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, May 15, 1951, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Eccles
Mr. Szymczak
Mr. Evans
Mr. Vardaman
Mr. Norton
Mr. Powell

Mr. Carpenter, Secretary

Messrs. Jackson, Congdon, Fleming, Davis, Brown, Hemingway, Ringland, and Beals, Members of the Federal Advisory Council from the Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, and Tenth Federal Reserve Districts, respectively.

Messrs. David E. Williams and Reno Odlin, who had been designated to attend the meeting of the Federal Advisory Council in the absence of Messrs. Potts and Lochead, Members of the Council from the Third and Twelfth Federal Reserve Districts, respectively.

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 at this joint meeting. The statement of the topic, the Council's views, and the discussion with respect to each of the subjects were as follows:

1. The Board would like to have the views of the Council on the prospective business and economic situation during the next six months and on the policies that should be followed by the System in the field of general credit controls.

The Council believes, based on current economic trends, that business will continue active in the next six months. The total volume of loans in the next sixty or ninety days will probably move sidewise, and may even decline slightly, because of the liquidation of inventories. However, the banking system will shortly be confronted with large demands for credit to finance new crops, defense plant expansion and the manufacture of defense products. The Council believes that by the Fall of 1951 the total loans required to maintain the defense effort and essential civilian production will exceed the volume of loans in the Fall of 1950. In this period of national emergency involving heavy defense expenditures, it is desirable for essential production and gross national product to rise. A larger volume of bank loans necessarily results. In addition, for the present at least, higher prices and wages have been frozen into the economy, and they require a larger volume of loans.

In view of the economic outlook for the balance of the calendar year, the huge refunding program confronting the Treasury and the large amount of new money which the Treasury will require in that period, stability in the financial and credit field is highly desirable, and drastic or rapid changes in general credit controls should be avoided. Unless conditions radically change, the Council believes therefore that no upward change in reserve requirements is desirable in the next six months. Indeed it is quite probable that a decrease in reserve requirements may be necessary by the end of 1951. In view of Treasury requirements and the present unsettlement and nervousness in the Government bond market, the Council also now believes that the rediscount rate should not be raised during the period immediately ahead. Open market operations should be conducted on a basis that will supply the minimum reserves needed for essential business credit and for Treasury financing, and to maintain a reasonably stable market for Government obligations at or around present levels.

President Brown commented that the statement of the Council represented the views of each of the representatives present at this meeting of the Council as to the probable demand for loans and loan expansion in his district, and that, while in the agricultural districts loans might decline prior to the movement of this year's crops, they would increase substantially again in the fall so that the total at that time would be in excess of last year. He also said that if it were not for the Treasury financing situation, a number of the members of the Council would feel that the rediscount rate of the Federal Reserve Banks should be increased but that this would have an adverse effect on Government security prices and might encourage the liquidation of savings bonds. It was the feeling of the Council, he said, that the Government securities market should be permitted to adjust to the recent open market policies of the System. He added that the Council was not in favor of completely pegging the market for Government securities but rather that since there had been violent changes in open market policy in the recent period the market required a period in which it could settle down.

Mr. Fleming made the additional comment that it was clear from the plans that had been announced by the Director of Defense Mobilization and others for the expansion of defense production that the continuation of essential civilian production would require a further expansion in gross national product which in turn would require a further expansion of bank credit and that while the banks were trying to restrict speculative and non-essential credit it would not be possible to reduce the volume of civilian credit sufficiently to offset the growth of credit for defense purposes, particularly in view of the fact that the latter would be required in large amounts at one time.

Reference was made by Chairman Martin to a statement released by the Board of Governors to the press yesterday with respect to member bank loans as of April 9, 1951, which indicated an increase of $1,653 million in loans since December 30, 1950. Copies of the statement and of a more complete statement on the same subject were distributed during the meeting. There was general discussion of the economic situation and the need for bank credit in the light of a comment by Chairman Martin that because of the very fluid situation over the next several months it would not be possible to say at this time what the credit needs of the economy would be. He also said that it would not be possible to continue to expand credit indefinitely and tie the hands of the System with respect to rediscount rates, open market operations, and further increases in reserve requirements, that it would be necessary to restrain such expansion, and that in the voluntary credit restraint program an effort was being made to establish criteria for lending. He also referred to the term "essential production" as used in the Council's statement and said that the question was how we were to determine what was essential in such a manner as to offset increased defense production by decreases in civilian production and whether there was to be a further inflationary growth in credit by an attempt to finance civilian production along with increased defense production.

President Brown stated that the term "essential production" as used in the Council's statement was taken from the voluntary credit restraint program and was used in the same sense that it was used in that program.

Mr. Vardaman stated that he had never felt that it would be possible to carry out the defense program without appreciable inflation and that for that reason he had advocated the strictest kind of controls which would include rationing, price control, etc. It was his view that the economy could not carry the dual burden of civilian and defense production without a major degree of inflation, that it should be the policy to cut back the standard of living until such time as the country was prepared for defense from a military standpoint, and that in order to accomplish that it would be necessary to cut civilian production to a minimum.

Mr. Eccles questioned whether it would be desirable further to expand bank credit which would mean a further expansion in the supply of money in a period of full production. He expressed the view that increases in defense production should be offset by reductions in civilian production, that only to the extent that additional facilities and manpower could be provided should credit be expanded, and that in order to avoid further inflationary pressures a tight rein should be held on the volume of credit, taking into account the velocity of turnover of existing credit. He agreed with the Council's statement relating to discount rates and the general situation in the Government securities market. He did not want to return to a situation in which support of the Government securities market would be provided at fixed pegs but he felt that the Open Market Committee was under obligation to take cognizance of the present form of the debt structure and that the question of confidence and stability in the market would depend on the management of the market by the Open Market Committee as the underwriter of that market. He felt that the Committee should be prepared to provide stability to the market and he had no question about its ability to perform that function. He felt that the changes that had taken place had had a very wholesome effect and accomplished largely the purposes which the Committee sought to accomplish. He felt that the System should be in a position to sterilize additional reserves that might be created by the System's stabilizing operations and that increased authority over bank reserves would be necessary for that purpose. He disagreed with the Council's suggestion with respect to the desirability of a reduction in reserve requirements at a later time for the reason that any reserves that should be supplied to the market could be provided more flexibly through open market operations than by creating large amounts of excess reserves by a reduction in reserve requirements.

There was a discussion of the refunding operations to be conducted by the Treasury during the balance of the year, the funds available for investment in Government securities, and the possible demands for funds for crop movements and the defense effort.

Mr. Jackson referred to the difficulty of controlling the expansion of bank credit when there was a widespread feeling that at the same time that private credit agencies were being asked through the voluntary credit restraint program and otherwise to limit the volume of their loans, credit extended by Government agencies was expanding.

The problem of further credit demands was discussed on the basis of the differences between the present period and during the second world war. Mr. Congdon commented on the difficulty of preventing bank credit from expanding in the period immediately ahead because of the difficulty of curtailing civilian production in the same places and in direct proportion to the expansion of defense production. While he did not believe that there would be inflationary increases in loans from this point on he did not think it was likely that the switchover from civilian to defense production could be made without some further increases in loans.

Chairman Martin stated that in a situation of undeclared war such as we have at the present time it was necessary to work with infinite patience toward an integrated pattern and that the questions that arose would have to be in terms of adjustments rather than absolutes. In that situation, he said, the various instruments of credit policy could not be separated but the System would have to try to work them into a unified program.

2. What, if any, action should be taken by the Board with respect to changes in the terms of Regulation W, Consumer Credit, and Regulation X, Real Estate Credit?

Regulation W has and is cutting into instalment credit and is accomplishing its intention. Regulation X is just beginning to show its effects due to the many starts and approvals made before its adoption, in which cases it does not apply. The Council after full discussion does not favor any change at present in the terms of Regulation W and Regulation X.

There was no discussion of this topic at this point.

3. The program for voluntary credit restraint is now getting into operation and the Board would be pleased to have any comments that the members of the Council might wish to make as to the progress of the program in their respective districts and what results are being obtained.

The program for voluntary credit restraint has met with the general approval not only of banks but of insurance companies and investment bankers. This general approval is even greater than was anticipated. Although the regional committees have only recently been organized and are just now getting in operation, the program has already resulted in much critical screening by banks of applications for loans as to their purpose. Many loans, particularly those for large amounts, have been turned down because they would not contribute to the defense effort or the carrying on of the essential civilian economy. Many borrowers have not applied for loans because of the knowledge that they would be declined because they could not meet the test of the program.

The Council believes that as the program is better understood and is further implemented and gets under way it will be increasingly effective in restraining unnecessary and undesirable credit expansion. The Council recommends the preparation and distribution at frequent intervals of additional literature and publicity materials on the subject to keep the program constantly before lenders and borrowers and in the press.

The Council wishes to express its appreciation to the Board of Governors and the officials of the Federal Reserve Banks for their leadership and cooperation in getting the program under way. In particular, the former Chairman of the Board, Mr. McCabe, the present Chairman, Mr. Martin, and Governor Powell, who has direct charge of the program, are to be commended for their active and unremitting efforts to promote the program both with Congress, other departments of the Government, and with the banks and other lending institutions.

The voluntary credit restraint program does not cover loans guaranteed by the Government or its agencies. The present program would be more effective if it involved not only private credit, but also loans so guaranteed. In this connection, the Council wishes to call attention to the following statement in its memorandum to the Board of Governors on February 20, 1951:

> "Government loans and guaranties of loans in all fields, including real estate, should be terminated, except where such loans are necessary for the defense effort."

Even if the demand for loans is restricted to those necessary for the defense effort and carrying on the essential civilian economy, the requests for credit for construction are and will be so heavy that the Council welcomes the action which the NPA has taken to require its approval of certain kinds of construction projects. The need of obtaining approval before materials can be obtained for construction should greatly help not only the conservation of scarce materials and labor but also should restrain credit expansion.

Mr. Powell discussed the basis on which the term "essential production" was used in the voluntary credit restraint program and stated that it was not known when the program was adopted what the defense needs would be, that those needs had not yet been defined, and that therefore the term might mean one thing today and something else six months from now when the defense program was more fully under way.

He added that the voluntary credit restraint committees were working on the program and were evolving a definition of what was essential which would become more and more restrictive as the defense program progressed. He outlined the reasons for the periodic bulletins issued by the Voluntary Credit Restraint Committee and the procedures followed by the subcommittee and the national committee in the handling of inquiries as to whether particular loans complied with the program. It was anticipated, he said, that at the meeting of the Committee on May 21 consideration would be given to a bulletin on credit on existing housing which is not within the scope of Regulation X. He also said that the Committee would study the problem of the sale in this country of foreign municipal issues. He made the further comment that the national committee was setting up a liaison arrangement with the defense agencies so that, in answering the problems coming before it, the committee would be familiar with what the defense agencies were thinking in terms of the use of materials and labor in the defense effort.

He expressed the opinion that there should not be too rigid a view as to the volume of credit that should be outstanding in a given situation, that the problem involved not only the amount of credit but the rapidity of its turnover as well, and that the success of a credit policy must be measured in terms of its effect on the price level and not in terms of the volume of credit outstanding. He also suggested that current ideas with respect to the productive capacity of existing manpower and facilities should not be too rigid, that notwithstanding the statement last fall that our manpower and facilities were fully employed production last winter was tremendous, and that therefore we should not "sell industry short" as to what it can do under forced draft. In addition, he said, there was always the possibility of further increases in imports in order to increase the overall supply of goods available for consumption.

During Mr. Powell's statement, Mr. Bucklin, the member of the Council from the First Federal Reserve District, joined the meeting.

In response to a comment by Mr. Fleming as to the desirability of bringing the Voluntary Credit Restraint Program to the attention of potential borrowers, Mr. Powell stated that the American Bankers Association was sending out a letter to all banks suggesting that they send copies of the voluntary credit restraint program to their borrowing customers. Mr. Fleming suggested that it would be more effective if it could be made clear to the borrowers that the letter was being sent at the request of the Voluntary Credit Restraint Committee.

At the request of Chairman Martin, Mr. Norton reviewed the information available as to housing starts during 1951 compared with the same period in 1950. He commented that the trend of starts was sharply downward, that the backlog of commitments for residential construction appeared to be in the neighborhood of 550,000 units, and that notwithstanding tighter credit conditions in the mortgage market it was probable that starts in 1951 would exceed one million.

Mr. Evans discussed briefly the effects of Regulation W and steps being taken by the Board for its enforcement. He also suggested that the banks could be very helpful if they would urge observance of the regulation as a wartime measure. He added that although requests had been received for relaxation of the regulation because of the decline in consumer demand, the Board at the present time could see no reason for such action. It felt, he said, that it should proceed cautiously in the administration of the regulation and, if necessary, err on the side of restriction rather than to relax the regulation and thereby add to inflationary pressures.

The members of the Council expressed the view that Regulation W was doing an effective job at the present time and President Brown stated that it was the unanimous view of the Council that the regulation should not be relaxed. He also said it was surprising how well the regulation was being observed.

Chairman Martin read from a memorandum handed to him by Mr. Vardaman containing information with respect to applications for loans that had been received by the guaranteeing agencies under the V-loan program which indicated that applications were coming in at the rate of approximately 125 per month.

Mr. Vardaman stated that the President had just signed the bill amending the Assignment of Claims Act which should have the effect of increasing the volume of V-loan applications.

4. It has been proposed that additional authority granted to the Board of Governors over bank reserves take the form of a supplementary reserve on any increase in a bank's loans from a base amount. Copies of memoranda relating to this and other suggested reserve requirement plans are attached and the Board would appreciate the views of the Council particularly with respect to the proposed loan expansion reserve plan.

In its memorandum to the Board on October 3, 1950, the Council said that if economic conditions should clearly necessitate any change in the maximum statutory reserve requirements, the Council was unanimously of the opinion that the pattern used in 1948 should be followed, extending temporary authority for increased maximum cash reserves. The Council also then stated that it believed any authority granted should be for a period of not more than two and one-half years so Congress could review the matter. For reasons which have been discussed in the answer to Item One of the agenda, present economic conditions make it untimely for the Board now to urge legislation to increase maximum statutory bank reserve requirements. The Council does not approve any proposal in any form to increase maximum statutory bank reserve requirements at this time. Under present international conditions it is obvious that the Congress will be in session almost continuously and could if necessary under radically changed conditions act promptly. The acceptance of any such proposal at present would be detrimental to the voluntary credit restraint program, and to Treasury financing in the months immediately ahead. Considering the large volume of credit which may be required this Fall for essential defense and civilian needs, and the magnitude of Treasury refunding and new financing, stability and confidence in the economy and in the Government bond market are highly to be desired.

The proposed loan expansion reserve plan is undesirable in general for the reasons given, and specifically because it (1) would not meet fluctuating seasonal credit requirements, (2) would work injustices between various banks, (3) would tend to freeze each bank in the same pattern of investment it happened to have had at the base period, and (4) would fail to provide credit for areas which are growing rapidly in production.

President Brown stated that the Council felt that the loan expansion reserve plan was the least practicable of the various plans that had been proposed for increasing authority over reserve requirements and would have less chance of approval by the Congress than other plans that had been suggested. He expressed the view that the plan would penalize banks that had been conservative in their lending policies.

In response to an inquiry from President Brown, Chairman Martin stated that the Board had not decided on the form of legislation on this subject that it would recommend to the Congress, that for that reason the views of the Council were being sought and that this problem had been discussed by the four-man committee appointed by the President on February 26, 1951. There was pressure, he said, for a recommendation for consideration in connection with the legislation extending the Defense Production Act, adding that the Board might be called upon to present something before that legislation was enacted as a part of a broad framework of credit control. He also said that if war should break out it probably would be strongly urged that direct limitations be placed on the extension of bank credit under authorities contained in the Trading with the Enemy Act and the Banking Act of 1933, that the Board would resist that as long as possible, and that the loan expansion reserve plan had been proposed as a means, in a period short of all-out war, of meeting the problem of the Government securities market and the further expansion of credit. He made the further statement that Mr. Powell had been careful to make it clear that the voluntary credit restraint program was not a device to avoid facing up to the problem of additional authority over bank reserves.

During Chairman Martin's statement the members of the Council were given copies of a memorandum dated May 11, 1951, from Mr. Vest, General Counsel, to which was attached the latest draft of the loan expansion reserve bill. There followed a general discussion of the problem of credit restraint in the light of the pressure for increases in bank loans for inventories and other purposes and how that problem should be met in the light of the need for restraining further increases in bank credit.

5. The desirability of the Federal Reserve Board undertaking a study of the prospective demands for and supply of credit over the next six to twelve months, the study to include:

A. Requirements for new productive plant, inventories and working capital, that cannot be financed from retained earnings and savings (Prospective outlays for new plant in 1951 are now estimated at $23,910 billion);

B. Amount of bank financing of Federal expenditures that will be required;

C. Estimated extent of net redemptions of savings bonds, and the methods of payment;

D. Amount by which private credit can be contracted in non-essential lines.

If such a study indicates that the demand for credit is likely to exceed the prospective supply of available funds, a decision should be reached as to whether demand is to be decreased by further restrictions, or whether the supply is to be allowed to increase.

The Council believes it would be advisable to maintain a continuing study of the kind suggested above.

Mr. Fleming stated that this topic was proposed by Mr. Potts, a member of the Council from the Third Federal Reserve District, that the problem had been discussed recently by the Reserve City Bankers Association, that it had been suggested that the study referred to be made, and that since the Board was the organization best able to conduct such a study it would be helpful if the Board would undertake it.

Chairman Martin read a memorandum on this topic which had been prepared by Mr. Young, Director of the Division of Research and Statistics, as follows:

"The Board's research staff is already engaged in continuing studies of prospective demands and supply of credit along the lines suggested by the Federal Advisory Council. As one phase of this program, the staff is pioneering in developing a special framework for showing the money and credit flows record -- sources and uses of funds -- of each major sector of the economy. This special "undertaking, which has been in process for the past four years, is now at an advanced stage and it is expected that the basic historical tables will be made available to the public within the next six months.

The matter of projecting these figures six to nine or twelve months ahead, presents many difficult technical problems and must at this stage of our empirical knowledge remain a judgment procedure. Gaps in the availability of critical current data, of course, present many handicaps to effective projection work. The filling of such gaps is not alone a matter of the statistical work of the Board, but also of the statistical work of other Government agencies and private organizations. Progress in this work is likely to be hampered in the immediate future because appropriations for the statistical programs of a number of Government agencies are being seriously cut back.

On the basis of existing data, the Board's staff is not hopeful that reasonable ways can be devised of estimating the amount by which private credit can be contracted in non-essential lines. The Council may wish to give consideration to suggestions as to how such estimate might be developed."

Mr. Fleming suggested that it should be the business of someone to hold down nonessential construction and other nonessential activities so that these would be available when the economy turned down and there was need for special activities to provide employment.

Mr. Eccles repeated a suggestion made earlier in the meeting that the Wilson 4-man committee might urge the Department of Defense to use existing facilities to the fullest extent possible rather than create other facilities, and members of the Council stated that that was the thought behind the statement of the Council on this topic.

At the conclusion of the discussion, Chairman Martin stated that the Board had not decided on the form its recommendation with respect to reserve requirement legislation would take and that the Board would like to have any comments that the individual members of the Council might wish to make on the subject.

President Brown stated that it was planned that the next meeting of the Council would be held in Washington on September 16-18, 1951.

Thereupon the meeting adjourned.

Secretary.