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 February 19, 1968, 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. David M. Kennedy. Mr. Herbert V. Prochnow, President (retired), The First National Bank of Chicago, attended as an Alternate.

The Secretary provided each member with a list of all the members of the Council for the year 1968, officially elected in accordance with communications received from the Federal Reserve banks.

Mr. John A. Mayer 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. Mayer, President
J. Harvie Wilkinson, Jr., Vice President
John Simmen, Director
Harold F. Still, 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 1967, which had been audited by D. O. Noren, Assistant Vice President of The First National Bank of Chicago. The report was approved and placed on file.

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 1968.

The by-laws were approved (copy attached). The Council approved the Secretary's notes for the meeting of November 20-21, 1967.

BY-LAWS OF THE FEDERAL ADVISORY COUNCIL

ARTICLE I. OFFICERS

The Officers of this Council shall be a President, Vice President, three Directors, and a Secretary, all of whom, except the Secretary, shall also serve as the Executive Committee.

ARTICLE II. PRESIDENT AND VICE PRESIDENT

The duties of the President shall be such as usually pertain to the office; in his absence the Vice President shall serve.

ARTICLE III. SECRETARY

The Secretary shall be a salaried officer of the Council and his duties and compensation shall be fixed by the Executive Committee.

ARTICLE IV. EXECUTIVE COMMITTEE

The Executive Committee, as indicated in Article I of the by-laws, shall consist of the President, Vice President, and the three Directors.

ARTICLE V. DUTIES OF THE EXECUTIVE COMMITTEE

It shall be the duty of the Executive Committee to keep in close touch with the Board of Governors of the Federal Reserve System and with its regulations and promulgations, and to communicate the same to the members of the Council, and to suggest to the Council, from time to time, special matters for consideration.

The Executive Committee shall have the power to fix the time and place of holding its regular and special meetings and methods of giving notice thereof.

The Executive Committee shall have full power, as officers of the Council, to act for the Council between meetings of the Council.

Minutes of all meetings of the Executive Committee shall be kept and such minutes or digest thereof shall be immediately forwarded to each member of the Council.

A majority of the Executive Committee shall constitute a quorum, and action of the Committee shall be by majority of those present at any meeting.

ARTICLE VI. MEETINGS

Regular meetings of the Federal Advisory Council shall be held in the City of Washington on the third Tuesday of the months of February, May, September, and November of each year, unless otherwise directed by the Executive Committee.

A preliminary meeting of the Federal Advisory Council shall be called by the Secretary in accordance with instructions to be given by the President of the Council.

Special meetings may be called at any time and place by the President or the Executive Committee, and shall be called by the President upon written request of any three members of the Council.

ARTICLE VII. ALTERNATES

In the absence of the regular representative of any Federal Reserve District, the Board of Directors of the Federal Reserve Bank of that District may appoint an alternate. The alternate so appointed shall have the right to be present at all the meetings of the Council for which he has been appointed. He shall have the right to take part in all discussions of the Council but shall not be entitled to vote.

ARTICLE VIII. AMENDMENTS

These by-laws may be changed or amended at any regular or special meeting by a vote of a majority of the members of the Federal Advisory Council.

February 19, 1968

President Mayer opened the meeting with a brief discussion of the Council's procedure, outlining the confidential nature of the Council's Memorandum to the Board of Governors. He also emphasized that the minutes of the joint meeting of the Council with the Board of Governors are highly confidential and intended only for the members of the Board and the Council.

There followed a brief discussion on the desirability of having members of the Council submit topics for the Agenda for discussion by the Board and the Council as well as questions that might be suggested for review by the Board's staff.

ITEM I A

ECONOMIC CONDITIONS AND PROSPECTS.

A. HOW DOES THE COUNCIL APPRAISE THE GENERAL ECONOMIC OUTLOOK FOR THE FIRST HALF, AND FOR THE SECOND HALF, OF 1968? THE OUTLOOK FOR WAGE AND PRICE DEVELOPMENTS?

The President of the Council read Item I A and invited the members of the Council to comment. An extended discussion followed. There was agreement that the level of business in the first half of 1968 would continue to rise. It was acknowledged that retail sales, including automobiles, had strengthened, although uncertainty remains as to the attitude of consumers. Several members reported a moderate rise in capital spending by businessmen. Inventory growth seemed to be limited to the stockpiling of steel, automobiles and aluminum.

The outlook for the second half of 1968 was less certain. To the extent that inventories accumulated in the first half of the year were used up, production would moderate. On the other hand, and as several members mentioned, recent developments in Vietnam may force defense spending to exceed current budget estimates. In addition, it is possible that at some point during the year the consumer spending-savings rate may change and expand retail sales. The relatively strong demand for labor, together with the recent trend in wage negotiations, suggests a continued rise in wages in excess of productivity. This in turn is likely to be reflected in higher prices although several members suggested that competitive pressures might limit price rises to something less than the increase in wages and other costs, thereby narrowing profit margins.

ITEM I B

B. WHAT IMPRESSIONS DO COUNCIL MEMBERS HAVE FROM THEIR CUSTOMER CONTACTS WITH RESPECT TO PROSPECTIVE TRENDS IN BUSINESS INVENTORIES?

President Mayer read Item I B. A brief discussion followed in which the members reiterated their judgment that stockpiling in excess of the rise in sales tended to be limited to steel, automobiles and aluminum.

ITEM I C

C. WHAT IS THE OUTLOOK FOR THE AVAILABILITY OF MORTGAGE FUNDS AND FOR RESIDENTIAL CONSTRUCTION IN THE COUNCIL MEMBERS' RESPECTIVE REGIONS?

President Mayer then read Item I C. The discussion disclosed that the outlook for the availability of mortgage funds and residential construction varied somewhat from district to district. It appeared, however, that the current difficulty continues to be the attractiveness of yields on alternative investments plus the usury laws in some areas. In general, however, the supply of savings appeared to be adequate. These developments and the threat of disintermediation if interest rates rise, have tempered the outlook for mortgage funds and residential construction.

ITEM II A

BANKING DEVELOPMENTS.

A. WHAT IS THE COUNCIL'S ASSESSMENT OF THE PROBABLE STRENGTH OF BUSINESS LOAN DEMANDS IN THE LATE WINTER AND SPRING?

The President of the Council read Item II A. The discussion disclosed that business loan demands had been less than anticipated. Despite this, the Council expects a moderate strengthening in business loan demands above seasonal in the late winter and spring. This will reflect the anticipated build-up of inventories, particularly of steel, the rise in the price level, the probability of an acceleration in corporate tax payments, and above all, the substantial increase in bank loan commitments.

ITEM II B

B. DO COUNCIL MEMBERS OBSERVE OR EXPECT ANY SIGNIFICANT ACCELERATION IN DEMANDS FOR CONSUMER CREDIT? HAS ANY CHANGE IN CONSUMER CREDIT TERMS BEEN DEVELOPING?

The President of the Council then read Item II B. The members of the Council reported no significant acceleration in the demand for consumer credit. Several mentioned, however, that if the recent improvement in auto sales persists, consumer credit demands will accelerate, but that this is not yet apparent. No member reported any significant change in consumer credit terms.

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 Mayer read Item II C. The ensuing discussion suggested that the recent decline in large denomination C/D's in

New York and Chicago probably reflects a number of developments including (1) a less than anticipated demand for loans; (2) less aggressive bidding for funds by the money center banks in view of the easing of rates for Euro-dollars; and (3) the use of corporate cash to finance recent inventory growth. Several members mentioned that even a moderate increase in loan demand or a tightening of credit policy would push rates above the present Regulation Q ceilings. Accordingly, the Council decided to again suggest that the Board consider raising the interest rate ceilings on large denomination C/D's. Consumer-type C/D's, it was reported, continued to increase but at a somewhat slower rate than a year ago. There was no clear evidence of the trend in passbook savings except that it seemed to vary from district to district.

ITEM II D

D. THE BOARD WOULD WELCOME ANY COMMENTS BY COUNCIL MEMBERS ON THE PROPOSED AMENDMENTS TO REGULATION D, CONCERNING TECHNICAL CHANGES IN THE COMPUTATION OF RESERVE REQUIREMENTS BY MEMBER BANKS, THAT WERE PUBLISHED ON JANUARY 29, 1968.

The President of the Council read Item II D. The members were unanimous in their praise of the proposed amendments to Regulation D concerning technical changes in the computation of reserve requirements by member banks.

ITEM III A

BALANCE OF PAYMENTS

A. HOW WOULD THE COUNCIL ASSESS THE PROBABLE EFFECTIVENESS OF KEY ELEMENTS OF THE NEW BALANCE OF PAYMENTS PROGRAM, INCLUDING THOSE RELATING TO DIRECT INVESTMENT, LENDING BY FINANCIAL INSTITUTIONS, AND TRAVEL ABROAD?

President Mayer read Item III A. An extended discussion followed. It was decided to acknowledge that the recent sharp deterioration in our balance of payments demanded prompt action and that the Council was hopeful that the Administration's program would help narrow the deficit. There was wide agreement, however, that the longer the program is in force, the less effective it is likely to become. The Council also believes that it does not come to grips with the basic problem. In the Council's judgment, national policies of fiscal restraint would be the most effective technique that could be employed to insure the continued confidence in the U. S. dollar.

ITEM III B

B. IN THE JUDGMENT OF THE COUNCIL, WILL THE NEW GUIDELINES FOR RESTRAINT OF FOREIGN CREDITS SIGNIFICANTLY AFFECT THE AVAILABILITY OF FINANCING FOR U. S. EXPORTS?

President Mayer than read Item III B. The Council concluded that the new guidelines are likely to reduce the availability of financing for U. S. exports. No one had a firm judgment as to just how significantly this financing would be affected.

ITEM III C

C. TO WHAT EXTENT, IF ANY, WOULD THE COUNCIL EXPECT U. S. BANKS TO INCREASE LENDING ACTIVITY AT THEIR FOREIGN BRANCHES TO OFFSET THEIR REDUCED ABILITY TO MAKE LOANS SUBJECT TO THE GUIDELINE CEILINGS? WHAT EFFECTS WOULD SUCH A DEVELOPMENT, AND OTHER FACTORS, BE LIKELY TO HAVE ON THE VOLUME OF EURO-DOLLARS "LOANED" BY THE BRANCHES TO THEIR HOME OFFICES OVER THE NEXT FEW MONTHS?

President Mayer read Item III C. The Council expects U. S. banks to increase substantially their lending activity at foreign branches. This will reflect the commercial banks' inability to expand loans to foreigners because of the guideline ceilings as well as the foreign investment limitations on U. S. firms. The growth of these lending activities may limit the volume of Euro-dollars loaned by branches to their head offices. In recent weeks U. S. banks have tended to step up their "borrowing" from foreign branches because of the relative attractiveness of the rates on these funds.

ITEM IV

WHAT ARE THE COUNCIL'S VIEWS ON MONETARY AND CREDIT POLICY UNDER CURRENT CIRCUMSTANCES, (a) ASSUMING REASONABLY PROMPT PASSAGE OF AN INCOME TAX SURCHARGE? (b) ASSUMING NO INCOME TAX SURCHARGE WILL BE PASSED?

President Mayer read Item IV. In general, the discussion suggested that the Council would favor a continuation of the somewhat less easy monetary and credit policy that has prevailed in recent weeks assuming prompt passage of an income tax surcharge. If no fiscal policy restraint is forthcoming, and inflationary pressures intensify, additional monetary restraint will be necessary. The Council suggested, however, that sufficient reserves be provided to underwrite Treasury borrowings and to avoid creating a 1966 type credit crunch.

It was suggested at this point that the Secretary preface the Council's Memorandum to the Board of Governors with a brief statement indicating the Council's concern about the recent deterioration in the U. S. balance of payments and the resulting challenge of the dollar in the money markets of the world.

The meeting adjourned at 12:25 P.M.

THE COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING, WASHINGTON, D.C., AT 2:30 P.M. ON FEBRUARY 19, 1968. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MR. DAVID M. KENNEDY. MR. HERBERT V. PROCHNOW ATTENDED AS AN ALTERNATE.

Mr. Daniel H. Brill, Director, and members of the staff of Division of Research and Statistics, participated in an audio-visual presentation on the federal budget and its implications for credit and money markets.

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THE COUNCIL RECONVENED AT 5:20 P.M. ON FEBRUARY 19, 1968, IN THE BOARD ROOM OF THE MADISON. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MR. DAVID M. KENNEDY. MR. HERBERT V. PROCHNOW 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 February 20, 1968. The Memorandum was delivered to the Federal Reserve Building at 9:45 P.M. on February 19, 1968.

The meeting adjourned at 6:20 P.M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON FEBRUARY 20, 1968

1. Economic conditions and prospects.

   A. How does the Council appraise the general economic outlook for the first half, and for the second half, of 1968? The outlook for wage and price developments?

The Council anticipates a continued rise in the level of business in the first half of 1968. There is little persuasive evidence yet that the consumer has become less cautious. Capital spending by businessmen is rising moderately. Outlays for inventories appear to be increasing in line with sales, except for the stockpiling of steel, automobiles and aluminum.

The outlook for the second half of 1968 is much less certain. To the extent that inventories accumulated in the first half of the year are used up, production may moderate. On the other hand, recent developments in Vietnam have caused some observers to question the ability of government to limit the rise in defense spending to current budget estimates. In addition, it is possible that at some point during the year, the consumer spending-savings rate may return to a more normal pattern, and result in expanding retail sales.

The relatively strong demand for labor as evidenced by the current unemployment rate, together with the trend in wage negotiations suggests a continued rise in wages in excess of productivity. This in turn will be reflected in prices although it is possible that competitive pressures will limit price rises to something less than the increase in wage and other costs, thereby narrowing profit margins.

B. What impressions do Council members have from their customer contacts with respect to prospective trends in business inventories?

As noted above, outlays for inventories appear to be increasing in line with sales, except for the stockpiling of steel, automobiles and aluminum. Several members reported that steel output is considerably in excess of sales to customers and that the steel companies are stockpiling items.

C. What is the outlook for the availability of mortgage funds and for residential construction in the Council members' respective regions?

The outlook for the availability of mortgage funds and residential construction varies somewhat from district to district. In general, however, the current difficulty continues to be the attractiveness of yields on alternative investments, plus the usury laws in some areas, rather than the supply of savings for investment. The resultant reluctance of some financial institutions to make mortgage commitments, together with the threat of disintermediation if interest rates rise, tempers the outlook for mortgage funds and residential construction.

2. Banking developments.

A. What is the Council's assessment of the probable strength of business loan demands in the late winter and spring?

Although business loan demands have been less than anticipated, the Council believes there will be a moderate strengthening of business loan demands above seasonal in the late winter and spring. This will reflect the anticipated build-up of inventories, particularly of steel, the rise in the price level and the probability of an acceleration of corporate tax payments as recommended by the Administration. This is also supported by the substantial increase in bank loan commitments.

B. Do Council members observe or expect any significant acceleration in demands for consumer credit? Has any change in consumer credit terms been developing?

The members of the Council have not observed any significant acceleration in the demands for consumer credit. If the improvement in automobile and other retail sales that developed recently persists, consumer credit demands obviously will accelerate, but this is not yet apparent. No significant change in consumer credit terms appears to be developing.

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 recent decline in large denomination CD's in New York and Chicago probably reflects a number of developments including (1) a less-than-anticipated demand for loans, (2) less aggressive bidding for funds by the money-center banks in view of the easing of rates for Euro-dollars, and (3) the use of corporate cash to finance recent inventory growth. Even a moderate increase in loan demand, or a tightening in credit policy, is likely to push rates to the present Regulation Q ceilings. The Council again suggests that the Board consider raising the present ceiling on large-denomination CD's.

Consumer-type CD's continue to increase, but at a somewhat slower rate than a year ago. The trend in passbook savings varies from district to district.

D. The Board would welcome any comments by Council members on the proposed amendments to Regulation D, concerning technical changes in the computation of reserve requirements by member banks, that were published on January 29, 1968.

In general, the Council members approve of the proposed amendments to Regulation D concerning technical changes in the computation of reserve requirements by member banks. Several members reported that they had communicated this view to the Board of Governors.

3. Balance of Payments.

A. How would the Council assess the probable effectiveness of key elements of the new balance of payments program, including those relating to direct investment, lending by financial institutions, and travel abroad?

Recognizing that the recent sharp deterioration in our balance of payments demanded prompt action, the Council is hopeful that the Administration's program, relating to direct investment, lending by financial institutions, and travel abroad will help narrow the deficit. However, there is wide agreement that the longer such a program is in force, the less effective it is likely to become. Moreover, it clearly does not come to grips with the basic problem. At best, it provides time to take the required action. National policies giving unmistakable evidence of fiscal restraint and a determination to reduce inflationary pressures would be the most effective technique to insure continued confidence in the U.S. dollar.

B. In the judgment of the Council, will the new guidelines for restraint of foreign credits significantly affect the availability of financing for U.S. exports?

In the Council's judgment the new guidelines for restraint of foreign credit are likely to reduce the availability of financing for U.S. exports. It is not possible at this time to know how significantly export financing will be affected.

C. To what extent, if any, would the Council expect U.S. banks to increase lending activity at their foreign branches to offset their reduced ability to make loans subject to the guideline ceilings? What effects would such a development, and other factors, be likely to have on the volume of Euro-dollars "loaned" by the branches to their home offices over the next few months?

The Council expects U.S. banks to increase substantially their lending activity at foreign branches as they seek to meet the needs of their customers. In some instances this will reflect the commercial banks' inability to expand loans to foreigners because of the guideline ceilings and in other instances will result from the foreign investment limitations on U.S. firms. If these lending activities expand substantially, it may be that the volume of Euro-dollars "loaned" by the branches to their home offices will be limited. However, if funds in the United States become sufficiently tight, lending activities at foreign branches may be curtailed in order to "lend" additional Euro-dollars to their home offices. In recent weeks, U.S. banks have tended to step-up their "borrowing" from foreign branches because of the relative attractiveness of the rates on these funds.

4. What are the Council's views on monetary and credit policy under current circumstances, (a) assuming reasonably prompt passage of an income tax surcharge? (b) assuming no income tax surcharge will be passed?

Assuming reasonably prompt passage of an income tax surcharge, the Council would favor a continuation of the somewhat less easy monetary and credit policy that has prevailed in recent weeks. If no fiscal policy restraint is forthcoming and inflationary pressures intensify, additional credit and monetary restraint will be necessary. However, sufficient reserves should be provided to underwrite Treasury borrowings and to avoid creating a 1966-type credit crunch.

ON FEBRUARY 20, 1968, 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. DAVID M. KENNEDY. MR. HERBERT V. PROCHNOW ATTENDED AS AN ALTERNATE.

THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: CHAIRMAN MARTIN, VICE CHAIRMAN ROBERTSON, GOVERNORS MITCHELL, BRIMMER, DAANE AND MAISEL. ALSO PRESENT WERE ROBERT HOLLAND, SECRETARY OF THE BOARD, MERRITT SHERMAN, ASSISTANT TO THE BOARD, AND KENNETH A. KENYON, DEPUTY SECRETARY.

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 12:30 P.M.

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The next meeting of the Council will be held on June 3-4, 1968.

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 20, 1968.

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

Mr. Holland, Secretary
Mr. Kenyon, Deputy Secretary
Mr. Sherman, Assistant to the Board

Messrs. Simmen, Moore, Still, Mayer, Wilkinson, Craft, Fox, Nason, Conn, Stewart, and Larkin, Members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Eighth, 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 1968:

President	John A. Mayer
Vice President	J. Harvie Wilkinson, Jr.
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. Mayer) and Vice President (Mr. Wilkinson): John Simmen, Harold F. Still, Jr., and Robert H. Stewart, III.

The following members of the Council had begun their service as such at the beginning of 1968 and were attending their first meeting of the Council:

George S. Moore, Chairman of the Board, First National City Bank, New York, New York
George S. Craft, Chairman of the Board, Trust Company of Georgia, Atlanta, Georgia
John Fox, Chairman of the Board, Mercantile Trust Company National Association, St. Louis, Missouri
Philip H. Nason, President, First National Bank, St. Paul, Minnesota
Jack T. Conn, Chairman of the Board, Fidelity National Bank and Trust Company, Oklahoma City, Oklahoma

Another newly-appointed Council member, David M. Kennedy, Chairman of the Board of Continental Illinois National Bank and Trust Company of Chicago, Chicago, Illinois, was unable to be present at this meeting of the Council. In his absence the Seventh District was represented by Mr. Prochnow.

In advance of today's meeting the Council had submitted a memorandum containing its replies to questions that had been suggested by the Board for discussion. The memorandum also contained the following prefatory paragraph:

> Although the Council will attempt to respond to the questions set forth in the agenda, we wish to preface our replies by stating that this meeting of the Council takes place in an atmosphere of impending crisis of confidence in the dollar greater than at any time in the Council's recent history. We have set forth with all the urgency we can summon our views on the necessity for a reduction in government expenditures abroad and at home to protect

our gold supply and to maintain a domestic price level that would sustain the competitiveness of our exports. Concurrently, we again urge the proposed tax increase. Failing these measures, a crisis of confidence in the dollar will occur. In the absence of resolute action on our part, the decision will be made for us by those who hold our present and potential dollar liabilities.

President Mayer stated that the paragraph had been included because the Council felt strongly about the seriousness of the situation and believed that this expression of opinion by a group of representative bankers might be of some use to the Board.

Chairman Martin replied that the Board appreciated knowing that the Council urged the proposed tax increase. Anything the members could do that would help to obtain the passage of the legislation would be helpful. It was a symbolic issue at the present time as well as a matter of figures.

Governor Brimmer then raised the question whether an effort should be made to share the views of the Council with others in a systematic way. From discussion with the Board's staff he understood that that had been done from time to time in the past, that on certain occasions the views of the Council had been transmitted to Congressional committees, and that in several instances resolutions of the Council were included in the Board's Annual Reports, for example, in support of bank holding company legislation. He presented for consideration whether the Council might want to consider adopting a practice of making the essence of its views on important issues available to the public. There were some elements of risk in doing that on an ad hoc basis in terms of specific legislation, for that might have aspects of lobbying.

Governor Daane commented that, as Chairman Martin had said, it would be useful for the Council members to do everything they could on the tax question, both individually and as a group. However, he would have reservations about releasing material indicating that the Council was predicting a dollar crisis. It was helpful for the Board to have a report reflecting the views of the Council, but he would be apprehensive about issuing any release containing the language of the prefatory paragraph.

Chairman Martin agreed that it would be unfortunate if the language of the paragraph were made public, and President Mayer said that such a possibility had not been considered by the Council members. It had occurred to the Council that this was something the Chairman might use within Governmental circles, as his judgment dictated, to buttress his own arguments. Conceivably it might be shown by the Chairman to individual members of the Congress. But the Council had not thought of the statement as something that would be made a matter of public record.

Mr. Moore suggested that it might meet the points that had been mentioned if the Council were to pass a resolution, which could be transmitted to the proper people, supporting the view of the Board on the proposed tax increase.

President Mayer asked for the judgment of the Board as to the value of such a resolution, and Chairman Martin replied that he thought it would have value. The problem was one of precedent; the real question was whether this was a situation such as to warrant initiating such a procedure.

In further discussion of what had been done at times in the past, Governor Brimmer repeated his understanding that on various occasions the views of the Council had been transmitted to Congressional committees, for example on the matter of bank holding company legislation. That resolution, he was informed, had been included in one of the Board's Annual Reports. He noted that his original question had been framed in terms of longer-run policy. In his opinion it would be unfortunate to proceed on an ad hoc basis. But if the Council felt that it would like to institute a general practice of making its views known on various subjects, that put the matter in a different perspective. For instance, the Council might decide to present, after each meeting, a summary of its views. He agreed with Governor Daane and Chairman Martin that making the Council's prefatory paragraph public at this time would not be desirable.

On the longer-run issue, Governor Daane said he would have some reservations. He wondered whether it would not be preferable for the Council simply to express its views to the Board and not try to tailor them for public consumption.

Mr. Wilkinson noted that the Council might give two different types of answers under those circumstances, and President Mayer agreed that the inhibitions could be substantial.

Chairman Martin agreed with those comments. However, assuming that the current situation was as grave as the Council implied in its prefatory paragraph, it seemed to him that it would be quite appropriate if the Council should want to express itself in the form of a resolution directed to the tax issue. If the Council was unanimous in its view on that score, such a resolution might be helpful.

President Mayer expressed the view that Council members, in making reports to the boards of directors of their respective Reserve Banks, should not discuss the prefatory paragraph, at least to the extent that it referred to an impending crisis of confidence in the dollar. Such reports, he thought, should be limited essentially to the Council's position on the proposed tax increase.

Chairman Martin again expressed the view that it would be helpful at this juncture if he could report to the Secretary of the Treasury or others that the Council was unanimous in urging the proposed tax increase, and President Mayer asked whether there was any Council member who did not feel that the tax increase was necessary at this time.

Mr. Conn commented that he had been President of the American Bankers Association at the time the Association adopted a policy statement urging enactment of the tax increase but also, in strong language, calling for a reduction of Government expenditures and more fiscal restraint. He would not like to see the Council come out flatly on the matter of the tax increase without also urging reductions in non-defense expenditures.

Mr. Moore said he thought all of the Council members would agree that any Council resolution should include some reference to the matters Mr. Conn had mentioned.

In further discussion of the possibility of the Council's adopting such a resolution, Governor Robertson expressed reservations as to whether that would be wise. The Chairman of the Board, he said, should be free to transmit the views of the Council informally to appropriate parties within the Government. However, he questioned whether those views should be reduced to the formality of a resolution. The real value of the Council's meetings with the Board lay in the freedom of the members to say what they thought and for the Board to have the benefit of those views. The advisory role of the Council should be dominant.

Mr. Nason observed that the use to be made of any resolution adopted by the Council would be within the Board's discretion, and Mr. Moore added that the Board could either keep such a resolution in its files or use the resolution as it saw fit.

Governor Brimmer agreed that the Council should not pass any resolution on the assumption that it would in fact be shared with others outside the Board, for that decision should be left to the Board's discretion.

President Mayer pointed out that an alternative would be simply to make the sense of the Council known to the Board, with the understanding that that could be used in the Board's discretion.

Chairman Martin agreed that that alternative would also be appropriate. The matter could be left on that basis, with the understanding that the Board could use the language expressing the sense of the Council in any way that it saw fit.

President Mayer commented that he thought the point Governor Robertson had made was a good one. When Council members left the meeting room, they should not carry to outside parties detailed reports on what had happened at the meeting. If that were done, the ability of the members to speak freely and the ability of the Board to probe what the Council members had said would be eroded.

Chairman Martin said he appreciated the point. However, at certain junctures there was no reason why, if the Council felt strongly on a particular subject, its views should not be transmitted to the proper authorities.

Mr. Larkin noted that the Council had made a very strong statement. He requested clarification as to how the memorandum was expected to be handled.

President Mayer observed that the Council's statement was not in response to a question asked by the Board. He felt that the statement should not be transmitted to the boards of directors of the Federal Reserve Banks, nor even to the Presidents.

Chairman Martin expressed doubt that it would be feasible for the Board to prescribe what reports Council members should make to the directors of their respective Reserve Banks.

Governor Mitchell then commented that the problem appeared to relate almost exclusively to the language of two of the sentences in the prefatory paragraph. They could be modified somewhat, and the Council could still have an emphatic statement.

Governor Daane pointed out that in any event the Board had received the benefit of the Council's views. And he understood that the Council had given Chairman Martin the right to express the sense of the Council to others in his judgment.

On the matter of precedent, Chairman Martin turned to Mr. Sherman, who recalled that a number of Council resolutions had been adopted over the years, although not in recent years. In 1948, for example, the Council adopted a resolution favoring the enactment of bank holding company legislation. Such resolutions typically had been handed to the Board for such use as the Board might want to make of them. In addition, the Council had occasionally used another type of communication, namely, a statement of views on credit policy. Those had been furnished to the Board for the Board's own purposes, sometimes with a notation that they might be helpful in connection with discussions of Treasury financing. While the use of such statements was left to the discretion of the Chairman of the Board, a few of the Council's resolutions subsequently became public documents.

Mr. Sherman also observed that no distribution was made by the Board of the memoranda submitted by the Council prior to each joint meeting with the Board except to Board members and selected staff. Any other distribution was made by the Secretary of the Council.

Mr. Moore then commented that he would be opposed to eliminating the prefatory paragraph from the memorandum, for he felt that it should be in the record. Further, he could see no objection to the adoption of a resolution by the Council, as long as it was clear that the prefatory paragraph of the memorandum was merely presented to the Board for the Board's use. The Council had adopted resolutions in the past, and he saw no objection to its transmitting a resolution to the Board again.

President Mayer commented that once a resolution was transmitted to the Board, it was something about which the Council should not talk from that point forward.

On the matter of reporting to the directors of the New York Bank, Mr. Moore said he did not believe he would be acting properly if he did not convey the view of the Council that the balance of payments problem was very serious and that fiscal restraint should be given priority. He would not have to talk about the prospect of a crisis, but he would want to report the essence of what the Council had recommended to the Board.

Chairman Martin then remarked that it was helpful to have had the discussion today. When he was in the Treasury many years ago, he added, the Secretary of the Treasury regularly received statements, of the kind Mr. Sherman had mentioned, reflecting views of the Council. When he (Chairman Martin) became a member of the Board, he decided not to pass such communications through to the Treasury. The circumstances and relationships at that time were of course somewhat different from those that now existed.

Mr. Moore suggested that the Secretary of the Council could prepare a resolution on which the Council members could agree unanimously and that the resolution could be transmitted to the Board for the use of the Board as it might see fit, and Chairman Martin replied that the form of a communication from the Council to the Board was a matter for the Council to decide. The Board would assume the responsibility for the use of such a communication. If the Council wanted to adopt a resolution, the Board could then decide whether to use it or not. On the other hand, the Board would also be agreeable to accepting the sense of the Council. In the present circumstances, he felt that it would be helpful if he (the Chairman) were able to tell the Secretary of the Treasury what the views of the Council were regarding the proposed tax increase.

President Mayer again expressed reluctance about having the Council's statement, with the fourth and fifth sentences included, transmitted by Council members to the directors of the Reserve Banks. There followed a suggestion that the statement might be redrafted, along with the submission of a Council resolution to the Board. However, Mr. Wilkinson observed that he understood the Council's statement would become part of the official record as it now read. President Mayer said he was agreeable to that, provided Council members did not refer to the fourth and fifth sentences in discussions with the directors of their respective Reserve Banks.

Governor Daane supported the view of President Mayer, and the latter then urged that the Council consider redrafting the language in the form of a resolution to the Board and stop there. However, Messrs. Moore and Wilkinson continued to feel that the full statement should be a part of the record. Mr. Conn then suggested that the Council adopt a separate resolution, with authority to the Board to use it as the Board saw fit. Then, as far as the Board was concerned, the official record could stand with the Council's full statement included. President Mayer observed that the minutes of the joint meeting would be kept confidential by the members of the Council.

Mr. Prochnow noted that there was, however, a certain inescapable risk that the memorandum from the Council to the Board would become available in some fashion to Reserve Bank directors or others.

President Mayer agreed that such a risk existed, as did Governor Daane. The latter suggested that the Council's memorandum, as it stood, become a part of the Board's records only. He felt, however, that there would be no objection if Council members related to the directors of their Reserve Banks the substance of whatever resolution the Council might adopt.

Governor Maisel then suggested a procedure according to which members of the Council would report orally to the boards of directors as they saw fit, the prefatory paragraph of the Council's memorandum would be eliminated from the final version of that memorandum, which might be distributed, but the paragraph would become a part of the records of the Board and the Council.

Chairman Martin noted that the Board had never prescribed what members of the Council should report to their respective boards of directors. He had attended a number of directors' meetings at which the Council's memorandum to the Board had been presented in full, while on other occasions there had been no reference to it. He did not believe that the Board should try to prescribe what the Council members should say to the directors of their Banks; that would require establishing an entire new set of guidelines.

Mr. Sherman commented that even if the Council should decide to leave the first paragraph out of its memorandum, there would be contained in the minutes of this meeting a reference to that paragraph and the discussion pertaining to it. However, the mimeographed memorandum could be redone with the paragraph in question omitted. The memorandum as originally prepared could then be destroyed.

Governor Daane commented that that would seem prudent, and Mr. Moore agreed.

There developed to be general agreement with such a procedure. Accordingly, it was understood that the mimeographed copies of the Council's memorandum that had been distributed would be picked up and that the memorandum would be reissued in a form in which the first paragraph was deleted.

> Secretary's Note: There follows the text of the resolution passed unanimously by the Federal Advisory Council, as subsequently transmitted to the Chairman of the Board of Governors:

The Federal Advisory Council of the Federal Reserve System today unanimously passed the following resolution and directed that it be forwarded to the Chairman of the

Board of Governors with permission to use it in any way that might be helpful to the Board in the attainment of the objectives stated in the resolution:

The Federal Advisory Council wishes to state, with all the emphasis it can summon, the critical and urgent need to reduce government expenditures abroad and at home to protect our gold supply and to maintain a domestic price level that will sustain the competitiveness of our exports. Concurrently, we also again strongly urge the proposed tax increase to help accomplish these objectives.

1. Economic conditions and prospects.

A. How does the Council appraise the general economic outlook for the first half, and for the second half, of 1968? The outlook for wage and price developments?

The Council anticipates a continued rise in the level of business in the first half of 1968. There is little persuasive evidence yet that the consumer has become less cautious. Capital spending by businessmen is rising moderately. Outlays for inventories appear to be increasing in line with sales, except for the stockpiling of steel, automobiles, and aluminum.

The outlook for the second half of 1968 is much less certain. To the extent that inventories accumulated in the first half of the year are used up, production may moderate. On the other hand, recent developments in Vietnam have caused some observers to question the ability of government to limit the rise in defense spending to current budget estimates. In addition, it is possible that at some point during the year the consumer spending-savings rate may return to a more normal pattern, and result in expanding retail sales.

The relatively strong demand for labor as evidenced by the current unemployment rate, together with the trend in wage negotiations, suggests a continued rise in wages in excess of productivity. This in turn will be reflected in prices although it is possible that competitive pressures will limit price rises to something less than the increase in wage and other costs, thereby narrowing profit margins.

Governor Daane referred to the Council's comment that there was as yet little persuasive evidence that the consumer had become less cautious. He asked whether the Council viewed a continuance of the present level of consumer saving as likely and what appeared to be the reasons for it.

President Mayer replied that there were a lot of uncertainties. People were worried, and for that reason cautious.

Mr. Moore noted an increase in purchases of automobiles on credit in January. He saw some straws in the wind suggesting the prospect of increased consumer spending. The evidence was not yet persuasive, but this might develop before the year was out.

Governor Maisel asked for the Council's views about prospective business spending for plant, equipment, and inventories. A fear of inflation should tend to speed up such spending, offsetting the general atmosphere of caution.

Mr. Moore remarked that plant and equipment improvement was the only way businesses could keep up with the increase in labor costs. Obsolescence in the steel industry was a serious matter; in situations of that kind it was necessary to move ahead regardless of other factors.

President Mayer observed that many companies had programs in process, the pay-off on which would not come until they were completed.

Governor Mitchell asked if it was not a matter of concern to companies if they were adding to capacity faster than the real economy was growing.

President Mayer said that this was a matter of concern in the aluminum industry. However, with competitors increasing plant facilities, individual companies were not willing to forego their share of the total market in the future.

Mr. Still commented that it was necessary to distinguish between efficient and less efficient plant facilities, to which Mr. Moore added that in the steel industry high-cost facilities were being used on which the companies were actually losing money.

Governor Mitchell noted that the over-all figures indicated plant was being utilized only to the extent of around 83-85 per cent of capacity, and Mr. Moore replied that the average age of facilities should be taken into consideration. It was important to distinguish between new plant and plant 20 years old. President Mayer added, however, that when capacity was being utilized at a rate of only about 85 per cent companies usually were not making as much money as when they were operating at higher levels, despite the fact that the higher levels brought less efficient facilities into use.

Governor Brimmer asked for the Council's views on what had been developing in terms of plans for new capital expenditures since last fall. It was his impression that in October and November many companies made decisions on the rate at which they would invest during the coming year, and he wondered whether those plans were being revised.

Mr. Moore said he knew of none that had been revised downward. At every board meeting that he attended he saw new programs being added.

Mr. Craft said he had seen no evidence of curtailment of plans in the areas with which he was familiar.

President Mayer commented that he thought top management was tending to be somewhat more critical of proposed programs and to ask more questions. They were not quite so willing to approve some projects that would have been approved in a different atmosphere. Despite this tendency, however, companies were still spending a lot of money, for example in the aluminum industry.

Mr. Wilkinson said two companies with which he was familiar were now taking a second look at modernization of plant of their foreign subsidiaries until financing could be assured, and that was now more difficult because of the Commerce Department's program relating to foreign investments.

President Mayer noted that in some cases foreign operations had proved not to be as profitable as the companies thought when they entered the field.

Governor Mitchell inquired whether Council members sensed any change in the psychology of businesses as compared with the 1961-65 period, in terms of domestic operations, and President Mayer replied that since 1966 programs were being looked at more skeptically. Mr. Moore commented that nevertheless programs were still larger than before, and President Mayer cited the factor of technology. Mr. Stewart noted that today few large companies were in only one line of business.

Governor Maisel said he assumed from the comments that there had not been an acceleration of expectations, and there were no indications to the contrary.

Governor Brimmer asked the Council to confirm his understanding that no substantial cancelations of programs had been noticed, and Council members indicated that they had not noticed such cancelations.

Mr. Simmen observed that the foregoing comments were not necessarily pertinent when it came to small businessmen, who appeared to be very cautious. A lot of the commitments they had obtained from banks had not been utilized.

Chairman Martin asked if the Council members felt there had been some disenchantment in terms of foreign investments, and the replies were in the affirmative. Mr. Moore said that earnings records in Europe had generally been disappointing. Even if the present balance of payments program were not in effect, he felt that the volume of investments would have declined. President Mayer agreed, adding that some companies had gone abroad without sufficient knowledge and the results had not met their expectations.

Governor Brimmer inquired whether the Council expected a substantial narrowing of corporate profit margins, and President Mayer replied that much depended on the line of business. Some companies were able to pass along added costs more easily than others. Mr. Moore noted that economists of his bank were estimating that gross earnings before taxes would be up 10 per cent this year, and President Mayer said that his bank's economists were making the same kind of estimates.

B. What impressions do Council members have from their customer contacts with respect to prospective trends in business inventories?

As noted above, outlays for inventories appear to be increasing in line with sales, except for the stockpiling of steel, automobiles, and aluminum. Several members reported that steel output is considerably in excess of sales to customers and that the steel companies are stockpiling items.

President Mayer said he did not think it was important whether the steel companies were stockpiling, or someone else. The inventories were piling up in any event. It should be borne in mind that the contract expiration date this year was two months later than three years ago, a point that some people apparently had overlooked, including the railroads.

Mr. Moore said that practically all of the large companies had options, not yet exercised, on Japanese and European steel. President Mayer noted that the exercising of those options might entail other obligations, and Mr. Moore added that when this happened before the foreign suppliers stayed in the picture. It was of concern to the steel people today that if foreign steel was used the foreign suppliers would keep their share of the market.

C. What is the outlook for the availability of mortgage funds and for residential construction in the Council members' respective regions?

The outlook for the availability of mortgage funds and residential construction varies somewhat from district to district. In general, however, the current difficulty continues to be the attractiveness of yields on alternative investments, plus the usury laws in some areas, rather than the supply of savings for investment. The resultant reluctance of some financial institutions to make mortgage commitments, together with the threat of disintermediation if interest rates rise, tempers the outlook for mortgage funds and residential construction.

President Mayer commented that the importance of State usury laws should not be underestimated. They were not compatible with the present pattern of interest rates, and some States were suffering because of them.

Governor Brimmer asked about the probable outcome of efforts being made to raise the rate ceilings in some States, and Mr. Wilkinson said that the effort in West Virginia appeared to have failed. In Virginia there was probably going to be an increase to 8 per cent, but he did not know about the current status of the effort being made in Maryland. Mr. Still said that in Pennsylvania the outlook was not favorable. In his area, he added, even the traditional mortgage lenders were not making mortgage loans today. Instead, they were placing funds in high-grade corporate bonds.

Governor Mitchell noted that the Council's statement did not suggest that the housing industry was going to be affected significantly by the present trend of developments, and Mr. Nason said that much depended on the region. There were no bothersome usury laws in the Ninth District and Eastern money was coming in. Mr. Craft said that a similar situation prevailed in the Sixth District, with plenty of mortgage loans being made and people apparently getting used to paying higher rates. Mr. Conn reported that in the Tenth District there was an abundance of mortgage money. Some savings and loan associations in Oklahoma City were buying mortgages because they had insufficient outlet for their funds. In that area the frustrations and fears engendered by lack of confidence apparently were contributing to lagging housing statistics; the problem was not lack of money or usury laws. Mr. Fox said those factors were not present in the Eighth District either. However, he did not agree that people were getting used to paying higher rates, and he thought that was one reason for the excess of available funds.

2. Banking developments.

A. What is the Council's assessment of the probable strength of business loan demands in the late winter and spring?

Although business loan demands have been less than anticipated, the Council believes there will be a moderate strengthening of business loan demands above seasonal in the late winter and spring. This will reflect the anticipated build-up of inventories, particularly of steel, the rise in the price level, and the probability of an acceleration of corporate tax payments as recommended by the Administration. This is also supported by the substantial increase in bank loan commitments.

Mr. Craft noted that the Council's comments inferred that some banks were holding back in order to be prepared to take care of their loan commitments.

Chairman Martin commented that he gathered, nevertheless, that loan demand was generally lower than expected, and Mr. Still agreed. Mr. Moore said he continued to feel that the loan demand would come. Some of the outstanding commitments reflected a desire for an insurance policy, but a lot of them would be used.

Governor Daane asked whether past experience did not indicate that a fairly high percentage of the commitments might remain unused, and there was agreement that that could be the case. Mr. Moore said, however, that he thought the net result would be a moderate increase in business loan demand. He and Mr. Larkin added that many companies did not like the price that had to be paid in connection with bond issues. They hoped that the bond market would improve, and they were to some extent holding out in hope of such an improvement. Mr. Craft agreed, saying that many companies would prefer to have commitments good for two years than to sell capital issues now. They hoped that in the meantime the bond market would improve.

Governor Brimmer said he had heard reports that commitments were being requested in a form that would make them much more firm than in the past, with fees being paid to a greater extent. He had received the impression that corporate lawyers were advising their clients to pin down the commitments. He asked to what extent it appeared that some of the commitments could be traced to efforts of companies that had sold commercial paper to back up that paper with bank commitments. He also asked how banks were preparing themselves to meet their commitments.

President Mayer said it was quite clear that more companies were now paying fees to make the commitments legally binding. They remembered 1966. He had not heard companies ascribe what they were doing to the fact that they were issuing commercial paper, although he could see that the companies would like an umbrella.

Mr. Fox said his experience had been a little different. Within the past year numerous companies had come in for commitments just to cover commercial paper.

Mr. Moore expressed the view that without question many companies felt that limitations were likely to be placed on bank lending, as in foreign countries. Those seeking commitments were trying to get under the wire. Other Council members indicated that they agreed.

Turning to Governor Brimmer's final question, President Mayer said that the banks had attempted to improve their liquidity. Most banks accepted the fact that, with about $20 billion of negotiable CD's outstanding, the rules of the game were now quite different. The money represented by such CD's did not have the same stability as the deposits held by banks in the past.

Mr. Moore said that many banks, including his own, had endeavored to double their liquidity.

> B. Do Council members observe or expect any significant acceleration in demands for consumer credit? Has any change in consumer credit terms been developing?

> The members of the Council have not observed any significant acceleration in the demands for consumer credit. If the improvement in automobile and other retail sales that developed recently persists, consumer credit demands obviously will accelerate, but this is not yet apparent. No significant change in consumer credit terms appears to be developing.

There was no discussion with respect to this topic.

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 recent decline in large-denomination CD's in New York and Chicago probably reflects a number of developments including (1) a less-than-anticipated demand for loans, (2) less aggressive bidding for funds by the money-center banks in view of the easing of rates for Euro-dollars, and (3) the use of corporate cash to finance recent inventory growth. Even a moderate increase in loan demand, or a tightening in credit policy, is likely to push rates to the present Regulation Q ceilings. The Council again suggests that the Board consider raising the present ceiling on large-denomination CD's.

Consumer-type CD's continue to increase, but at a somewhat slower rate than a year ago. The trend in passbook savings varies from district to district.

President Mayer reported that there was no clear pattern with respect to consumer-type CD's, and Mr. Stewart said that outlying banks were still virtually at the ceiling in terms of large-denomination CD's.

Mr. Wilkinson asked if there was any way in which statistics could be furnished breaking down the several categories of time and savings deposits. President Mayer added that if savings certificates could be separated from other time deposits, that would be a very significant figure. At present, other time deposits was an all-inclusive category, meaningless to bankers.

Governor Robertson said that efforts were being made in that direction in connection with the call report.

Governor Mitchell commented that an ownership breakdown would be helpful and, after some discussion of that point, President Mayer said that the furnishing of such figures should not be too great a burden for the large banks. Each bank would like to know what its competitors were doing and whether its own operations were typical. There might be a problem of burdening the smaller banks, but perhaps an adequate sample could be constructed from the weekly reporting member banks.

D. The Board would welcome any comments by Council members on the proposed amendments to Regulation D, concerning technical changes in the computation of reserve requirements by member banks, that were published on January 29, 1968.

In general, the Council members approve of the proposed amendments to Regulation D concerning technical changes in the computation of reserve requirements by member banks. Several members reported that they had communicated this view to the Board of Governors.

President Mayer said that none of the Council members opposed the lagged reserve proposal. The members considered it a forward step. Some Council members had forwarded their comments to the Board already, and others expected to do so shortly.

Chairman Martin noted that some criticism had been expressed, particularly by country banks, one reason being that they preferred not to shift to a weekly computation period.

3. Balance of payments.

A. How would the Council assess the probable effectiveness of key elements of the new balance of payments program, including those relating to direct investment, lending by financial institutions, and travel abroad?

Recognizing that the recent sharp deterioration in our balance of payments demanded prompt action, the Council is hopeful that the Administration's program relating to direct investment, lending by financial institutions, and travel abroad will help narrow the deficit. However, there is wide agreement that the longer such a program is in force, the less effective it is likely to become. Moreover, it clearly does not come to grips with the basic problem. At best, it provides time to take the required action. National policies giving unmistakable evidence of fiscal restraint and a determination to reduce inflationary pressures would be the most effective technique to insure continued confidence in the U.S. dollar.

B. In the judgment of the Council, will the new guidelines for restraint of foreign credits significantly affect the availability of financing for U.S. exports?

In the Council's judgment the new guidelines for restraint of foreign credit are likely to reduce the availability of financing for U.S. exports. It is not possible at this time to know how significantly export financing will be affected.

C. To what extent, if any, would the Council expect U.S. banks to increase lending activity at their foreign branches to offset their reduced ability to make loans subject to the guideline ceiling? What effects would such a development, and other factors, be likely to have on the volume of Euro-dollars "loaned" by the branches to their home offices over the next few months?

> The Council expects U.S. banks to increase substantially their lending activity at foreign branches as they seek to meet the needs of their customers. In some instances this will reflect the commercial banks' inability to expand loans to foreigners because of the guideline ceilings and in other instances will result from the foreign investment limitations on U.S. firms. If these lending activities expand substantially, it may be that the volume of Euro-dollars "loaned" by the branches to their home offices will be limited. However, if funds in the United States become sufficiently tight, lending activities at foreign branches may be curtailed in order to "lend" additional Euro-dollars to their home offices. In recent weeks, U.S. banks have tended to step-up their "borrowing" from foreign branches because of the relative attractiveness of the rates on these funds.

Governor Daane asked for further comments by the Council with respect to export financing, and President Mayer replied that the Council found it difficult, at the moment, to appraise what might happen. Mr. Moore said he did not see how lending, either direct or indirect, could be cut back without affecting exports in one way or another. However, he could not cite any specific figures. President Mayer noted that the impact of the new guidelines for foreign credit restraint would depend to a large extent on where the loans were, and Mr. Moore remarked that his bank's foreign lending would necessarily have to be reduced considerably because so many of its loans were to European borrowers.

Governor Robertson commented that the Board was concerned that adequate export financing be available. If problems were seen in that area, the Council members should let the Board know of them.

If members became aware of any situations where exports were being impeded, their advising the Board would be a real service.

Reference was made to Export-Import Bank financing, and Governor Robertson commented that the situation was being watched closely.

Mr. Moore noted the increasingly close relationship between the Eurodollar market and the U.S. market. He had the feeling that central banks in Europe were monitoring the Eurodollar market so that it did not get out of line. There would be a marked squeeze if Eurodollar rates were allowed to rise materially above CD rates in New York.

Chairman Martin said that at the moment the central banks were cooperating wholeheartedly. They were enthusiastic that something was being done to improve the U.S. balance of payments, and they were doing everything possible to assure that the program would work. It was highly important that those in the United States also did everything possible to make the program work.

Chairman Martin added that it was vital to make the program successful in its early stages. Otherwise, as time passed, the effects would tend to erode. All were aware of the basic steps that were needed; if those steps were not taken, the present program could not serve long as a substitute. But he was discouraged about the number of people who were expressing a non-cooperative attitude, on the ground that they expected the program to break down. It behooved the banking community to do everything possible to deal with this attitude of defeatism, which was misplaced and inappropriate.

President Mayer said that the Council agreed.

4. What are the Council's views on monetary and credit policy under current circumstances, (a) assuming reasonably prompt passage of an income tax surcharge? (b) assuming no income tax surcharge will be passed?

> Assuming reasonably prompt passage of an income tax surcharge, the Council would favor a continuation of the somewhat less easy monetary and credit policy that has prevailed in recent weeks. If no fiscal policy restraint is forthcoming and inflationary pressures intensify, additional credit and monetary restraint will be necessary. However, sufficient reserves should be provided to underwrite Treasury borrowings and to avoid creating a 1966-type credit crunch.

President Mayer remarked that the Council's statement left something unsaid. There was a general skepticism that monetary policy alone could handle a problem of the present dimensions. He asked whether any Council members disagreed with that comment, and none so indicated.

Governor Brimmer noted the Council's comment that a repetition of the 1966 situation should be avoided. As he understood it, the Council appeared to be saying that if there had to be a trade-off, prices should be allowed to rise a little more.

President Mayer said he believed the Council would make such a choice, but Mr. Moore observed that he would prefer a credit crunch to a large price increase if he had to choose between them.

Governor Mitchell commented that the use of the word "crunch" implied a repetition of all of the things that happened in 1966. The difficulty then was compounded by the firmness on the part of the Federal Reserve at a time when the banking system did not expect the System to become so firm. There could be a lot of tightness without the same results if the banking system knew what was coming.

Mr. Moore agreed that the banking system was now better prepared, more liquid. There could be tighter money with a less adverse effect. Mr. Nason said that much depended on what was meant by "tighter money," and Mr. Moore replied that he was referring to a tighter monetary policy, not a crunch.

Governor Daane commented that he understood the Council to be saying that it was skeptical that monetary policy and fiscal policy were substitutable; or, in other words, that the use of monetary policy could substitute for fiscal restraint at this juncture.

Governor Brimmer observed that nevertheless there was some configuration of monetary restraint that would produce the same restraint on spending as fiscal policy. If a certain amount of excess demand had to be removed from the economy, the necessary result could be achieved through a combination of monetary and fiscal policy, or by fiscal policy, or by monetary policy alone. However, the consequences would be different.

President Mayer noted that there were practical limitations to what could be done. Were it not for those limitations, a lot could be done through monetary policy, but the impact would not be evenly distributed throughout the economy.

Governor Brimmer agreed that although the rate of growth of bank credit could easily be cut down, it was necessary to go beyond that and try to see the impact, given the limitations that President Mayer had mentioned.

Governor Mitchell commented that the housing industry probably would have to bear the brunt of monetary restraint. He asked, however, whether the banking system might not be disposed to pass around the impact to a certain extent. That was the essence of the Board's September 1, 1966, letter. In 1966 a lot of marginal lenders were simply shoved out of the loan window and, in addition, there was a severe constraint on selected segments of the economy. The savings and loan people were expressing the view that this was not going to happen to them again. They felt that they were now better prepared. But if the aggregate rate of credit growth was curtailed, that was still the most vulnerable spot.

Governor Robertson commented that the fundamental question to be decided, assuming no fiscal restraint was forthcoming, was what amount of inflation should be tolerated. No one should have the impression that the Federal Reserve could not deal with the problem if necessary, for it could.

Mr. Moore said he would favor moving through monetary policy alone, if necessary, and taking the consequences, but Mr. Nason expressed doubt whether that would be politically feasible, in view of the risk of deflation. President Mayer agreed that that was the real question.

Mr. Still suggested that the word "crunch" was unfortunate, for it implied a crisis. An equivalent degree of restraint could be obtained gradually by tightening monetary policy over a period of time. If that were done, he felt it would be feasible.

Mr. Wilkinson agreed with Mr. Still that the element of gradualness was the key to the question.

Governor Mitchell observed that the Council had again suggested that the Board consider raising the ceiling on large-denomination CD's. That was an important issue. He raised the question whether the Council would see any value in raising the ceiling for CD's with maturity of a year or more.

Mr. Moore replied that that might be of some help, and Mr. Wilkinson agreed that such a step could help somewhat because there were many kinds of money in the market. Mr. Moore suggested, however, that it would be better if the ceiling could be raised on CD's with a maturity of six months or more. President Mayer observed that there was little corporate money in the longer-term CD market; he did not think that even raising the ceiling for maturities of six months or more would really answer the problem.

Governor Mitchell then commented that in his judgment the existence of the ceilings constituted a major restraint on the banking system. They tended to make the banks cautious, and the banks had to live with them. Any change probably would be interpreted by the banking system as a relaxation of policy.

Chairman Martin inquired as to the minimum size that the Council had in mind in referring to large-denomination CD's, and President Mayer recalled that at a previous meeting he had mentioned a minimum of $1 million. Having now made a study, it did not appear to him that the minimum of $1 million made as much sense as he had thought, and he would now suggest a minimum of $100,000.

Governor Brimmer reverted to the discussion of commitments and asked whether banks were in fact making commitments on the assumption that the Federal Reserve would not really have to tighten monetary policy substantially.

President Mayer responded that he thought many banks had built into their forecasting provisions to take care of quite a substantial CD runoff and also to take care of calls that might be expected against their commitments if conditions were as bad as at the peak of the crunch in 1966. In other words, the banks were making allowance for substantially greater calls on commitments than might normally have been anticipated in the past.

Mr. Larkin said that banks with which he was familiar were much better prepared liquiditywise and that they had benefited from the 1966 experience. However, for reasons of competition, they were still making the commitments requested by their good customers. It was of some concern to him that the banks might really be deluding themselves. If the Federal Reserve decided that it must slow things down, there would have to be a squeeze somewhere along the line. When that happened, the banks' customers would all try to take their money down. He was not sure that the whole process could be carried through smoothly, and without considerable strain at some point.

Mr. Still commented that history did not indicate that a Federal Reserve policy of this type could become effective immediately. However, it could become effective over a period of six months or so. Once the ultimate point of restraint was reached, bankers would begin to pull in their horns and stop making one-shot deals. In six or eight months the banking system would have adjusted.

Chairman Martin inquired how firmly the Council held the view that the second six months of this year would be substantially weaker than the first six months, and Mr. Nason said that his thinking on that score was not firm. Mr. Moore commented that his bank's economists were pushing up their estimates for the second half, and President Mayer said he thought the Council members' views were now less certain than they had been earlier.

With further reference to commitments, Governor Robertson inquired whether bankers were making them in such volume as to mean that the banks would require more negotiable CD money. In other words, did the banks fear primarily a loss of CD's, or was there a feeling that the banks would need more?

Mr. Stewart replied that he thought the banks would need more if commitments were taken down in quantity, and Mr. Wilkinson agreed that much would depend on how rapidly the commitments were taken down.

Governor Robertson then commented that he assumed the banks would be in a bind if interest rates were to go up much further and CD money left the banks in considerable volume. He also assumed that the suggestion that the ceiling be raised on large-denomination CD's was intended to provide assurance that the banks would not lose CD's in quantity.

Mr. Moore replied that that would help, and Mr. Nason said he thought that kind of a situation would not be too bad. Mr. Moore observed that those holding the CD's were not necessarily going to spend the money; they would be likely to put it back in CD's if a competitive rate was available.

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President Mayer commented that the Council would welcome any suggestions on ways in which the meetings of the Council could be made more worth while from the Board's standpoint.

Governor Robertson said he would suggest that the Council not feel bound by the questions suggested for consideration by the Board and, instead, that the Council feel free to express itself on any matters that it considered important.

President Mayer said the Council did not feel bound in that respect. For example, the members might have some questions as a result of their meeting with the Board's staff on the day preceding the joint meeting that they would like to discuss further with the Board.

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In view of a conflict between the dates on which the Council would ordinarily hold its next meeting and the dates of the ABA

Monetary Conference to be held in Puerto Rico, it was agreed that the next meeting of the Council would be held on June 3-4, 1968.

The meeting then adjourned.

Secretary