Minutes of actions taken by the Board of Governors of the Federal Reserve System on Monday, July 24, 1950. The Board met in the Board Room at 10:45 a.m.

PRESENT: Mr. Szymczak, Chairman pro tem.
Mr. Evans

Mr. Carpenter, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Thurston, Assistant to the Board
Mr. Riefler, Assistant to the Chairman
Mr. Thomas, Economic Adviser
Mr. Leonard, Director, Division of Bank Operations
Mr. Young, Director, Division of Research and Statistics
Mr. Solomon, Assistant General Counsel
Mr. Sloan, Assistant Director, Division of Examinations
Mr. Chase, Assistant Solicitor
Mr. Fauver, Administrative Assistant to the Chairman

Mr. Lewis, Assistant Vice President of the Federal Reserve Bank of St. Louis, who is assisting the Board's staff temporarily in its work on the regulation of consumer credit, also attended the meeting.

Mr. Szymczak stated that on Saturday, July 22, Mr. Pierotti, Washington representative of Bank of America National Trust and Savings Association, San Francisco, California, tried to reach Chairman McCabe and when he was unable to do so called to request that he be permitted to sit down with a member or members of the Board for the purpose of discussing the difficulties involved in compliance by Bank of America and Transamerica Corporation with the order of the United States Circuit Court of Appeals for the Ninth Circuit requiring that certain banks previously owned by Transamerica Corporation which had been converted into branches of the national bank as of June 26, 1950, be restored to their status prior to that date. Mr. Szymczak said he told Mr. Pierotti that, as stated previously, while members of the Board would be willing to meet with representatives of the Bank it did not appear that anything could be accomplished by such a meeting. Subsequently, he said, representatives of Bank of America talked with Chairman McCabe in Denver, following which Mr. Pierotti called again to say that the Chairman had suggested that the matter be discussed with Mr. Szymczak. The latter stated that he told Mr. Pierotti that although he still could not see that there was anything to be discussed since the matter involved an order of the court over which the Board had no jurisdiction, he would discuss the matter here, whereupon Mr. Pierotti said that he would call again on Monday morning for an appointment.

Mr. Szymczak made the further statement that over the weekend he discussed the matter with appropriate members of the staff, including Mr. Townsend in San Francisco, and when Mr. Pierotti called this morning he (Mr. Szymczak) made substantially the following statement:

> "We have been thinking about this thing and this is the way it sets. (1) If the Bank of America or Transamerica have any legal questions relating to the court order, they should be taken up with the court; (2) If they have any operating questions having to do

"with the mechanics of the roll-back of the banks, they should be taken up with the supervisory agencies that had to do with this in the first place, i.e., the Comptroller of the Currency and the State Bank Supervisor. We would only be a delaying tactic and would get you and us nowhere. Therefore you have two questions. If it is a legal matter, it should be taken to the court. If it is an operating matter, you should go to the operating agencies - the Comptroller of the Currency and the State Bank Supervisor in California.

"We are willing to see you at any time but where you should go is to the Comptroller of the Currency and the State Bank Supervisor on questions of compliance or to the court if it is a legal question."

Mr. Szymczak went on to say that, in response to a reference by Mr. Pierotti to the Department of Justice, he (Mr. Szymczak) stated that he had discussed the matter with them (meaning Mr. Bergson, Assistant Attorney General) and that they felt the same way. He also said that what he meant was that, as Mr. Bergson had said, if representatives of Bank of America or Transamerica wanted to talk to representatives of the Board there was nothing the representatives could do but listen and then report to the Board. Mr. Szymczak added that in further conversation, he repeated again what he had said with respect to the two questions referred to above.

At this point Mr. Chase withdrew from the meeting.

Mr. Young reported that he received a telephone call today from Mr. Ensley, Assistant Director of the staff of the Joint Committee on the Economic Report, in which the latter stated that the Committee planned to issue a statement in approximately 10 days which would emphasize the role of fiscal and monetary and credit policy in meeting the current situation, and that the Committee would like to have a statement from the Board or from its staff covering the tax problem and a review of the System's authority for dealing with the existing situation in terms of credit restraint and the alternative steps that might be taken. Mr. Young said that he had told Mr. Ensley that he would have to discuss this matter with the Board, to which Mr. Ensley replied that if the Board could respond to the request, the Chairman of the Committee would write a letter to the Board formally requesting the statement.

At Mr. Szymczak's suggestion, it was agreed that the staff should begin working on the statement with the understanding that upon the return of Chairman McCabe and Mr. Vardaman later in the week a decision would be made whether the statement should be submitted as a statement of the Board or of its staff.

At the meeting on July 21 consideration was given to a draft of statement to be submitted by the Board to the Senate and House Banking and Currency Committees presenting the Board's views with respect to the provisions of the Defense Production Act of 1950 concerning consumer and real estate credit regulation and the guarantee of defense production loans. A revised draft of statement had been prepared on the basis of the discussion at that meeting.

The revision was read and discussed at this meeting, and after further changes the statement was approved unanimously in the following form with the understanding that it would be forwarded to the Senate and House Banking and Currency Committees today and that Mr. Evans would attend the hearings before the House Committee on Tuesday, July 25, for the purpose of answering questions:

"The Defense Production Act of 1950 would carry out the steps toward economic preparedness recommended by the President in his message of July 19 to the Congress. Because of the responsibilities which the Congress has placed upon the Board in the credit and monetary area, we are especially interested in those provisions of the bill relating to the guarantee of defense production loans and the regulation of consumer and real estate credit. We are, therefore, addressing this statement primarily to the reasons why we believe that these provisions should be promptly enacted as a part of the broad legislation needed to meet the present situation.

Guarantee of Defense Loans

"Section 301 of the bill would authorize the President to reinstitute a guarantee program similar to the V-loan program operated by the Federal Reserve System during World War II. The proposed program would be confined to the guarantee by the national defense procurement agencies of loans made by banks and other financial institutions to contractors to finance the production of defense materials needed by the United States in the present emergency. This program is not to be confused with various proposals advanced in post-war years for the peacetime guarantee of business loans.

"The financing problems of contractors engaged in defense production, particularly where they are small and medium-size, are unique in character. The loan guarantee mechanism here proposed provides an effective solution of these problems. Contracts for essential defense materials often require much larger financing by contractors than they are able to command under ordinary financing practices. It can make possible maximum participation by numerous smaller business enterprises in the Government's defense production program, particularly those who do not themselves have direct Government contracts but whose work as subcontractors is essential for prompt performance on the larger prime contracts. It can also make practical the awarding of more Government contracts, requiring unusually large working capital or expansion in plant and facilities, directly to relatively small and medium-size concerns. Without such financing, these concerns would not be able to make a full contribution to defense production. Finally, where great speed is essential in the performance of Government contracts, the mechanism "can serve to expedite the consummation of loans with a promptness which is not always possible under usual procedures.

"The loan guarantee proved to be an eminently successful means of encouraging the extension of private credit for facilitating production under Government contracts during World War II. The guarantee program of that period--the so-called V-loan program referred to earlier--was set up under Executive Order of the President in March 1942. Under that program, loans for war production were guaranteed by the Armed Services through the agency of the Federal Reserve System. The twelve regional Federal Reserve Banks and twenty-four branches, with experienced personnel and close daily contacts with financial institutions, afforded an already existing and well-adapted organization for making such guarantees promptly available to contractors throughout the country. The Board of Governors in Washington acted as the coordinating agency in the administration of the program.

"During the course of the V-loan program, bank loans to war contractors, both large and small, amounting to about $10-1/2 billion were approved for guarantees by the Armed Services through the agency of the Federal Reserve System. Over 90 per cent of the number and one-third of the amount of these guarantees were on loans to small and medium-size businesses; that is, businesses with total assets of less than $5 million. Notwithstanding the great volume of loans handled, the program was self-supporting; receipts of the Treasury from the program exceeded expenses and losses by $23 million by the end of 1949. Without the program, the production of war materials would have required more Government financing through direct lending and other means.

"For the reasons indicated, the Board feels that the program of guaranteed loans which would be authorized by Section 301 of the bill would constitute an essential part of any plan for expediting deliveries under defense production contracts. If the President should see fit again to utilize the Federal Reserve System for this loan guarantee program, the Board and the Federal Reserve Banks would immediately direct their facilities toward its vigorous and expeditious administration. With the experience gained by the System under the V-loan program during World War II and with personnel both at the Board "and at the regional Reserve Banks who participated in the previous operations, it would be possible to develop and put into effect within a very short time the new program of guaranteed loans contemplated by this bill.

Regulation of Consumer and Real Estate Credit

"Section 401 of the bill authorizes the President to regulate consumer and real estate credit. Under such authority minimum down payments on purchases, maximum maturities, and other standards appropriate to limit credit extension could be prescribed. Section 402 of the bill would strengthen the President's authority to curtail Federal financing programs in the housing field when the national interest so requires. We regard these as important provisions of the proposed legislation.

"Consumer credit regulations were administered by the Board of Governors from September 1941 through October 1947 and again from September 1948 through June 1949.

"Such regulations as might be necessary in the real estate credit field under Section 401 would have to be designed to meet the special needs of this area. They would have the general purpose of supporting and supplementing the President's program of cutting back on Federally guaranteed and insured mortgage credit.

"Authority for restrictions on consumer and real estate credit should be provided for use to the extent necessary as an essential part of the program for conserving resources for defense and protecting the economy against inflation. This authority would help to prevent current and potential demand from exceeding supply in the areas affected. Accordingly, it would help to reduce inflationary pressure upon prices in these areas. It would help to make materials and manpower more readily available for the national defense and military effort, including the materials and manpower necessary to expand our total productive capacity.

"The present international situation not only increases greatly the Government's demand for the goods and services of our economy, but at the same time accelerates private demand. These two additional factors of demand are imposed on a condition of already very high demand, employment, and prices. Even before the attack by the Communist North Koreans on June 25, prices were rising and we were in a potentially inflationary situation. Because of developments of the past few weeks, it is imperative that steps be taken to reduce "or defer civilian demands and to lessen inflationary pressures.

"The state of public psychology has already stimulated consumer buying and the accumulation of business inventories. In the week ending July 15 department store sales rose to a level 24 per cent above a year ago, with increases ranging from 12 per cent in the Richmond District to 39 per cent in the Dallas District. Sales of automobiles and houses have risen to record levels.

"Prices of 28 basic commodities, which had risen 7 per cent from January 3 of this year to June 23, advanced sharply after the invasion of South Korea--10 per cent in one month. The all-commodity index of wholesale prices, which had risen 4 per cent by June 20, has since jumped 3 per cent further. Consumer prices began to rise in March and recently the advance has been further accelerated. Consumer prices are now higher than at any other time, except for a short period in the latter part of 1948.

"Unless prompt action is taken, the country will face serious problems of gray markets and spiraling prices. Not only would this situation upset our economic balance but it would add to the difficulty in procuring the manpower and materials necessary for the military effort.

"One of the major factors in the expansion of private demand is the growth of mortgage and consumer credit. Since the end of 1945, as shown on the attached chart, consumer credit has been increasing by about $3 billion a year. The increase in the past twelve months was $3.5 billion and in May was about $500 million, the largest increase on record for that month. This was before the Korean crisis precipitated the present buying spree.

"The most important segment of total consumer credit is instalment credit, especially for the purchase of durable goods. During the past year instalment credit rose nearly $3 billion and accounted for 83 per cent of the increase in total consumer credit. The role which instalment credit has been playing in the growth of demand is illustrated not only in the amount of the expansion but also by the relaxation in the terms under which such credit is extended. Reports of declines in the required down payment are widespread and the average period of repayment has lengthened "progressively.

"The current record rate of residential construction involves the greatest increase in mortgage credit which the country has ever experienced. Home mortgages made by all lenders in the first half of 1950 amounted to about $6-1/2 billion or at an annual rate of $13 billion as shown on the attached chart.

"The net increase in mortgage debt outstanding during the first half of 1950 (after regular amortization and other repayments) was about $3 billion, bringing the total outstanding on June 30 to about $40 billion. The home mortgage debt of this country has more than doubled since the end of the war.

"Expansion of consumer and mortgage credit contributes not only to the current demand for labor and materials that go into housing and durable consumer goods, but also augments the demand for all other goods. The purchasing power created by consumer and mortgage credit enters the income stream where it adds to the competition for goods including materials vital to the national defense.

"Growth of consumer and mortgage credit increases the volume of money and other liquid assets. Expansion of bank loans for such purposes adds to the growth of bank deposits. Bank holdings of both consumer instalment paper and mortgage paper are rising rapidly and are thus adding to the total supply of money which is already so large in relation to current output as to provide a constant inflationary threat. Restriction of consumer and mortgage credit, therefore, would help to keep within bounds the quantity of money and other liquid assets in the hands of the public.

"In normal times consumer and mortgage credit play a very important and desirable role in our economic system. Without such credit widespread home ownership and mass distribution of durable goods would not have been possible. If our mass production economy is to sustain its expansive character in normal times, we will need to have expansion of mortgage and consumer financing. However, in order that such financing may be of greatest value it is important that it be used most fully when industry is in a position to meet the demands created. When industry is already occupied to capacity and important resources must be diverted to the defense effort, the creation of new credit can "not increase the general availability of goods. On the contrary it contributes to inflation and economic disorganization. If mortgage and consumer credit is appropriately limited now it will be in a better position to play a necessary and desirable role whenever adequate productive capacity is once more available to meet freely consumer demands.

"Regulation of consumer credit should and can be flexible. The previous regulations were tailored to fit prevailing conditions, with coverage and terms suited to changing circumstances. To illustrate, in the fall of 1941 the regulation applied only to instalment credit relating for the most part to consumer durable goods of substantial unit cost--automobiles, refrigerators, and the like. When the country entered the war the regulation was enlarged in scope in keeping with the general mobilization which took place. It covered practically all consumer durable and soft goods and instalment, single payment, and charge account credit. After the war, late in 1946, the scope of the regulation was made even more limited than when it was originally applied.

"The decentralized character of Federal Reserve System operations proved well adapted to the administration of consumer credit regulation as well as to the V-loan guarantee program. Through our twelve Federal Reserve Banks and twenty-four branches, located in every region of the country, we were able to tap quickly and effectively the informed opinions of small as well as large business.

"In our experience with the administration of consumer credit regulation, the business community gave us excellent cooperation. Various trade associations took an active part in acquainting businessmen and the public with credit regulations, and they cooperated to the fullest in helping to assemble needed technical information. Large and small financing institutions responded generously to our requests for information and advice. State and Federal supervisory authorities also gave us valuable assistance during the course of their regular work.

"With respect to real estate credit, there should be an equally practicable approach. The full cooperation of leaders in the mortgage financing field should be "enlisted to design a regulation, similarly flexible and adapted to the changing economic situation.

"The commercial banks play a strategic role in the real estate credit market. Any regulation of such credit will have significant effects on general credit conditions in which the Federal Reserve System is primarily interested.

"The need to strengthen our economic defenses is no less than the need to strengthen our military defenses. We can not afford to risk disrupting our economy by leaving it unduly exposed to the inflationary pressures that are inherent in large defense expenditures. Prompt action is imperative. As the President said in his message on the present situation: 'We must be sure to take the steps that are necessary now, or we shall surely be required to take much more drastic steps later on.'"

At this point all of the members of the staff with the exception of Messrs. Carpenter and Kenyon withdrew, and the action stated with respect to each of the matters hereinafter referred to was taken by the Board:

Memorandum dated July 14, 1950, from Mr. Young, Director of the Division of Research and Statistics, recommending the reemployment of Mrs. Alice R. Williams as a clerk in that Division, effective as of her return to the office, with no change in her previous basic salary of $2,810 per annum. The memorandum stated that Mrs. Williams had been on maternity leave since March 20, 1950.

Approved unanimously.

Memorandum dated July 24, 1950, from Mr. Bethea, Director of the Division of Administrative Services, recommending that the resignation of Miss Edith Eloise Giddings, a clerk in that Division, be accepted to be effective, in accordance with her request, at the close of business August 18, 1950.

Approved unanimously.

Memorandum dated July 24, 1950, from Mr. Millard, Director of the Division of Examinations, recommending an increase in the basic salary of Anne S. Temple, a clerk in that Division, from $2,955 to $3,035 per annum, effective August 6, 1950.

Approved unanimously.

Letter to the Federal Deposit Insurance Corporation, Washington 25, D. C., reading as follows:

"Pursuant to the provisions of section 12B of the Federal Reserve Act, as amended, the Board of Governors of the Federal Reserve System hereby certifies that the 'Bank of Silvis', Silvis, Illinois, became a member of the Federal Reserve System on July 19, 1950, and is now a member of the System. The Board of Governors of the Federal Reserve System further hereby certifies that, in connection with the admission of such bank to membership in the Federal Reserve System, consideration was given to the following factors enumerated in subsection (g) of section 12B of the Federal Reserve Act:

1. The financial history and condition of the bank,
2. The adequacy of its capital structure,
3. Its future earnings prospects,
4. The general character of its management,

"5. The convenience and needs of the community to be served by the bank, and

6. Whether or not its corporate powers are consistent with the purposes of section 12B of the Federal Reserve Act."

Approved unanimously.

Letter to Mr. Hill, Vice President of the Federal Reserve Bank of Philadelphia, reading as follows:

"Reference is made to your letter of July 19, 1950, regarding the request of the Wilmington Trust Company, Wilmington, Delaware, for a six months' extension of time within which the establishment of its proposed branch in Greenville, Delaware, may be accomplished under the approval granted by the Board of Governors on August 15, 1949.

"In view of your recommendation, the Board extends to February 15, 1951, the time within which establishment of the branch may be accomplished."

Approved unanimously.

Telegram to Mr. Slade, Vice President of the Federal Reserve Bank of San Francisco, reading as follows:

"Reurtel July 21 earnings and dividends reports covering the first half of 1950 need not be required for the purposes of Section 9 of Federal Reserve Act, unless called for later depending on future developments, from the 3 State member banks acquired by the Bank of America. However, for statistical purposes, we would like to have the earnings and expenses of these banks as contemplated by letter S-1005, also to have your preliminary earnings tabulations include earnings and expenses of the 13 national and 3 State member banks acquired. For statistical purposes, these earnings and expenses may be estimated at your Bank, if not obtainable from the banks themselves."

Approved unanimously.

S. R. Carpenter
Secretary.