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, October 7, 1946, at 10:30 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Ransom
Mr. Evans
Mr. Vardaman

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Morrill, Special Adviser
Mr. Thurston, Assistant to the Chairman
Mr. Paulger, Special Adviser
Mr. Thomas, Director of the Division of Research and Statistics
Mr. Vest, General Counsel
Mr. Parry, Director of the Division of Security Loans
Mr. Smead, Director of the Division of Bank Operations
Mr. Leonard, Director of the Division of Examinations

Messrs. Spencer, Traphagen, Williams, McCoy, Wiggins, J. T. Brown, Edward E. Brown, Penick, Baird, Bradshaw, and Odlin, members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, and Twelfth Federal Reserve Districts, respectively

Mr. Prochnow, Acting Secretary of the Federal Advisory Council

President Brown opened the meeting by referring to the bills introduced toward the end of the last session of Congress (H.R. 7211 and S. 2494) which among other things would provide for retirement of the capital stock of the Federal Deposit Insurance Corporation, and he asked whether the Board of Governors had taken a position on the bills.

Chairman Eccles stated that the bills were introduced with no thought of getting action on them during the last session, and that similar bills undoubtedly would be introduced at the next session and the views of the Board would be requested at that time. He also said that the Board felt that retirement of the stock of the Federal Deposit Insurance Corporation would be desirable but that because of the present large earnings of the Federal Reserve Banks it would be a mistake to return to the Reserve Banks the $139 million which they paid for stock of the Corporation and that this amount should be paid to the Treasury. He added that the insured banks would be in a much better position if the assessment rate of 1/12 per cent per annum were retained until the entire stock of the Federal Deposit Insurance Corporation were repaid so that it could not be said that the banks were beneficiaries of a subsidy in connection with the insurance of their deposits.

In this connection, Chairman Eccles referred to the bill introduced shortly before the close of the last session of Congress which would have reduced the rate of insurance assessment on share deposits held by Federally insured savings and loan associations to 1/12 of 1 per cent. He said that the Board of Governors took the position that the existing rate of 1/8 per cent should not be reduced until the stock of the Federal Savings and Loan Insurance Corporation held by the Government was retired and that the President had vetoed the bill.

President Brown stated that it appeared that no action was required at this time, but that there was considerable opposition among the banks to a flexible insurance assessment on bank deposits as had been proposed, and that it had been suggested that because of the uncertainty as to the outcome of any proposal for a change it would be better to let the present arrangement continue for the time being.

President Brown referred to the present bill buying procedure of the Federal Reserve Banks under which the Treasury sold bills to dealers in the open market and almost the entire amount of such bills was promptly offered to and purchased by the Federal Reserve Banks. The Federal Advisory Council, he said, did not like this fiction but on the other hand did not like direct purchases by the Federal Reserve Banks and felt the present procedure was preferable to increasing the authority of the Reserve Banks to purchase directly from the Treasury. He asked if that problem had been up for consideration recently.

Chairman Eccles outlined the background for the large bill holdings of the System now totaling about $14-1/2 billion, noting that their purchase grew out of the need for providing additional reserves to banks as an offset to the wartime expansion of currency in circulation and that establishment of a 3/8 per cent buying rate on bills and a repurchase option was a device to facilitate adjustment in the reserve positions of banks during the war financing program. He said that because of the small amount of bills now in the hands of the banks they had ceased to be a market instrument; that the need for the posted buying rate and repurchase option no longer existed; that, therefore, entirely apart from the fiction of the weekly offering in the market and purchase of bills by the Reserve Banks, the posted rate should be discontinued, and that the problem was one of the timing of the action. Chairman Eccles also discussed some of the problems with which the System and the Treasury would be faced in the event the buying rate were discontinued and stated that the Federal Open Market Committee had considered the matter and had agreed that so long as the Treasury was able to continue its debt retirement program there would be very little upward pressure on the Government securities market and the Committee felt that action to eliminate the posted rate would not be necessary, and that if it were discontinued when the current retirement program was over it might have somewhat the same effect as the discontinuance of the preferential discount rate. He added that it was hoped that some time after the first of the year it would be possible to work out with the Treasury some program for handling the problem with respect to bills.

President Brown suggested that consideration might be given to a demand or renewable note to the Federal Reserve Banks for their holdings of bills with a free market on the remaining bills outstanding.

Chairman Eccles responded that that suggestion had been discussed with the bankers' group which met with the Secretary of the Treasury in August and that the group was opposed to a special issue.

In response to a further comment by Chairman Eccles that under present conditions the limitation on direct purchases from the Treasury had no significance, Mr. Wiggins responded, "except psychologically". Chairman Eccles' further remark was that as long as the Federal Reserve Banks purchased unlimited amounts of securities in the market the System could pump reserves into the market and thereby make effective any schedule of market rates that it might wish.

President Brown inquired as to what extent the Treasury would be willing to use its balances in carrying out the current debt retirement program, and Chairman Eccles stated that while the matter had not been discussed with the Treasury since September the indication was that the program would be continued as long as balances permitted, and that representatives of the Federal Open Market Committee had urged the point that the Treasury no longer needed to maintain a large cash balance and that a balance of between $1 and $2 billion would be entirely adequate.

At this point Mr. Draper joined the meeting.

Chairman Eccles made the further statement that the Federal Open Market Committee felt that the Treasury balances would be sufficient to permit from $1-1/2 to $2 billion of the November 1 certificates to be retired, that since the December 1 certificates were held largely outside the banks it was possible that between $500 million and $1 billion of these would be redeemed for cash, and that the entire December 15 note issue in the amount of $3.261 billion should be retired. That program, he said, could be carried out if the Treasury were willing to allow its balances to fall as low as $1-1/2 billion. He added that it was expected that the sale of savings bonds would exceed redemptions and that income should exceed expenditures during the first three months of 1947 so that it appeared that it might be possible to retire as much as $4 billion of maturing debt during the first three months of 1947.

In response to a comment by President Brown that if the 7/8 per cent short-term rate and the 2-1/2 per cent long-term rate on restricted issues were supported by the System the intermediate issues would fluctuate somewhat, Chairman Eccles stated that during the recent break in the stock market it had not been necessary for the System to purchase any Government bonds. He also said that it would be necessary to maintain the 2-1/2 per cent long-term rate for the reason that, if long-term restricted issues went below par, it would upset the entire rate structure and that if the Treasury did not issue long-term bonds, which he felt were not needed at this time, the market should be able to support the rate so that support from the System would not be required.

President Brown said that since, with the exception of the December 15 notes, the Treasury would have no maturities other than certificates until the latter part of 1947 the question of the issuance of a higher rate security would not come up for about nine months. He commented that the banks in the larger centers during the last 90 days had experienced demands for credit in amounts which they had not expected to get, that this was due to higher prices, higher inventories and receivables, work stoppages, and the fact that a great many corporations were engaged in expansion programs which they expected to finance through stock issues and found that they could not sell their stock on as favorable a basis as had been anticipated. He also expressed the opinion that the decline in the stock market was a good thing.

Chairman Eccles noted that despite the increased demands for credit there had been a reduction of several billion dollars in bank deposits in recent months and concurred that the recent decline in stock prices was a healthy influence in the anti-inflation program.

President Brown then stated that the Federal Advisory Council felt the time had come when Regulation W, Consumer Credit, should be liberalized and a number of listed articles removed from the Regulation. He discussed the conditions under which articles presently listed in the Regulation might be exempted and stated that, while it was realized that there was a sharp difference of opinion regarding the desirability of controlling credit on major items of durable consumer goods and the Council did not want to discuss that question at this time, there were a number of smaller items which were coming into supply and to continue to apply the Regulation to these was resulting in widespread violations and a situation in which it was impossible to enforce compliance. He said that in these circumstances the Board should immediately begin to remove these items from the Regulation and continue controls only on a few large items such as automobiles, etc.

Mr. Ransom asked if that was a recommendation from the Council and Mr. Brown replied that the Council felt very strongly that the Board should begin to reduce the number of listed articles and that it was realized that this question was one of timing.

In a discussion of the recent increase in consumer credit outstanding, Mr. Parry stated that that was largely the result of a large increase in charge accounts and some increase in instalment loans and that there had not been much of an increase in instalment sales credit.

There was a discussion of the extent to which veterans needed and were using consumer credit to reestablish themselves, the extent to which they could meet that need under the terms of the Regulation, the fact that they were limited in their purchases by the down payment required by the Regulation, and the suggestion that because of short supplies, low quality goods, and high prices, the present was a bad time for people to go into debt. It was also stated that the greater the consumer debt at the present time the greater the pressure on prices so that if consumer credit continued to expand there might be as much as $20 billion of consumer credit outstanding within two years which would carry into a real boom and be the seed for a major collapse.

President Brown stated that the question whether the control of instalment credit with respect to important items should be given to the Board was a matter for Congress to decide, that he personally was opposed to such control, but there were a number of able thinkers who took the opposite view realizing that the question would have to be settled by the Congress. He also said that, as he understood it, it was the position of the Board last year that all controls under Regulation W, with the exception of large items such as automobiles and the regulation of small loan companies, would be discontinued as soon as possible, but that up to the present time that had not been done. It was the opinion of the Council, he said, that the time had come when such things as radios and soft goods should be removed from the Regulation and that the Regulation in its present form was "making liars of a lot of people" who were becoming contemptuous of Government regulation and making it impossible to police Regulation W.

Mr. Ransom stated that the question was constantly being studied to determine what articles should be removed from the Regulation and that that was a question of timing.

In response to Mr. Ransom's comment, President Brown asked why action in that direction had not been taken.

Mr. Ransom stated that it was almost impossible to get any agreement from the trade, and Mr. Wiggins stated that the Regulation was not designed to protect merchants from extending credit that they should not have extended, that it had been used in many cases to impose requirement that the merchants should have required as a sound business proposition, that some merchants favored it because it kept their competitors in line, and that the provision of the Regulation relating to charge account credit did not accomplish much and was one of the first things that should be eliminated.

Chairman Eccles stated that the Board could ask the President to repeal the executive order under which Regulation W was issued and inquired whether the Council would favor such action. President Brown responded that he would repeal all of the Regulation except the controls on automobiles and small loan companies, and Mr. Wiggins suggested that the Regulation should not be abandoned but that there should be a gradual relaxation.

Mr. Vardaman stated that he would prefer to have the Regulation eliminated entirely rather than to keep it in its present form but that it would be well to retain the control of major items.

Chairman Eccles stated that the Presidents were divided on the question whether legislation should be enacted to provide for the continuation of consumer credit control.

Mr. McCoy asked how much inflation the Board felt had been stopped by the Regulation to which Chairman Eccles responded that that was not known but that it had stopped some and with the present low interest rates, the excessive supply of funds, and the large number of banks and other concerns going into the instalment loan business there would be a very large increase in consumer credit which could easily reach an amount which would be the primary basis for a boom and subsequent depression.

Mr. Vardaman stated that the Board had recommended in its Annual Report that the authority to the Board to regulate instalment credit be made permanent and that the present Regulation was based on an executive order which in turn was based on the Trading with the Enemy Act, and he suggested in these circumstances some thought be given to proposing to the President that he give notice to Congress that unless legislation were adopted by a certain date he would repeal the outstanding executive order.

This suggestion was discussed and Mr. Ransom stated that the relaxation of the Regulation should be carefully thought out and that he would like to see it relaxed as rapidly as under the existing circumstances was advisable.

President Brown repeated the statement that if the Regulation were retained it should be relaxed and that otherwise the Board would force a repeal of the authority by Congress. He also said that he did not know whether the Board realized how much enforcement of the Regulation was breaking down, that it was observed during the war but now it was causing irritation as goods were becoming available, that the Board was doing damage by keeping a lot of controls which he did not believe were significant, that he had been told that examiners were giving up trying to determine whether banks were complying with the Regulation, that continuation of the Regulation was creating a nasty situation, and that except for the retention of controls of important items the Board was doing harm to the cause of Government enforcement of regulations.

Mr. Baird stated that he thought it would be possible to do away with a number of annoying points in the Regulation. He said there was very little compliance with the Regulation and very little policing of it in his district. Controls could be kept, he said, on the larger items which account for the major volume of consumer credit and he would like to see those continued but he did not like to see the Board continue a principle which "was making liars" out of masses of people.

Mr. Wiggins referred to the redemption of war bonds by the public rather than the use of credit for the purpose of purchasing goods and he expressed the opinion that it would be a good thing if people would hold their savings bonds and if necessary borrow for current needs. The reason for his position on this point was that if savings bonds were sold there was no incentive to replace them but if the individual borrowed he would pay the debt and continue to own his bonds.

Chairman Eccles inquired why a person should borrow and pay interest on funds when he could obtain cash from the redemption of bonds, and Mr. J. T. Brown said that in many cases people were proud of their bond holdings and did not want to redeem them, and that while a banker might not recognize it as sound to hold bonds and borrow for current needs, the ordinary citizen did not feel that way and took pride in holding his bonds as a nest egg. Mr. Brown also said his bank saw cases of that kind every day, that it was constantly making loans against savings deposits which under Regulation Q had to be made at a rate which was at least 2 per cent higher than the rate on the savings deposits, and that if that was sound it was proof positive that it was sound for the borrower to pay a little more to retain his investment in savings bonds. He felt that the trouble was that bankers were inclined to look at this matter from the viewpoint of sound finance rather than from the standpoint of human nature.

Chairman Eccles pointed out that when an individual borrowed to buy it added to the cost of the purchase, that there was tremendous pressure on the "little fellow" to go into debt which he was not strong enough to resist, and that when a depression came he stopped buying on balance which created unemployment.

President Brown stated that the Council did not want to argue the long-term principle but felt that there were a number of things in Regulation W which were relatively unimportant, that it had been understood that it was the desire of the Board after VJ-Day to eliminate these, and that it was the opinion of the Council that the time had come for such action and it was strongly urged that it be taken.

President Brown then stated that one of the topics on the agenda of the Federal Advisory Council had been whether joint recommendations for changes in the banking laws might be made to Congress in a special report by the Board of Governors, the Presidents of the Reserve Banks, and the Federal Advisory Council. He also said that such a proposal was not being suggested by the Council at this time as it was not thought possible to obtain agreement among the members of the Council or between the Board of Governors, the Presidents of the Reserve Banks, and the Federal Advisory Council on the recommendations to be made.

President Brown then stated that there were many banks in the United States the preferred stock and capital debentures of which were held by the Reconstruction Finance Corporation and, since it was not desirable for the Corporation to continue to supply permanent capital to the banks, some plan should be devised to have the necessary capital sold to private owners so that the stock held by the Reconstruction Finance Corporation could be retired. He said that it would be possible for the banks to sell such stock at the present time but that they did not want to take the action because (1) considerable blocks of stock were held in trust accounts and under the provisions of the Board's Regulation F a bank was not permitted to exercise rights for the purchase of its own stock for trust accounts held by it, (2) in some cases the Federal Deposit Insurance Corporation objected to the retirement of stock held by the Reconstruction Finance Corporation, and (3) in some States the stock held by the Reconstruction Finance Corporation was exempt from taxation whereas private capital was not. He added that the Council did not know what the Board of Governors could do in these circumstances except possibly to have its examiners continue to urge retirement of the Reconstruction Finance Corporation stock where it appeared that that could be done and to consider the amendment of Regulation F to permit a bank to exercise rights held in trust accounts to purchase its own stock.

Chairman Eccles questioned whether the Board should take action on this suggestion for the reason that the aggregate amount of stock and capital debentures still outstanding was relatively small and was being reduced automatically under rules of the Reconstruction Finance Corporation and it was not the prerogative of the Board to suggest that the time had come for all banks to retire the Reconstruction Finance Corporation holdings.

Mr. Vardaman commented that the matter had come up in conversations which he had at the meeting of the State Bank Supervisors and the convention of the American Bankers Association, that he had taken the position that it was not a matter on which the Board should take a position as to all banks but that it might well be taken up by the State Bank Supervisors and the Comptroller of the Currency with the Reconstruction Finance Corporation, and that undoubtedly the question would come up at the next session of Congress. He said that he had not understood that examiners were encouraging retirement of the stock and Mr. Leonard stated that that was done only in a case where private capital could be issued to replace retiring Reconstruction Finance Corporation stock so that there would be no net reduction in the capital stock of the bank.

President Brown referred to the case where a bank had built up a reserve for the retirement of preferred stock and wanted to retire the stock held by the Reconstruction Finance Corporation using the reserve for that purpose, and stated that in some States such an operation would result in an increase of the bank's taxes by 6 per cent or more of the stock replaced. In a further discussion he recommended that the Board consider the modification of Regulation F to permit a national bank to exercise rights, issued in connection with stock of the bank held in its trust department, to purchase shares for the trust accounts in which the stock was held. In response to a comment that the problem of the Reconstruction Finance Corporation holdings of bank stock and capital debentures was not a very serious one, President Brown stated that it was bad in principle and at the present time banks should be encouraged to replace such capital by sale of stock to private holders.

In reply to an inquiry from President Brown as to the possibility of the Board reducing the margin requirements prescribed in Regulations T and U, Chairman Eccles stated that the Board expected to consider that matter again very shortly and that he could not say at this time what the decision would be. He also said that the Presidents of the Reserve Banks who met in Washington last week had advised against the reduction of margin requirements at this time.

President Brown stated that the over-all question was an extremely difficult one of timing, and that action by the Board at this time might be interpreted as an indication of fear of a further market collapse.

Chairman Eccles referred to the fact that the action of the Board in increasing margin requirements was not because of the level of prices or activity in the market but because of the general inflationary situation in which it was felt that the use of credit for the speculative purchasing and carrying of securities was unsound.

President Brown stated that the Council felt that conditions had changed very greatly during the last 90 days, and that some flexibility in the market was desirable, but that the members of the Council did not agree that the present was the time for action to reduce margin requirements or what the amount of the reduction should be. It was the feeling of the Council however, he said, that the time had come when the Board should discuss it. He made the further statement that there was one phase of the problem on which the Council was agreed, that is, that action should be taken by the Board to permit the extension of credit in connection with the exercise of rights in the hands of the original holders. He added that there was a considerable volume of expansion plans under way that should be financed by stock expansion and that the owners of the present stock of corporations involved should be permitted to borrow on stock exchange collateral in order to exercise their subscription rights.

Mr. Draper stated that this suggestion had been made by the Presidents of the Federal Reserve Banks last week and was being given consideration.

Chairman Eccles stated that from the long-run point of view it would be better for the economy if many of the expansion plans now being considered were deferred because if long-term commitments were made under present inflationary conditions it might result in serious difficulties in time of recession. He felt that it might be better if business followed the example set by Government of deferring public works and expenditures as that might result in a slowing up in the economy which would be wholesome and which would result in more stable conditions. He recognized, however, the inclination of concerns to want to take advantage of present conditions in the money market and issue long-term securities at a very low rate of interest and said that such action might be profitable if they would defer immediate construction until that could be undertaken under more stable conditions.

In a discussion of the recent decline in the stock market, President Brown stated that the Council agreed that the 100 per cent margin requirement was not responsible for the break, and that the decline was a desirable one, but that the Board of Governors should consider whether conditions were now such as to make action to reduce margin requirements desirable.

President Brown then asked whether there had been any new developments in connection with the proposed holding company bill and whether there had been any agreement in that connection with the Federal Deposit Insurance Corporation or the Comptroller of the Currency.

Chairman Eccles stated that there had been no further discussions by the Board since the last meeting of the Council but that it was expected that a new bill would be introduced in the next session of Congress which would be modified in some respects after consideration of the views of the independent bankers associations, holding company groups and others, and that if possible the Board should get an agreement with the Federal Deposit Insurance Corporation and the Comptroller of the Currency on the bill that would be proposed.

President Brown stated that ordinarily the next meeting of the Council with the Board would be on November 18 but that it had been suggested that it might be postponed until December 2. In a discussion, it was understood that the meeting would be held on the latter date.

Thereupon the meeting adjourned.

S R Carpenter
Secretary.

Approved:

M S Eccles
Chairman.