

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, D. C., on Monday, February 18, 1946, at 10:50 a.m.

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

Mr. Carpenter, Secretary
 Mr. Hammond, Assistant Secretary
 Mr. Connell, General Assistant,
 Office of the Secretary
 Mr. Morrill, Special Adviser
 Mr. Smead, Director of the Division
 of Bank Operations
 Mr. Parry, Director of the Division
 of Security Loans
 Mr. Thomas, Director of the Division
 of Research and Statistics
 Mr. Vest, General Attorney
 Mr. Bethea, Director of the Division
 of Administrative Services
 Mr. Wyatt, General Counsel
 Mr. Brown, Assistant Director of the
 Division of Security Loans

Messrs. Spencer, Traphagen, Williams, McCoy, Wiggins, Strickland, Brown, Penick, Baird, Bradshaw, Winton, and Odlin, Members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively

Mr. Prochnow, Acting Secretary of the Federal Advisory Council

Mr. Brown reported that at the meeting of the Council yesterday the following officers, and members of the executive committee, were

2/18/46

-2-

appointed to serve during the current year:

Officers

E. E. Brown, President
Chas. E. Spencer, Vice President

Executive Committee

John H. McCoy
John C. Traphagen
A. L. M. Wiggins
David E. Williams
Edward E. Brown, ex officio
Chas. E. Spencer, ex officio

In response to an inquiry by Mr. Brown whether the Board had any information with respect to plans for consolidating Government agencies under the authority of the Reorganization Act of 1945, Mr. Eccles stated that so far as he knew nothing had been done under the Act that would affect banking, that agencies and departments of the Government had been requested to submit their suggestions to the Bureau of the Budget by January 25, 1946, but that the Board had submitted nothing. In this connection, he called attention to the fact that the Board had gone on record as favoring the consolidation of the Federal bank supervisory agencies and that it did not seek any exemption from the Reorganization Act. He added that it might be necessary for the Board to take up some of the questions involved with other agencies.

Mr. Ransom asked if the members of the Council had any information on the matter and Mr. Brown replied in the negative.

Answering a second inquiry by Mr. Brown as to the status of

2/18/46

-3-

Bank Holding Company legislation, Mr. Eccles said that members of the Board's staff had had several conferences with representatives of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Department of Justice, that there remained two or three important points on which there was a difference, and that it was expected that a decision would be made within the next two or three weeks whether to present the bill to Congress. He added that there was a lot of support for a decision to do nothing and the longer a decision was delayed the more likely it was that nothing would be done.

Mr. Brown asked what had been done with the proposed amendment suggested by the Board to the Kefauver Bill (H. R. 2357) and Mr. Eccles said that the amendment was not in the bill as it was reported out and that apparently the Committee felt it could not get the bill approved with the amendment and therefore was not willing to support it.

Mr. Ransom commented that while there was no opposition to the amendment it was his impression that the attitude of the banks was a major factor in influencing the House Committee to drop it.

Mr. Brown then made substantially the following statement:

The principal thing the Council wishes to discuss with the Board and about which the members of the Council talked for about five hours yesterday is the question of interest rates and Government financing. With one exception,

2/18/46

-4-

the members of the Council strongly favor doing away with the preferential discount rate, which we understand the Board wants but which the Treasury has more or less opposed up to this time. We also favor the abolition of the option rate on Treasury bills. We think open market operations should be handled in such a way as to keep certificates from going below par, but that the market on the short term securities should not be supported and excess reserves put into the market as freely as has been the case in the past. We are glad to see the War Loan accounts pulled down and we would like to see them reduced very much more than the Treasury has indicated would be done.

We do not know whether there has been any arrangement between the Board and the Treasury, as to March 1 and March 15 maturities, by which the Federal Reserve has agreed to buy in the market, at approximately current levels, short term securities to replace the holdings of the Reserve Banks, but we think it is ridiculous in the present situation for the Treasury to continue to carry a balance anything like \$25 billion. We feel it should be around \$10 billion. We also think that the Treasury should issue to bona fide investors long term bonds which could not find their way directly or indirectly into the banking system. That would mean that they would not only be ineligible to the banks but also ineligible as collateral for loans. Such a security might take the form of a 20 or 25-year "G" bond. There is probably only six or seven billion a year available for long term investment in Government bonds, but to the extent that that investment demand exists we think that it ought to be satisfied by something that would not find its way into the banks. In that way you would gradually check the monetization of the public debt that is going on. At the present time insurance companies are purchasing real estate and the laws of several of the States are being amended to allow them to invest in stocks. If the rate on Government bonds continues to be forced down, the insurance companies and other investors will try to find other forms of investment, although they would much prefer Government securities if they could get something like a $2\frac{1}{2}$ per cent rate.

If the Board thinks it would be desirable to have the Council embody its views in a resolution, we would

2/18/46

-5-

be glad to do so, but we do not know what the situation is between the Treasury and the Board, nor do we know whether the submission of such a resolution would be helpful at this time.

We would like to know what the Board can tell us about the situation, and how far our conclusions differ from those of the Board's.

Replying to Mr. Brown's statement, Mr. Eccles commented substantially as follows:

With reference to the size of the Treasury balance, the Board has felt for a long while that the Treasury maintained unnecessarily large balances. We never were able to persuade the Treasury that it did not need a minimum balance of \$10 billion, or that the Reserve System could create all the credit the Treasury might need to meet an emergency. They seemed to feel a sense of security as long as they had big balances, and when Mr. Vinson came in he did not undertake to make any change. Some of the men at the Treasury felt that last fall was the time to make a Victory Drive right after the end of the war, the assumption being that they should capitalize on the psychology of the people at that time and that they could not get all they needed later on. We took the position that there should be no drive and that they could get additional funds when they needed them. The best we could do was to get them to put the drive off until the end of November, and cut down the amount to be raised from \$14 to \$11 billion.

After the drive, there was an effort to get the Treasury to announce that the $2\frac{1}{4}$'s and $2\frac{1}{2}$'s would continue to be available for investment funds. However, we thought it would have been a mistake for the Treasury to have made such an announcement. They already had a \$25 billion balance and to have announced that the $2\frac{1}{2}$'s would continue to be available would have served only to build up the balances still further and increase the cost of financing. Until you could block the banks off and control the amount of securities they could buy, it would be foolish to try to satisfy the investment market demand

2/18/46

-6-

by putting 2½'s on tap.

It now appears that instead of the volume of outstanding E F and G bonds being reduced on balance, they are going to be increased. During the month of January right after the drive, and with all the strikes and unemployment, there was no great amount of cashing, and there is every indication that the Treasury is going to have a larger demand for the E F and G's than the Treasury will need to sell.

The executive committee of the Open Market Committee presented a program to the Treasury last week with respect to the use of a portion of the Treasury cash balance to retire securities that are due or callable through June 1946. I spent two hours with the Treasury people discussing the matter and the Secretary has accepted the program. I think it is a good program as the first move. As you know, it takes out about \$500 million of the 3-3/4's; \$1,300 million of the 1% notes; \$1,036 million of the 3's; \$819 million of the 3-1/8's and \$1 billion of the \$4,147 million certificates which fall due March 1st.

That should have, if anything, a tightening effect. Of the total amount to be redeemed in March, approximately \$360 million is held by the Federal Reserve Banks. What will happen is that war loan accounts will be reduced by \$2.8 billion, so that the banks will lose that amount. They will not get back the \$360 million held by the Reserve Banks, and therefore, will have to sell \$360 million of their holdings to offset that loss. In addition, there are \$550 million that will be redeemed by nonbank investors. That money will go back into the banks and increase required reserves. In the operation, the banks will lose the income on about \$2 billion of securities, and to offset that loss of income there may be some tendency on their part to sell some of the short terms and replace them with long terms. In any event they will have to sell about \$460 million to the System and if they undertake to replace shorts with longer term issues the purchases of the System will be that much larger. We did not propose any more than we did because a \$2.8 billion refunding job is a fair size operation and we felt we would like to see how it works. The System will support the certificate market and we think

2/18/46

-7-

it will be handled very smoothly. We will not let the yield on short terms go up and will support the market at whatever level seems necessary to assure a smooth and successful operation.

There are about \$4.8 billion maturities in April and about \$1.6 billion in May, so I would think that there should be a further retirement of certificates in April. I would not suggest a partial retirement in May. In June there will be a big operation, \$4.8 billion in certificates and about \$1.8 billion of the 3's and 3-1/8's. A billion of certificates and both issues of bonds should be paid off.

As long as the E F and G's are available, they will take care of the investment demand except for corporations, savings banks, etc., and therefore there is no reason to put out a long term market issue. I think I express the views of the Board and possibly the Federal Open Market Committee when I say that any increase in long term Treasury marketable bonds would be a mistake. The nonmarket issues available will take care of all investors except corporations, savings banks, and large institutional investors. I would think that of the long term securities now outstanding about three or four billion would be purchased by the insurance companies and others if you could prevent bank purchases of eligible securities from putting pressure on the long term market. In November and December the banks created about \$11 billion of new credit; they bought \$7 billion of securities; they loaned \$3 billion on Governments and \$1 billion on other loans and investments. Therefore, \$10 billion of credit was pumped into the Government security market which helped to drive the rates down. Unless we can prevent further purchases by the banks, I see no way to keep the long term rate from falling and it may go as low as 1-3/4 or 1-1/2. It would be a question then of whether certificates could be held at 7/8 or whether they would go down to 3/4. There are two ways of stopping this trend, but only one practical way. The orthodox way of doing it is to increase the short term rate. That is just not practicable. The banks will be extremely fortunate if they can hold the 7/8's rate. There is pressure to get that down to 3/4, especially in view of the bank earnings picture. In my opinion, there is no chance of increasing the short term rate. That is the only power

2/18/46

-8-

the System has at the present time to deal with the problem. If the public debt were what it was when the System's powers were given, the situation would be entirely different than at present, when two-thirds of the outstanding credit is Government credit. The discount rate could be used then, but when an increase in the rate increases the cost of supporting the public debt, the burden on the taxpayer, and further increases bank earnings, it could be done only over the vigorous opposition of the Treasury and at the expense of vigorous public denouncement of the banks and the Federal Reserve System. That situation would be very difficult to defend or explain. If there is any other way out, it would be disastrous to the banks and the Reserve System to take the position, in opposition to the Treasury, that short term rates should be increased.

A problem with respect to the preferential discount rate is whether it should be eliminated in the face of the contemplated program for the retirement of public debt.

The whole matter will be discussed by the Federal Open Market Committee at the end of this month.

In the ensuing discussion of ways in which the problem of future policy might be met, Mr. Traphagen suggested that elimination of the preferential discount rate would create uncertainty in the minds of the bankers about the trend of long term rates, and that the banks would then stop buying the intermediate bonds and be more inclined to purchase certificates.

Commenting upon Mr. Traphagen's suggestion, Mr. Eccles said that it might be unwise to do anything that would create uncertainty in the minds of the bankers, as that might result in the smaller banks selling Governments, and that the Treasury did not want to do anything that would "rock the boat". Instead of banks increasing their holdings of Government securities, Mr. Eccles said, they should be forced

2/18/46

-9-

to sell about \$15 or \$20 billion, which could be done only by legislation. He added that if the Board were given the authority to determine the extent to which demand deposits of banks should be invested in one-year paper or less, the fact that that authority existed would stop the banks from buying the intermediate and long term bonds if they already had as many as they could hold if the authority were exercised. He thought that in that situation the banks would sell intermediate and long term bonds and instead of the bill and certificate market having to be supported by the Reserve Banks, the support would come from the banks themselves.

Mr. Wiggins suggested that another way to meet the problem was to sell the securities to the nonbank investor and Chairman Eccles asked how that could be done as long as banks were free to purchase issues in the market.

Mr. Williams asked if it would be possible to remove the limit on the purchase of G bonds and Chairman Eccles expressed the opinion that that should be done.

Mr. Strickland asked whether the Board felt that present monetary conditions would accelerate inflationary tendencies and, after an affirmative answer by Chairman Eccles, suggested that there was justification for action by Government to control the situation.

Mr. Eccles concurred and said that the problem should be met on all fronts including price and wage controls, etc.

2/18/46

-10-

Mr. Strickland said the System's authority was only in the credit field and it should do what it could even if such action as the elimination of the short term rate did result in a stiffening of the short term rate.

Chairman Eccles said that the present situation as reflected by existing yields on securities was a reflection of the monetization of the public debt and not of the supply of what could be called real savings funds in relation to the demand. He thought that an arbitrary long term rate could not be determined until that process was reversed to some extent, and that when that was done, if the long term rates continued to decline it would be because the amount of savings exceeded the investment demand. He pointed out that if people spent their income on consumption, the savings rate would likely stay higher than if people were inclined to save and put their savings in banks and insurance companies, in which event the supply of funds would force the long term rate down still further.

During a further discussion of legislation to require banks to invest a portion of their deposits in short term securities, Mr. Williams suggested that action need not wait on legislation but that action could be taken to eliminate the preferential rate and the buying rate on bills, to continue reduction of Treasury balances, and possibly extending the limit on G bonds or the issuance of a new type of G bond to supply the bona fide investment demand.

2/18/46

-11-

Chairman Eccles said he was sure the Treasury would oppose any action which would increase the cost of the public debt.

Following a discussion of the possibility of further inflationary pressures, the characteristics of a period of inflation, and the question whether Congress would be willing to give the System the authority to require the investment by banks of a stated portion of their deposits in short term securities, Mr. Eccles stated that the Board as an agency of Congress was under obligation to report to the Congress the situation which confronts the System, to point out that the powers of the System are not sufficient or adequate to deal with the present situation, and to suggest ways in which the problem could be met.

At this point Mr. Winton said that he was the member of the Council who agreed with the Treasury's viewpoint that the preferential discount rate should not be discontinued at this time, and that, in his opinion, it would be unfortunate to do anything which might create uncertainty as to the future of interest rates. To take such steps, Mr. Winton said, would be premature and unwise as the action might be taken as an indication that the System was getting ready to stiffen rates and might have an adverse effect particularly as regards purchasers of E F and G bonds.

Mr. Eccles inquired whether it was the view of the Council that the preferential rate should be discontinued and Mr. Brown replied that 11 of the members of the Council were of that opinion.

2/18/46

-12-

Chairman Eccles said that the Board felt the preferential discount rate as well as the bill buying rate should have been discontinued long ago, that the reasons for which they were put into effect no longer existed, that it was necessary and desirable now to discourage banks from further buying of Government securities, and that these steps could be taken without increasing the cost to the Treasury.

Following comments as to possible changes in the volume of currency outstanding and other factors affecting the reserves of member banks, Chairman Eccles referred to the fact that the continued downward pressure on rates was resulting in a situation that might involve danger in that refunding of outstanding issues of private securities were being refunded at very low rates, and that this was extending into second grade securities and in term loans as low as 2%. Some members of the Council indicated that term loans were being made at rates as low as 1-3/4%. Chairman Eccles added that such rates did not justify the banks in assuming any amount of risk and that unless the situation were changed it could have dangerous results.

In response to an inquiry as to the possibility of loans to foreign countries, Mr. Eccles said that aside from the British loan there was little inclination on the part of the Government to ask Congress to authorize loans to other countries, and that, pending the organization of the International Bank, any credits extended to

2/18/46

-13-

foreign countries would be financed through the Export-Import Bank. He pointed out that foreign countries had assets in this country amounting to about \$10 billion which would be spent as soon as they could get goods, and that any credit extended would mean a further demand on the goods available in this country. He stated that it was important that the British loan be approved as it was spread over a period of five years, was not related to the purchase of goods here as would be the case with loans to other countries, but was to enable sterling exchange to be freely convertible into other currencies and to put England on a cash basis so that she could start trading with the rest of the world.

Mr. Brown then asked whether the Board desired the Council to draw up a resolution stating its position as referred to earlier in this meeting, and Mr. Eccles said that such a statement might be helpful. Mr. Brown stated that the Council would submit a resolution to be released to the press or used in such other way as the Board saw fit.

Mr. Brown made the further statement that although the Council had on its agenda for discussion at this meeting questions with respect to Regulation U, selling price of real estate, and control of rents on new construction, it had been decided that they were not of sufficient importance to warrant discussions with the Board at this time.

2/18/46

Thereupon the meeting adjourned

A. Carpenter
Secretary.

Approved:

M. S. ...
Chairman.