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, February 19, 1945, at 10:30 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Ransom, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Draper
Mr. Evans

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Thurston, Assistant to the Chairman
Mr. Smead, Director of the Division of Bank Operations
Mr. Parry, Director of the Division of Security Loans
Mr. Dreibelbis, General Attorney
Mr. Leonard, Director of the Division of Personnel Administration
Mr. Thomas, Director of the Division of Research and Statistics
Mr. Bethea, Director of the Division of Administrative Services
Mr. Vest, Assistant General Attorney
Mr. Pollard, Assistant Director of the Division of Examinations
Mr. Wyatt, General Counsel

Messrs. Spencer, Traphagen, Kurtz, McCoy, Berry, Brown, Gifford, Baird, Bradshaw, and Wallace, Members of the Federal Advisory Council from the First, Second, Third, Fourth, Sixth, Seventh, Eighth, Ninth, Tenth, and Twelfth Federal Reserve Districts, respectively

Messrs. Charles E. Rieman, President of the Western National Bank, Baltimore, Maryland, and J. H. Frost, President of the Frost National Bank, San Antonio, Texas, who attended as observers in place of Messrs. Fleming and Winton, respectively
Mr. Brown stated that the members of the Council in their separate meeting yesterday were concerned most about the departure from the pattern established by the Treasury which had been reflected by the decline in the market yields on Government securities during the last six months and particularly during the last 60 or 90 days. He said the Council felt that it was unfortunate that there should be such a development and would like to know what the Board thought should be done about it. He went on to say that the Federal Advisory Council, with one or two members dissenting, felt that the forthcoming war loan drive should include, in addition to E, F, and G War Bonds and tax notes, a 7/8 per cent certificate, a bond or note with a maturity of about five years, and a long-term 2-1/2 per cent bond with perhaps a somewhat longer maturity than the more recent issues of long-term bonds. It would be understood, he said, that the certificate and five-year obligation would be eligible for bank purchase but that the long-term bond would continue to be restricted. He also said that the Council realized that if this program were adopted it would result in a further increase in the market price of outstanding 2 per cent bonds but that that was regarded as the lesser of the evils. He made the further statement that, with two members of the Council dissenting, there was a strong feeling that at the time of the next drive
there should be an announcement that a stated amount of certificates and the five-year obligation would be offered to the banks after the drive on some basis of allotment. He added that the Treasury had called a number of conferences during the next several days for the purpose of discussing Treasury financing, that the American Bankers Association Committee on Treasury War Borrowing was to meet with representatives of the Treasury on Tuesday and Wednesday of this week, that several members of the Council were members of that Committee and that they would like to get the views of the Board as to what had caused the recent decline in yields of Government securities and with respect to the best way of dealing with the situation which everyone regarded as unfortunate.

In response to an inquiry from Chairman Eccles, Mr. Brown went on to say that the Council understood that the quota for individuals in the next drive would be increased by $1 billion, and that the Council had discussed whether any purpose was served in permitting corporations to purchase certificates offered in the drive which they sell in order to purchase additional amounts in the succeeding drive. He said that it was the view of a majority of the Council that, while corporations should be permitted to purchase certificates, something should be done to prevent such purchases for purposes of resale. He also said a majority of the Council felt that corporations should be included in the drive.
Chairman Eccles then made substantially the following statement:

The suggestion has been made that we would be able to do a better job in selling to individuals if corporations were excluded from the drive until after the individual quota was raised. If individuals were given a quota that would make them "stretch", after which there would be an offering to corporations, it is believed a better result would be reached. There is also the question whether a corporation should not be permitted to take the securities which are offered to individuals. It seems to me that they should be unless banks are to be permitted to subscribe directly. If the banks are permitted to buy certificates and the five year note or bond then you could restrict the intermediate issue as to corporations; but if corporations are to be permitted to take the intermediate issue directly there is a question whether banks should be permitted to make direct subscriptions. The basket for the next drive is not any more important than the size of the drive and the question who is to be permitted to subscribe.

Last year it became obvious that "playing the pattern of rates" would continue to increase notwithstanding the fact that everything that could be done to prevent it by persuasion was done. In the last drive approximately $12 billion came from the banks so that it is obvious that it is an illusion to say that we are financing the war by nonbank purchases of Government securities.

The pattern of rates is getting to a point where it is impossible to maintain it. The spread between the 7/8 per cent certificates and 2 per cent bonds is too great. It has been obvious for some time that the short rate would have to go up or the long rate would have to go down. The banks were going out into the 2's to a greater extent and the cost to the Treasury was increasing. The objective of Treasury financing has been to sell the maximum amount of securities to nonbank holders who would hold them and to keep the cost of the financing as small as possible. To bring that about a greater amount of short-term securities should be sold. Therefore, we should get a larger proportion of the public debt in bills and certificates so far as the banks are concerned. The banks have
been willing to purchase the 2 per cent bonds and would be perfectly willing to buy a 1-3/4 per cent issue with a ten-year maturity. The banks are responsible for the pressure on the pattern of rates and for the change in market yields that has taken place. The pattern of rates could be maintained by issuing a large amount of 2's directly to the banks but that would increase the cost of financing and would put the bank earnings "through the ceiling."

It was inevitable that the pattern of rates would give us trouble sooner or later. The Open Market Committee did not adopt the pattern of rates. What we did was to agree with the Treasury to see to it that the cost of financing the war would not have to be done at an increasing cost to the Government as was the case in the last war. We could not prevent yields from going down. It was apparent that when the public became familiar with the pattern of rates that the short rate would have to go up or the long rate would have to go down.

There is an argument that, if we made it more profitable to play the pattern of rates in certificates by keeping the yields up, they would become more attractive and banks would be induced to purchase more certificates and less of the long-term securities. The difficulty with that is that the corporations would play the pattern of rates in certificates, buying heavily at the time of a drive and selling between drives so that they could purchase in the succeeding drive, and the profits from the operation would go to them.

I think 1-1/2 per cent should be the highest rate on securities eligible for bank purchases. Their earnings are such that that is a good rate and it seems to me that if that were done there would not be as great a difficulty in maintaining the pattern between the 7/8 per cent certificates and the 1-1/2 per cent securities. The long-term 2-1/4 per cent and 2-1/2 per cent rates should be held where they are. Then we could hold the 7/8 per cent rate and let the intermediates go to whatever rate the market determined. With the volume of securities that the banks are going to have to take there is no purpose in their increasing their earnings to a point where they would be subject to charges of profiteering from Treasury financing.

During Mr. Eccles' statement Mr. Piser, Chief of the Government Securities Section in the Division of Research and Statistics,
joined the meeting.

In the discussion which followed comments were made on the question raised by Mr. McKee as to whether the rate on certificates would or should be reduced to 3/4 per cent and the desirability of a direct offering of securities to banks in the next drive.

Chairman Eccles referred to the suggestion that had been made by the Treasury staff that approximately the amount of reserves that would have to be supplied by the Federal Reserve System before the next war loan drive be put into the market before the drive in the form of Treasury bills which would supply the banks with additional reserves and "put them in a buying mood." He felt that that should not be done and that needed reserves should be supplied to the market only as they were required by the banks and that the funds should be furnished by purchasing securities from the banks which needed reserves. This procedure, he said, would discourage the banks from purchasing additional amounts of the intermediate securities while the sale of additional bills in the market would have the opposite effect.

Mr. Brown stated that all of the members of the Council felt that if the rates on Government securities declined further there was danger that in the postwar period these rates could not be maintained.

Chairman Eccles questioned whether that would develop into a serious problem but said that if the feeling of the members of the Council on the point could be sufficiently widespread to prevent a
further substantial decline in the yields on intermediate securities the result would be a desirable one.

In response to a question from Mr. McKee as to the effect on subsequent financing drives of a termination of the war in Germany, there was a discussion of this point and of the possible effects of shifts of deposits that might take place after the war.

Chairman Eccles said he believed it would be helpful if the members of the Council could use their influence to keep the volume of outstanding bills to a minimum with the understanding that the individual banks would determine the securities that they would sell from their portfolios to obtain the reserves that they might need.

Chairman Eccles referred to another suggestion that had been made that a 1-3/4 per cent security be offered only to individuals and expressed the opinion that such an offering would only result in widespread speculative purchases by individuals for resale to corporations and banks. The comments by members of the Council indicated that they were in agreement with the view expressed by Chairman Eccles.

Mr. Brown inquired whether the Board had taken any position with respect to providing some broader means for investment by commercial banks of savings deposits. He felt that this would be desirable because many of the smaller banks have as much as 50 per cent
of their deposits in the form of savings, that it was necessary that these banks earn at least 1-1/2 per cent on such deposits in order to pay interest at the rate of 1 per cent, and there should be some expansion of the limitation on the investment of savings deposits in long-term securities so that this situation could be met in the interest of the smaller banks which were losing deposits to savings and loan associations.

Chairman Eccles stated that the matter had been considered by the Federal Open Market Committee, which did not have a unanimous opinion regarding it, and that the Treasury apparently was not favorable to a continuation of such an offering.

Mr. Brown then referred to the speculative trend in urban real estate and inquired whether anything was being considered in the way of applying controls similar to Regulation W. He also stated that it appeared that the rise in prices of farm lands had stopped because of the belief that present prices for agricultural products would not be maintained.

Chairman Eccles stated that the responsibility for action in this field was in the Office of Economic Stabilization and War Mobilization and Reconversion and that so far as the use of credit for the purchase of urban real estate was concerned the Board of Governors had no powers to deal with the situation.
Mr. Brown inquired whether the power could be given to the Board by executive order, and Chairman Eccles responded that it could and that efforts had been made to give the Board authority over real estate similar to that vested in it with respect to regulation of consumer credit. He said that at the time he had presented a memorandum pointing out that the problem was not primarily one of credit as the total volume of credit used for that purpose had declined in 1942 and 1943, that an effort to prevent real estate speculation by over-all credit controls would interfere with legitimate transactions, and that the best way to handle the problem was through the imposition of a capital gains tax which would tax away speculative profits.

In response to a question by Mr. Brown as to whether there was any movement at the present time to give the Board authority to regulate the use of credit in the real estate field, Chairman Eccles responded in the negative.

In reply to a request for his comments on the matter Mr. Evans outlined briefly the procedure that had been adopted in Australia of requiring that a prospective purchaser of farm lands obtain a certificate that he or members of his family would actually operate the property as a farm. He added that the informed opinion in this country seemed to be that the over-all trend of farm land prices would be downward in the long-term future.
Chairman Eccles stated that there had been some indication that there was speculative purchasing of farm lands for resale to returning veterans.

In response to a request from the Council for a statement as to the present situation with respect to absorption of exchange and collection charges, Mr. Ransom said that the Board of Governors had no choice other than to enforce the law and that what the result of that would be he did not know. He said that because of the favorable earning situation of the banks there could not be a better time to persuade them to discontinue the absorption of exchange charges, that the Board had been working on a procedure for cooperation with the Comptroller of the Currency, and that an agreement had been worked out. He thought that the Board and the Comptroller would take action very soon in accordance with that agreement.

Mr. McKee stated that the outstanding cases of absorption of exchange charges involved only approximately 30 banks, and he asked for the opinion of the Council as to whether it would be desirable to get representatives of these banks together for a frank discussion of the whole problem. The responses received indicated a feeling that this might be a desirable step and that if some effective action were not taken the practice of absorbing exchange charges would expand from one trade area to another.
Mr. McKee also said that when the matter had been taken up with individual banks the response had always been that the bank would be willing to discontinue the absorption of exchange if other competing banks were required to do likewise, and he suggested that the banks in the various areas be brought together to work the matter out.

Mr. Gifford did not think that would be a practical solution and thought that if representatives of all the banks involved were brought together the Board would have to do it.

Chairman Eccles said that there was a considerable question as to why the Government should prohibit the payment of interest on demand deposits, that a strong argument could be made for the repeal of the statute, but that as long as the law remained unchanged it should be enforced.

Mr. Ransom concurred in Chairman Eccles' statement, adding that, while he felt the prohibition served a purpose in the public interest, if it could not be enforced it would be better to repeal it.

Mr. McKee made the further comment that he felt that prompt action should be taken and that if an effective solution were not found consideration should be given to the repeal of the prohibition against the payment of interest on demand deposits.

Mr. Brown stated that the Council had noted that Senator
Wagner had introduced a revision of the Wagner–Spence bill which would amend Section 13(b) of the Federal Reserve Act to authorize the Federal Reserve Banks to guarantee industrial loans, and he inquired whether that bill was being pushed.

Chairman Eccles replied in the negative, stating that while Congressman Spence, Chairman of the House Banking and Currency Committee was anxious to get the bill passed, there were so many other bills of primary importance which would require the attention of the Banking and Currency Committees over the next few months that it might be some time before consideration could be given to the Wagner–Spence bill.

Mr. Brown stated that, in accordance with the present schedule for meetings of the executive committee of the Federal Advisory Council, the next meeting would be held on March 7 but that, in view of the fact that that was only three weeks away, it had been decided that the next meeting of the executive committee should be on April 4, 1945.

Chairman Eccles stated that it would be the suggestion of the Board of Governors, in view of the request from Mr. Byrnes, Director of War Mobilization and Reconversion, that travel be limited as much as possible, that the Advisory Council give consideration to discontinuing the meetings of its executive committee for the time being and limiting meetings of the Council to the four meetings each
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year required by law. He also said that because of Mr. Byrnes' request the Conference of Chairmen of the Federal Reserve Banks had been cancelled and, while the Presidents of the Federal Reserve Banks came to Washington periodically, their meetings were held in connection with the meetings of the Federal Open Market Committee, which was required to meet four times a year as was the case with the Federal Advisory Council.

Mr. Brown stated that, in view of the rapidity with which things were moving at the present time it was his feeling that the members of the Council would like to continue the meetings of the executive committee so that they could keep in touch with what was going on.

Chairman Eccles suggested that the meetings of the executive committee might be made subject to call, to which Mr. Brown responded that it was his opinion that it would be easier to set a date for the meetings and then cancel them than to attempt to call a meeting later which might not meet the convenience of the members of the executive committee. Chairman Eccles stated that the decision in the matter was one for the Council to make but that it was the suggestion of the Board that as long as Mr. Byrnes' request was outstanding it would be well for the Council to restrict its meetings to the number required by the law.
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Thereupon the meeting adjourned.

[Signature]
Chester Morrow
Secretary

[Signature]
Approved: [Signature]
Chairman