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 Tuesday, November 18, 1947, at 10:30 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Szymczak
Mr. Draper
Mr. Evans
Mr. Vardaman
Mr. Clayton

Mr. Carpenter, Secretary

Messrs. Spencer, Burgess, Williams, McCoy, Fleming, J. T. Brown, E. E. Brown, Penick, Atwood, Kemper, 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

At its separate meeting before this joint meeting the Federal Advisory Council approved statements with respect to the matters which were to be discussed with the Board of Governors and yesterday copies of these statements were furnished to the members of the Board for consideration in accordance with the procedure agreed upon by the Council and the Board on December 3, 1946. At this meeting the discussions with respect to the topics were substantially as follows:

1. What position does the Council wish to take now on Bill S. 408?

The Council is cognizant of the investigation of the activities and powers of the Reconstruction Finance Corporation now being made by a Congressional Committee. Until Congress has determined whether the Reconstruction Finance Corporation should be continued, and, if continued, what powers to make or guarantee loans should be given it, the Council feels that no action by Congress should be taken on Senate Bill 408. The Council feels that Senate Bill 408 should be considered only as an alternative to legislation continuing the present loan and guarantee powers of the Reconstruction Finance Corporation. If the Congress should decide to continue the Reconstruction Finance Corporation without greatly curtailing its loan and guaranteeing powers, the Council would be opposed to the passage of Senate Bill 408. The majority of the Council would prefer Senate Bill 408 to the continuation of the Reconstruction Finance Corporation powers, but it should also be noted that a minority of the Council is against giving any guarantee or commitment powers to the Federal Reserve Banks under any circumstances, as proposed in Senate Bill 408.

President Brown stated that in accordance with the understanding at the last meeting, the Council had given further consideration to what its position should be with respect to the industrial loan bill and that the above statement was the result of that consideration.

Chairman Eccles said that the new statement which indicated a preference for the industrial loan bill rather than an extension of the lending powers of the Reconstruction Finance Corporation was much more satisfactory to the Board than a statement which would oppose the enactment of the industrial loan bill.

2. The Board is very much concerned about the rapid expansion of bank credit. The Board, therefore,

desires to have the views of the Council as to the further steps that might be taken to correct this serious situation through monetary or fiscal means.

The Council has reviewed the question of the volume of bank credit both in the aggregate and as shown in the banks with which they are familiar.

We do not know what "serious situation" in bank credit the Board has in mind. For the past year the total volume of bank credit (i.e. the available amount of bank money) as measured by adjusted demand deposits has been practically level. As bank loans have increased, the banks have decreased their investments.

We find nothing in bank loans themselves to suggest that growth of loans has been an active inflationary factor. It rather appears to have been a reflection of the very high level of business activity and high prices.

To a large extent growth of loans is a direct result of government policies. For example, an increase of nearly 4 billion dollars in the real estate loans by insured banks since the end of the war reflects directly the purchase of FHA and GI mortgages in the housing program.

The Reconstruction Finance Corporation is encouraging bank lending by guaranteeing risky loans.

Commercial loans are influenced by high prices and active movement of agricultural and manufactured products for the foreign aid program.

High wages and high costs of materials have meant that business needed more money to take care of its customers.

There is nothing in the figures or our experience to suggest that there exists any substantial lending for speculation or for unnecessary uses. Loans for carrying securities are much reduced.

In this period the government, through the R.F.C., the C.C.C., the P.C.A., and other agencies, has been making loans

that the banks refrained from making because of their speculative nature. The Reserve System itself is asking for more power to guarantee loans on the presumption that bank lending is too cautious.

The causes of our present inflation are not in current banking policies but are found in the great wartime expansion of buying power together with unusual events and public policies since that time. Among recent inflationary causes may be listed the following:

The foreign aid program
A cycle of wage increases in excess of increases in either the cost of living or productivity
A shorter working week
A short corn crop
Veterans bonuses and relief payments
Agricultural price subsidies
U. S. Government spending of 36 billion dollars a year
Housing subsidies

In the face of these developments a substantial increase in bank loans was inevitable and the banks have shown restraint. The dangers in the present situation are understood by bankers and there is hardly a bank in the country which has not been warning its customers against overexpansion. The loans being made are mostly for direct production.

The first thing to do is to reconsider government policies which are inflationary and especially excessive government spending and subsidies.

We recognize that even though the causes of inflation are largely outside the sphere of monetary policy, the Reserve System has a special responsibility for bank credit and in this situation should take all reasonable care to assure conservative credit policies.

In this special area we suggest that the System and the Treasury already have large powers, without new legislation, to place credit under broad restraints.

One of these powers is the discount rate which is a recognized instrument for serving notice on the public of the need for restraint in the use of credit.

Similarly by open market operations the System can control the reserves of the member banks and limit their lending power.

The Board also still has the power to raise reserve requirements in Central Reserve Cities and so tighten money.

The Treasury by the pricing of new issues and the handling of its balances has great influence on the rate and volume of money.

In the past year the System and the Treasury have used these powers effectively.

The money markets and the policies of business men are today so sensitive to action of these sorts which the Reserve System and the Treasury take that present powers are ample to place all restraints on credit expansion which the System and the Treasury may consider necessary.

The Council wishes it clearly understood that it shares the apprehension of the Board of Governors with respect to inflation dangers. It does, however, most strenuously object to the singling out of the increase in bank loans as a principal contributing factor; and it has attempted to point out above, the vastly more important elements of inflation - of which bank loans are a barometer.

This is not to say that there have not been unwise bank loans in some cases. After all, banking is a form of human endeavor, operated by human beings. It would be amazing if there were not some errors in judgment. But we submit that, on the record, there is no evidence of bank credit expansion beyond that which could be expected under all the circumstances. There is every evidence that loans are today doing a wholesome and constructive work in their intended place in the economy.

The Council has studied the increase in consumer credit in relation to the termination of Regulation W. While consumer credit has increased substantially, much of this reflects the availability of automobiles and household appliances. There is so far too little experience on which to judge the effect of the termination of Regulation W. The American Bankers Association is undertaking with considerable success to ensure maintenance by banks of sound lending standards. This effort towards voluntary cooperation seems to the Council the sensible and the democratic method of dealing with this problem, both with respect to the banks and other lenders. The Council is opposed to legislation giving the Board new regulatory powers in this matter.

President Brown said that the above statement was prepared by the Council before the delivery of the President's message at the opening of the special session of Congress, and that since then the Council had given further consideration to the matter and wished to add the following paragraphs to the statement:

Suggestions in the President's message to Congress with respect to credit control indicate the possibility that the Federal Reserve Board may present to Congress the proposal in its 1945 Annual Report for a required bank reserve of short term government securities. The Council therefore wishes to state its views on this proposal.

The proposal as we understand it is that banks should be required by law to maintain, in addition to cash reserves, reserves of short term government securities in a percentage relationship to deposits, to be fixed from time to time by the Federal Reserve Board.

The Council is unanimously opposed to this scheme for the following reasons:

1. It is impractical. The operations of banks are so different, reflecting as they do adaptation to the varying

needs of their communities and customers, that no percentage of short term government security holdings can be applied fairly or practically to all banks. Any percentage high enough to offer any measure of restraint on a substantial number of banks will have disastrous effects on many other banks, compelling them to liquidate sound and necessary loans and thus actually check production. The very banks which have served the business in their communities most aggressively and helpfully would be hardest hit.

2. Such a plan would substitute the edicts of a board in Washington for the judgments of the boards of directors of 15,000 banks throughout the country as to the employment of a substantial part of the funds of their banks. This is a step towards socialization of banking.

3. As indicated earlier, the Federal Reserve System and the Treasury already possess large powers of credit control not now being fully used. Such new powers as those proposed are not necessary.

President Brown added that the Council would like to have the entire statement made public by the Board and sent to the Chairmen of the Senate and House Banking and Currency Committees.

Chairman Eccles stated that yesterday afternoon Senator Taft called on the telephone and after referring to the statement contained in the President's message with respect to restraining the creation of inflationary bank credit, stated that he was calling a joint meeting of the Banking and Currency Committees and the Joint Committee on the Economic Report for consideration of this phase of the program presented by the President, that the Committees wanted to reach a conclusion on the matter as promptly as possible, and that they would

like to have him (Chairman Eccles) appear before the three Committees on Thursday of this week. Chairman Eccles also said that he suggested to the Senator that he be given until Monday to prepare for the hearing, and that he did not know at this time whether he would appear before the Committees on Thursday of this week or early next week.

In connection with the comment in the Council's statement that the discount rate was one of the powers available to the Board, President Brown stated that an increase in the rate of 1/4 or 1/2 per cent would have a very great psychological effect on the money market, that bankers and business men were "jittery" at the present time, and that any increase in the rate would have a much greater effect than a very substantial increase would have had before the war. He also said that open market operations could be used greatly to tighten the money market without driving the price of Government securities (other than possibly Treasury certificates) below par. He added that the Committee felt that the war loan accounts were larger than necessary and that calls on war loan accounts resulted in withdrawals from large correspondent banks in amounts larger than they needed to be, and that, while an increase in the reserve requirements of banks in central reserve cities would result in the loss of a large amount of earning assets to the banks in New York and Chicago,

it was felt that the reserve requirements of banks in those cities should be increased before a request was made for additional powers to control the credit situation.

In response to the Council's statement Chairman Eccles commented substantially as follows:

> Aside from direct controls such as were in effect during the war, two accepted methods of dealing with an inflationary situation are fiscal and monetary measures. Both of these methods were largely suspended while the war was on and resort was had to direct controls. The financing by the banks of the Government deficit during the war was highly inflationary--more inflationary than if more of the debt had been financed outside of the banks as it should have been. The monetary policy during the war period was also inflationary as it had to be adjusted to carry out the Treasury fiscal policy. Although the System was opposed to the program of maintaining a pattern of rates and the sale of Government securities on a basis which enabled banks to play the pattern of rates and sell securities at a premium as they neared maturity, there was nothing the System could do about the matter. Inflation during the war period was prevented by direct controls, and when these controls were removed following the war there was little done, or that could be done, in the fiscal and monetary fields to prevent inflation. It is true that steps were taken to retire Government debt, but that reduction was effected largely through a reduction of Treasury balances, and not through a substantial budgetary surplus which is the means by which an anti-inflationary fiscal policy is made effective.
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> At the present time we are confronted with a very dangerous inflationary situation. The reimposition of the harness of direct controls, which were in effect during the war and which should not have been removed until we were "out of the woods", is impractical if not impossible. In the absence of such controls and particularly if the Marshall Plan is put into effect it

is necessary to have a fiscal policy which will produce a substantial budget surplus. Such a policy would be much more effective in dealing with the inflationary problem than anything that can be done in the monetary field, and it should be pointed out that no monetary policy can deal with the problem of inflation adequately in the absence of an effective fiscal policy.

During the last session Congress tried to reduce expenditures but was unsuccessful in making very substantial reductions. In view of the character of the large items making up the budget such as veterans' benefits, interest on the public debt, military expenditures, and the foreign relief program, it is not to be expected that there will be a very substantial reduction in expenditures in the immediate future. In addition there are various items of public works and payments to farmers which will be continued, all of which makes it difficult to follow a fiscal policy which will result in a substantial budget surplus.

On the monetary side of the picture we already have a volume of credit and deposits in excess of the amount needed to make full utilization of available supply of labor and materials. When that condition prevails the expansion of private credit at a more rapid rate than the debt can be retired from a budget surplus adds to the inflationary pressures and that is the prospect at the present time. Even loans for productive purposes are inflationary if they increase the demand for labor and material that are already in short supply.

In this connection the monthly letter from The National City Bank of New York states:

> "Rapidly accumulating debt is both a cause and a consequence of the inflationary pressures, for in a wage-price spiral, business constantly needs more and more money to keep going and this leads to the incurrence of more and more debt by business and more and more spending by the individual. To check this kind of spiralling--which is to the ultimate benefit of no one and to the injury of all--is not simple."

The point of that statement is that, as increases in wages may be inflationary, increases in the outstanding volume of credit may be inflationary also.

When direct controls were taken off, the supply of money was far in excess of the supply of goods and services that was available and this condition was immediately reflected in increased prices. As prices have gone up banks have added to the already excessive supply of credit and this has been further reflected in the price structure. This development has to be stopped somewhere and we cannot say that it should be stopped everywhere except in the field of bank credit.

The statement adopted by the Council contains the comment: "For the past year the total volume of bank credit (i.e. the available amount of bank money) as measured by adjusted demand deposits has been practically level. As bank loans have increased, the banks have decreased their investments." According to the information available to the Board that is not true. Total deposits and currency held by individuals and businesses (excluding U. S. Government and interbank deposits) increased by $5.5 billion in the 12 months ending September 30. In the third quarter of 1947 this increase was $2.3 billion, an annual rate of over $9 billion. The principal factors accounting for this growth in bank credit were an expansion of bank loans in the twelve-month period of $7 billion and an inflow of gold of $2.7 billion. Banks, including Federal Reserve Banks and mutual savings banks, reduced their holdings of government securities by nearly $11 billion, but at the same time there was a decrease in United States Government deposits of nearly $8 billion. During the third quarter of 1947 the large loan expansion of $2.3 billion was the principal factor accounting for the further growth in deposits.

The Council's statement is apparently based upon figures for weekly reporting member banks which have shown only a moderate increase in demand deposits adjusted during the last 4 or 5 months following a sharp increase in the second quarter of the year. In recent months, however, deposits at country member banks, and no doubt also at nonmember banks, have increased sharply

reflecting a seasonal flow of funds to agricultural regions which has been particularly great this year because of the high prices of farm products. City banks have contributed to the overall growth in deposits by the sharp increase of over $2.5 billion in their loans since June. They have been able to increase these loans in part because of the gold inflow and in part because of an increase in interbank balances, as well as through a decline of about $1 billion in their holdings of U. S. Government securities. So it is not true even in the case of city banks, as is implied in the Council statement, that banks have decreased their investments corresponding to the increase in loans.

The Board agrees that credit for housing has been so easy and so excessive--and a great portion of it has been made available through the banks--that it has far exceeded the supply of labor and materials with the results that costs have gone up materially. There is very little housing credit outside the banks for the reason that a great many individuals and concerns in the mortgage field obtain their funds from banks. We agree that it is difficult to restrain the banks if government agencies such as the F.H.A. insure housing credit, but it is hoped that without a change in the law there will be a tightening of Federal policy in the real estate mortgage field. G. I. mortgage credit is more difficult because of the pressure brought to bear by the Veterans Administration but we are hopeful that in that field also there will be further restraint. I have discussed the question of housing credit with Under Secretary of the Treasury Wiggins and we have also talked to Mr. Foley, of the Federal Housing Administration, about it.

In response to a comment by Mr. Burgess that the Council was in agreement with the views expressed by Chairman Eccles on the real estate mortgage situation and that he would suggest that the Board and the Council agree on a statement that might be issued in this connection, Chairman Eccles replied that if the Council would

prepare a statement the Board would undoubtedly be glad to consider it. He said that his discussions with Under Secretary of the Treasury Wiggins grew out of the fact that the three Federal bank supervisory agencies had discussed a joint statement by the Federal and State bank supervisory agencies urging the banks to follow a more restrictive lending policy, but that it would be difficult to take that position when the pressure to expand credit was being put on the banks by the Veterans Administration and the Federal Housing Administration and that he had discussed the matter with Under Secretary of the Treasury Wiggins and Mr. Foley in that light.

Mr. Burgess said that if the Board would state its position on the real estate situation as outlined by Chairman Eccles he as a member of the Council would be glad to endorse it. Thereupon, Chairman Eccles suggested that the Council refer the matter to a committee so that if and when something was worked out it could be submitted to the committee for endorsement if the members of the committee agreed with it. Mr. Burgess suggested that when Chairman Eccles appeared before the committees of Congress this week or next he might say that the Council was in agreement with the Board as to the dangers in the real estate mortgage field resulting from pressures from the Veterans Administration and the Federal Housing Administration for additional mortgage credit.

During a discussion of the statement of the Council with respect to lending activities of the Reconstruction Finance Corporation, the Commodity Credit Corporation, and the Production Credit Associations, Chairman Eccles expressed the view that these agencies were not increasing credit extensions on balance and that the Council should revise its statement to make clear just what phases of the activities of these agencies were being objected to.

Mr. Fleming stated that he could not help but feel that the pronouncements that had been made to date with respect to the expansion of bank credit were a step in the direction of making the banks the "whipping boy" again. He thought that was a dishonest thing to do since the banks had done a good job during and since the war. He asked what the banks were to do when they were under heavy pressure to extend credit for needed housing and to enable merchants, who were entirely satisfactory credit risks, to meet increased pay rolls and higher costs of goods.

Chairman Eccles stated that the Board was not blaming the banks to which Mr. Burgess responded that the implication was that the banks were to blame.

Chairman Eccles said that he did not blame the banks at all for the policy that they had been following, for the reason that if a bank could sell a low yield security and make a loan it was to be

expected that it would do so, and that it was the job of the banks to make more profits if they could do so by making sound loans and investments. He also said that the problem was that Federal Reserve Bank credit had been made available to the banks without adequate controls, that Congress and the Administration had asked what could be done to meet that situation, and that the only thing that the Board could do was to state the facts and make the suggestions contained in its Annual Reports for 1945 and 1946. The Board, he said, did not want the banking system to be the "whipping boy" and for that reason had pointed out the situation that had been created as the result of war financing and the need for additional controls. He added that the Board was not critical of any individual bank or of the banking system, that the banks should not be criticized for what they had done, but that there should be criticism of the situation in which the private banking system was given the free access to Federal Reserve credit that it had at the present time without adequate controls.

Chairman Eccles then explained why the Board felt that its existing powers were not, as stated by the Council, ample to place all restraints on credit expansion which the System or the Treasury might consider to be necessary. In that connection he read the following paragraphs from the memorandum prepared in the Board's offices

on the proposal for a special reserve requirement against deposits of banks.

The extent to which short-term interest rates may be permitted to rise in order to prevent credit expansion is determined by the behavior of long-term rates and Government bond prices as well as by the effect on the cost to the Government. It appears that the recent rise in short-term rates may have gone as far as can be justified in view of current conditions in the bond market. This situation makes it impossible to bring about increases in rates charged on bank loans to private borrowers. Only by divorcing the Government securities market from the private credit market through some such means as the special reserve proposal can rates on private credits be increased without raising rates on short-term Government securities and thus further upsetting the medium and long-term Government bond market.

The recent rise of yields on long-term corporate and municipal securities has been due to the great increase in demands for capital funds rather than to the moderate rise in interest rates on short-term Government securities. The heavy business demands for capital have been generated by the current inflation and the resulting large dollar volume of business expenditures. The increased supply of corporate securities at higher rates is attracting available investment funds and inducing investors, primarily institutional, to shift from Government to corporate securities, with consequent downward pressure on prices of long-term Government issues. This necessitates Federal Reserve support of long-term Government securities with resulting expansion of bank reserves. Only through the use of the special reserve requirement would the System be able to neutralize the expansion of reserves that results from supporting the price of long-term Government securities.

Chairman Eccles stated that the only reason that could be given for a further increase in the short-term rate would be as a step to discourage further extension of credit but that an increase

in the rate to 1-1/2 or 1-3/4 per cent would have no anti-inflationary effect as it would not deter the borrower but, on the contrary, would encourage lenders to make loans because of the high return. Therefore he could see no justification for a further increase in the short-term rate unless the situation should change again.

He pointed out that the System had no way of offsetting the increase in member bank reserves which resulted from gold imports which were at the rate of about $3 billion a year. He stated that these imports could not be sterilized as that would require provision for the necessary funds in the budget which was out of the question at this time.

It was necessary also, he said, to support the Government security market at the present time, and the purchase of Government securities for that purpose together with gold imports might make it possible for banks to expand credit further without selling additional securities, or borrowing from the Federal Reserve Bank, in which event an increase in the discount rate would have no effect in combating inflation. In that connection he said that Mr. Sproul, President of the Federal Reserve Bank of New York, thought it would be a mistake to have a discount rate at a higher level than the rate on Treasury certificates. He also said that he felt, for reasons which he would not take the time to explain, that the

discount rate should be higher than the certificate rate and therefore a penalty rate. Furthermore, any increase in the rate that could be made under present conditions would not be effective in combating inflation and would be such a minor matter as to be unimportant.

President Brown again expressed the opinion that an increase in the rate would have a marked psychological effect on borrowers. He said that during the past 45 to 60 days there had been a distinct hesitancy on the part of borrowers, that projects had been deferred because of higher costs and fears of a recession, and that when individuals were in that frame of mind an increase in the discount rate of even 1/4 of 1 per cent would have a very marked effect.

Chairman Eccles stated that what was having a greater effect was the increased cost of long-term credit, but that if the special reserve plan were put into effect it would be possible to raise the discount rate to 1-1/2 or 2 per cent without affecting adversely the short-term Government security market, because the banks would be required to hold a certain portion of their deposits in short-term Governments or cash which would separate the short-term Government rate from the private credit rate.

Mr. Burgess questioned whether this would be the result of the plan stating that the two markets did not operate in that way.

Chairman Eccles explained why he thought the plan would operate to have that effect.

In explanation of why he felt the authority of the Board to increase reserve requirements of banks in central reserve cities was not an effective weapon in dealing with the inflationary situation, Chairman Eccles stated that the growth of credit outside of these cities was much larger than in New York and Chicago, that an increase in reserve requirements would only result in the sale of Government securities to the Federal Reserve Banks to provide the additional reserves, that this would reduce the earnings of these banks at a time when their earnings had declined more than any other group of banks, and that they would be under increased pressure to make additional loans to offset the loss of earnings. For these reasons he doubted that an increase in reserve requirements would be helpful in the present situation.

At this point Messrs. Vardaman and Fleming left the meeting.

Following a discussion of questions asked by members of the Council with respect to the special reserve plan, Chairman Eccles read the first nine pages of the memorandum of November 13, 1947, including pages 2a and pages 5 and 6 of the memorandum as revised under date of November 17, 1947.

During the reading Mr. Burgess asked when copies of the

memorandum would be made available to the members of the Council. Chairman Eccles stated that they would be sent to the Council after he had appeared before the Congressional committees this week or next.

Thereupon the meeting recessed and reconvened at 2:35 p.m. with the same attendance as at the beginning of the morning session except that Mr. Fleming was not present.

Chairman Eccles suggested that the Council consider revising its statement with respect to the bank credit situation to make it more constructive. He felt that it was in such an antagonistic and critical tone that it would not react to the benefit of the Council. He said that it gave the impression that the Council felt that everyone was wrong except the bankers, and that if it were to be issued in its present form the Board would be under the necessity of answering it and pointing out that the Council was wrong in stating that the System and the Treasury had adequate powers to deal with the present situation and had failed to use existing powers. Chairman Eccles discussed briefly some of the changes which he felt should be made in the statement and suggested that it was of such importance that the Council should consider the appointment of a committee to study it from every aspect to see that it was in proper form so that it would be a constructive statement in the light of the present serious

situation and not one which put the bankers in a position where they criticized everyone but themselves.

President Brown stated that the Council would consider the matter and advise the Board of its decision.

3. There is an obligation resting upon the Federal Reserve System constantly to improve and expedite check collection processes for the benefit of industry, agriculture and commerce. A constructive move in this direction is indicated in recent correspondence between the President of the Reserve City Bankers Association and the Chairman of the Board of Governors, copies of which are attached. The Board would appreciate an expression of the views of the Council as to how best to promote and advance the modernization and maximum development of the check collection system.

The Council appreciates the efficiency of the check collection processes of the Federal Reserve System and the desire of the System constantly to improve and expedite these processes for the benefit of industry, agriculture, and commerce. The Council suggests that when changes in the collection system are being considered by the staffs of the Federal Reserve Banks and the Board of Governors, that the Council be advised regarding the particular operating matters under consideration. The members of the Council are policy-making officials in their respective banks, and they desire an opportunity to refer these questions of bank operation, as they come up, to bank officials handling such problems. The Council, as well as the Board of Governors, may also request the cooperation and advice on these matters of the proper committees of the American Bankers Association and the Reserve City Bankers Association.

No changes in the check collection processes should result in making items available sooner, on the average, than the period required for their collection. For example, for the Federal Reserve Banks to make all items

immediately available would be unsound, as it would make funds available when they were not actually collected. It would be the equivalent of granting a loan without interest and of paying a cash subsidy for deposits in the Federal Reserve Banks.

President Brown stated that the Council understood that the Board was studying the possibility of giving immediate credit for all cash items. He also said that the Federal Reserve Bank of Chicago was giving credit on Saturday for items drawn on New York although they could not be collected until the following Monday thereby absorbing some $20 or $30 million of float and that he thought this practice was unsound.

Chairman Eccles stated that the Board had no plan for giving immediate credit for all items, that such a step would add a very substantial amount to member bank reserves and would only increase existing inflationary pressures. He added that the Board did not agree that it would be unsound to give immediate credit for all cash items at a time when such action would be in harmony with the over-all credit policy of the System. He also said that, as stated in the letter to Mr. Baird, President of the Reserve City Bankers Association, if such a step were actively considered the Board would give the Council an opportunity to express its views. In connection with his statement, Chairman Eccles read an excerpt from the 1915 annual report of the Board which expressed the opinion that it was not the intention of Congress that member banks should continue to hold

deposits of other banks, that the Federal Reserve Banks should perform the work then being performed by correspondent banks, and that the reserve balances carried by the Reserve Banks should serve as the basis for an effective system for collecting checks.

Chairman Eccles then explained why he felt the giving of immediate credit by the Federal Reserve Banks for cash items would not be unsound but would be in the interests of business, industry, and agriculture. He stated that the present practice of requiring banks to sort checks and maintain records of deferred availability deterred banks from joining the Federal Reserve System. He also said that if the System was to render the service to commerce, industry, and agriculture and make membership in the System sufficiently attractive to induce members to join the System it would be necessary to do something in the direction of giving immediate credit on cash items. He also stated that when the question of compulsory membership in the System was under consideration in the 1930's, Congressman Steagall expressed the view, which was concurred in by others, that banks should not be forced into membership but should be free to join the System if they felt that membership was sufficiently attractive. He emphasized the fact, however, that in taking action in this field the Board would not want to do anything which would interfere with the earnings of

the reserve city banks, that any change of this kind would require a long period of preparation, and that it should be remembered that the benefit of immediate credit would accrue largely to the city banks.

President Brown stated that the Council agreed that the giving of immediate credit on all items would be inflationary which would appear to preclude action for some time to come. He also said that it was understood that the Board was giving thought to requiring banks which had more than a stated number of items payable in the territory of another Federal Reserve Bank or branch to sort such items separately. He added that such a policy would add about $40 thousand a year to the check collection costs of his bank.

Chairman Eccles stated that it had been found that about 60 banks in different parts of the United States had a large volume of checks payable in other Federal Reserve Bank or branch territories which they were dumping on the Federal Reserve Banks without sort, that it was felt that this was taking unfair advantage of the services provided by the Federal Reserve Banks, and that either these banks should be required to sort the items or all banks should be permitted to deposit items without sort.

President Brown stated that, if some way could be found under which the Presidents of the Federal Reserve Banks could discuss proposed changes in the check collection system with operating

officers of the banks in their districts without violating the confidence of the System, it would be helpful.

Chairman Eccles said the change referred to by President Brown had not been put into effect and the banks would have a chance to express their views before the change was made.

4. The Council would appreciate any information the Board has regarding developments that may have occurred since the last meeting of the Board and the Council in connection with the Bank Holding Company bill.

Chairman Eccles stated that there had been no changes since the last meeting of the Council with respect to the bank holding company legislation except that the Independent Bankers Association of the Twelfth Federal Reserve District and the National Association of Supervisors of State Banks had taken action strongly favoring bank holding company legislation. He also reviewed the present status of the bank holding company bill in Congress and stated that the bill would be given further consideration in its present form with possibly one or two minor amendments which would be offered on the floor of the Senate or before the House Banking and Currency Committee.

Chairman Eccles stated that it now appeared that there was very substantial support for the restoration of the authority for the regulation of consumer installment credit and that installment credit was expanding at a very rapid rate. He also said that because

of the relaxation of installment credit terms banks were unable to compete and were losing installment business to other lenders, and that if the authority for regulation were restored and the restrictions of Regulation W were again in effect the banks would continue to do a very substantial amount of this kind of business.

Thereupon the meeting adjourned.

Secretary's Note: Following this joint meeting the Federal Advisory Council met in separate session after which Messrs. Spencer and Prochnow advised the Secretary of the Board that the Council had made two changes in the statement submitted by the Council with respect to the expansion of bank credit: (1) The sentence in the second paragraph which stated that the total of bank credit had been practically level was changed to read: "For the past year the total volume of bank credit (i.e. the available amount of bank money) as measured by adjusted demand deposits has shown only a moderate increase." (2) The sentence in the ninth paragraph which referred to the R.F.C., C.C.C., and the P.C.A. was changed to read: "In this period the government, through various agencies, has been making loans that the banks refrained from making because of their speculative nature. The Reserve System itself is asking for more power to guarantee loans on the presumption that bank lending is too cautious." Messrs. Spencer and Prochnow also stated that it was the request of the Council that Chairman Eccles present the statement when he appeared at the hearing this week or next before the Joint Committee on the Economic Report and the Banking and Currency Committees but that it was not the request of the Council that the statement be made the subject of a separate press release.

S R Carpenter
Secretary.

Approved:

M S Eccles
Chairman.