL, JR. AND A.M. BRINKLEY, JR.

THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: CHAIRMAN MARTIN, VICE CHAIRMAN ROBERTSON, GOVERNORS SHEPARDSON, MITCHELL, DAANE, MAISEL AND BRIMMER. 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 reproduced and distributed to the members of the Council.

The meeting adjourned at 12:25 P.M.

* * * * * *

The next meeting of the Council will be held on May 15-16, 1967.

A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the Board Room of the Federal Reserve Building in Washington, D. C., at 10:30 a.m. on Tuesday, February 21, 1967.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Simmen, Still, Mayer, Wilkinson, Fleming, Bodman, Moorhead, Knight, Stewart, and Larkin, Members of the Federal Advisory Council from the First, Third, Fourth, Fifth, Sixth, Seventh, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively

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

The following officers had been elected by the Federal Advisory Council to serve for the year 1967:

President	John A. Moorhead
Vice President	Sam M. Fleming
Secretary	Herbert V. Prochnow
Assistant Secretary	William J. Korsvik

The following had been elected members of the Executive Committee to serve with the President (Mr. Moorhead) and Vice President (Mr. Fleming): Roger D. Knight, Jr., Robert H. Stewart, III, and John A. Mayer.

The following members of the Council had begun their service as such at the beginning of 1967 and were attending their first meeting of the Council:

Harold F. Still, Jr., President, Central-Penn National Bank of Philadelphia, Philadelphia, Pennsylvania
John A. Mayer, Chairman of the Board and Chief Executive Officer, Mellon National Bank and Trust Company, Pittsburgh, Pennsylvania
J. Harvie Wilkinson, Jr., Chairman of the Board, State-Planters Bank of Commerce and Trusts, Richmond, Virginia
Frederick G. Larkin, Jr., President, Security First National Bank, Los Angeles, California

George A. Murphy, Chairman of the Board of Irving Trust Company, New York City, represented the Second District at the Council's meeting on Monday in the absence of R. E. McNeill, Jr., member of the Council from that District, who was unable to attend because of illness.[1] However, because of a previous commitment, Mr. Murphy was unable to remain for today's meeting with the Board.

A. M. Brinkley, Jr., member from the Eighth District, also was unable to attend this meeting of the Council.

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

1/ Mr. McNeill, Chairman of the Board of Manufacturers Hanover Trust Company, New York City, began his service as a member of the Council at the beginning of this year.

1. Economic conditions and prospects.

A. How does the Council appraise the general economic outlook for the first half of 1967, and for the full year?

The Council anticipates a moderate rise in general economic activity during the first half of 1967. During the latter half of the year there is some expectation that the rate of rise may increase slightly. While a number of members of the Council anticipate some further softening in the private sector, as certain self-correcting forces assert themselves--a possible topping out of the capital spending boom, some liquidation of inventories, and a slow-down in consumer buying of durable goods--the expected increase in Government spending and some increase in total consumer spending are likely to offset these developments. As a consequence, the Council believes that over-all business and economic activity in 1967 will continue to rise, though at a considerably slower and more sustainable pace.

President Moorhead said not much difference of opinion was reflected in the reports from the individual districts. Generally speaking, it was felt that the second half of the year would show an upward trend but that the first half would be relatively flat.

Governor Mitchell inquired whether the Council's views were close to the projections of the Council of Economic Advisers, and President Moorhead replied that the Advisory Council had not attempted to attach numbers to its forecast. He added, however, that the CEA model predicted a growth in GNP in the order of 4-1/2 per cent. He thought that might be reasonable; it would represent a growth considerably slower than the pace of 1966.

Chairman Martin inquired whether the Council anticipated an appreciable rise in unemployment, and President Moorhead replied that he did not. In the automobile industry and a few others there had been reports of substantial layoffs, but over all he would not anticipate any appreciable unemployment rise. One factor was that additions to the labor force should be less than last year. Another member of the Council suggested that there might be a substantial reduction in overtime.

Governor Mitchell asked whether the Council was apprehensive about the secondary effects of layoffs in the automobile industry, about consumer conditions generally, and about inventory liquidation. He gathered the Council was not sufficiently apprehensive to depart from the general framework of the CEA model.

President Moorhead said he thought that was correct. There was some opinion within the Advisory Council that the CEA model was too optimistic with regard to the revival of housing, a subject that was to be discussed later on today's agenda.

B. What impressions do Council members have from their customer contacts with respect to the outlook for wages, prices, and profits in 1967?

The members of the Council have the general impression from contacts with their customers that wages will be under strong upward pressure in 1967. As competition is likely to prevent price increases adequate to absorb rising costs fully, profit margins will narrow, with little or no increase in total corporate pre-tax profits.

President Moorhead said there was some difference of opinion on this question. Mr. Murphy had felt that over-all profits in the Second District would be up, but he was the only member who felt that profits would be up, at least by any significant amount.

Mr. Larkin said he felt it was necessary, in talking about the West Coast, to divide into two major categories. Industries that were construction oriented would continue to have some problems, but in the broad aerospace category he felt that profits would rise. Thus, there was likely to be a mixed picture.

Governor Robertson recalled that at this time last year a rather general feeling existed within the Council that there would be a significant profit squeeze in 1966, but it did not materialize.

President Moorhead said the Council was more concerned about wages now than a year ago. Many instances were seen where the union leadership seemed no longer to be in control and proposed contracts were rejected by the union membership. The Council foresaw a substantial increase in wages throughout the year, with prices unlikely to increase to the same extent.

Mr. Fleming agreed that the determining factor would be whether industries could raise prices sufficiently to offset the almost universal increase in costs. Some industries would be able to do that better than others. The increase in the minimum wage would squeeze profits drastically for many smaller concerns, while firms with defense contracts were likely to make good money.

Mr. Still expressed doubt that industries would be able to increase productive efficiency this year as much as during the past several years to offset rising wage costs.

Mr. Simmen reported mixed views in the First District. While there was some thinking that profits would be off as much as 5 per cent, there was also some feeling that over-all profits would be relatively stable because in certain sectors it would be possible to increase prices sufficiently to maintain margins.

Mr. Knight noted that the recent boycotting of retail food stores by women began in the Denver area. Many businessmen thought it would not amount to anything, but store profits had suffered as the consumers turned to cheaper foods.

Governor Brimmer brought out that the recent McGraw-Hill survey indicated that profits would be much higher in 1967 on an absolute dollar basis and that margins might not shrink much. He then asked whether the Council had assigned any numbers to the anticipated increase in wages.

President Moorhead observed that 5 per cent seemed to be almost a minimum in current wage settlements. Mr. Fleming mentioned that many companies in his area were not unionized. Anticipating union settlements involving increases of about 5 per cent, nonunion companies were voluntarily increasing wages to beat the gun.

C. Recent surveys point to marked slackening in growth in business outlays on plant and equipment. Would Council members expect these outlays to respond promptly and vigorously if and as financing becomes more readily available? If the investment tax credit were to be restored?

The members of the Council doubt that business outlays on plant and equipment would promptly and vigorously respond to an increased availability of financing and the restoration of the investment tax credit. These factors would be helpful but in present circumstances other forces may be more determining. These forces would include the fact that business investment has been rising rapidly for a number of years and is at an exceedingly high level, profit margins are narrowing, and the rate of growth of over-all demand has lessened.

President Moorhead said the Council would expect that if the investment tax credit was not restored there might be some further postponements of capital expenditures. However, capital spending plans reflect primarily the need of companies for additional plant and equipment. If the need is there, a company is likely to go ahead with its plans whether a tax credit is available or not. The availability of the tax credit had been a substantial reason for plant expenditures, but it was not the overriding reason.

Governor Brimmer referred to a Commerce Department survey published yesterday which indicated that corporations had in fact postponed a substantial amount of expenditures. Turning to the latest McGraw-Hill survey, he noted that it suggested that expenditures in 1967 would be higher than anticipated earlier. He inquired whether the Council members could assign any reasons for this more bullish outlook.

Mr. Fleming referred, by way of illustration, to a printing concern in his area that had run into substantial overtime last year and decided to purchase new equipment in an effort to reduce overtime. Also, with the increase in the minimum wage, many companies were realizing that the only way to maintain earnings was to modernize equipment. He believed there were likely to be substantial expenditures for equipment in an attempt to offset wage costs. In the South, he pointed out, the impact of the minimum wage increases should not be underestimated, for the operations of many companies were geared to the minimum wage.

President Moorhead commented, with regard to the Commerce Department survey, that when companies were asked why they had not gone ahead with their plans it was easy for them to refer to the suspension of the investment tax credit. Actually there may have been a number of more complex factors involved. It could be an oversimplification to say that the whole decision-making process turned on the suspension of the tax credit.

D. What is the Council's judgment on the likely course of business inventories over the next few months? Does any involuntary inventory accumulation appear to be reflected in current business loan demand, or in changes in loan repayment patterns?

Most members of the Council believe that the rate of inventory accumulation will moderate considerably over the next few months. While there may be some involuntary inventory accumulation, this is not readily documented from a review of current business loan demand. However, several members reported that some businessmen feel no urgency to liquidate inventories in view of rising prices, and that this may be changing loan repayment patterns.

Mr. Wilkinson said a number of businessmen were taking the position that, if they were under no great pressure, they should not liquidate inventories because, with prices rising, they would not be able to replenish their inventories at existing cost. There had been no reflection of strong pressure in the form of requests to postpone loan repayments. Retained earnings from 1966 were good, and companies perhaps were using the liquidity available from those retained earnings to help carry their inventories.

Governor Mitchell suggested that some bank customers must have large inventories relative to sales, yet the Council members apparently were not apprehensive.

Messrs. Wilkinson and Still said they saw no need for great apprehension. They pointed out that companies could cut back new production rather than take discounts to reduce inventories. They felt that the existing inventories could be worked off satisfactorily over a period of time.

Governor Mitchell inquired whether the Council members saw any evidence that loan repayments were not coming in because of the inventory problem, and Mr. Wilkinson said there was no such evidence. He mentioned two construction loans that were to be closed out through permanent financing, one in May and one in June. For certain reasons the builders wanted to close out earlier, and to their surprise found that the insurance companies were willing to close out earlier than scheduled. In his opinion the insurance companies had experienced quite a turnaround in their positions. The increase in the volume of policy loans had made them apprehensive until they could see the situation topping out, and that had now occurred. He would say that the insurance companies, while not in as easy a position as in 1965, were in a much easier position than they had expected to be a few months ago.

With respect to loan repayment problems, Mr. Larkin said there were some in the aerospace industry. A lot of loans on the books of many banks were there because of the inventory jam-up. The jet motor problem was perhaps the most important; in that case, inventories had backed up to sub-subcontractors and supply firms. Firms were delaying payments for goods because they could not delay paying their labor costs. The situation was causing a good deal of difficulty, and the end was not in sight.

Asked by Governor Mitchell whether that was a more important problem than the pile-up of inventories in consumer goods industries, Mr. Larkin said he was not qualified to say which was the more important. There were some tender spots in the automobile situation. He felt that some of the inventories could be worked off only at the expense of production.

Chairman Martin noted that nevertheless Mr. Larkin had suggested earlier that profits in the aerospace industry were likely to rise. Mr. Larkin confirmed that that was his view. He felt that a fair amount of cost could be pushed on to the Government.

Governor Mitchell observed that inventory accumulation was at an annual rate of close to $18 billion, a lot of which showed up in goods in process, and Mr. Larkin commented that one might ask why companies did not slow down production. The reason often given was that their skilled labor force was too important and that they did not dare to let those workers go.

Governor Maisel asked whether there was any feeling as to how far the inventory accumulation process had proceeded. In other words, how much of the inventory problem had already been experienced?

Mr. Bodman expressed the view that a very jolting readjustment would be involved if inventories suddenly stopped increasing.

Mr. Still said it was felt in the Third District that inventories, measured in absolute terms, might go down between now and the middle of the year. However, that was not the general view within the Council.

Mr. Knight reported that cattle feeders were holding off on their marketings to some extent, following which Governor Shepardson commented that anyone of experience should know that the longer he held the stock the more he would increase the supply, with less prospect of price improvement. The more weight put on the cattle, the more beef there was to market. The successful feeder moved his cattle when they were ready to go. Mr. Knight noted that nevertheless there was always a temptation to hold out temporarily in the hope that prices would go up.

Governor Mitchell then inquired whether any of the Council members were apprehensive about the inventory positions of their customers.

Mr. Larkin replied that, while no great pressure was being exerted, the matter was being discussed all the time. President Moorhead said he thought there was some pressure on auto dealers. In his area the used car situation was quite good, however, perhaps because not so many used cars were being taken in recently. Mr. Knight said that in his area there were relatively few independent dealers, the manufacturers having gradually taken over most of the dealerships.

Governor Shepardson inquired whether any of the Council members were familiar with the NFO (National Farm Organization) program to encourage accelerating the slaughter of cows and sows with a view to cutting down the supply in the longer-run period ahead.

Mr. Knight said pressure in that direction had been seen in some instances. President Moorhead commented that, while he did not know how effective the program had been, at least it was a better approach than dumping milk on the highways.

Mr. Fleming reported that conversations with representatives of the Sears and Penney organizations in his area revealed no particular concern about inventories. Although inventories were regarded as somewhat high, it was believed they could be worked off within the next few months. Undue pressure to work them down might result in shortages of selected types of inventories, leading in turn to loss of sales to an extent that would cost more than carrying the larger inventory. They were trying hard to get inventories balanced and not to cut back on fast-moving items.

Mr. Simmen said there had been a lot of inventory build-up in the First District in anticipation of defense spending and some plants had been ordered by company headquarters to reduce inventories or to postpone capital expenditures until inventories were cut back.

Mr. Still remarked that he thought a number of banks would have difficulty in keeping their volume of consumer instalment credit at last year's levels. The man in the street did not seem to have quite the same sense of confidence as a year ago. When that happened, the consumer tended to put more money in savings and not to spend so freely.

Governor Mitchell commented that that was certainly what the statistics suggested. However, the statistics were sometimes difficult to interpret.

Mr. Bodman noted that the rate of saving had increased quite substantially in the past couple of months. His bank had not expected much of an increase in January and February, but it had experienced a large increase. The rate of decline in passbook savings had slowed down, and the 5 per cent savings certificates were going well. The savings and loan associations were enjoying substantial gains.

Mr. Stewart said that while he doubted that any banks were gaining in passbook savings in his area, the decline had leveled off.

Mr. Mayer reported that in his area there were even moderate gains in passbook savings. The savings and loans and the mutual savings banks were doing well. That situation was characteristic of a period when people could not see so clearly into the future. Also, it might be that the rate of debt to disposable income had reached the point where people were uncomfortable about incurring more debt.

Mr. Larkin suggested that there had been so much talk about tight money that people might be assuming money was not available.

Mr. Wilkinson commented that his bank had stopped advertising for consumer loans in February 1966. The volume kept moving up through November, but now the bank had started advertising again because repayments were exceeding new extensions of credit.

President Moorhead referred to a boat builder in his area who could not turn out boats fast enough to meet the demand. The same thing was true with snowmobiles. The situation in many consumer durable goods areas evidently was quite strong. Perhaps after three good years the automobile business was due for some slowdown.

E. In the judgment of Council members, how long will it be before housing activity revives significantly in their respective regions, given the recent signs of enlarged flows of funds to major groups of mortgage lenders?

> Although the judgment of Council members varies somewhat by district, most members anticipate some revival of housing activities in 1967, given the recent signs of enlarged flows of funds to major groups of mortgage lenders. However, the increasing costs of construction may serve as a deterrent.

President Moorhead reported some difference of opinion within the Council and some skepticism that housing starts at an annual rate of 1.6 million could be achieved by the fourth quarter of this year.

Mr. Larkin expressed the view that the problem was not going to be solved quite that fast in his area. The peak in residential starts was reached in 1964, so a considerable decline already had been experienced before anyone became concerned about the supply of mortgage money. The lessening of the supply of such money merely aggravated the situation. With continued population growth, the problem would be taken care of in due course; the area had gone through many such cycles over a long period of time. While there were still vacancies in considerable volume, developments should follow the national pattern to some degree, and the increased supply of money would certainly help. As to single-family housing, however, it would take atleast six months to get new developments in process and a year before the houses were ready for occupancy. In short, he doubted that the recovery in housing would proceed as rapidly as the model of the Council of Economic Advisers suggested, although the national totals should begin to rise. In response to a question, he said that the vacancy rate in Southern California was well under 1965.

Governor Maisel inquired whether any Council members felt that the recovery would proceed faster than anticipated. He referred to the impressive January figures as suggesting the possibility that the situation may have turned around faster than expected.

Mr. Still said he believed the general feeling was to the contrary and that the January figures were probably a fluke.

Governor Mitchell inquired whether the banks were ready to go into new housing now or still preferred to stay away from it.

Mr. Still commented, in reply, that his bank had not opened the doors wide. Mr. Bodman reported that his bank was advertising for mortgage loans, and President Moorhead said his bank was doing its first advertising for a long time. Mr. Simmen remarked that his bank had been in the mortgage loan business continually for years. Mr. Wilkinson predicted that mortgage loans in many bank portfolios would be down more than desired by June and said his bank was taking active steps to build up its portfolio, being aware of circumstances such as Mr. Larkin had cited.

Mr. Fleming commented that there had been a lot of apartment-house building in his area in recent years. Whereas two-bedroom apartments were formerly offered at perhaps $95 a month, similar new apartments would have to rent for at least $120 a month. In the single-family dwelling field many carpenters who called themselves contractors had now gotten defense jobs and were making good money. They would not be inclined to leave those jobs and turn to building a few new houses. Speculative builders of the type who obtained tracts of land and the financing to put up houses in quantity would have trouble getting started again, one reason being that there was no significant unemployment in the construction field. It would take quite a while for such contractors to get organizations built up, buy land, put in utilities, and get tooled up for production.

Mr. Knight said that in his area banks had lost savings accounts while savings and loans had gained substantially. Now the savings and loans wanted to come around and buy mortgage loans from the banks. That would not help the builder much. He did not foresee any building boom in his area.

2. Banking developments.

A. What are the present attitudes of banks with respect to the adequacy of their liquidity positions?

> The Council believes that most bankers, especially in the larger cities, are not satisfied with their liquidity positions and are desirous of improving them as soon as possible.

President Moorhead reported that there had been a good deal of discussion of this topic by the Council. Liquidity, he noted, involves many things. While loan demand was less frantic at present, the comparison was with a near-crisis period. The money center banks were still depending largely on certificates of deposit for liquidity, and memories of what had happened last fall were fresh.

Mr. Mayer said his bank would be pleased if certain customers would refinance some of their loans on a long-term basis. A number of customers had borrowed from the bank principally to get better rates, and the loans had no place in a bank portfolio on a permanent basis. The bank would be glad to have some of those loans move out, as several had already this year.

Chairman Martin referred to the heavy calendar of new corporate issues and asked whether they appeared to be directed mainly toward the repayment of bank loans.

Mr. Mayer replied that some were, some were not. The steel industry issues were designed to enable the companies to maintain programs in which they were already engaged, programs that must be completed to be worth much in terms of a pay-off.

Governor Brimmer asked if Council members had views as to the reasons for the rush into the long-term market at present. He noted that as recently as a month ago no one would have forecast such a calendar.

Mr. Stewart believed the more favorable rate situation was the principal factor, for example in the case of utilities, which were moving into the market heavily. President Moorhead agreed with that observation, while Mr. Simmen pointed out that in the case of certain corporations liquidity was a problem. Mr. Mayer commented that some corporations had exhausted their bank lines. They did not have much flexibility, and they needed money to complete various programs.

Governor Brimmer inquired about the outlook for the future, and President Moorhead said that when corporations had been looking at a 6 per cent market and now found money available at 5-1/4 per cent, that was tempting to them. There was also uncertainty as to how long the present rates would hold.

Mr. Larkin referred to a feeling among many industrialists that the longer-range outlook was inflationary. They knew that they would need more money sooner or later, and with rates down at present they were moving in fast.

Governor Mitchell referred to the Council's statement that banks were not satisfied with their liquidity positions and inquired what would make them satisfied.

President Moorhead replied that the banks did not like to have their liquidity rely so heavily on certificates of deposit that were, among other things, subject to an interest rate ceiling. Also, a lot of the banks' secondary reserves were not truly liquid. In the case of many banks, virtually all of their Government securities were pledged. There had been a slight easing of loan demand, but that situation could change rapidly. If it did, the banks could quickly find themselves in a situation similar to that of last fall. They were presently more comfortable, but only in comparison with a period of near crisis.

Mr. Mayer commented that if a bank's customer mix was heavily larded with industries like steel and aluminum and those customers were known to have large capital needs over the next several years, the bank was impressed that it would be called upon from time to time to step up and fill the market basket for those customers before they did long-term capital financing.

Governor Maisel said he would understand from these comments that if a bank had a build-up of CD's it must put a discount on them as compared with other types of deposits, and several Council members replied in the affirmative.

Mr. Fleming observed that customers might come in again and seek credit beyond what would normally be expected. Then the banks must look at the composition of their available funds. Passbook savings had stopped growing for about two years. Certificates of deposit had now increased to about $18 billion, and the rate ceiling would not permit the banks to compete with other market instruments beyond a certain point. Only quite recently the banks had been struggling to retain their CD's on a 30-day basis. In short, the banks were depending for their raw material largely on funds on which they could not count for stability.

Governor Mitchell noted that although the Council had forecast a relatively flat economy, liquidity objectives appeared to be related to the situation that prevailed in 1966.

Mr. Fleming pointed out that the banks had been given a good scare only about four months ago, and Mr. Stewart referred again to the heavy dependence of banks on certificates of deposit as the only real source of deposit growth.

Governor Mitchell said he gathered the Council felt some further downward movement in rates would be required to produce growth of passbook savings and that otherwise the banks were left in a position where they could rely only upon consumer- and business-type CD's for growth.

Mr. Mayer agreed and said that from the banker point of view the quality of consumer-type CD's was not as good as the quality of passbook savings. The funds represented by the CD's were a little more nervous.

Mr. Wilkinson said that the banker rated consumer-type CD's midway between passbook savings and large negotiable CD's. Some of the CD's involved investment money that would move with a rate differential of as little as 1/2 per cent. Investor sophistication, particularly in the money centers but in other places also, was vastly greater than five years ago.

Governor Mitchell then asked whether the banks would use a 4-1/2 per cent rate ceiling on savings accounts if they were given that latitude.

Several Council members indicated that they would. However, Mr. Mayer suggested that banks might want to think about that for a while because payment of the higher rate would mean a substantial cut in earnings. Mr. Wilkinson added that much would depend on the level of competitive rates; he was not sure that everyone would jump to 4-1/2 per cent. Mr. Bodman indicated that he would be inclined to go to 4-1/2 per cent, and Mr. Stewart commented that that should be a help to bank liquidity. Mr. Fleming observed that banks in Tennessee could not go higher than 4 per cent due to State law.

Mr. Larkin said his bank had had about $2 billion in passbook savings. When the 5 per cent savings certificate was introduced, about $1/4 billion moved into the certificates, but the bank still had about $1-3/4 billion of savings accounts at 4 per cent. With savings and loan associations paying 5.37 per cent (on the basis of daily compounding) a move by the bank to 4-1/2 per cent on savings deposits probably would have no appreciable result except to cost the bank money.

Mr. Moorhead noted that the situation varied by districts. He felt that banks in his area could make some inroads if they went to 4-1/2 per cent.

Chairman Martin recalled that at the last meeting of the Board and Council nearly all of the Council members were in favor of raising the savings deposit ceiling rate. However, there appeared to be a mixed opinion today.

President Moorhead replied that at the time of the last meeting the savings deposit maximum rate was more clearly out of line with other rates and that fact influenced the Council to favor a change.

Mr. Wilkinson suggested that much would depend on the movement of bank loan rates. Payment of 4-1/2 per cent would have been a desirable way for banks to acquire raw material under rate conditions such as prevailed at the time of the last meeting. But if lending rates were going to soften, the situation became different.

Mr. Still remarked that with banks depending more and more on time money, they were looking more closely at the price paid against the price received. There was concern about bank profit margins. Last year the banks showed record per share earnings, but examination of many annual reports revealed that the relationship of net earnings to gross continued to decline.

> B. What is the Council's assessment of the strength of business loan demands currently and over the next few months?

> The Council believes there is a strong underlying demand for business loans and that this will continue over the next few months, reflecting in part, borrowing to cover accelerated tax payments. However, the pressure is not as intense as it was in the latter half of last year.

President Moorhead said the Council could foresee a fairly flat economy yet a rising demand for loans, particularly in terms of the tax periods ahead.

Governor Maisel said it seemed implicit in the Council's answers to three of the questions on the agenda that a flat economy would not change business views materially as to the amount of investment that would be necessary over the next few years. Traditionally that had not been the case. He wondered why the Council felt that the situation was now different.

Mr. Fleming commented that the economy was flattening out at a very high level, and it would take a lot of money simply to maintain the economy at such a level.

Mr. Mayer said that the aluminum and steel industries had made a bet and must live with it. They realized that, and they were not sufficiently worried to change their plans. They also foresaw the danger of increased foreign competition and knew the only way to deal with it was to achieve greater efficiency.

Mr. Wilkinson expressed the thought that the consumer, barring a severe jolt, had not turned away from rising expectations for himself and his family. The consumer apparently was simply playing it cool in an uncertain period.

Governor Mitchell suggested that a pause in the economy for six months could do quite a bit in terms of expectations. There might be a period in the first half of this year during which conditions would be flat enough that some people would speak of a recession, particularly if the index of industrial production continued to falter. If the economy was still flat after nine months, that probably would make quite a difference in business expectations.

President Moorhead said he did not sense any great degree of pessimism among businessmen regarding the longer-run future, although it might be that a change in psychology could develop over a shorter-run period.

Mr. Bodman said, in reply to a question, that he did not think people in Detroit were as upset as stories in the press might suggest. They felt that this would be a reasonably good year, and there was no sense of panic.

Governor Maisel recalled that in 1957 auto companies walked away from plants that were partially completed, but Mr. Bodman said he could not remember that occurring in any widespread manner. He went on to say that there could be a rise in GNP and at the same time a decline in the index of industrial production, and he asked what that would mean in terms of the Federal budget.

Governor Mitchell replied that while such a trend would have some impact on the tax yield, offhand he did not think it would do much else over a relatively short period of time. Continuing activity at the current high level was not especially injurious to anything except expectations and what might be called the decelerator effect. If the economy went along on a flat basis, it could easily turn down, particularly if expectations were disturbed, and the situation could snowball.

Mr. Bodman observed that a large Federal deficit at such a time could create a real bind.

Governor Brimmer asked the Council members to comment on the trend of loan demand since around November, and President Moorhead replied that the situation varied somewhat by district. In his area loan demand had been flat, with virtually no change. Mr. Bodman said that loan demand in his area had followed a high-level seasonal pattern so far this year, and Messrs. Still and Wilkinson concurred in that observation.

Governor Brimmer then inquired whether greater loan demand was expected primarily for tax purposes, and President Moorhead said he felt there was a great deal of pent-up demand for loans that the banks had been turning down last year.

In response to a question by Governor Daane, several Council members said that the banks had not yet opened the doors for that type of loan. Mr. Wilkinson observed that it took some time for banks to adjust. They had gone through a trying period and could not be expected to turn around in a matter of 30 days. But he was convinced that that could come about later.

Mr. Still said that in the Third District loans always went up in the spring. They had done so since World War II, and he expected to see that kind of seasonal pattern superimposed on the high current loan levels this year. He did not anticipate that the rise would be comparable to last year on a percentage basis, but the banks would be making more loans in dollar volume.

C. Do Council members expect any significant relaxation of bank lending policies in the near future?

The Council members do not expect any significant relaxation of lending policies in the near future, as banks are not yet satisfied with their present liquidity positions.

President Moorhead said that that was the majority view. In his own view, if monetary policy continued to be relatively easy, there would be some relaxation. Generally speaking, however, the banks appeared to be holding about the pattern of last year in terms of loans they would make and those they would not.

Governor Brimmer inquired whether pressure on the prime rate was foreseen, and President Moorhead replied that that was a great puzzle. He had thought a few weeks ago that the trend was downward and that the Chase prime rate of 5-1/2 per cent might prevail, but he was less sure now. The banks saw a substantial loan demand ahead; they did not know what the tax periods might bring. If he was right in his feeling that loan demand was still strong, and if the business situation did not deteriorate, he thought loan rates might hold or even increase.

Mr. Fleming said that the consumer sector was still the main source of bank funds, and the cost of those funds was high. It would be difficult to cut loan rates and still make a profit. The cost of bank operations was up significantly, with salary costs increasing at perhaps 5 per cent a year.

Mr. Wilkinson thought it was inevitable, with operating costs increasing, that banks would have to stay quite fully loaned in comparison with past standards. They could not move their loan-deposit ratios much below 65 per cent and hope to carry the prevailing cost structure.

Mr. Mayer observed that bank customers were growing faster than the banks, and Mr. Bodman agreed. Mr. Wilkinson added that he thought it would be necessary to produce a whole new set of liquidity standards over a period of time. The banks, by virtue of their experience last year, were going to find themselves examining and relying more on internal liquidity and turnover than before, but the new standards would take some time to develop.

Mr. Mayer observed that pledging requirements presented a serious problem. The government was growing, and the government's share of deposits was already substantial. Thus, a lot of bank funds were being tied up. He would personally favor some form of government insurance. There should be some relationship to the size of bank capital, however, for one should not place a premium on loose handling of government funds.

There followed some discussion of the volume of government deposits relative to total deposits and of collateral requirements, along with possibilities for achieving some relaxation of collateral requirements for State and local government deposits over a period of time. Mr. Larkin mentioned that one part of the problem lay in the fact that most government treasurers wanted collateral maintained up to the maximum amount of their deposits in the bank on any one day during a year. Thus, the securities pledged were far in excess of the average deposit level.

D. How would Council members appraise recent and prospective changes in demand for certificates of deposit on the part of various kinds of bank customers?

The Council anticipates an increased demand for certificates of deposit on the part of various kinds of bank customers. This reflects some slowing in economic activity and easing of credit policies, which has increased the availability of funds and forced the structure of interest rates lower, making corporate CD rates competitive with other market instruments. In addition, there has been a step-up in consumer savings and a shift of funds from passbook savings to higher yielding consumer certificates.

President Moorhead commented that the Council was saying essentially that ample funds should flow into CD's when the rates were competitive, but that those funds would flow out if the rates were not competitive.

3. Balance of payments.

A. How strong and widespread are current foreign demands for term loans, short-term loans, and acceptance credits from U.S. banks? Have such demands shown recent signs of changing significantly?

The members of the Council believe there is a strong and widespread current foreign demand for term loans, short-term loans, and acceptance credits from U.S. banks. The Council is not aware of any recent significant change in the intensity of these demands.

B. How far towards the level specified in the 1967 guidelines would the Council expect the banking system as a whole to expand its holdings of foreign assets?

The members of the Council anticipate that the foreign asset holdings of the banking system as a whole will approach the 1967 guidelines.

C. Would the Council expect U.S. bank indebtedness to the Euro-dollar market to increase, decline, or remain about unchanged in the months just ahead?

The Council anticipates that U.S. indebtedness to the Euro-dollar market is likely to decline as these obligations mature in the months ahead. By and large, the rates paid for Euro-dollars have been somewhat above prevailing money market rates in the U.S. As a consequence, banks are likely to reduce these liabilities in preference to others.

President Moorhead said the Council members were somewhat surprised that U.S. bank indebtedness to the Euro-dollar market had not decreased more rapidly than it had up to this point. He then turned to Mr. Prochnow, who commented that his bank was letting such obligations run off as they matured. The rate paid for Euro-dollars was out of line with U.S. money market rates last fall, and it still was, although recently it was a toss-up ratewise between borrowing Euro-dollars or Federal funds.

Mr. Prochnow added that there was, of course, a broad, complicated problem in terms of where the Euro-dollars would go if U.S. banks reduced their liabilities. He thought they would run into the same market as before, so he was not sure that the liquidity position domestically would really change a great deal. A risk would be involved to the extent that the Euro-dollars found themselves in the hands of monetary authorities abroad.

Governor Brimmer inquired why the Council was so convinced that the foreign asset holdings of the banking system as a whole would approach the level specified in the 1967 guidelines of the voluntary foreign credit restraint program.

President Moorhead said Mr. Murphy had felt there was a great deal of pent-up foreign demand, and that view was shared by the Council.

Mr. Larkin reported having talked with several bankers about this question. The consensus was that banks had held back from taking on foreign commitments when the domestic pressures were so great and corporations were pressing the banks so hard. That pressure having eased somewhat, there would be a tendency for dollars to move out within the limits of the guidelines. His bank had had a number of situations presented to it in the past week or so; one looked attractive, the others did not. The people with whom he had talked said that they detected no increase in the interest of foreigners, but only because the interest had been there continuously. The key point was that many banks were interested in foreign business. Last year, because of the pressures and problems in the domestic economy, the banks tended to hold back, but they would gradually start increasing their foreign asset holdings again. Thus, it appeared probable that the banking system would come closer to the guideline ceiling this year than last year.

Mr. Mayer said his bank had seen more proposals in the past month than in a long time. It had turned them all down, but under other circumstances it probably would not.

Chairman Martin asked for the Council's views about the balance of payments problem in general, and President Moorhead replied that it was a difficult situation to which he did not pretend to have an answer. Among other things, the Council had in mind the matter of international rate relationships. If domestic short-term rates were to drop much further, that could mean a substantial outflow of dollars. The Council did not see the solution.

Mr. Larkin mentioned that the figures shown to the Council yesterday by the Board's staff were somewhat encouraging in terms of the trade balance, but that was only a part of the total problem. Mr. Bodman commented that he did not think the Federal budget was very encouraging to the solution of the problem because of the budget's inflationary characteristics.

Mr. Fleming referred to various elements of the balance of payments problem, including the war in Vietnam, foreign travel by U.S. residents, and the maintaining of U.S. troops abroad. It might be possible to achieve a better trade surplus, but only if costs did not rise too much domestically. In sum, he felt that the balance of payments situation was critical.

Mr. Wilkinson said he felt military expenditures might well be greater than predicted in the budget figures.

Mr. Still referred to the concern that had been expressed about rising costs and said that if they went up as much as anticipated the trade balance might not develop as favorably as the staff charts had indicated yesterday. Mr. Fleming added that rising steel costs might stimulate imports.

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

The Council in general approves of the easing that characterizes current monetary and credit policy. Moreover, the Council is hopeful of favorable consideration by the Congress of a more restrictive fiscal policy--a reduction in nondefense expenditures, or failing that, an increase in taxes. This will permit a more balanced mix of fiscal and monetary policy rather than the undue reliance on credit restriction which marked much of 1966.

Because of the balance of payments and inflationary problems, any further significant easing of monetary policy should be contingent upon a more balanced mix of fiscal and monetary policy or a further slowing in over-all business activity.

President Moorhead remarked that the Council was saying, in essence, that it favored maintaining the status quo for the time being as far as monetary policy was concerned.

When Governor Brimmer inquired how the Council defined status quo, President Moorhead replied that the Council favored no particular further easing of monetary policy at this time. It favored no change in reserve requirements, the discount rate, or the thrust of open market operations. Conditions were in a pleasant equilibrium judged by former standards. The Council would want to wait and see what happened to loan demand in March and April, what happened in terms of the economy over the next few months, and what fiscal action was taken by the Congress.

Governor Brimmer observed that the three-month bill rate was now around 4.6 per cent, Federal funds were trading in the 5 to 5-1/4 per cent range, and there was a heavy forward calendar of corporate issues. He inquired whether these were conditions that the Council had in mind in recommending a continuation of the status quo, and President Moorhead indicated that he thought so.

Mr. Still pointed out that there had been a substantial reduction of net borrowed reserves since November, from roughly \$400-\$500 million to around zero. He guessed that historically this was a sharp movement during such a short period, and it would take time for the money markets to adjust. The Council would like to stay about in the present situation for a while and let the markets adjust.

Governor Mitchell inquired whether the Council would be likely to favor a change after the April tax date, and President Moorhead said that could happen. Mr. Mayer said he could not see beyond the tax date very clearly, but he did foresee an increase in loans at that time. Messrs. Wilkinson and Larkin agreed. The latter added that the banks were sensitive because of their experience last fall. They foresaw some increase in loans around tax time, and they were not about to get tied up too much in the meantime.

Balance of payments. Governor Robertson said that he would like to explore what specific steps the Council members would propose to deal with the balance of payments problem, assuming that there was a deep interest in the problem and that it was regarded as serious. He asked first whether the members would favor pulling back U.S. troops from Western Europe, and several indicated that they would. He then inquired whether the members would favor placing restrictions on foreign travel by U.S. residents, and only one member (Mr. Fleming) replied in the affirmative. Mr. Fleming explained that although he would place no restriction on letting U.S. residents travel abroad, he would make that travel somewhat more costly.

Mr. Bodman said he would use every opportunity to curtail nondefense expenditures in order to defend the dollar. He felt that that would improve the confidence of foreigners, particularly Europeans. Governor Robertson inquired how that would cut down the outflow of dollars, and Mr. Bodman replied that he thought the confidence of foreigners who controlled dollar balances and short-term investments that could be converted into gold would be improved if the U.S. showed evidence of a valiant effort to maintain the purchasing power of the dollar. If such evidence was seen, foreigners should be more inclined to hold dollars. Also, such an effort would indicate that the U.S. was trying to be more competitive pricewise in foreign markets and thus achieve a better trade balance.

Governor Brimmer inquired whether Council members would favor extending the interest equalization tax to short-term bank loans or direct foreign investments.

Mr. Fleming replied that whenever an effort was made to pick out measures to deal selectively with any particular facet of the balance of payments problem, it might be found that correction of the one problem would give rise to other difficulties. In his opinion the balance of payments situation was so critical that everything possible should be done to try to correct it. With only $2-1/2 billion of free gold available, there should be a massive attack on the over-all problem in order to restore confidence. He felt that the American public would go along with such an approach in the circumstances.

President Moorhead then asked Governor Robertson for his solution, and the latter replied that he refused to pass judgment on military requirements, for he could not pose as an expert in that area. As to foreign travel, he agreed with the view that that was a very delicate area. He did know, however, that a large volume of dollars continued to be invested and loaned abroad. The only effective method that he saw of correcting the dollar outflow was to impose a tax to eliminate the interest rate or profit gap between investments abroad and investments in the U.S. He would favor a flexible tax that could be applied according to the circumstances prevailing at any given time.

Governor Robertson noted that there had been efforts on the part of the Government to curtail the outflow of dollars through foreign aid and through the military establishment. The travel situation had been explored, with careful consideration given to the benefits and disadvantages of imposing restrictions. The judgment had been that for the long pull it was better to concentrate efforts on inducing foreigners to travel more in this country, as opposed to preventing U.S. residents from traveling abroad, and he agreed with that judgment.

Mr. Prochnow observed that Governor Robertson's solution ran toward placing restrictions on the private sector. However, if such restrictions were relied upon increasingly, that would curtail the inflow from foreign earnings in the future. Also, a pressing down on private transactions would probably tend to encourage foreign aid expenditures. And it was clear from the record that the military establishment would spend several times as much abroad if the dollars were available. In short, he felt that exertion of pressure on private investment might simply open the floodgates for outflows of dollars through military spending and foreign aid.

Governor Robertson commented that he would favor pressing down on private investment but not opening the gates on the other side. He would favor pulling back troops to the extent possible, and he would insist on more efficient use of foreign aid funds. In substance, he would focus on the entire problem, both public and private, at the same time.

Governor Daane remarked that the Council might well get seven different solutions from members of the Board. Personally he would emphasize the need for maintenance of relative price stability. If the inflationary battle was lost, that would necessitate one restriction after another.

Governor Robertson agreed that it was vital to strive for price stability, without which the chances for an improved export position would be lost. He thought everyone would agree on that point; it was, in fact, the fundamental basis on which the Federal Reserve System operated. It was a condition precedent to anything else that might be suggested to deal with the balance of payments problem. Nevertheless, despite everything that had been done to maintain price stability in the past several years, there had still been a large dollar outflow.

In reply to a question about the impact of expenditures for the war in Vietnam, Governor Robertson brought out that even if the war should terminate soon, troops could not be pulled back immediately. And the program of foreign aid to that area might well have to be increased for some time.

Chairman Martin inquired how the Council members would propose to handle a gold crisis if it should occur; that is, whether they would prefer demonetization and an embargo or, in the alternative, removal of the gold cover requirement and a paying out of gold to the extent necessary.

Mr. Mayer indicated that he would consider the latter alternative preferable. He believed that the imposition of an embargo would cause the dollar to lose standing as a reserve currency all over the world.

Chairman Martin remarked that the longer-run solution to the balance of payments problem really lay in an increase in the trade surplus sufficient to cover the deficit in other accounts. How to achieve that goal was another question.

Mr. Fleming expressed the view that a fundamental decision was needed quickly. Removing the gold cover against note liabilities would, he thought, have a more pronounced psychological impact than removing the gold reserve requirement against Federal Reserve Bank deposits, particularly in the rural parts of the country. Before that move became necessary, he felt there should be massive over-all attack on the balance of payments problem. In a situation such as Chairman Martin had described, no good alternatives would be available.

It was agreed that the next meeting of the Federal Advisory Council would be held on May 15-16, 1967.

The meeting then adjourned.

Secretary