A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in Washington on Tuesday, November 17, 1936, at 10:00 a. m.

PRESENT: Mr. Eccles, Chairman
Mr. Ransom, Vice Chairman
Mr. Broderick
Mr. Szymczak
Mr. McKee
Mr. Davis

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Thurston, Special Assistant to the Chairman
Mr. Wyatt, General Counsel
Mr. Paulger, Chief of the Division of Examinations
Mr. Goldenweiser, Director of the Division of Research and Statistics
Mr. Parry, Chief of the Division of Security Loans
Mr. Vest, Assistant General Counsel

Messrs. Steele, Perkins, Loeb, Braun, Gohen, Young, Brown, Smith, Wold, Frost and Arnold, Members of the Federal Advisory Council representing the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Eleventh and Twelfth Federal Reserve Districts

Mr. Walter Lichtenstein, Secretary of the Federal Advisory Council

ALSO PRESENT: Mr. J. J. Thomas, Chairman and Federal Reserve Agent at the Federal Reserve Bank of Kansas City, who had been requested by the executive committee of the bank to attend the meetings of the Federal Advisory Council in the absence of Mr. Kemper, the member of the Council representing the Tenth Federal Reserve District

At the request of President Smith, Mr. Lichtenstein read the following recommendation adopted by the Federal Advisory Council at its meeting yesterday:

"RECOMMENDATION REGARDING SUBSECTION (E) OF SECTION 1 OF REGULATION Q

"The Federal Advisory Council would prefer that the regulation governing savings accounts stand as it is now since most American banks have become adjusted to it. If, however, there is to be a change, the Council prefers that it be in the direction of greater liberality, and in that case recommends the adoption of the more liberal interpretation omitting, however, the third clause reading as follows:

'a corporation, association or other organization which is organized and operated for the mutual benefit of its members and transacts more than half of its business with or for its members, and in respect to which deposit - -'"

President Smith stated that in considering the above matter it had been the impression of the members of the Council that bankers generally were living up to the definition of "savings deposits" contained in Regulation Q and were endeavoring to comply with it to the best of their ability. Mr. Brown stated that the suggestion had been made that the third clause in the more liberal form of definition be omitted for the reason that it was felt that it would be unduly burdensome upon the banks to attempt to determine whether the corporations, associations and other organizations referred to transact more than half of their business with or for their members.

Mr. Ransom referred again to the difficulties experienced by the Board in determining upon a satisfactory definition of "savings deposits" for use in the regulation and stated that the two definitions which had been submitted to the Council had been considered in an effort to find a definition which would be as simple as possible and at the same time enable the Board effectively to prevent the payment of interest on deposits which in fact are not savings deposits.

In response to an inquiry from Mr. Ransom as to whether the members of the Council felt the intent of the statute was being carried out in a practical way by the present definition, President Smith replied in the affirmative, but expressed a doubt as to whether the definition would be fully effective in the event of a substantial increase in interest rates. It was suggested that in such an event a revision of the definition could be considered to meet that situation. There followed a general discussion of the question whether deposits of organizations such as labor unions, manufacturers' associations and chambers of commerce under any circumstances should be regarded as bona fide savings deposits. In response to an inquiry by Mr. Ransom it appeared that the members of the Council had assumed that under the present definition labor unions could have savings deposits.

Mr. Lichtenstein read the second recommendation adopted by the Federal Advisory Council at its meeting yesterday, which was as follows:

"RECOMMENDATION REGARDING SUBSECTION (F) OF SECTION 1 OF REGULATION Q

"The Federal Advisory Council recommends to the Board of Governors of the Federal Reserve System that it put into effect subsection (f) of section 1 of Regulation Q as proposed by the Board in the memorandum submitted to the Federal Advisory Council under date of October 27, 1936.

"The Federal Advisory Council answering the queries of the Board in its memorandum of October 27, 1936, addressed to the Council, states the following:

"1. If made operative, what effect, if any, would the Board's definition of interest have on:

(a) Membership in the Federal Reserve System?

"The Federal Advisory Council is of the opinion there would be no material effect; there might be a temporary one resulting in the withdrawal of some banks from the System but it is the belief of the Council that in the long run the Federal Reserve System would be strengthened by putting into effect the proposed regulation.

(b) Correspondent bank relationships?

"The Federal Advisory Council believes there would be no permanent adverse effect.

"2. Assuming for the purpose of the question in this paragraph that the prohibition against the payment of interest on demand deposits is in the interest of sound banking practice, does the Council feel that the Board's definition of interest would effectuate the purposes of the statutory provision that such interest shall not be paid, directly or indirectly, by any device whatsoever?

"The Federal Advisory Council replies in the affirmative.

"3. Two opposing views have been presented to the Board on one question connected with this definition. It has been stated that making the definition effective will cause nonmember banks now remitting at par to leave the par list, thus increasing the cost of banking service to the public. It has also been stated that it will have exactly the opposite effect, and that non-par banks would be forced to remit at par and such banks would be deprived of an important source of revenue. The views of the Council are asked as to which, if either, of these suggested consequences they would anticipate if the definition were made effective.

"The members of the Federal Advisory Council are divided in their opinion. Some members of the Council believed that the regulation would drive nonmember banks on to the par list while some are of the contrary opinion.

"4. It has come to the attention of the Board that some nonmember banks have withdrawn or are contemplating withdrawal from the par list in order to obtain additional revenue from exchange and collection charges. The Board would appreciate the Council's comments as to the extent to which member banks are bidding competitively for accounts of banks or others on the basis of the absorption of exchange and collection charges and its opinion on the question whether the making effective of the definition of interest contained in Regulation Q would correct this situation or whether the Board should take some additional action.

"In a very few of the Federal reserve districts some banks are bidding for accounts on the basis of absorbing exchange and collection charges; in most of the districts, however, there is no such competition. The Federal Advisory Council believes the proposed regulation will put a stop to the practice of competitive bidding for accounts of banks or others on the basis of the absorption of exchange and collection charges."

In connection with paragraph numbered 3 above, Mr. Ransom suggested that the Council clarify the extent of the feeling on the part of some of the members of the Council that the making of the definition of interest effective would result in banks withdrawing from the par list. He also stated that it was his understanding, in view of the opinion of the Council that the definition should be put into effect, it was not the feeling of any of the members that the withdrawal of banks from the par list would be such a serious matter as to make it inadvisable for the Board to make the definition effective. Mr. Smith read a resolution adopted by the Iowa Bankers Association in June urging banks to clear their checks at par and referred to a tendency on the part of banks in Missouri to withdraw from the par list. Mr. Ransom regarded the latter as an indication that some banks would withdraw from the par list regardless of any action by the Board prohibiting the absorption of exchange and collection charges.

There was a general discussion of the possible effects of the prohibition of the absorption of exchange and collection charges during which Mr. Loeb stated that he was the only member of the Council that had disagreed with the opinion of the Council that the definition of savings deposits should be put into effect, and that in his opinion such action would defeat the educational work which has been done since the Federal Reserve System was organized in influencing banks to clear their checks at par. He felt that the charging of exchange and collection charges to customers' accounts would be very unpopular with the public, would make the banks "exchange conscious", and would result in withdrawal of banks from the par list on a large scale in order to charge exchange, and that some other method should be used to meet the problem.

Mr. Young stated that he felt that the definition should be put into effect for the reason that banks on their own motion were not able to reach an agreement on the matter, that they would welcome a ruling which would prohibit the absorption of exchange and collection charges, and that such action on the part of the Board would not accentuate the withdrawal from the par list which might continue regardless of whether or not the definition was put into effect.

President Smith stated that some of the members of the Council felt that the country might be facing an inflationary condition with respect to credit and prices, and that the Council would appreciate a statement from the Board as to what means might be available in checking such a trend. Chairman Eccles inquired just what form an inflationary condition would take, what causes would be responsible for it, and whether the Council had any suggestions to make with regard thereto.

At the request of President Smith, certain members of the Council expressed their views regarding the matter, some feeling that there was an increasing tendency on the part of the public to build inventories without regard to possible demands for goods, and to invest in equities, in anticipation of price increases. Some of the members felt that action might be taken by the Board to curb such a tendency and others felt that while no action should be taken at the present time it should be watched very carefully by the Board so that action could be taken at the proper time in order to prevent the situation from getting out of hand.

Chairman Eccles pointed out that the Board had limited powers in connection with any activity or inflationary tendency that might develop without the use of bank credit; that the present increase in values and activity in the stock market was not the result of the use of bank credit; that the large volume of available funds was due to factors beyond the Board's control; and that so long as the country was faced with the major problems of unemployment and excess production facilities it would be difficult to sustain an unhealthy increase in the general price level. He expressed the opinion that the immediate problem of importance was the great volume of foreign funds that had entered this country for investment purposes and that while a substantial decrease in excess reserves might have a psychological effect on the investing public it was not likely to result under present circumstances in increasing long term interest rates.

At the request of the Chairman for Mr. Goldenweiser's comments on the subject, the latter stated that, while the country was closer at the present time to a situation which might get out of hand, it still might be too soon for the Board to take restrictive action, as was the case earlier in the period of recovery when such action was urged on the Board by some for the purpose of preventing an inflationary movement. He also said that prices during the past year had been more steady than in any recent period; that employment and productive capacity had not been fully utilized; and that there was no indication of the development of an unhealthy situation except possibly in the stock market, in connection with which the Board had already taken action to increase margin requirements to 55%.

During Mr. Goldenweiser's statement, Mr. W. I. Myers, Governor of the Farm Credit Administration, entered the meeting.

President Smith stated that in some of the agricultural districts member banks were of the opinion that the time had come when Federal credit agencies should withdraw from the agricultural credit field in view of the fact that commercial banks in the respective localities were now prepared to meet the needs of their communities for such credit. Mr. Arnold said that this matter had come up in his district and that the request had been made that the matter be considered by the Federal Advisory Council, in view of the fact that it was the feeling in some of the Western states that there was an increasing volume of loans being made by Federal credit agencies, particularly production credit associations, which should be made by the local banks. In this connection, Mr. Arnold referred to an advertisement of the Puget Sound Production Credit Association which had appeared in a newspaper in that locality soliciting farm loans. Mr. Arnold stated that the association was located in a rich county in which there was little need for Government assistance as there were few loans arising in the district which could not be taken care of by local banks, and that if the present trend were to continue it would weaken the local banking structure and affect the ability of the banks to make profits. He also added that, while this position was taken by the banks in the states referred to, they were very appreciative of the work done by the Federal credit agencies during the emergency period.

Mr. Myers reviewed briefly the circumstances surrounding the creation of the production credit associations. He also discussed the organization and operation of the production credit system and pointed out that, while this activity was organized in an emergency period, it was not an emergency measure but was intended to fill a permanent need in localities and under circumstances where farmers were unable to obtain necessary credit from local banks on terms which were suited to their needs, and to supplement the activities of local banks in the field of agriculture credit. He stated that, while there was some competition between the production credit associations and local banks, the question was largely one of choice by the individual borrowers in connection with which he pointed out that the associations were in a position to make loans for a length of time which would meet exactly the individual borrower's requirements and which, generally speaking, would be for a longer term than commercial banks would care to lend.

Mr. Arnold stated that there appeared to be no competition in this field between the city banks and the production credit associations, but that there was a competitive situation between the associations and the smaller country banks.

Mr. Davis referred to the permanent character of the production credit associations and to the fact that loans of the associations have been more numerous where agricultural distress was greatest, and said that, in view of the fact that the associations were conceived as a means of assuring necessary production credit to farmers, it would seem that the banks should recognize their permanent character and adjust their own activities accordingly.

Upon inquiry from President Smith as to whether the Farm Credit Administration undertook to edit the advertising of the production credit associations, Mr. Myers stated that, while the Administration had not undertaken such a censorship, if anyone felt that any advertising was misleading the Administration would be glad to hear of the matter and to look into it.

At the conclusion of his statement Mr. Myers left the meeting.

Mr. McKee inquired whether the members of the Council felt that any good had resulted from the increase in reserve requirements which became effective on August 15, 1936, and whether they felt the situation would be any different if reserves had not been increased. Mr. Frost expressed the opinion that the action of the Board had had no effect. Mr. Perkins said that he felt that, while the effect has been largely psychological, it had placed the Board in a position to act in the case of necessity. Mr. Broderick pointed out that the action showed that the Board would use its powers in the field of credit control whenever the circumstances justified.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.