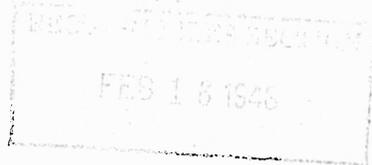


THE BANK SUPERVISORY VIEWPOINT



Mr. Dodge and Fellow Bankers:

It is a privilege for me to present to this gathering the viewpoint of the Federal bank supervisory agencies with respect to the ABA program. While I can't speak for the various State supervisory authorities, I have met recently with the President and the Chairman of the Executive Committee of their National Association, and I can assure you that the official attitude of that Association is one of wholehearted approval of this campaign. No one could have reasonably expected that any supervisor - Federal or State - could do other than approve and support this organized effort to restrain by voluntary means further expansion in bank loans. In fact, this program of the ABA goes hand in hand with the joint statement issued last November by the three Federal agencies and the National Association of Supervisors of State Banks.

That appeal by the supervisory authorities was addressed to bank management through their boards of directors, because there was at the time no agency of private banking organized for a campaign of restraint to which the bank supervisors could address themselves. Happily, that lack has now been filled by the American Bankers Association through the announcement of this program by President Dodge and its implementation through the series of pilot meetings now under way throughout the country.

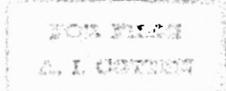
All of us who share any measure of responsibility for bank credit policy must have a real concern in the success of this program. Indeed, we have an anxious concern. It is now almost universally recognized that the inflation has progressed to a point of great danger.

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Our economy, upon being released from the harness of controls imposed during the war effort, has not been able to maintain stability in spite of a most successful reconversion to civilian production followed by an impressive increase in the volume of physical production. But this instability is no reflection upon the inherent superiority of our system of free enterprise. No system can be expected to perform perfectly under wholly abnormal conditions. There never was a chance that our physical production could in a year or two increase sufficiently to accommodate the volume of spendable funds accumulated by individuals and businesses during nearly five years of all-out production for war.

Whether postwar economic stability could have been achieved by different conduct on the part of Government or business or labor, acting separately or in concert, will remain a subject of debate for a long time to come. One point I do wish to stress at this time is that there is no inclination by the public or any responsible source to blame the bankers for the inflation as it has developed thus far. The bankers, along with millions of others, have been victims -- and not the instigators -- of the inflation. However, in view of more recent events, organized banking has recognized a responsibility for future inflationary developments in the banking field. Therefore, their actions henceforth, especially in view of the assumption by them of a leading role in combatting the inflation on the credit front, must bear the spotlight of public appraisal.

The severity of the inflationary situation indicates the great responsibility the bankers of the country are shouldering in this con-

paign. It would be vastly easier if there were some assurance that the "climate" in the money market would be conducive to restraint. If bank reserves could be kept relatively tight, bankers could restrain loan expansion with less criticism from their borrowing customers. The most difficult task for you bankers, but one that in all likelihood must be faced, will be to forego increased loans or investments at the very time that you find yourselves with excess reserves, or with the means to obtain additional reserves readily. Without developing this point further, it serves to indicate the degree of self-discipline which will be required.

But forewarned is forearmed. The educational phase of this campaign should impress upon bankers the necessity for restraint by all banks, regardless of the relative liquidity of individual institutions. The results we all hope for cannot be attained if a substantial proportion of bankers feel that, because their own institutions are not overextended, it is the other fellow who must exercise the restraint. It is indeed a situation that calls for constructive banking, so aptly defined by your president in an article published last October, soon after he assumed his present high office. This is the quotation:

"Constructive banking includes making certain that loans are good for the borrower over the longer term as well as in meeting immediate needs or wants; keeping borrowers from embarking on speculative transactions and assuming possible unrepayable debt; measuring the effect of our individual acts on the national economy and banking as a whole; not progressively weakening asset investment standards by a mistaken belief it is necessary to equal or exceed the terms of other lenders whose policies are not sound or who have a different type of obligation or responsibility to meet; and being prepared to fulfill our essential functions of paying out deposits and making new loans at the time of greatest need."

While all of the above precepts are praiseworthy, I think the foundation upon which this campaign must be built is contained in the one phrase which calls upon bankers to measure the effect of their individual acts on the national economy and banking as a whole.

In one respect, the position of the Federal Reserve System with regard to this program calls for a word of clarification. As is well known to bankers, the Federal Reserve has two distinct, though closely related, functions in the banking field. Like the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the various State Bank Commissioners, the System has bank supervisory functions. These functions are normally implemented thru the Federal Reserve Banks and are concerned with the credit policies and practices of the member banks.

It should be equally well known to bankers, however, that the Federal Reserve System has responsibilities for national monetary and credit conditions that lie -- partly at least -- outside and beyond the function of bank supervision. At the time of the release of the joint statement by the Federal and State supervisory agencies already referred to, the Board issued a separate statement, as follows, and I quote: "The statement by the Federal and State bank supervisory authorities, entitled 'Bank Credit Policy During the Inflation', was participated in by the Board of Governors of the Federal Reserve System on the basis of its bank supervisory responsibilities. The statement obviously does not concern itself with the System's functions in the monetary field nor its joint responsibilities with the Treasury respecting debt management." Unquote. The successful management of the public debt and the

related open market operations present problems that may well become critical even though the commercial banking system accomplishes a substantial restraint of bank credit expansion. It is pertinent to point out here that "other investors" hold a greater aggregate of marketable government securities than do the commercial banks, and of such holdings, bonds maturing or callable after five years are nearly three times the amount of like maturities held by the commercial banks. Sales of such bonds by "other investors," notably insurance companies, do not, under present conditions, attract purchases by private investors. Consequently the Reserve System steps in as buyer and this unfortunately adds to member bank reserves just the same as though the bonds had been sold by commercial banks. Should such a development attain large proportions, the Reserve System would have no other alternative than to ask for legislation. There is no present need and we hope that this program of the ABA will be sufficiently effective that the Board would not find it necessary to make use of any additional powers.

I am informed that in addition to the thirteen pilot meetings being conducted by the ABA, other meetings will be held at other points by the various State associations, in order to insure that the program is fully implemented in every part of the country. I am sure the Federal Reserve Banks and their Branches would be happy to assist in any way they can in connection with those meetings or any other phase of your program. In such activities, they will have the fullest approval of the Board of Governors in Washington. And I am sure, also, that the regional representatives of

the Comptroller of the Currency and the Federal Deposit Insurance Corporation have the same desire to assist in this campaign.

Gentlemen, the thoughtful presentations by the preceding speakers have impressed me greatly. There has been no attempt to minimize the problems and many helpful suggestions have been offered. In the main, it is a problem of subordinating the immediate to the long view and the individual advantage to the welfare of banking as a whole. While the task is a heavy one, the opportunity is correspondingly great. It is the opportunity of private banking to show leadership during a critical period in our country's economic and financial history.