

A meeting of the Board of Governors of the Federal Reserve System with the Executive Committee of the Federal Advisory Council was held in the offices of the Board of Governors in Washington on Wednesday, September 13, 1950, at 10:35 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Szymczak
Mr. Evans
Mr. Vardaman
Mr. Norton
Mr. Powell

Mr. Carpenter, Secretary

Messrs. Brown, Jackson, Potts, Congdon, and
Fleming, members of the Executive Committee
of the Federal Advisory Council

Mr. Prochnow, Secretary of the Federal
Advisory Council

Chairman McCabe reviewed the considerations which led to the decision of the Federal Open Market Committee in August to increase short-term rates in the money market and the decision of the Federal Reserve Banks and the Board of Governors to increase the discount rates of the Federal Reserve Banks from 1-1/2 per cent to 1-3/4 per cent. He then summarized the conversations which he and Mr. Sproul, Vice Chairman of the Federal Open Market Committee, had with Secretary of the Treasury Snyder in August with respect to System credit policy and the debt management policies of the Treasury. He also commented on the operations in the System account which were made necessary by the Treasury decision to refund the September 15 and October 1 maturities with a 13-month, 1-1/4 per cent

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note, and the problems which the decision had created for the System in maintaining stable conditions in the Government securities market.

Mr. Fleming reviewed the recommendations which had been made to the Treasury by the American Bankers Association Committee on Government Borrowing, of which he is Chairman, in connection with the September and October refunding, and, in this connection, he referred particularly to the strong recommendation of the Committee that a long-term bond be offered as a means of getting as many funds as possible from nonbank sources.

Following a discussion of the effects of the Treasury decision relating to the September and October refunding and of the amount of funds that might be available for investment in a long-term Treasury issue, Chairman McCabe stated that the Board would like to have the advice of the Executive Committee of the Federal Advisory Council on what the future position of the System should be in its relations with the Treasury, having in mind the necessity of maintaining close and effective working relations with the Treasury. In response to an inquiry from President Brown, Chairman McCabe stated that the Board had received no indication of the present attitude of the Treasury toward future refundings and other debt management policies. He went on to say that, although the Federal Open Market Committee recognized the necessity of working

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closely with the Treasury, it also felt that it could not ignore its definite responsibility to carry out open market operations in accordance with the requirements of Section 12A of the Federal Reserve Act which he read. Therefore, he said, the members of the Board would appreciate the views of the members of the Federal Advisory Council as to whether the Open Market Committee had made a mistake in the actions it had taken and as to what the policy should be in the future.

Individual members of the Executive Committee of the Federal Advisory Council expressed the view that the policies followed by the Federal Open Market Committee were sound and were in general agreement with the views that had been expressed to the Treasury by the Committee on Government Borrowing since the early part of 1949.

For the benefit of Messrs. Norton and Powell, Mr. Fleming outlined the origin of the American Bankers Association Committee on Government Borrowing and stated that the Committee continued in an advisory relationship to the Treasury. He also outlined briefly how the Committee's discussions with the Treasury and its separate deliberations were conducted.

Mr. Potts commented that it had come to his attention that the last three recommendations of the Investment Bankers Association to the Treasury on Treasury financing were in general accord

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with the views of the American Bankers Association Committee on Government Borrowing and the Federal Open Market Committee so that it would appear that all major investment groups were in agreement on the general policies followed by the Federal Open Market Committee.

Mr. Fleming stated that, as chairman of the Committee on Government Borrowing, he felt that he had the responsibility to sit down with Secretary Snyder, following the latter's return from Europe, for the purpose of trying to work out a satisfactory solution of the problem.

Chairman McCabe stated that the wise course for the System to follow was to try to bring about a better working understanding between the Treasury and the System, that there was no desire on the part of the System to insist on its prerogatives or to emphasize its statutory responsibilities, particularly in the period of crisis with which the country was faced at the present time, but that the question on which he would like the advice of the members of the Executive Committee of the Federal Advisory Council was the extent to which the System would be justified in subordinating its responsibilities under the law to the needs of Treasury financing.

In the general discussion of this question the individual members of the Council indicated the view that, while it was difficult to advise the Board in the absence of all of the facts and

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information as to the present thinking of the Treasury, they felt that the Federal Open Market Committee and the Board should make every effort to arrive at a satisfactory working arrangement with the Treasury, that if such an agreement could not be reached the matter should be taken up with the President, and that if it should be the wish of the Administration that the System follow a policy which the members of the Open Market Committee and the Board felt they could not support in the light of their responsibilities under the law, they would have to consider whether the situation was such that they should resign. They felt, however, that the present situation did not call for such a decision, that the demands growing out of the Korean war were not such as to call for the establishment of a rigid pattern of rates on Government securities, that there should be a policy on the part of the System and the Treasury which would be effective in combating inflation and which would provide flexibility in Treasury financing, and that the Treasury should be made fully aware of the results of a policy of a rigid pattern of rates and should take full responsibility if such a policy were adopted. The point was emphasized, however, by the members of the Executive Committee of the Federal Advisory Council that the Board should make every effort to work out a satisfactory compromise of any differences between it and the Treasury, and that the System could not, consistent with its responsibility in the existing situa-

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tion, accede to the Treasury's views to the extent of returning to a 1-1/4 per cent rate on a 13-month security.

During the discussion, Mr. Szymczak pointed out that the problem was not one of rates alone but rather a question of policy under which reserves would be put into or taken out of the market for the purpose of easing or tightening credit conditions, that a mere increase in short-term rates would not be effective as a policy, that monetary and credit policy standing alone could not be effective in combating inflation and that the important thing in the present inflationary situation was to have an effective coordination of monetary and fiscal and debt management policies. It was a question, he said, of whether there could be an effective coordination of fiscal and monetary policies and whether the powers of the System were adequate in the existing situation or whether additional powers should be asked for.

The nature of the respective responsibilities of the System and the Treasury was also discussed, particularly in the light of the comments made by the Subcommittee of the Joint Committee on the Economic Report and by Senators Douglas, Fulbright, and Flanders, of the Senate Banking and Currency Committee, in a separate statement on the Defense Production Act of 1950.

At the conclusion of the discussion, during which Chairman McCabe pressed for an answer to the question to what extent should

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the System subordinate its policies to the needs of Treasury financing, President Brown summarized the general views of the members of the Executive Committee of the Council by stating that they felt the System should try in every way possible to reconcile the differing views of the Treasury and the System, that if the Treasury should not be willing to reach a satisfactory compromise the matter should be taken up with the President, that if the Open Market Committee and the Board were overruled the members of the Board would have to consider whether the situation was such that they should accept the policies of the Administration or whether the issues were of such importance that they should resign.

President Brown then stated that, because of the problems that the regulation on real estate credit to be issued by the Board might present to the banks, the members of the Executive Committee were especially interested in knowing what the Board had in mind with respect to the regulation.

The authority granted to the President by the Defense Production Act of 1950 in the real estate field and the manner in which that authority had been delegated by the President to the Board of Governors and the Housing and Home Finance Administrator in the Executive Order dated September 9, 1950, were discussed. Mr. Norton pointed out that under the terms of the Executive Order there would have to be full coordination of the policies of the Board and the

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Housing Administrator. During the discussion of this point Mr. Vest, General Counsel, was called into the meeting and he explained the nature of the respective authorities delegated to the Board and the Housing Administrator and the relationship of the authorities to each other.

Following a brief discussion of the various problems faced by the Board in drafting the regulation and a comment by Mr. Norton that it would be at least three weeks before the regulation could be issued, President Brown inquired as to the possible effects of the regulation on a situation in which a bank made a large loan to a large corporation for general purposes when the corporation might have a substantial construction program in progress and some of the funds might be used to finance such a program. He pointed out that it was very difficult to earmark such funds and that care should be taken to see that the regulation did not unduly hamper the banks in their lending operations.

It was stated that this and many other questions were being given consideration in the drafting of the regulation.

Chairman McCabe stated that the Board was arranging an informal conference on Thursday and Friday of this week with a group of individuals who were recognized as leaders in the various segments of the real estate field. He read the names of the individuals who had been invited to the conference and emphasized that they had been invited in their individual capacity and not as repre-

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sentatives of any particular group.

Members of the Executive Committee suggested other names which might be considered as representing large insurance companies or banks which did a large business in term loans and Mr. Norton stated that the Board would be holding later conferences with representatives of the trade and consideration would be given to the suggested names when those meetings were arranged.

President Brown expressed the view that the terms prescribed in Regulation W (Consumer Credit) were too liberal and would have to be tightened.

At the conclusion of the discussion the meeting adjourned.


Secretary.