A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the offices of the Board of Governors in Washington on Monday, September 15, 1941, at 10:40 a.m.

PRESENT: Mr. Ransom, Vice Chairman
Mr. Szymczak
Mr. Draper

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. Smead, Chief of the Division of Bank Operations
Mr. Parry, Chief of the Division of Security Loans
Mr. Dreibelbis, Assistant General Counsel
Mr. Thomas, Assistant Director of the Division of Research and Statistics

Messrs. Charles E. Spencer, William F. Kurtz, B. G. Huntington, Robert M. Hanes, Edward E. Brown, S. E. Ragland, Lyman E. Wakefield, W. Dale Clark, R. E. Harding, and Paul S. Dick, members of the Federal Advisory Council representing the First, Third, Fourth, Fifth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively

Mr. Walter Lichtenstein, Secretary, Federal Advisory Council

Mr. Leon Fraser, President of the First National Bank of the City of New York, attended the meeting in the absence of George L. Harrison, a member of the Council from the Second Federal Reserve District

Mr. Brown stated that the Council was very much concerned about the growing indications everywhere of price inflation and that it was interested in discussing with the Board the steps in the monetary and banking field that could or should be taken to meet that situation. He said that he was sure he expressed the opinion of every member of the Council in stating that the first step that should be taken, independently of any other steps, would be to increase reserve requirements to the maximum of the present authority of the Board. He made the further statement that there had been considerable discussion of the subject of selective credit controls, that the attitude of the Council was that, if once applied to all bank loans or to major categories of bank loans in the manner that restrictions on capital issues were applied in the last war, there would have been effected a complete socialization of credit, that if by selective credit control that was what was meant the Council would be opposed to it, and that the Council was interested in knowing what forms of selective credit control other than restrictions on loans on securities and instalment credit were under consideration by the Treasury and the Board as it would like to have an opportunity to express its views with respect thereto. He added that the Council had adopted a recommendation on the subject of increasing reserve requirements to the limit of the Board's existing authority which the Council would like to have published promptly.

Mr. Ransom stated that the question before the Board at the present time was to what extent over-all credit control, through such means as changes in reserve requirements of member banks, could be used and whether and to what extent the so-called selective control measures might be used. He then reviewed the circumstances which gave rise to the recent discussions with representatives of the Treasury relating to possible action in the credit field and stated that it was believed an agreement would be reached shortly by the Board and the Treasury relating to (1) the use by the Board of its existing authority to increase reserve requirements, and (2) the action to be taken with respect to seeking additional authority, and that in his opinion the two matters were so closely related that the Board should not exercise its existing authority without reaching a conclusion as to what should be done with respect to the remaining excess reserves of member banks. Numerous suggestions had been made, he said, as to the form that any additional power that might be granted over reserves should take, but that, in his opinion, the only methods that merited consideration at this time were the present method of increasing reserves on a percentage basis and the so-called "ceiling plan", a modification of either of these plans, or a combination of the two. He made the further statement that the System would be remiss in its duty if it did not press for settlement of these two questions, that it was not anticipated that any increased powers over reserves that might be granted would be used in the immediate future, but that in the emergency situation that existed at this time the authority to take further action promptly in the case of necessity was highly desirable. One of the questions involved in the development of an over-all control program, Mr. Ransom commented, was whether there should be some reclassification of cities for the purpose of determining reserve requirements which would, for example, place the money market banks in New York City in one group and the remaining banks in the country in three or four other classifications.

Mr. Ransom referred again to the conferences that were being held by the representatives of the Board and the Treasury and stated that in the discussion of selective credit controls the opinion had been expressed that Regulation W, which had intentionally been made liberal, should be tightened by the inclusion of other articles or by shortening the maximum maturity for credit extensions in connection with certain articles, and that instalment credit granted in connection with housing should be covered in some manner. It was also felt, he said, that under present conditions there seemed to be no immediate need for anything like the restrictions placed on capital issues at the time of the last war but that that was another point that was being studied. The whole problem he said, involved the two difficult considerations of declining interest rates on the one hand and, on the other, the danger of general action in the credit field hardening interest rates to a point where the treasury might feel that the increased cost of defense financing would be more than would result from price inflation, but that, if the Board should undertake to use its present authority to increase reserve requirements and additional authority were asked for, the Board was in a position to assure the Treasury that it would take such steps as would be in its power to prevent disorder in the bond market.

Mr. Brown stated that, although it was recognized that the exercise by the Board of its remaining authority was only a partial step, it would be a step in the right direction and the Council could see no objection to it particularly at this time when no Treasury financing was in prospect.

Mr. Ransom responded that while personally he saw no objection to such a step he did not think the System or the Treasury should reach a decision on that single matter and leave undisposed of the question of what the Treasury and the Board thought should be done about additional authority to control reserves after the present authority was used up, as he thought to do so might further increase pressure for the use of additional credit controls and present other difficulties not contemplated at the present time. He stated that his preference was for full authority to use over-all controls when the situation warranted with continued use of the selective controls now in operation, increasing them in at least one respect, namely, to include housing.

Mr. Ransom then inquired whether the Council felt that the two questions referred to by him could be considered separately and Mr. Brown replied that action increasing reserve requirements to the maximum permitted by present law could stand alone and could be taken at this time with very salutary effect as it would indicate to a good many bankers that were investing an undue portion of their assets in government securities that they were facing the possibility of definite action which might result in an increase in interest rates and a decline in the price of government bonds. He made the further statement that the Council agreed with the comment made earlier in this meeting that before the Treasury did any major financing it was only fair to the market that a statement be made as to what the future policy of the administration would be.

Mr. Brown then said that, while bank opinion was divided, there was a substantial body of opinion opposed to selective credit controls, particularly if they were in the form of specific treatment of individual borrowers and not by general regulation, that selective credit control in the minds of many people indicated that the government was considering the revival of the idea of a capital issues committee such as was used during the last war and extending it to loans by banks, and that while at some stage in the war effort it might be desirable to apply this control to a large expansion of term loans by banks and insurance companies, it would be almost impossible to apply it to bank loans for the accumulation of inventory or other purposes, that if there was any consideration being given to that form of control the Council would like to know about it and that it was felt that the public was entitled to be advised.

Mr. Ransom expressed the opinion that the present problem was not one of rationing credit as was the function of the Capital Issues Committee in the last war, but rather one of dealing with an abundance of credit which might produce an inflationary condition. He also pointed out that credit control was only one phase of the whole picture at the present time, and conditions might arise where the government would have to take steps beyond any contemplated at the present time to deal effectively with the situation.

Mr. Kurtz referred to the present upward trend of prices and expressed the opinion that the time for effective action was almost past, that if the Board were inclined to defer action until it could get agreement on a complete program before taking action it might be too late, and that the increased cost to the government, which was the principal purchaser of materials, of a substantial increase in prices was very much greater than the cost of any increase in interest rates that might result from action in the credit field for the purpose of counteracting inflationary developments.

Mr. Ransom indicated that he was in agreement with the statement made by Mr. Kurtz as to the existence of an inflationary situation. He also suggested that the Board's powers and responsibilities to seek a solution extended only so far and no further and that while the statement issued by the System on December 31, 1940, was not well received at that time it was his hope that the changed circumstances since that date would be effective in enabling the Board to work out a program for action.

Mr. Fraser stated that there was an implication in Mr. Ransom's comment that if the Board could not get an agreement on a complete program no action would be taken, that if that were the case he felt it would be a grave mistake as generally the public was wondering why the Board did not act, and that he would like to urge that the System raise reserve requirements and continue its efforts to get action on such other parts of a program as it felt might be necessary. He added that action on reserve requirements at the present time was important as indicating the Board's attitude and, therefore, would have an effect beyond the actual mathematical increase in required reserves.

Mr. Ransom explained that it was not the Board's purpose at this time to undertake a program such as that suggested in the December 31 statement but simply to get an agreement with respect to an increase of reserve requirements to the limit of the existing authority and what the policy should be beyond that with respect to general credit controls.

Mr. Szymczak pointed out that if reserve requirements were raised the public would immediately expect a statement as to the policy with respect to asking for additional powers over reserves and that it would be necessary to answer that question.

Mr. Ransom added the comment that the whole question was going to be decided by the Board and the Treasury within the course of the next week or two and that while the matter had been the subject of lengthy discussions, it was not anticipated that a decision on a policy would be long delayed.

In a further discussion there was agreement that any action that the System might take could not in and of itself prevent price rises as there were many other more important factors in the picture, including labor and agricultural policies, that had a more direct effect on price movements.

In a reference to the recommendation that had been adopted by the Federal Advisory Council with respect to action by the Board to increase reserve requirements, Mr. Brown expressed the opinion that the publication of the recommendation would not injure the Board's position and might be effective in supporting it.

Mr. Ransom responded with the statement that he did not believe a public statement by the Council would help the situation in any way and that, although the Council was at liberty to make such statement as it might see fit, he did not feel that the release of a statement at this time would be helpful in the current discussions.

In response to an inquiry from Mr. Wakefield as to what the Secretary of the Treasury had in mind in connection with selective credit controls, Mr. Ransom stated that he did not think the Secretary had reached any conclusions on that point but that he was simply trying to find the answer to the question as to what action should be taken in a situation that he regarded as dangerous. He added that if the Council wanted to take the position that the Board should raise reserve requirements without regard to the question what to do with respect to the remaining excess reserves it would be more helpful if instead of releasing a statement to the press, the Council would authorize him to convey that message to the Secretary. In a further statement Mr. Ransom emphasized the fact that there were no plans for the adoption of selective credit controls beyond those that were now in existence and that, in his opinion, the only way these controls should be extended would be to provide some regulation of housing both public and private, excepting therefrom such defense housing as might be necessary. He added that the only understanding that had been had with the representatives of the Treasury was that there should be some action under the Board's existing authority to increase reserve requirements, that in consultation between the Treasury and the Board there should be a decision on the further steps to be taken with respect to controlling the volume of bank credit, that Regulation W should be made more restrictive, and that housing should be brought under control.

Mr. Brown stated that the Council felt that Regulation W should be kept as simple and as liberal as possible for the reason that the reactions to it were already very unfavorable, and that further reaction would be not only against the policy of the administration but also against the Board as the instrumentality administering the Regulation. He said that the Council would like to urge again the recommendation that the Regulation be changed to provide that whenever there is a declaration from the borrower that a loan for less than $1,000 is not for the purpose of purchasing a listed article such loan would be exempted. He added that the burden placed on the banks of policing the Regulation should be held to the minimum for the reason that it would otherwise result in considerable expense to the banks, and that a decrease of five or ten per cent in its effectiveness would be preferred to the tremendous policing burden that would otherwise be imposed.

During the discussion of the Regulation which ensued, Mr. Wakefield referred to interpretation W-47 in which the Board took the position that if at the time a particular extension of credit is made the registrant and obligor have an understanding that the obligor will be required to make only a partial payment at maturity and that, upon making such partial payment, the balance will be renewed, the extension of credit is an extension of instalment credit, notwithstanding that the obligation, upon its face, provides for repayment in only one scheduled payment, and he expressed the opinion that such an interpretation would make a large number of bank loans in small amounts for purposes other than the purchase of a listed article subject to the provisions of the Regulation and that the reaction to that situation would be bad. Several of the members of the Council made comments in which they expressed the opinion that bank loans not for the purpose of purchasing listed articles should be excluded from the Regulation and Mr. Brown stated that the adoption of a purpose test would meet this situation and assist greatly in the administration of the Regulation so far as the banks were concerned. Messrs. Ransom and Parry explained briefly that the reason for the interpretation was to prevent evasions of the Regulation and stated that the comments of the members of the Council would be given consideration.

There was also discussion of the question whether the Regulation would prohibit the renewal of a bank loan in the original amount of $1,500 if it were reduced below $1,000 and then renewed with an agreement for further renewal with curtailment at maturity.

In a discussion of the desirability of incorporating a purpose test in Regulation W question was raised by Mr. Parry whether the purpose statement should be required to be in the form of an affidavit and the opinion was generally concurred in that, although an affidavit should not be required, the statement of purpose should be in such form as to make it effective.

At the conclusion of the discussion of Regulation W, Mr. Brown referred to the re-introduction in the House and Senate under the sponsorship of the Farm Credit Administration of bills revising the farm credit system which would provide among other things that the Federal Reserve Banks could make advances to Federal land banks on promisory notes secured by farm loan bonds, real estate, real estate mortgages, sheriffs' certificates, and contracts for the sale of real estate. He said that the Council was of the opinion that it was undesirable to make the credit of the Federal Reserve Banks available to a government agency on the security of non-liquid collateral of the kind referred to and that such an amendment to the law should be resisted.

There was a discussion of the consideration given by the Board to a similar bill which was before Congress last year and, at the request of Mr. Ransom, Mr. Wyatt stated that, so far as his office had been able to ascertain, no active consideration was being given to the bills at this time, that no committee hearings were scheduled, and that no action was anticipated looking toward passage of the legislation, but that that situation could not be taken as an assurance that the bills would not be brought up for active consideration at this session of Congress as the committees might take the position that in view of the hearings held last year further hearings would not be necessary.

Mr. Brown stated that if agreeable to the Board, the Council would hold a separate session for the purpose of reconsidering, in the light of the discussion at this meeting, its request that publicity be given to its recommendation with respect to action by the Board to increase reserve requirements of member banks, following which the Council would like to meet with the Board again for the purpose of reporting its decision.

Thereupon the meeting recessed and reconvened at 3:25 p.m. with the same attendance as at the morning session except that Messrs. Thurston, Wyatt, and Parry were not present, and Mr. Ryburn Clay, a member of the Federal Advisory Council representing the Sixth Federal Reserve District was in attendance.

Mr. Brown said that the Council had decided to withdraw its request that publicity be given to its recommendation, it being understood that the recommendation would in any event be published in the Board's annual report, and that it was hoped that, if the discussions with the Treasury were carried to a satisfactory conclusion, the recommendation would be released to the press shortly thereafter. He added that, while it was anticipated that the Board would ask for additional authority over reserve requirements of member banks, the Council did not know what form that authority would take and that, therefore, it was felt that no reference should be made in the recommendation to that phase of the matter.

The recommendation adopted by the Council was read by Mr. Lichtenstein as follows:

"The Federal Advisory Council has frequently drawn "the attention of the Board of Governors to the many elements in our monetary and credit system that are of an inflationary character and has recommended action to eliminate or to control them. Most of these defects require legislation for correction; and a composite program looking to that end was contained in the special report by the System to the Congress dated December 31, 1940. In the meanwhile inflationary tendencies have manifested themselves with steadily growing and disturbing rapidity.

"Concerned by this development the Federal Advisory Council, therefore, unanimously recommends to the Board of Governors that it immediately raise the reserve requirements for the three classifications of banks to the maximum limits authorized by the Banking Act of 1935, such increases to become effective upon 30 days' notice to the banks affected."

Mr. Brown said that Mr. Clay had raised a question whether it would be within the authority of the Board of Governors to require banks to report in their published statements only the net balances in reciprocal deposit accounts, that the Council felt that such accounts were contrary to good banking practice but that, if they were carried, banks should be required to publish only the net balances in such accounts in order to present a more accurate picture of their accounts. The Council felt, he said, that this was a matter primarily within the jurisdiction of the Comptroller of the Currency with respect to national banks and the State banking authorities so far as State banks were concerned, and that it did not see any point in doing anything more than presenting the matter to the Board at this time.

9/15/41

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved: Ronald Ransom
Vice Chairman.