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.

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

The Secretary's notes of the meeting of the Federal Advisory Council on November 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 Mr. Frederick G. Larkin, Jr. Mr. Ransom M. Cook, Chairman, Executive Committee, Wells Fargo Bank, San Francisco, California attended as an Alternate.

The Council approved the Secretary's notes for the meeting of September 18-19, 1967.

Fleming expressed appreciation on behalf of the other members of the Council for the contributions of John Moorhead during his term as President of the Council.

ITEM I A

ECONOMIC CONDITIONS AND PROSPECTS.

A. HOW DOES THE COUNCIL APPRAISE THE GENERAL ECONOMIC OUTLOOK FOR THE NEXT 6 MONTHS? THE OUTLOOK FOR WAGE AND PRICE DEVELOPMENTS?

B. WHAT IMPRESSIONS DO COUNCIL MEMBERS HAVE FROM THEIR CUSTOMER CONTACTS WITH REGARD TO THE TREND OF PROSPECTIVE BUSINESS OUTLAYS (1) FOR CAPITAL INVESTMENTS AND (2) FOR INVENTORIES?

C. WITH RESPECT TO RESIDENTIAL CONSTRUCTION, ARE MORTGAGE FUNDS JUDGED TO BE ADEQUATE TO MEET CURRENT AND NEAR-TERM DEMANDS IN THE COUNCIL MEMBERS' RESPECTIVE REGIONS? DO PRESENT LEVELS OF INTEREST RATES ON MORTGAGES APPEAR TO BE DETERRING POTENTIAL HOME BUYERS?

President Moorhead read Item I A, B and C and invited the members of the Council to comment on the outlook and on developments in their respective districts. An extended discussion followed. In general, the members indicated that they anticipate a continued rise in the level of economic activity in the next six months. Several thought that the events of the past weekend, however, would tend to restrain the expansion until some of the present uncertainties are resolved. There was some feeling that business in recent weeks had been adversely affected by strikes, particularly in the automobile industry,

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but that this was likely to be partially offset in the months ahead. Several members said that in the latter half of the period business would be stimulated by an expansion in steel inventories as users step up their buying in an attempt to hedge against a possible strike in that industry. There was wide agreement that wage settlements would follow the generous pattern established in recent negotiations. This would result in additional upward pressures on the price structure. Price rises, however, might be limited because of competitive conditions, thus narrowing profit margins.

Some of the members of the Council felt that the rise in capital outlays might be more moderate than some of the recent surveys suggest, although this situation did vary somewhat from district to district. The sharp rise in wage costs, however, tends to force management to maintain investment expenditures in an effort to improve productivity. From their customer contacts, the members of the Council have the impression that businessmen seem reasonably satisfied with the level of inventories. As a consequence, only limited growth is anticipated with the possible exception of automobiles and steel. A discussion of the construction and residential mortgage situation indicated that there were adequate funds to meet current and near-term demands. Moreover, the members had no evidence that the present level of interest rates were deterring potential home buyers. Several Council members reported, however, that the 6 per cent ceiling on mortgages that prevails in some states has tended to channel funds from typical mortgage lending sources into alternative higher yielding investments. Despite this, most members reported a relatively large volume of residential construction in their respective districts.

ITEM II A

BANKING DEVELOPMENTS.

A. WHAT IS THE COUNCIL'S ASSESSMENT OF THE PROBABLE STRENGTH OF BUSINESS LOAN DEMANDS OVER THE NEXT 6 MONTHS?

President Moorhead read Item II A. It was quickly determined that the members of the Council thought that the events of the past weekend could precipitate a sharp rise in loan demand as corporate borrowers and others uncertain about the future take down funds under present commitments and lines. Thereafter, the Council expects loan demand to remain strong following the customary seasonal decline early in the year.

ITEM II B

B. IN THE COUNCIL'S JUDGMENT, ARE BANK LIQUIDITY POSITIONS STILL IMPROVING? WHAT ARE CURRENT POLICIES OF BANKS REGARDING PREFERRED TYPES AND MATURITIES OF INVESTMENTS?

The President of the Council then read Item II B. The Council reported that although liquidity ratios are improving, more slowly in recent weeks, bankers continue to be somewhat uncomfortable since such a large portion of their deposit growth this year has been in

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the time deposit category and thus subject to Regulation Q ceilings with the risk of disintermediation. This concern, which the events of the past weekend intensified, has been an important factor in persuading most bankers, particularly in the money centers, to confine their investments to relatively short maturities.

ITEM II C

C. HOW WOULD THE COUNCIL APPRAISE RECENT AND PROSPECTIVE CHANGES IN MARKET DEMANDS FOR LARGE-DENOMINATION C/D'S OF VARIOUS MATURITIES? FOR CONSUMER-TYPE C/D'S AND SAVINGS DEPOSITS?

President Moorhead read Item II C. A brief discussion followed. Because of the risk of disintermediation, bankers are concerned about their ability to meet prospective loan demands. As a consequence, rates on larger denomination C/D's have risen to their present high levels. Should the rate on alternative short-term investments rise much further, bankers believe they will find it increasingly difficult to maintain present C/D balances. Accordingly, several members suggested that the Council urge the Board to consider raising the interest rate ceiling on large denomination negotiable C/D's. The Council also acknowledged that consumer-type C/D's, and to a lesser extent savings deposits, are subject to some of the same risks. There is little evidence so far of the channeling of any consumer savings funds into alternative investments.

ITEM II D

D. WHAT ADDITIONAL STEPS, IF ANY, SHOULD BANK SUPERVISORS TAKE, OR ENCOURAGE BANKS TO TAKE, IN ORDER TO HELP COMBAT THE RECORD VOLUME OF INTERNAL CRIMES (EMBEZZLEMENTS) AND EXTERNAL CRIMES (ROBBERIES) COMMITTED AGAINST BANKS?

The President of the Council read Item II D. A brief discussion followed. It was suggested that the supervisors might review a bank's written internal control, employment and security procedures in an effort to determine their adequacy. Moreover, if such written procedures were not available, the supervisors should suggest that they be prepared. Several members mentioned that banks are finding it useful to finger print new employees. The use of cameras and various electronic equipment has also been an aid in solving bank robberies.

ITEM II E

E. THE BOARD WOULD BE INTERESTED IN COMMENTS OF COUNCIL MEMBERS CONCERNING DEVELOPMENTS WITH RESPECT TO BANK CREDIT CARD OPERATIONS SINCE THIS SUBJECT WAS DISCUSSED AT ITS MEETING WITH THE COUNCIL ON MAY 16. IN PARTICULAR, COMMENTS WOULD BE WELCOMED ON VOLUME, CARD DISTRIBUTION TECHNIQUES, LOSS EXPERIENCE, AND PROSPECTS FOR DEVELOPMENT OF REGIONAL AND NATIONAL INTERCHANGE ARRANGEMENTS.

President Moorhead read Item II E. A discussion revealed that experiences varied widely from bank to bank. There was agreement,

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however, that there are many costly aspects to bank credit card operations. Several members pointed out that the importance of bank credit cards, relative to other services, has been over-emphasized. There also seemed to be agreement on the fact that some of the present problems will need to be resolved before the prospects for expanded regional and national interchange arrangements improve significantly.

ITEM III A, B AND C

BALANCE OF PAYMENTS.

A. DO COUNCIL MEMBERS EXPECT U. S. BANK LOANS TO FOREIGN BORROWERS TO CHANGE SIGNIFICANTLY IN THE MONTHS AHEAD?

B. IN THE JUDGMENT OF THE COUNCIL, HAS THE VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM AFFECTED THE AMOUNT OF U. S. BANK CREDIT AVAILABLE FOR FINANCING U. S. EXPORTS? DOES THE COUNCIL EXPECT ANY CHANGE IN THIS SITUATION IN THE NEAR FUTURE, AND IF SO, IN WHAT DIRECTION?

C. WHAT DO COUNCIL MEMBERS EXPECT TO BE THE COURSE OF EURO-DOLLAR BORROWINGS BY U. S. BANKS THROUGH THEIR FOREIGN BRANCHES FROM NOW THROUGH THE YEAR END?

The President of the Council read Item III A, B and C. It was acknowledged that the uncertainties which presently characterize the domestic and international money markets make it extremely difficult to answer this item. Although no one expected U. S. bank loans to foreign borrowers to increase significantly in the months ahead, some addition was possible if loan demand to domestic borrowers continued to lag behind expectations. The voluntary foreign credit restraint program apparently has not affected the amount of U. S. bank credit available for financing U. S. exports. Moreover, no significant change in the volume is anticipated. The volume of Euro-dollar borrowings by U. S. banks through their foreign branches between now and the year-end will be determined largely by rate differentials and the relative availability of funds.

ITEM IV

THE BOARD WOULD WELCOME COMMENTS BY COUNCIL MEMBERS ON THE PROPOSED CHANGES IN THE BOARD'S MARGIN REGULATIONS THAT WERE PUBLISHED ON OCTOBER 20, 1967.

The President of the Council read Item IV. Although there was agreement with the broad objectives of the proposed changes in margin regulations, there are a number of technical and operational exceptions which should be resolved.

ITEM V

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

President Moorhead read Item V. A brief discussion followed.

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It was acknowledged that the devaluation of the pound sterling and the chain of events this precipitated altered the monetary and credit policy that otherwise might have been pursued. The resulting uncertainties, therefore, dictated the direction of policy, i.e., rates should be sufficiently firm to restrain any large outflow of funds while at the same time supplying the banking system with adequate reserves to maintain an orderly credit and money market. The Council decided to reiterate its strong conviction that a reduction in government expenditures and an increase in taxes are essential to ease the burden now placed on monetary policy in its effort to maintain price stability and promote sound growth.

The meeting adjourned at 12:30 P.M.

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THE COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING, WASHINGTON, D.C., AT 2:30 P.M., ON NOVEMBER 20, 1967. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MR. LARKIN. MR. COOK ATTENDED AS AN ALTERNATE.

Mr. Dan Brill, Director of Business Research and Statistics, assisted by several of his associates, participated in a presentation on current business and economic developments.

* * * * *

THE COUNCIL RECONVENED AT 5:30 P.M., ON NOVEMBER 20, 1967, IN THE BOARD ROOM OF THE MADISON. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MR. LARKIN. MR. COOK ATTENDED AS AN ALTERNATE.

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 21, 1967. The Memorandum was delivered to the Federal Reserve Building at 7:45 P.M.

The meeting adjourned at 6:20 P.M.

* * * * *

ON NOVEMBER 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 MR. LARKIN. MR. COOK ATTENDED AS AN ALTERNATE.

THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: CHAIRMAN MARTIN, VICE CHAIRMAN ROBERTSON, GOVERNORS MITCHELL, BRIMMER, DAANE AND SHERRILL. MR. MERRITT SHERMAN, SECRETARY, AND MR. KENNETH KENYON, ASSISTANT SECRETARY, OF THE BOARD OF GOVERNORS WERE ALSO 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 12:20 P.M.

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The next meeting of the Council will be held on February 19-20, 1968.

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CONFIDENTIAL

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

1. Economic conditions and prospects.

A. How does the Council appraise the general economic outlook for the next 6 months? The outlook for wage and price developments?

The Council anticipates a continued rise in the level of general economic activity in the next six months, although the events of the past weekend may tend to restrain the expansion until some of the present uncertainties are resolved.

Business in recent weeks has been adversely affected by strikes, particularly in the automobile industry, but this is likely to be partially offset in the months ahead. In the latter half of the period the pace of business activity may be stimulated by an expansion in steel inventories as users step up their buying in an attempt to hedge against a possible strike in that industry.

The trend of wage settlements in the future is likely to follow the generous pattern established in recent negotiations. This in turn will exert additional upward pressure on the price structure. Competitive pressures, however, may limit price rises, thus narrowing profit margins.

B. What impressions do Council members have from their customer contacts with regard to the trend of prospective business outlays (1) for capital investments and (2) for inventories?

The members of the Council have the impression based on contacts with their customers that the rise in capital outlays of business may be more moderate than some of the recent surveys suggest, although this situation varies somewhat from district to district. The sharp rise in wage costs, however, tends to force management to maintain investment expenditures in an effort to improve productivity.

Businessmen presently seem reasonably satisfied with the level of inventories. As a consequence, the members of the Council expect only limited growth in inventories with the possible exception of automobiles and steel.

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C. With respect to residential construction, are mortgage funds judged to be adequate to meet current and near-term demands in the Council members' respective regions? Do present levels of interest rates on mortgages appear to be deterring potential home buyers?

Mortgage funds to finance residential construction appear generally to be adequate to meet current and near-term demands. Moreover, there is little evidence that present levels of interest rates on mortgages are deterring potential homebuyers. Instead, the present 6 per cent ceiling on mortgages that prevails in some states has tended to channel funds from typically mortgage lending sources into alternative higher yielding investments. Most members of the Council report a relatively large volume of residential construction in their respective districts.

2. Banking developments.

A. What is the Council's assessment of the probable strength of business loan demands over the next 6 months?

The events of the past weekend may precipitate a sharp rise in loan demand as corporate borrowers and others, uncertain about the future, take down funds under present commitments and lines. Thereafter, the Council expects loan demand to remain strong following the customary seasonal decline early in the year.

B. In the Council's judgment, are bank liquidity positions still improving? What are current policies of banks regarding preferred types and maturities of investments?

Bank liquidity ratios continue to improve though more slowly in recent weeks. Despite the improvement that has taken place, banks continue to be somewhat uncomfortable since such a large portion of deposit growth this year has been in the time deposit category, and thus subject to Regulation Q ceilings, with the risk of disintermediation. This concern has been an important factor in persuading most bankers, particularly in the money centers, to confine their investments to relatively short maturities. The events of the past weekend have intensified this concern.

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C. How would the Council appraise recent and prospective changes in market demands for large-denomination CD's of various maturities? For consumer-type CD's and savings deposits?

The growing concern of banks about their ability to meet prospective loan demands, because of the risk of disintermediation, have lifted rates on larger denomination negotiable CD's to their present high levels. Should the rate on alternative short-term investments rise much further, bankers will find it increasingly difficult to maintain present CD balances. As a consequence, the Council continues to believe that the Board might wish to consider the desirability of raising the interest rate ceiling on larger denomination negotiable CD's.

Consumer-type CD's and to a lesser extent savings deposits may be subject to some of the same risks, but so far there has been little evidence of any channeling of consumer savings funds into alternative investments.

D. What additional steps, if any, should bank supervisors take, or encourage banks to take, in order to help combat the record volume of internal crimes (embezzlements) and external crimes (robberies) committed against banks?

Bank supervisors might review the bank's written internal control, employment and security procedures to determine their adequacy. If such written procedures are not available, the supervisor should suggest they be prepared. An increasing number of banks are finding it useful to fingerprint all new employees, and bank supervisors may wish to make this a requirement. Bank supervisors may also wish to suggest the use of various devices such as cameras and electronic equipment.

E. The Board would be interested in comments of Council members concerning developments with respect to bank credit card operations since this subject was discussed at its meeting with the Council on May 16. In particular, comments would be welcomed on volume, card distribution techniques, loss experience, and prospects for developments of regional and national interchange arrangements.

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The members of the Council whose experiences with bank credit cards vary widely will comment orally on this Agenda item. In general, there are many costly aspects to the operation. Any bank contemplating the issuance of credit cards should conduct a detailed and intensive survey before undertaking this service. Experience indicates that the importance of bank credit cards relative to other services of a bank has been overemphasized. Before the prospects for expanded regional and national interchange arrangements improve significantly, some of the present problems will need to be resolved.

3. Balance of Payments.

A. Do Council members expect U.S. bank loans to foreign borrowers to change significantly in the months ahead?

The uncertainties which presently characterize the domestic and international money markets make it difficult to provide an adequate answer to this item. In general, the members of the Council do not expect U.S. bank loans to foreign borrowers to increase significantly in the months ahead. However, should loan demand from domestic borrowers lag behind expectations, some addition in U.S. bank loans to foreign borrowers might be anticipated.

B. In the judgment of the Council, has the voluntary foreign credit restraint program affected the amount of U.S. bank credit available for financing U.S. exports? Does the Council expect any change in this situation in the near future, and if so, in what direction?

The Council has little evidence that the voluntary foreign credit restraint program has affected the amount of U.S. bank credit available for financing U.S. exports. In view of the continuation of the voluntary foreign credit restraint program, the Council does not expect any significant change in the volume of U.S. export financing.

C. What do Council members expect to be the course of Euro-dollar borrowings by U.S. banks through their foreign branches from now through the year end?

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The volume of Euro-dollar borrowings by U.S. banks through their foreign branches between now and the year-end will be determined largely by rate differentials and the relative availability of funds.

4. The Board would welcome comments by Council members on the proposed changes in the Board's margin regulations that were published on October 20, 1967.

The members of the Council agree with the broad objectives of the proposed changes in margin regulations. However, there are a number of technical and operational exceptions which should be resolved and about which several members of the Council have written the Board.

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

The devaluation of the pound sterling and the chain of events this has precipitated have altered the monetary and credit policy that otherwise might have been pursued. For the immediate future, the Council believes that interest rates should be sufficiently firm to restrain any large outflow of funds, while at the same time supplying the banking system with adequate reserves to maintain an orderly credit and money market.

A reduction in government expenditures and an increase in taxes are essential to ease the burden now placed on monetary policy in its effort to maintain price stability and promote sound growth.

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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, November 21, 1967.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

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

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

Mr. Ransom M. Cook, Chairman of the Executive Committee, Wells Fargo Bank, San Francisco, California, attended in place of Mr. Larkin, member of the Council from the Twelfth District, who was unable to be present.

1. Economic conditions and prospects.

A. How does the Council appraise the general economic outlook for the next six months?

The Council anticipates a continued rise in the level of general economic activity in the next six months, although the events of the past weekend may tend to restrain the expansion until some of the present uncertainties are resolved.

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Business in recent weeks has been adversely affected by strikes, particularly in the automobile industry, but this is likely to be partially offset in the months ahead. In the latter half of the period the pace of business activity may be stimulated by an expansion in steel inventories as users step up their buying in an attempt to hedge against a possible strike in that industry.

The trend of wage settlements in the future is likely to follow the generous pattern established in recent negotiations. This in turn will exert additional upward pressure on the price structure. Competitive pressures, however, may limit price rises, thus narrowing profit margins.

President Moorhead commented that, as could be imagined, views previously held by Council members on a number of the questions on today's agenda had become rather out of date by yesterday in light of developments over the weekend, including the devaluation of sterling and the subsequent increase in the Federal Reserve discount rate. Nevertheless, most of the Council members did look forward to a strong first half in 1968.

Chairman Martin inquired whether the members had a judgment on the impact of devaluation in terms of U.S. domestic business, and President Moorhead replied that the judgment, to the extent any had been made, was that the economy might be a little less expansive than would otherwise have been expected. Mr. Simmen thought it was quite possible that higher interest rates might slow down the pace of expansion somewhat, and President Moorhead commented that the devaluation could have some adverse effect on U.S. exports.

Chairman Martin then asked if he understood correctly that the Council members did not foresee any serious effects on American

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business as the result of the developments over the weekend, and responses indicated that the members did not have any great concern.

Governor Brimmer noted that one large U.S. company was reported in the press to have had a substantial amount of profits from British operations wiped out by the devaluation, and President Moorhead expressed the view that any such one-time losses should not have a seriously adverse effect on large U.S. companies over time.

Chairman Martin inquired whether any of the banks represented on the Council had experienced substantial losses in sterling, and members representing those banks active internationally reported that their banks had, if anything, made small profits, since they had been operating cautiously and taking a slight short position.

In response to a question whether it was known that any U.S. banks had been hurt seriously, Chairman Martin said he did not know of any such cases although he had heard that some banks had sustained substantial losses.

B. What impressions do Council members have from their customer contacts with regard to the trend of prospective business outlays (1) for capital investments and (2) for inventories?

The members of the Council have the impression based on contacts with their customers that the rise in capital outlays of business may be more moderate than some of the recent surveys suggest, although this situation varies somewhat from district to district. The sharp rise in wage costs, however, tends to force management to maintain investment expenditures in an effort to improve productivity.

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Businessmen presently seem reasonably satisfied with the level of inventories. As a consequence, the members of the Council expect only limited growth in inventories with the possible exception of automobiles and steel.

President Moorhead said there was evidence from customer contacts that some corporations were pulling back on capital expenditures because they were not willing to pay the prevailing price for long-term money.

Mr. McNeill reported that an increasing number of companies with which his bank was familiar were either eliminating capital investment programs or stretching them out over longer periods of time. Companies that had embarked on such programs could not terminate them in a partially completed stage, but he thought there would be cutbacks on the part of some of the large corporations.

Mr. Mayer said he had noticed the same development to a modest degree. Many companies, however, had committed themselves to go ahead.

Governor Mitchell asked about the psychological attitude of corporations today, as compared with the summer of 1966, with respect to expansion programs and appraisal of their prospects.

President Moorhead replied that he thought corporate appraisals had been dampened a little, particularly because of fear of a profit squeeze. If corporations felt they could obtain a 10 per cent profit as a result of expansion programs, they would not worry too much about an increase of 1/2 per cent in the borrowing rate. But at present they did not see quite the same potential for profits as they did in 1966.

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Mr. Fleming spoke of an influx of industry into the Southeastern part of the country at an accelerated pace. Construction costs had been rising rapidly, particularly in the past year, and that factor, together with the higher cost of money, had been causing some re-examination of programs. On the other hand, with companies attracted to the area because of the more favorable labor situation and distribution advantages, it appeared that industrial expansion would continue.

Governor Mitchell referred to three methods of appraising the business outlook. First, there were the so-called leading indicators, which had been giving mixed signals for quite a while. The second technique, which involved the use of econometric models, appeared to be in the ascendancy. Then there was the so-called seat-of-the-pants approach, based on such things as order books and what businessmen saw in the immediate offing. Economists were quite influenced today by the models of the Commerce Department and the Council of Economic Advisers. His question was whether Council members sensed a feeling that businessmen were optimistic as a result of what they saw in their own businesses or on the basis of what economists were telling them they ought to be seeing.

President Moorhead referred in reply to a recent meeting in his area at which an economist for a large insurance company predicted productivity increases on the basis of greater volume. However, questions from the audience reflected skepticism that productivity

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would outrun wage increases. It appeared that many of the businessmen in the audience were inclined not to share the conclusions derived from the economist's models.

Mr. Mayer commented that the businessman customarily takes a short-run point of view and puts a great deal of emphasis on such things as earnings figures. Therefore, his sentiments tend to swing rapidly in one direction or another. At this particular time the businessman might be a little more pessimistic than the facts warranted. On the other hand, the typical businessman apparently was not too much concerned about higher interest rates; he seemed to have in mind that they would be a way of life for some time to come. Interest rates probably would not affect business decisions too much.

Mr. Wilkinson remarked that the aggregate of national and international problems and uncertainties had clearly made the consumer cautious. That could be seen in the consumer credit statistics and the department store sales data.

Mr. Simmen said that in the First District the consumer and the businessman were uncertain about conditions generally and were not doing what might normally be expected of them.

Mr. Still commented that although there was a lot of talk by economists about rebuilding inventories, in his area there was no evidence from loan figures that inventories were being rebuilt to any significant extent.

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Chairman Martin inquired whether any Council members sensed a feeling that there was a possibility of recession.

Mr. McNeill said the large corporations with which he was familiar had not gone that far, although they were definitely more cautious and jittery.

President Moorhead added that businessmen apparently expected what might be called a profitless kind of prosperity.

C. With respect to residential construction, are mortgage funds judged to be adequate to meet current and near-term demands in the Council members' respective regions? Do present levels of interest rates on mortgages appear to be deterring potential homebuyers?

Mortgage funds to finance residential construction appear generally to be adequate to meet current and near-term demands. Moreover, there is little evidence that present levels of interest rates on mortgages are deterring potential homebuyers. Instead, the present 6 per cent ceiling on mortgages that prevails in some States has tended to channel funds from typically mortgage lending sources into alternative higher yielding investments. Most members of the Council report a relatively large volume of residential construction in their respective districts.

President Moorhead said that, while the situation varied considerably from one district to another, in general there was believed to be an adequate availability of mortgage funds. In States that had a 6 per cent ceiling on mortgages, however, funds had pretty well dried up. Even in other States insurance companies seemed to have pulled back considerably, mortgages not being attractive compared with other investments. Nevertheless, the savings and loan associations were still active, and none of the Council members felt that a lack of

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availability of funds was deterring housing activity. Other costs had gone up more than the cost of money.

Mr. Still commented that funds, though available, were not going into mortgages. Instead, they were being placed in bonds and other investments. He felt that the question on the agenda had grown a little stale. As of today, it might more appropriately have been asked whether potential interest rate levels were sufficient to continue to attract investors into the mortgage market.

Mr. Wilkinson related that in Virginia, where a 6 per cent limit prevailed, the situation was aggravated by the fact that the State was an importer of mortgage funds. A study indicated that roughly one-third to one-half of Virginia's mortgage funds normally were imported. At present such money was just not coming into the State. Neither was there any great desire on the part of domestic suppliers to lend at the 6 per cent ceiling, and local needs were being met begrudgingly. South Carolina had recently changed its maximum rate, and the Governor of Virginia was going to recommend next year to the legislature that the ceiling be removed or increased. New York had made a move in the same direction. However, this was a highly emotional issue and the process of change would be slow.

Mr. Wilkinson also noted that much of the current housing activity was in multi-family construction rather than single-family residences, and Mr. Mayer pointed out that in the financing of multi-family dwellings, where the lending was to corporations, State

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usury laws on mortgage loans to individuals did not apply. Mr. McNeill said that in New York some builders were paying 6-3/4 and 7 per cent. The 6 per cent ceiling on loans for single-occupancy residences was of course a deterrent to that kind of construction. In addition, insurance companies preferred the larger loans.

2. Banking developments.

A. What is the Council's assessment of the probable strength of business loan demands over the next six months?

The events of the past weekend may precipitate a sharp rise in loan demand as corporate borrowers and others, uncertain about the future, take down funds under present commitments and lines. Thereafter, the Council expects loan demand to remain strong following the customary seasonal decline early in the year.

President Moorhead said that there appeared to be a trend out of the long-term market and into the banks for financing. In view of the recent developments the Council felt that that trend would accelerate.

Governor Brimmer inquired about prospects for an increase in the prime rate. He noted that the press yesterday reported mixed banker attitudes, but at least one large bank had increased its prime rate. President Moorhead said he expected that others might follow suit. (Note: Reports were brought into the meeting later that other large banks, including one in New York City, had raised the prime rate.)

Mr. Fleming noted that it was of some concern that only about 40 per cent of the outstanding lines of credit at many large banks

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were being utilized. If corporations decided not to go into the long-term market at present rates, they could utilize their outstanding commitments from the banks. That could put a great deal of pressure on the banks, for the lines were open and corporations were paying a commitment fee. Many banks, while not worried about their liquidity right now, were worrying about what might happen.

Chairman Martin asked Mr. Fleming if the latter was suggesting that the liquidity of many corporations was being maintained by a 1/4 per cent commitment fee, and Mr. Fleming replied that the companies had bought insurance from the banks. How much they would use that insurance, he did not know. But if the rates on long-term borrowing continued to go up, it was only reasonable to believe that the companies would turn increasingly to the banks for intermediate-term credit, which they had available to them because it was already pledged for a fee.

Another matter of concern to the banks, Mr. Fleming said, was the use of the commercial-paper market. Something like $17 billion of loans were outstanding in the commercial-paper market, up quite substantially from a year ago. Corporations had been using lines of bank credit to back up the use of commercial paper at cheaper rates. If those rates were to rise, they would certainly come back to the banks against their lines of credit. Further, if the maximum Regulation Q rate should be exceeded by competitive market instruments, a lot of negotiable CD's would not be renewed.

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B. In the Council's judgment, are bank liquidity positions still improving? What are current policies of banks regarding preferred types and maturities of investments?

Bank liquidity ratios continue to improve, though more slowly in recent weeks. Despite the improvement that has taken place, banks continue to be somewhat uncomfortable since such a large portion of deposit growth this year has been in the time deposit category, and thus subject to Regulation Q ceilings, with the risk of disintermediation. This concern has been an important factor in persuading most bankers, particularly in the money centers, to confine their investments to relatively short maturities. The events of the past weekend have intensified this concern.

C. How would the Council appraise recent and prospective changes in market demands for large-denomination CD's of various maturities? For consumer-type CD's and savings deposits?

The growing concern of banks about their ability to meet prospective loan demands, because of the risk of disintermediation, has lifted rates on larger denomination negotiable CD's to their present high levels. Should the rate on alternative short-term investments rise much further, bankers will find it increasingly difficult to maintain present CD balances. As a consequence, the Council continues to believe that the Board might wish to consider the desirability of raising the interest rate ceiling on larger denomination negotiable CD's.

Consumer-type CD's and to a lesser extent savings deposits may be subject to some of the same risks, but so far there has been little evidence of any channeling of consumer savings funds into alternative investments.

President Moorhead recalled that there had been quite a discussion of the ceiling on large-denomination CD's at the last meeting of the Board and the Council, and he added that the situation was now even more acute.

Mr. Mayer said he believed that the Federal Reserve could control the CD situation even if the ceiling were removed by issuing guidelines similar to those that it now applied to foreign credits under the voluntary

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restraint program. That would prevent banks from building up CD's to any great extent, and at the same time would prevent what happened a year ago when the money center banks lost CD's heavily. Today there was ample liquidity for loan purposes, but the banks did not feel comfortable because they could lose deposits quickly and find themselves in difficulty.

Governor Daane asked whether there was an acute fear of disintermediation, adding that there had not been much evidence of it as yet.

Mr. Mayer replied that the 5-1/2 per cent rate previously available on longer CD's now prevailed for maturities down to 90 days, so the cut-off point was gradually approaching. Everyone who had lived through 1966 had a vivid recollection of the sequence of events.

Mr. Stewart said the posted rate on CD's did not mean anything today. In his area the treasurer of a large corporation could obtain 5-1/2 per cent on 90-day CD's no matter what rates were posted.

Governor Brimmer inquired what kind of Regulation Q action would enable banks to hold most of their outstanding CD's.

Mr. Mayer suggested a cut-off at $1 million. A lot of CD's in smaller denominations were issued to corporate customers, but they were not in fact negotiable because there was no market for them.

Governor Brimmer said his conversations with bankers had suggested that a $1 million cut-off point might be too high. For some banks, second-line corporations were the largest in their

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neighborhoods, and they needed to hold on to the money of those corporations.

Mr. Brinkley agreed. In Louisville, for example, the banks had quite a number of local customers for CD's from $100,000 to $500,000. It was felt that they should have the same treatment as $1 million CD customers of the money center banks. They were of the same degree of importance so far as the local banks were concerned.

President Moorhead said he would prefer a cut-off at $100,000 rather than $1 million, and Mr. Mayer said he would have no objection. He had simply thought that the Board might be hesitant to move down that far out of deference to the savings and loan associations.

Governor Brimmer inquired whether it was believed that the savings and loan associations held many deposits of $100,000, and several Council members indicated that they did not think so, except perhaps on the West Coast.

Mr. Cook reported that average balances of savings accounts had been increasing a great deal. There had been quite a shift from savings accounts to CD's, but the situation had now leveled off. The question was how far CD rates could be raised without forcing a further shift from savings deposits and savings and loan share accounts.

Mr. Cook went on to say that it seemed to him the huge demand for long-term money reflected a desire for insurance against the threat of continuing inflation. If there was any truth in the press

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reports this morning about the prospect of reduced Government expenditures and an increase in taxes, that could take a good deal of the fright out of corporations that had been doing anticipatory and excessive long-term borrowing. Action on those fronts might make it possible for the rate structure to move down somewhat, or at least not to rise further. Lack of such action might lead to excessive demand pressures.

Mr. Still asked whether it was true that the Treasury was considering an increase in the savings bond rate, and Chairman Martin said a bill had been passed by the Senate yesterday. It was not anticipated that the bill would pass the House. Governor Brimmer commented that the Senate bill would gear the rate on savings bonds to the note level, and the latest notes carried a rate of around 5-3/4 per cent.

Mr. Still remarked that he was State Chairman of the ABA Savings Bond Committee, and that in a sense he felt guilty, under today's conditions, in urging people to buy savings bonds.

Mr. Brinkley commented that nevertheless many people were still buying savings bonds, just as many people were still putting money in savings accounts at 4 per cent.

Asked by Governor Brimmer whether he would advocate raising the rate on savings bonds, Mr. Still said he had seen figures recently on the sources from which the Government expected to raise money, and the public sector apparently was still fairly important. If that

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was true, he would answer Governor Brimmer's question in the affirmative, realizing that that would have an effect on the savings and loan associations.

Reverting to Governor Brimmer's earlier question about large CD's, Mr. Knight said he would agree with Mr. Brinkley. He would not like to see a cut-off as high as $1 million. The typical CD's issued to corporations in his part of the country were closer to $100,000.

Governor Brimmer asked if any Council member felt that the cut-off figure should be $1 million, and Mr. Mayer said he would rather have a cut-off of $100,000. Mr. Stewart said he thought all of the Council members felt that way; they just had not contemplated that the Board would be willing to consider such a cut-off point.

Governor Brimmer said the question in his mind was one of trying to judge the vulnerability point. He gathered most of the Council members felt that an increase in the maximum rate on CD's above $100,000 would not pose much of a threat to the thrift institutions.

Mr. McNeill said that in New York a cut-off of $100,000 would present no threat to the mutuals or savings and loans. He could understand that banks in smaller cities would be as vulnerable to loss of customers at $100,000 as the money center banks would be to the loss of their $1 million CD customers. In fact, his bank had a lot of $100,000 CD customers also.

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Mr. Mayer said a study of his bank's experience in 1966 disclosed differing tendencies according to size of customers. The smaller accounts remained with the bank more consistently and renewed their CD's while the large customers ran off their CD's.

Mr. McNeill commented that he would much rather have 10 customers with CD's of $100,000 each than one customer with a CD of $1 million.

Mr. Fleming said that in his District a $100,000 cut-off point would not adversely affect the savings and loans, whose accounts usually went up only to the $15,000 insured maximum. He did not think that a $100,000 cut-off would lead to any shifting of funds, for different types of instruments were involved.

Governor Brimmer asked Mr. Fleming whether he would recommend changing the maximum rate on passbook savings or the maximum rate on consumer-type CD's.

Mr. Fleming said he would not be in favor of changing the 4 per cent maximum for savings accounts. Smaller savers seemed satisfied with that rate on their thrift accounts, and the shift to 5 per cent CD's seemed to be about over. Passbook savings were not gaining appreciably, but he did not think many banks were losing.

Mr. Wilkinson noted that an increase in the maximum passbook rate would put quite a bit of pressure on small country banks, and Mr. Fleming agreed that their earnings would be damaged badly in many instances.

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Question was raised whether, if it was immoral to pay only 4.15 per cent on savings bonds, it was not also immoral to pay only 4 per cent on savings accounts, and Mr. Wilkinson cited the convenience of the latter, with immediate access to the funds involved.

President Moorhead noted his personal view that the 4 per cent savings rate should be raised, and Mr. Knight expressed agreement. The latter added that banks in his area had taken a real beating from the savings and loans and that he would settle for a maximum 4 per cent savings rate if the maximum rates payable by the savings and loans were lower. His bank had even sold $1 million of real estate loans to a savings and loan association, and he was not sure just how that had really helped anybody. Passbook savings accounts at his bank were absolutely flat. Meanwhile savings and loans were posting new high rates, mounting campaigns advertising their soundness, liquidity, and growth, and even offering inducements such as trips to Hawaii. While his bank was offering consumer CD's, most of the growth there was at the expense of passbook savings.

Mr. McNeill commented that the New York banks received strong competition from the mutuals, with whom they could compete at a 1/2 per cent differential but only with difficulty at any wider differential. At his bank passbook savings declined throughout last year; this year they had climbed slightly, and consumer CD's had increased somewhat more percentagewise. He added that his institution's smaller correspondent banks around the country wanted no part of an increase in the 4 per cent passbook maximum.

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Governor Brimmer said that many banks apparently were offering two distinct instruments, the passbook account to people who would take it and the CD when it was necessary to offer a higher rate.

Mr. Knight remarked that although banks offered the two instruments, so did the savings and loans, and at higher rates in each case.

Mr. Mayer noted that the competitive situation varied from one area to another, and that banks in his area were outperforming the savings and loans.

D. What additional steps, if any, should bank supervisors take, or encourage banks to take, in order to help combat the record volume of internal crimes (embezzlements) and external crimes (robberies) committed against banks?

Bank supervisors might review the bank's written internal control, employment and security procedures to determine their adequacy. If such written procedures are not available, the supervisor should suggest they be prepared. An increasing number of banks are finding it useful to fingerprint all new employees, and bank supervisors may wish to make this a requirement. Bank supervisors may also wish to suggest the use of various devices such as cameras and electronic equipment.

President Moorhead said that while the Council members did not profess to be experts, they did feel that more careful scrutiny of internal controls and security procedures by the bank examiners would be useful. Many banks had no written procedures, and they might be more careful if required to maintain them in writing.

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Governor Robertson inquired as to the Council's views about legislation of the type introduced a year ago that would require the use of protective devices determined to be appropriate, such as cameras and electronic equipment.

President Moorhead said he felt that might be useful. Many banks, he noted, were now using cameras.

Mr. Mayer said that his bank's offices had been victimized by several robberies. While the robbers were apprehended, they were let out on bail and then given relatively light sentences. He cited one case where an individual robbed several banks in the area. Substantial rewards were offered, but when the criminal was finally apprehended only a light sentence was imposed.

Mr. Fleming thought that it might be effective if surety companies were to require the use of effective procedures by banks as a condition to supplying coverage.

Governor Brimmer inquired about the cost of installing and maintaining protective devices as compared with accepting losses, and Mr. Fleming said his bank's insurance company, after a series of robberies, wanted to include a $25,000 deductible. Another company, however, offered complete insurance if cameras were installed. Although some initial expense was involved, the maintenance had not proven costly.

Mr. Mayer said it had cost his bank about $250,000 to install cameras in all of its branches. The losses from previous robberies

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had not amounted to such a figure, but the robberies had been occurring at an accelerating rate. Now they seemed to have stopped.

Mr. Bodman observed that another factor was the protection of employees and customers, for which he would be willing to pay a lot.

Governor Sherrill reported that according to the FBI cameras were now available at a cost of $1,000 for each installation. He added that the FBI and the Justice Department were going to push for legislation that would require the regulatory agencies to establish minimum standards for the installation of equipment for protection against external crimes.

Mr. Knight inquired whether that would mean that the regulatory agencies would have to maintain a qualified staff to assist banks. He noted that when the Reserve Bank Branch in Denver was being built, officers of the Branch spent a good deal of time in discussion with the security officer of his bank. He would have expected the officers of a Reserve Bank to know a great deal about security problems. If legislation placed responsibility on the bank supervisors, they would have to have training and knowledge in this area. Mr. Knight also suggested that it would be helpful if publicity could be given to laws or regulations against threatening bank officers and their families.

Governor Robertson commented that he did not think the bank supervisors, as of today, could possibly devise the correct procedures

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for all individual banks in terms of protection against external crimes. That was something for the banks themselves to determine, with the assistance of the law enforcement agencies. The supervisory agencies ought to be able to advise banks how to locate available information, but he did not see the advantage in placing on the supervisors the responsibility for trying to determine what procedures and devices were most suitable for individual banks.

President Moorhead remarked that the FBI was holding meetings around the country to provide information on protective measures, but that agency had no power of enforcement. Until the supervisory authorities had power to require banks to follow certain procedures, a lot of banks would fail to take appropriate steps.

Governor Robertson replied that if the supervisory agencies required banks to install bell or camera systems, for example, those might not be the most appropriate devices for all institutions. He suggested that the bankers associations assume leadership in this area. He was concerned about agitation that the bank supervisors take over the job.

E. The Board would be interested in comments of Council members concerning developments with respect to bank credit card operations since this subject was discussed at its meeting with the Council on May 16. In particular, comments would be welcomed on volume, card distribution techniques, loss experience, and prospects for development of regional and national interchange arrangements.

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The members of the Council whose experiences with bank credit cards vary widely will comment orally on this agenda item. In general, there are many costly aspects to the operation. Any bank contemplating the issuance of credit cards should conduct a detailed and intensive survey before undertaking this service. Experience indicates that the importance of bank credit cards relative to other services of a bank has been overemphasized. Before the prospects for expanded regional and national interchange arrangements improve significantly, some of the present problems will need to be resolved.

Mr. Mayer expressed the view that bank credit cards were highly overrated. His bank was making a little money on them, but credit cards were not nearly as important as the volume of conversation about them would seem to suggest. They were a relatively unimportant part of the whole banking system. As to losses, he gathered that over the first three years losses of somewhere between 1 and 3 per cent of total volume could be expected, generally speaking, and that thereafter the loss ratio should move down to about 1/2 per cent. All kinds of things could happen when a bank issued credit cards; the bank could encounter real problems. Fortunately, his bank had issued its cards fairly carefully; it had not sent them to all of its customers by any means. As to volume, available data indicated that outstandings in the Fourth District totaled around $28 million, with an estimated $22 million accounted for by two banks.

At this point Mr. Prochnow commented briefly on the credit card experience in Chicago.

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Mr. Simmen reported that in the First District bank credit card and check credit activities apparently were growing quite rapidly. Credit outstanding had risen considerably since spring, and the number of banks offering credit card or check credit plans also showed a substantial increase. Outstandings were said to account for about 5 per cent of all consumer credit outstanding at district commercial banks.

Governor Brimmer recalled having testified at recent hearings before the House Banking and Currency Committee on proposed legislation that would prohibit the mailing of unsolicited credit cards and require an agreed-upon ceiling on the amount of credit that could be outstanding for any cardholder. He did not think that the Committee was likely to push the legislation vigorously in the short run, but there was obvious concern on the part of Committee members. At the hearings certain questions were raised on which he would appreciate the Council's views. One had to do with the fact that Federal legislation prohibiting the transportation of stolen checks across State

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lines does not extend to credit cards. He asked whether the Council saw any reason not to support legislation that would also prohibit the transportation across State lines of illegally possessed credit cards.

Council members indicated that they saw no reason not to support such legislation.

Governor Brimmer also asked whether it was the experience of Council members that most credit-card customers paid off their indebtedness within the so-called free-ride period and therefore did not become subject to interest charges.

Mr. Mayer said his bank's experience was about half and half, and Mr. Prochnow said he understood the general experience was that about one-third of the debts were paid within the free-ride period.

Governor Brimmer commented that the System's study of bank credit card and check credit plans was proceeding and that hopefully a report would be available by next summer.

3. Balance of payments.

A. Do Council members expect U.S. bank loans to foreign borrowers to change significantly in the months ahead?

The uncertainties which presently characterize the domestic and international money markets make it difficult to provide an adequate answer to this item. In general, the members of the Council do not expect U.S. bank loans to foreign borrowers to increase significantly in the months ahead. However, should loan demand from domestic borrowers lag behind expectations, some addition in U.S. bank loans to foreign borrowers might be anticipated.

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Mr. Cook said it was difficult to give any answer to this question today. The outlook depended largely on international rate relationships and on business trends in various parts of the world. At present there was not too much room under the voluntary foreign credit restraint program ceilings for bank loans to increase. If the demand for loans in this country should lag behind expectations, there would be a tendency for banks to want to fill out on the foreign side. But as of today no good answer to the question could be given.

Governor Sherrill asked whether banks tended to use loans to foreigners to counterbalance domestic demand, and President Moorhead replied that the situation often worked out that way. When domestic loan demand was less heavy, banks were likely to entertain foreign loan requests more freely.

Mr. McNeill said his bank had all the foreign loans it wanted. The demand was there, but the bank had been able to stay within its ceiling and satisfy most of its foreign customers to the extent that it was willing to satisfy them. Prospective borrowers in some countries could never be completely satisfied. He did not believe that the voluntary program had affected exports adversely, and only one New York bank had expressed a contrary opinion to him.

B. In the judgment of the Council, has the voluntary foreign credit restraint program affected the amount of U.S. bank credit available for financing U.S. exports? Does the Council expect any change in this situation in the near future, and if so, in what direction?

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> The Council has little evidence that the voluntary foreign credit restraint program has affected the amount of U.S. bank credit available for financing U.S. exports. In view of the continuation of the voluntary foreign credit restraint program, the Council does not expect any significant change in the volume of U.S. export financing.

Governor Brimmer referred to the changes just announced in the structure of the bank program, particularly the change that would permit banks with small bases a certain amount of leeway, in the aggregate some $600 million.

Governor Robertson observed that the leeway could be used only for export financing and credits to less developed countries. He added that he hoped the granting of that leeway would put an end to allegations that exports were being deterred by lack of financing, especially by the smaller banks.

Governor Brimmer inquired whether Council members anticipated that the leeway would be used, and Mr. Knight replied that some banks probably would take advantage of it. Mr. Still recalled that banks in his area had complained previously on the ground that the large banks already active in the foreign field enjoyed a preferred position. In his opinion some banks would take advantage of the additional leeway quite promptly.

Mr. Cook referred to the aircraft export program and inquired how it was anticipated that the sales would be financed. The amounts that appeared to be required over the next several years were staggering.

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Governor Robertson replied that conceivably the guidelines of the voluntary program might have to be adjusted at some stage. As of today, however, it was felt that the exports should be financed to the extent possible in the countries where the purchasers were located. If aircraft were purchased by Europeans, for example, the purchases should be financed in Europe. If it could be shown that exports were going to be lost, other possibilities would have to be considered, but for the present the situation appeared to be in hand. It could not be said that any sales had been lost thus far.

Governor Brimmer said that he had been endeavoring, through discussions with manufacturers and otherwise, to put together projections of aircraft exports to 1970 in order to reach some judgment on financing requirements. The numbers put forward by the manufacturers on prospective sales, and their estimates of the credit required to finance them, were indeed staggering. Increasingly, however, the aircraft were being sold to strong airlines, many of which were really owned by their respective governments. Moreover, the aircraft were going largely to countries with strong balance of payments positions. In his view, therefore, the manufacturers should look more and more to foreign financing of their sales, and he saw no reason why the Export-Import Bank should continue to provide the lion's share of such financing. Some types of aircraft had to be sold on a competitive basis with aircraft produced in foreign countries, and in those cases there might be more reason to seek

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out domestic sources of financing to assure obtaining the orders. In other cases, however, the U.S. aircraft had no foreign competition.

Mr. Cook commented that aircraft exports appeared to offer one significant possibility for improvement in the U.S. balance of payments, and Chairman Martin concluded the discussion by commenting that the balance of payments situation was not improving and at some point was likely to create a very serious problem.

C. What do Council members expect to be the course of Euro-dollar borrowings by U.S. banks through their foreign branches from now through the year-end?

The volume of Euro-dollar borrowings by U.S. banks through their foreign branches between now and the year-end will be determined largely by rate differentials and the relative availability of funds.

President Moorhead asked whether Board members had up-to-date information on Euro-dollar rates, and Governor Daane replied that yesterday those rates were up about 3/4 of a percentage point, in a range from 5-1/8 to 6-1/4 per cent. There were reports that they had gone a bit higher, but he had no specific information as of today.

President Moorhead commented that the answer to the question on the agenda appeared to the Council to involve largely the matter of rate differentials and that in the present circumstances the Council could not guess what might happen.

4. The Board would welcome comments by Council members on the proposed changes in the Board's margin regulations that were published on October 20, 1967.

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The members of the Council agree with the broad objectives of the proposed changes in margin regulations. However, there are a number of technical and operational exceptions which should be resolved and about which several members of the Council have written the Board.

President Moorhead said the Council members did not feel that it was feasible to try to go into technical details at this meeting. Several of the members had already written to the Board, so their comments were on record.

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

The devaluation of the pound sterling and the chain of events this has precipitated have altered the monetary and credit policy that otherwise might have been pursued. For the immediate future, the Council believes that interest rates should be sufficiently firm to restrain any large outflow of funds, while at the same time supplying the banking system with adequate reserves to maintain an orderly credit and money market.

A reduction in government expenditures and an increase in taxes are essential to ease the burden now placed on monetary policy in its effort to maintain price stability and promote sound growth.

Governor Robertson referred to the phrase "while at the same time supplying the banking system with adequate reserves to maintain an orderly credit and money market." He asked whether that reflected an opinion that the Federal Reserve should tighten or ease.

President Moorhead replied that the Council had been thinking about Treasury requirements primarily when it spoke of an orderly market, for those requirements were an overriding problem. He added that the Council had composed its statement at a difficult time, in view of developments over the weekend. The Council was saying, in

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essence, that it would not recommend further tightening for the time being until the shape of things became more clear.

Governor Brimmer asked what policy stance the Council would consider appropriate if the situation settled down and the devaluation of sterling did not provoke too much additional disturbance over, say, the next three months. Asked whether he had in mind fiscal action or no fiscal action, Governor Brimmer suggested that one model might include some fiscal complement to monetary policy while another model might not.

Mr. Still said he felt that the Federal Reserve should begin to tighten. The System may have overstayed its easy monetary policy, and the reactions to a tighter policy might be much worse if the System waited much longer. This had been his view for some months, although he appreciated the problems presented by Treasury financing and other considerations.

Mr. Fleming expressed the view that the Federal Reserve was on the horns of a dilemma and that whatever it did would have some kind of adverse effect. If monetary policy were tightened and interest rates went up much more, there would be the danger of disintermediation, which could throw the whole economy out of balance. If the Federal Reserve did not tighten, there was the question whether the forces of inflation could be held in check. The pressures were obvious and in some sectors, such as wages and construction costs, they were gaining momentum almost by the hour. It was to be hoped that some help could be obtained through fiscal policy.

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Chairman Martin inquired whether the members of the Council felt that the Federal Reserve had been right or wrong in raising the discount rate, and several members replied that they thought the action had been appropriate.

Mr. Brinkley inquired what the Federal Reserve had hoped to accomplish, and Chairman Martin replied that the discount rate had been placed in better alignment with existing market interest rates. The thought was not to lead the market, but instead to follow the market. The increase in the discount rate did not signal a dramatic tightening of money.

Mr. Brinkley asked whether the main objective was to achieve a psychological effect, and Chairman Martin said that that was involved. With the British Bank rate raised to 8 per cent, the question was whether the Federal Reserve should sit by and appear unaware of what was going on.

Mr. Fleming suggested that balance of payments considerations now had to take precedence over some domestic problems. If the discount rate had not been raised, that would have invited a flow of dollars abroad. He felt there had been no alternative to discount rate action in view of the balance of payments situation.

Mr. Still commented that excess reserves were plentiful and there had been little discount window activity even at the 4 per cent rate. Except for the psychological effect, he could not see that the higher discount rate would mean too much unless the System took some

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further action. He agreed with the discount rate move in terms of psychological effect. However, if banks had not been borrowing at 4 per cent, his question was why they would borrow at 4-1/2 per cent.

Mr. Wilkinson noted that John Maynard Keynes had said it was easy for money managers to handle an economy that was relatively impervious to external forces. Keynes also said that it was relatively easy to manage an economy in relation to external forces bearing upon it. But he further said that there had not yet been devised a system under which money managers could operate successfully when external and internal forces met head on. With sterling now substantially crippled in terms of its role as a reserve currency, the focus was clearly on the dollar. The U.S. could no longer continue to follow certain policies that it had heretofore pursued on the ground of assisting the British, at least in the European view. Looking at the longer-run implications, Mr. Wilkinson suggested the need for greater U.S. policy emphasis on protecting the dollar, lest all of the palliatives given to the internal economy go down the drain.

Mr. Cook observed that at present the Federal Reserve was receiving little help in dealing with the problems of protecting the dollar, keeping interest rates under reasonable control, and combating inflationary pressures. Some time ago it had been argued that inflation was inevitable in the absence of a tax increase, no matter what the Federal Reserve did. Now the discount rate had been raised in the light of market conditions and international considerations.

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Perhaps it would have to be left at its present level, and perhaps the Federal Reserve would have to reduce the availability of reserves somewhat, though not to such an extent as to bring about a repetition of last year's credit crunch. Then the burden would be on the Congress. Tax action and a reduction of Government expenditures would help to avoid further increases in interest rates. A further increase of 1 or 1-1/2 percentage points was not impossible to envisage under some circumstances, and that would cause repercussions around the world. It would be desirable if the present rate levels were the highest that would prevail for a long time.

Mr. Bodman asked whether, if reserves were supplied in large amounts over a period of time, it was not likely that interest rates would go up anyway, and Chairman Martin commented that that was what they had been doing recently.

Mr. Stewart said that he thought Regulation Q was a most serious problem. He had expressed that view at the last meeting of the Council with the Board, and he still held it.

Mr. Simmen noted that the needs of the Treasury would not be great over the rest of this year. Interest rates were now high, and the economy reflected a statistical pause. His question, therefore, was to what extent the Federal Reserve really had to move. Today's papers indicated that the prospects for tax action and a cutback in Government expenditures might have improved, and those steps would

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relieve the burden on the Federal Reserve. So the road ahead over the next six months conceivably might be smoother for monetary policy.

Chairman Martin inquired whether he understood correctly that a majority of the Council believed the Federal Reserve had been right in raising the discount rate, and Mr. Fleming said he thought the view was unanimous. The Chairman then inquired whether any of the members felt that the rate should have been raised to 5 per cent. President Moorhead replied that without question the rate should have been raised. The only question was how much. Perhaps an increase of a full percentage point would have created too much shock. Mr. Mayer suggested that such an increase would have signaled something more than the Federal Reserve might have had in mind. The increase to 4-1/2 per cent indicated an awareness on the part of the Federal Reserve but did not signal anything more. All members of the Council then indicated that they felt the increase to 4-1/2 per cent was appropriate.

Chairman Martin expressed concern that a period of easy money resulted in a number of banks being caught in unsound credit practices. When that happened, people tended to say that the Federal Reserve was at fault. However, reliance must be placed on the judgment of the banking industry.

Mr. Mayer remarked that good bank management could not be legislated, and Chairman Martin agreed. Mr. McNeill said that he did not like the deposit mix at the present time, and Chairman Martin

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replied that he did not either, but the question was how to change it. Mr. McNeill, after observing that that came right back to the matter of bank management, added that there were no members of the Council who did not have some concern about the deposit mix and the vulnerability of banks to CD's.

Mr. Mayer said he did not like to contemplate what might have to be done if no adequate fiscal action was taken. It was too much to expect the Federal Reserve to hold its hand in the dike.

Chairman Martin inquired whether there were any Council members who did not believe there was a need for some fiscal help, and no members so indicated. Mr. Brinkley said he was concerned that perhaps the Council had not worded its statement strongly enough. Mr. Fleming commented that the Council members thought the Federal Reserve had done a creditable job under all the circumstances, and Mr. Stewart agreed.

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Chairman Martin noted that several Council members--President Moorhead, Vice President Fleming, and Messrs. Bodman, Brinkley, and Knight--would conclude their service at the end of this calendar year. He expressed appreciation to them on behalf of the Board.

President Moorhead replied that he and the other members had found the experience rewarding.

It was agreed that the next meeting of the Federal Advisory Council would be held on February 19-20, 1968.

The meeting then adjourned.

Secretary

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