

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 21, 1950, at 10:35 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Eccles
Mr. Szymczak
Mr. Evans
Mr. Powell

Mr. Carpenter, Secretary

Messrs. Bucklin, Potts, Congdon, Fleming, J. T. Brown, Edward E. Brown, Hemingway, Ringland, Beals, and Lohead, members of the Federal Advisory Council from the First, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, and Twelfth Federal Reserve Districts, respectively.

Mr. DeWitt Ray, President, National City Bank of Dallas, Texas, who attended the meeting in the absence of Mr. Woods, a member of the Council from the Eleventh Federal Reserve District.

Mr. Prochnow, Secretary of the Federal Advisory Council

Before this meeting the Council submitted to the Board a memorandum setting forth the Council's views on the subjects to be discussed with the Board. The statement of the topics, the Council's views, and the discussion with respect to each of the subjects were as follows:

1. Selective credit controls:

- (a) What information do the members of the Council have with respect to the effects of Regulations W and X?

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(b) What are the views of the Council as to what, if any, action should be taken by the Board to change the existing Regulations W and X or to broaden their scope?

(a) Regulations W and X have not been in operation sufficiently long to determine their full effect on the economy.

New car sales have been reduced 10 to 15 per cent in some areas, although other sections report a decline as high as 50 per cent. The Pacific Coast and the South have apparently felt the impact of Regulation W more severely than the rest of the country.

Because of the large volume of outstanding commitments, no reduction in real estate credit has yet occurred. Contractors report that when their present commitments are completed construction will decline substantially in volume. The decline in the price of lumber may be partly due to Regulation X. A simplification of the reporting forms for Regulation X, with a resulting reduction in the paper work required, would be highly desirable.

(b) The Council is unanimously of the opinion that no change in Regulations W or X is desirable at this time.

Members of the Council have previously discussed with the Board some of the difficult problems involved in working out a regulation covering industrial and commercial construction loans. The Council would appreciate the present views of the Board relative to the regulation of loans of these types.

In connection with the suggestion of the Council that a simplification of the reporting forms for Regulation X would be highly desirable, President Brown stated that the suggestion referred to the requirement that a bank maintain records which demonstrate on their face whether a credit was or was not real estate construction credit,

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that this requirement resulted in a considerable burden, and that a bank should not be required to make such a record unless it had some reason to believe that the loan was an extension of real estate construction credit.

During a discussion of this matter Mr. Riefler, Assistant to Chairman McCabe, was called into the meeting and he outlined the consideration given to, and the reasons for, the requirement in Section 4(c) of Regulation X which had been designed to make compliance by Registrants as simple and easy as possible and still meet the need, for enforcement purposes, for some evidence as to whether a particular loan was or was not real estate construction credit.

In this connection, reference was made to the interpretation issued by the Board on October 17, 1950, which stated that if the Registrant was satisfied that the credit was not real estate construction credit, the requirement of the first sentence in Section 4(c) of Regulation X would be met by a written endorsement or rubber stamp legend, placed upon the credit instrument or other papers in connection with the credit and signed by the Registrant or a responsible officer of the Registrant, stating that he was satisfied that the credit in question was not real estate construction credit.

Some of the members of the Council indicated that under that interpretation the requirement would not be a burdensome one.

The question was asked of President Brown whether he had in

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mind that in certain cases no record would be required and how his problem would be solved by his suggestion that a Registrant have in the record of the loan a statement that he had no reason to believe that the loan was real estate construction credit. He responded that he felt that the requirement should be something less than a flat statement on the part of the Registrant that the credit was not real estate construction credit.

At the end of the discussion of this point Chairman McCabe stated that this suggestion would be considered by the Board, but that he did not see how the requirement could be made much less burdensome and still serve the purpose for which it was intended.

In connection with the statement that the requirement of Regulation W for the preservation of records was that every Registrant shall preserve such records as are relevant to establishing whether or not a credit qualified for exemption or whether it was otherwise in conformity with the requirements of the Regulation, President Brown stated that he did not think that any such records were maintained by his bank.

President Brown then stated that it was the feeling of the Council that the complaints received by the Board that the terms of Regulation W were too restrictive were prompted largely by self-interest, that the objectives of the Regulation could not be achieved unless it was in fact restrictive, and that the Council saw nothing in the situation at the present time which would justify relaxation

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of the Regulation.

There was a general discussion of the complaints that had been received by the Board with respect to the effect of Regulation W on the sale of automobiles, and Chairman McCabe referred to the statistics obtained by the Board of automobile registrations in November of this year as compared with November of last year and statistics collected by six large automobile manufacturers on the sale of new and used cars in some of the leading cities in the United States.

President Brown emphasized that the Council did not feel any action to liberalize the Regulation should be taken by the Board and that the pressures for such action were largely the result of organized efforts by automobile dealers and other interested parties. He also said that the complaints on Regulation X would come later when the Regulation began to take effect, and what the effects of the Regulation would be was difficult, if not impossible, to state at this time.

Chairman McCabe outlined how the prospect for residential construction in one- and two-family residences and in multiple housing construction over the next few months was affected by the large accumulation of commitments made before Regulation X was adopted, and stated that the decline in construction would not be as great as had been hoped when the Regulation was first put into effect. President

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Brown was of the opinion that the decline in construction would not begin until the middle of next year.

Mr. Bucklin said that he had been informed that there had been some abuses of the provision of the Regulation relating to oral and written commitments for financing new construction and, unless something were done to correct this situation, construction starts next year might go as high as 1 million.

In connection with the last paragraph of the Council's statement, President Brown said that all the members of the Council felt that it would be wise for the Board's Regulation to cover multiple-family housing but that it should not be extended at this time to commercial and industrial construction, particularly since limitations on that type of construction could best be applied by the National Production Authority.

Mr. Riefler said that it was expected that an amendment to Regulation X to include multiple unit housing would be issued shortly, that the problem as it was related to industrial construction was a very complicated one, particularly since the Board did not want to restrict essential industrial expansion, and that the question whether credit restrictions could be applied effectively to commercial construction was a very debatable one.

President Brown stated that the Council wanted to make it clear that it felt that the extension of the Regulation to multiple

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housing should be the next step and that the coverage of commercial and industrial construction should be deferred.

At this point Mr. Riefler withdrew from the meeting.

2. The Board has been asked by the President to submit its suggestions as to subjects to be included in the State of the Union message and the Economic Report and the legislation which the Board desires to have considered at the session of the Congress which convenes in January. The Board is now formulating its views on these two matters and would like to have any advice or recommendations that the Council might wish to offer with respect to them.

The Council does not know what subjects the Board contemplates recommending for inclusion in the State of the Union message and the Economic Report, or what legislation the Board contemplates proposing at the session of the Congress which convenes in January. The Council would be interested in what the Board has in mind on these two matters, and would be glad to discuss them with the Board.

Until the economic situation has become clearer and until the effect of Regulations W and X (which the Council unanimously believes will materially reduce bank credit in the installment and real estate fields) can be more fully evaluated, the Council believes that it would not be desirable to introduce any legislation to change existing laws governing bank reserves.

Chairman McCabe stated that the Board was disappointed at the Council's answer to this question, that the Board had a responsibility to offer suggestions in response to the President's request, that the purpose of the Council was to advise the Board in matters of this kind, and that the reason for the question was that the Board wanted to be sure that it had the benefit of the Council's views.

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Among the specific questions, he said, was whether the Board should suggest an extension of the authority with respect to consumer and real estate construction credit and what the recommendation of the Board should be with respect to reserve requirements when bank credit was increasing at an alarming rate. In that connection, he referred to the appeals that had been made to the banks by the bank supervisory agencies and the American Bankers Association to curtail credit, and the discussions which members of the Board had had with representatives of the American Bankers Association with respect to voluntary agreements by financing institutions under the Defense Production Act of 1950.

Mr. Fleming expressed the opinion that the authority for the regulation of real estate and consumer credit should be continued but that action to obtain voluntary agreements on the part of financing institutions had been almost if not entirely blocked by the attitude of the Department of Justice as outlined in the letter received by the Board from the Attorney General under date of October 19, 1950.

Chairman McCabe stated that the question of voluntary agreements had been discussed with the Attorney General on Friday of last week, that Mr. Peyton Ford, Deputy Attorney General, participated in the discussion at which time it was stated to the Attorney General that the position set forth in his letter of October 19 was such as

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to influence the counsel of any bank to advise against the bank's participation in any such agreements, that voluntary agreements in the financing field were different from the problems presented in other fields covered by the Defense Production Act, that it was difficult to see how in the highly competitive field of finance banks and insurance companies could get together in an effort to create a monopoly, and that there was a possibility of effective action in this field to achieve the objectives of the Act to curtail the use of credit. The representatives of the Department of Justice, Chairman McCabe said, agreed with this approach and the Attorney General stated that the Board might go ahead immediately in New York or some other principal city to get a group together for the purpose of drafting a statement of objectives, that such a meeting would have "the blessing" of the Department of Justice, and that, if desired, the Department would have one of its best qualified men attend the meeting for the purpose of assuring those present that the meeting was held with the concurrence of the Department of Justice so that no counsel for a participating financial institution would have any objection to what was worked out. Chairman McCabe added that the Attorney General suggested that he send the Board a letter approving this suggested procedure, that it was understood that the Board's General Counsel would prepare a draft of such a letter which would be cleared by the Justice Department, and that as soon as the letter was received a meeting along

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the lines suggested would be proposed.

Members of the Council indicated concurrence in the procedure outlined by Chairman McCabe stating that the question whether it would be desirable to have a representative of the Department of Justice attend the meeting to be held in New York would depend upon the person selected. Chairman McCabe stated that he would try to get Mr. Ford to go to the meeting.

President Brown stated that, while the Council would be opposed to authority over consumer and real estate construction credit in peacetime, it felt that until the international situation was clarified the authority should be continued. On the question of a change in the authority of the Board with respect to reserve requirements he said the Council felt that the situation was different today from what obtained in 1948 and that higher reserve requirements at this time would tend to defeat the rearmament program.

Chairman McCabe inquired how the Council would explain why the Board had applied restrictions to consumer and real estate construction credit and had failed to take more vigorous action directly to curb the unusually large expansion of bank credit that had taken place. While he hoped it would be possible to work out something in the field of voluntary agreements, he recognized that that would be a difficult task.

The problems inherent in working out such agreements were discussed and Mr. Fleming stated that Mr. Cravens, Vice President of the

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Mercantile Commerce Bank and Trust Company, St. Louis, and a member of the Credit Policy Commission of the American Bankers Association, was prepared to go to work on the development of such an agreement as soon as the Board had cleared the matter with the Department of Justice and that it was felt that the sooner the task was undertaken the better it would be.

In discussing the large growth in credit in recent months the members of the Council outlined the reasons why it would be difficult to get a quick reversal of that trend. In that connection Mr. Eccles expressed the opinion that an expanded defense program would continue for an indefinite period, that increased defense production should be offset by a reduction in civilian production, and that the accompanying reduction in the use of civilian credit should offset the increased use of credit for defense production so that there would be no need for an increase in the over-all volume of credit outstanding.

Chairman McCabe expressed the opinion that if considerable time elapsed before indirect controls could be made effective, the pressure for the application of direct controls would be greatly increased.

Several of the members of the Council were of the opinion that there would be a drastic decline in the volume of bank loans after the turn of the year.

Chairman McCabe asked how that could occur in the face of an almost universal expectation of further price increases and he ex-

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pressed the view that it would be necessary for Congress to enact an adequate tax bill and for other action to be taken so that the public would realize that the movement of prices could not continue to be in one direction only.

Returning to the question of what legislation the Board might recommend, President Brown said that it would be unwise to increase reserve requirements in a war economy.

Chairman McCabe inquired whether the Council would continue to have that view if bank credit continued to expand, and in that connection he referred to the difficulty of convincing a particular bank that its loans were too high.

Mr. Beals stated that he had discussed that matter with seven banks in livestock centers, that unusually favorable weather conditions in the Mississippi valley area had resulted in large feed crops and wheat pastures which had induced farmers to increase livestock loans by about 50 per cent, and that the banks in question felt that loans for this purpose were too high.

3. One of the questions that has had a very important bearing on the credit policies of the System is the impact of the prospective defense program on the economy. The Board would be glad to have the comments of the Council on the economic and business situation over the next six months, particularly in the light of the probable impact of prospective expenditures for defense and the current inflationary situation.

During the next six months, according to the Council's information, the cash budget of the Federal Government is

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expected to be in balance, or show a surplus. The credit impact of the defense program during this period will be chiefly due to requirements of manufacturers for money for plant changes and expansion to take care of government orders received or anticipated. The main impact for financing defense production is not likely to take place until after the middle of 1951.

It is the opinion of the members of the Council that bank loans due to seasonal demands will probably increase from now until January, but they expect a decline in loans in their respective districts in January and February. Regulation W should cut new installment credit sharply by January or February. Regulation X should begin to reduce new construction credit by the middle of next year. It may be that the calendar year 1951 will show no increase in bank loans or only a moderate increase.

The Council would be interested in knowing what steps have been taken to encourage voluntary agreements for the restriction of credit, and what the present attitude of the Department of Justice is regarding the legality or propriety of such agreements.

President Brown outlined reasons why the members of the Council felt that the over-all decline in loans after the first of the year would be very sharp and stated that whether the decline would be sharp or moderate in a particular area would depend upon conditions in that area.

Following a discussion of the factors that might affect the trend in bank credit after the first of the year, Mr. Fleming expressed the opinion that the System had accomplished more through the increase in the short-term rate than would be accomplished by an increase in reserve requirements.

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4. A discussion of the Treasury refundings for December and January.

The Board is familiar with the views of the Council, as expressed in previous discussions, regarding the necessity of shifting a portion of the debt to intermediate and longer maturities. The Council believes that the present is a desirable time to bring out an intermediate maturity in connection with the refundings of December and January. If the members of the Board wish to express their views, the Council will be pleased to have them.

President Brown stated that the Council realized the difficulty of discussing matters affecting the Government security market which the System had under discussion with the Treasury, that the Board was familiar with the recommendations made to the Treasury by the American Bankers Association Committee on Government Borrowing, and that the Council did not know whether the Board would wish to express any opinion on this matter or whether it would favor the suggestion that the Treasury offer an intermediate issue in the December and January refunding. The objection to such an issue, he said, was that corporations hold a substantial percentage of the maturing issues and might not want to hold an intermediate security, but it appeared to the Council that that situation could be met by the Federal Open Market Committee following a liberal policy of making the October and November 1951 notes available at around 1-1/2 per cent.

There was a general discussion of the market effect of an intermediate issue and Chairman McCabe asked the Council's view on the action of the Open Market Committee in allowing the short-term rate to move to a somewhat higher point. Members of the Council in-

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icated that the increase was desirable because it put the banks in a position where if the Board should raise reserve requirements the banks could obtain additional reserves through the sale of short-term securities only at a penalty rate which had had a restrictive influence on the extension of bank credit. President Brown stated that the apprehension of the Council had been that the increase in the short-term rate above 1-1/2 per cent would result in sales of long-term securities, particularly restricted issues, and that he did not see how the rate could go above that level at this time without serious unsettling effects on the long-term market.

In response to an inquiry by Chairman McCabe as to whether an intermediate refunding issue would tend to put pressure on the short-term rate and to freeze that rate, President Brown said that he did not want to say that the short-term rates should never be permitted to move higher, that it might be desirable to examine that question at a later date, that he disagreed with the policy of the Treasury and the Board that the long term 2-1/2 per cent rate should be supported, and that he felt that the price on long-term securities should be permitted to go below par.

In a discussion of these points, Mr. Eccles stated that the purpose of the System's actions was to restrict credit, that he did not feel that the actions taken up to this point had accomplished that objective, and that the issuance by the Treasury of an intermediate security in connection with the December and January refunding

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would only tend to reduce flexibility in the market because a further increase of the short-term rate would cause the new issue to go below par. In these circumstances, he thought the current refunding should take the form of a one-year certificate and that the short-term rate should be permitted to go just as high as possible without putting continuing pressure on the long-term 2-1/2 per cent rate.

At the conclusion of the discussion, Chairman McCabe stated that yesterday he had conferred with the Treasury with respect to the December and January refunding and that he did not feel free to tell the Council what the recommendations of the Federal Open Market Committee had been. However, he said, in the discussion that had taken place at this meeting with the Council, he could not detect any area of disagreement.

President Brown stated that the next meeting of the Federal Advisory Council would be on February 18-20, 1951, and that, if it were found to be desirable to have a meeting of the executive committee of the Council with the Board in the interim, the date for such a meeting could be fixed later.

Thereupon the meeting adjourned.


Secretary.