October 29, 1947

Memorandum to Messrs. Delano and Cook

From Lawrence Clayton

The Federal Reserve authorities in the monetary and credit fields (the Board of Governors and the Federal Open Market Committee) are of the view that the present condition of the economy and the continued expansion of bank credit call for a joint statement by the Federal and State bank supervisory authorities. While it is not likely that these agencies can impose restraints sufficient to arrest the further progress of inflation, nevertheless they should do everything within their power to lessen the upward pressures of bank lending during the inflation.

It is therefore proposed that the three Federal agencies and the National Association of Supervisors of State Banks:

(1) Issue a joint statement along the lines of the attached draft, and

(2) Follow policies of supervision in harmony with the joint declaration and instruct their examining staffs accordingly.

Attachment

LC:ac

BANK CREDIT POLICY DURING THE INFLATION

Recent inflationary developments make it desirable that the Federal and State Bank supervisory authorities direct attention to the relationship between bank credit expansion and the current condition of the national economy.

Our country is experiencing a boom of dangerous proportions. The demand of businesses and individuals for goods and services continues to exert strong inflationary pressures in spite of the high volume of physical production. This demand would be excessive without any further increase in the use of bank credit. But the demand is being steadily increased through continued rapid expansion in bank loans. There can be little further increase in production with the available supply of basic raw materials, plant capacity, and labor. Therefore, a further growth in the aggregate of outstanding bank credit can only add to an already excessive demand and make for still higher prices.

The Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the National Association of Supervisors of State Bank, are unanimously of the view that expansion of bank credit in the aggregate should be restrained. They call upon all banks to reexamine their lending policies. It is recognized that a continuing flow of bank credit is necessary for the production and distribution of goods and services. There should be no increase in loans, either to individuals or businesses, for speculation in real estate, commodities, or securities. Banks should discourage consumers from going further into debt and should not relax the terms of installment financing. Directors are urged to see that their banks follow these policies and maintain adequate capital in relation to risk assets. In some cases this will require either curtailment of credit or provision of additional capital.

The bank supervisory authorities and their examining staffs will discourage the expansion of bank credit when inconsistent with the principles set forth above and will insist upon the maintenance of adequate capital.

The policies herein adopted will be continued until inflationary developments no longer threaten and there is need to encourage bank lending in order to sustain employment and production.