

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 20, 1951, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman  
Mr. Szymczak  
Mr. Vardaman  
Mr. Powell

Mr. Carpenter, Secretary

Messrs. Bucklin, Jackson, Potts, Congdon, Fleming, Davis, Brown, Hemingway, Ringland, Beals, Ray, and Lohead, Members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively.

Mr. Prochnow, Secretary of the Federal Advisory Council.

Before this meeting the Federal Advisory Council submitted to the Board of Governors a memorandum setting forth the Council's comments 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. Prospective business and economic conditions and System credit policy. The Board would like to have any views the Council might wish to express 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.

Assuming no major change in the economy, such as an all-out war or a substantial curtailment of the defense program, the Council believes that business will be good

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in the months immediately ahead. Activity in certain lines, such as textile and shoe manufacturing, has been depressed. Considerable spottiness is likely in the next six months even if the over-all level of business is high. Retailers and suppliers have made considerable progress in liquidating excess inventories. By reducing their forward commitments also they have helped to lessen the inflationary pressures. Employment is high and savings are large, so that consumers have the current income and the backlog for substantial personal purchases.

There is a noticeable apprehension on the part of many customers of banks relative to the future of business. This apprehension results in questioning the wisdom of further expansion programs, and has caused considerable postponement and some abandonment of construction and other capital expenditures.

The members of the Council representing the highly industrialized districts report a continuing demand for loans, and believe that there will be some increase in the over-all volume of loans in their districts. The members of the Council representing districts in which heavy manufacturing is not so important expect loans either to remain stationary or to decline.

Under present conditions,

A. The Council believes that the Open Market Committee has followed the proper policy of maintaining a flexible and orderly market for government securities and a reasonably firm money market. A continuance of this policy is recommended. The Council also believes that no change should now be made in reserve requirements or in the rediscount rate. Conditions may change by the next meeting of the Board and the Council. The Council will be pleased to review this item of the agenda again at that time.

B. The Council believes the Voluntary Credit Restraint program has had, and is continuing to have, a salutary effect in restricting credit to loans essential to the defense effort and the functioning of the economy. The Council strongly urges continued emphasis on the program and dramatization of its objectives.

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President Brown amplified the views of the Council as set forth above after which he called on Mr. Jackson who stated that business loans in the New York area had increased by small amounts almost every week during the fall period and that this had occurred in the face of heavy loan liquidation in all phases of the textile industry. He also said that a private study which had been made in the area as to what might be expected in the way of demand for loans by corporations had provided a considerable amount of information all of which indicated that banks would be faced with substantially increased demands for loans for working capital purposes next year, particularly if the goals for defense production were realized in 1952.

In response to Chairman Martin's inquiry, Mr. Jackson stated that the increase in bank loans in his district was smaller than had been expected. President Brown stated he thought that was the case in all Federal Reserve Districts, but Mr. Congdon was not in a position to say whether it would be true in the Fourth District.

At this point Mr. Powell joined the meeting.

Mr. Jackson stated that loans of the New York banks that had a large commodity business had been substantially less than expected and that others had anticipated higher demands for loans than had actually developed.

President Brown stated that one of the reasons for the lower loan demand was that smaller amounts were needed to move the cotton

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and other agricultural crops than had been anticipated.

Mr. Fleming inquired whether the Board had made any study of the effect on the working capital position of business of the payment of Federal taxes pursuant to the requirements of the Mills Plan.

Chairman Martin stated that the Board had not made such a study, but that an excellent study made by one of Mr. Congdon's associates had recently come to his attention which pointed up the problem very well.

In response to an inquiry by Chairman Martin, Mr. Jackson stated that he would be glad to make available to the Board the private study to which he had referred.

In response to Chairman Martin's request for his comments on the outlook for bank loans, Mr. Powell stated that, on the basis of statistics collected in connection with the voluntary credit restraint program, the expansion of loans this fall had been about what was to be expected seasonally, and that since there had been an expansion in defense loans in the same period of between \$800 and \$900 million, it was clear that credit for other purposes had been held in check pretty well. With respect to security flotations he stated that a great majority of the issues were defense supporting, that municipal issues had largely been held to essential needs such as schools, hospitals, sewers, and major highways, and that veterans' bonus issues had been held up since the screening of municipal issues was undertaken. He reviewed briefly the present status of the proposed West Virginia

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veterans' bonus issue and stated that he did not know what the outcome of that issue would finally be. He made the further statement that the American Bankers Association was collecting information on the loans which banks had actually turned down pursuant to the voluntary credit restraint program but that the resulting statistics would not be an adequate measure of the effectiveness of the program for the reason that, because of the program, many applications for loans were not being made and banks were declining loans without formal applications being submitted.

Mr. Lohead commented on the freedom with which funds were being made available for so-called defense housing in his district and the difficulty faced by his bank in that situation in meeting competition and at the same time trying to comply with the voluntary credit restraint program.

Mr. Powell pointed out that the voluntary credit restraint program could do very little in this field for the reason that these projects were being carried out under legislation passed by the Congress. In the discussion of this program, he also referred to an issue to be put out shortly in the State of Texas to finance the purchase of farm lands by veterans and stated that it was not possible for the voluntary credit restraint program to prevent issues of that kind.

President Brown stated that the Council would appreciate any

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comments that the members of the Board might wish to make with respect to the future business and credit situation.

Mr. Szymczak stated that he was in general agreement with the views that the Council had expressed but that it was not possible to make a definite statement at this time as to what would happen in the future, particularly because of the uncertainty as to developments in connection with the defense program.

Chairman Martin stated that, as indicated earlier during the meeting, the growth in bank loans this fall had been in considerably smaller volume than he had anticipated, that the agricultural situation had not required as much credit as had been anticipated, that some increase in cotton loans might occur, but that he would expect only a gentle increase in loans up to around the end of March. Beyond that, he said, he was not able to make a forecast. He made the further statement that if the expansion of bank loans had been considerably larger he would not have been satisfied to put funds into the market through the medium of open market operations on the scale that had occurred in connection with the October and November refunding, but that it had been possible subsequently to take practically all of these funds out of the market, and that if bank loans continued in the period prior to March 30, 1952 in the general trend indicated at the present time the situation would not be an unhealthy one.

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Mr. Vardaman commented that he did not see much possibility of any cessation in the demand for bank credit or any change in the unwillingness of the public to invest in Government securities. He was concerned about the extent to which credit was extended for so-called defense activities and felt that there should be a much more careful analysis of what should be regarded as loans for defense purposes. He stressed the view that there would be a tremendous demand for bank credit next year and expressed complete agreement with what had been said as to the futility of trying to curb private housing construction if the Government was to continue to encourage large scale defense housing.

Mr. Powell referred to the factors entering into the expansion of bank credit and said that he had been trying to develop information as to how far along the country was in the construction of plant and equipment for defense, that is, whether it was felt that the peak of demand for this purpose was now being experienced and would taper off in 1952. He felt that inventories were now beginning to decline and that the demand for loans from these sources would taper off with the result that the total volume of outstanding bank credit would either flatten out or decline somewhat. He made the further comment that at the request of the Office of Price Stabilization a study had been made of the cattle situation from which it appeared that a sharp increase in cattle marketings was now taking place which would effect a reduction

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in the high level of live stock credit outstanding. While the situation could be changed by developments in the international situation or a resumption of scare buying, he did not see in the absence of such developments any major pressures of the kind which caused the sharp increase in bank credit last year. He expected to see the total volume of credit remain relatively constant until February and then decline substantially during the spring months.

2. Patman Subcommittee Questionnaire. The Board would like to have a further discussion of the answers to be prepared in response to the questionnaire addressed to the Chairman of the Board by the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report. Copies of the answers to the questions submitted to the Board will be sent to the members of the Council as they are prepared for sending to the Patman Committee.

The Council will be pleased to discuss the answers to be prepared in response to the questionnaire addressed to the Chairman of the Board by the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report.

President Brown stated that the members of the Council had received the answers which had been prepared to 11 of the questions in the Subcommittee questionnaire addressed to the Chairman of the Board of Governors, and that while they represented an excellent staff job they were answers to questions relating to historical, factual, and legal matters and did not include questions touching on the structure of the System and other questions which would be much more difficult



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to answer. He added that the Council would be glad to discuss any of the questions that the Board might wish to consider.

Chairman Martin outlined the procedure being followed in the preparation of the answers to the questionnaire that had been addressed to him and stated that the Board would like to get the benefit of any comments that the Council might wish to make on any of the questions. He said that the 11 answers to which President Brown referred had been sent to the Patman Subcommittee on November 15 in order to get some of the answers in by that deadline date and to demonstrate that every effort was being made to prepare the answers as promptly as possible, but that it was understood with the Subcommittee that if it should be desired to make any changes in these answers or in any other answers subsequently submitted before they were set up in type by the Subcommittee, there would be an opportunity to do so. He went on to say that while drafts of answers to 60 of the 61 questions would be completed by tomorrow, many of them were first draft form, that the task of drafting was a Herculean one, and that an effort was being made to get the benefit of comments without getting into an editorial job which would not be possible in the available time. He said all of the answers were being reviewed by members of the Board, that any differences in the staff were being brought before the members of the Board, and that it was hoped that all of the answers with the possible exception of three or four

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would be transmitted to the Subcommittee before Christmas. He then suggested that perhaps the best procedure would be to send the drafts of the remaining answers to the members of the Council and get their individual replies by letter rather than to try to get a consensus from the Council as such. In a discussion of how the views of the members of the Council could best be submitted, Chairman Martin stated that if the Council should wish to undertake to agree on each of the answers he would be glad to have their views but he questioned whether such a procedure would be a practical one in the time available.

Mr. Fleming suggested that it would not be possible in the time that they would have for the members of the Council to read critically the answers to all of the questions and that it would be productive of better results if when the drafts of answers were sent to the members of the Council there was some indication of the important points on which the views of the Council were particularly desired.

Chairman Martin stated that he would try to follow that procedure.

Mr. Bucklin inquired whether it was expected that the comments of the Council should be in such form that they could be transmitted to the Subcommittee. In a discussion of this point, Chairman Martin stated that the views of the members of the Council were desired for consideration in connection with the preparation of the final answers and while it would not be the intention to submit such views to the

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Subcommittee, their submission would not be precluded if the members of the Council should so desire.

Mr. Fleming stated that if the views of the members of the Council were requested on only certain important questions the Board would be at liberty to submit to the Subcommittee any comments that he might make.

In response to an inquiry by President Brown, Chairman Martin stated that he had no information as to the number of witnesses that would be called before the Subcommittee, that Congressman Patman had indicated that he would start the hearings about January 15, but that it was probable that they would not commence before the first of February or later. He also said that he had no information as to the basis upon which economists and others were selected to receive questionnaires. In connection with comment by members of the Council which raised the question as to whether the inquiry would be a friendly one, Chairman Martin stated that the Board felt that it should be assumed that the hearing would be a friendly one until it was proved to be otherwise, that there was a disposition in certain quarters to attack the hearing unduly, but that the Board continued to regard it as a hearing with a constructive purpose and that it would be helpful to try to keep it on that plane.

Chairman Martin then said that he considered of overriding importance the answer which would be made to Question B-8, which asked

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whether the Board of Governors and the Federal Open Market Committee were parts of the executive branch of the Government and if not what their status was. He said that copies of a preliminary draft of the answer would be placed in the hands of the members of the Council before they left Washington and that any comments that they might wish to make with respect to it would be particularly helpful. He referred briefly to some of the points raised by the question and there was a discussion of how these points, particularly with respect to the independence of the System, should be treated.

At the conclusion of the discussion, Chairman Martin said that it would be appreciated if the members of the Council would give the draft of answer a very critical reading.

3. Discussion of the Public Debt. The Board would like to have an informal round table discussion participated in by all members of the Federal Advisory Council of the problem of the public debt in so far as it affects the responsibilities and operations of the Federal Reserve System.

Members of the Council will welcome such an informal round table discussion.

Chairman Martin stated that Governor Vardaman was particularly interested in the conversion of a greater portion of the public debt into long-term securities and that Governor Vardaman had suggested that the above topic be placed on the agenda for this meeting and would present his thinking on the problem.

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Governor Vardaman stated that he, with certain other members of the Board, for a number of years had urged the abandonment of support of the Government securities market except for purposes of maintaining orderly market conditions. He said that he had not agreed on the timing of the action taken last March when the market was allowed to go below par because he felt that action should have been preceded by an understanding with the Treasury on how future requirements would be met, but that the action was taken and the market had been well handled since. He continued to feel that one of the danger points was the continued Treasury financing in the form of short-term securities and that he would like to get the views of the members of the Council as to what might be done to meet that problem.

President Brown stated that Mr. Hemingway had led the discussion on this topic in the separate meeting of the Council and would open the discussion at this joint meeting.

Mr. Hemingway said that except in times of emergency such as total war or large gold imports the Government securities market should be permitted to find its own level, that Federal Reserve operations should be directed only toward the maintenance of an orderly market, and that it was his opinion that such a policy would be less costly in the end. He felt that the delay in adopting that policy following the war had complicated the problem of carrying it out when it was adopted. He added that the only way in which interest could be revived

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in defense bonds was to get away from a patriotic appeal and allow the rate to go to a point where the securities would again be on an investment basis.

Mr. Jackson stated that one important fact was overlooked in the policy adopted by the Federal Open Market Committee last March, that there was a distinction between the market for defense bonds and the "professional" market for marketable securities, and that while he agreed with the reasons for making defense bonds nonmarketable and redeemable at a fixed price he did not feel that the "professional" market would be disturbed when marketable issues fell below par.

Mr. Fleming renewed the suggestion made by him at the last meeting of the Board and the Council, and at a meeting of the Committee on Government Borrowing of the American Bankers Association with the Secretary of the Treasury, that a program be drawn up which would be directed toward the conversion of short-term debt into longer-term securities so as to avoid the increasingly heavy concentration of the debt in the short-term area and so that an opportunity to issue long-term securities would not be lost as it was in the early part of 1950 when funds were available for investment in such securities. For reasons which he outlined he was in agreement that it would not be possible to issue long-term Government securities at this time, but he felt that a program along the lines which he had suggested should be drawn up so

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that if the Treasury faced a period of heavy deficits such as now appeared likely in the latter part of 1952 the problem could be met with the least possible resort to the banking system. On the defense bond program he felt that it was necessary to get away from the concept that in order to get the public to hold defense bonds there must be a penalty on their redemption. It was his view that there should be a change in the return on such bonds during their earlier years so that they would compete with other forms of savings and the public would buy them because they felt they were a good investment.

Comments were made by Messrs. Jackson and Congdon indicating agreement with Mr. Fleming's suggestion and Mr. Congdon expressed the view that the abandonment of the policy of supporting the market for other than orderly market reasons was only part of a necessary program and that the only way to get further amounts of long-term bonds into the hands of private holders was to offer them at a rate which would meet the market.

President Brown agreed with what had been said in the preceding discussion except that he questioned whether it would not be possible to sell restricted 25 or 30-year securities on a 3 per cent rate. He felt that there would be a market for substantial amounts of such funds in the hands of trust accounts, eleemosynary institutions, etc. He recognized that the System could not permit a Treasury offering to fail and that whatever action was taken should be worked out

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with the Treasury so that the System would not be called upon to provide undue market support.

Mr. Hemingway inquired whether it would be possible to get tax exemption on the income from defense bonds in some small amount and Mr. Vardaman said he thought it would be and that the matter was receiving consideration. He also said that he had been interested in a discussion with the Council of the whole problem of financing the public debt because he felt the problem was an immediate one and that there should be a program which would meet the situation which would develop in the fall of 1952 when it appeared that the Treasury deficit would be large.

In the discussion members of the Council expressed the view that the problem of Treasury financing would not be solved until the Treasury adopted a higher rate on long-term issues as had been done in England and Canada.

Mr. Potts felt that the longer an increase in the rate was postponed the more difficult the change would be.

Mr. Bucklin questioned whether it would be possible to sell any substantial amount of long-term 3 per cent bonds in the present market but he agreed with Mr. Fleming's suggestion that a program should be worked out. It was also his view that it would be necessary to proceed cautiously with any change in this regard and that it was



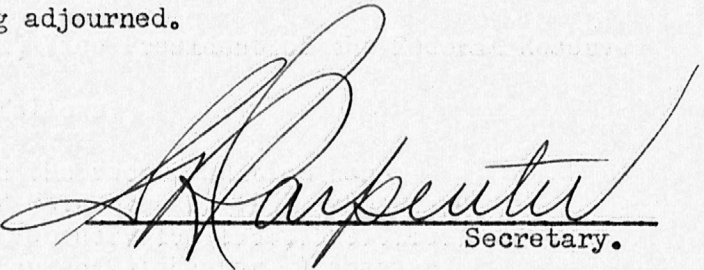
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tremendously important not to do anything that would "rock the boat". He also favored the tax exemption feature on defense bonds rather than a higher rate and commented that there was still an element of patriotism in the appeal of these bonds but that it was important that they have an investment appeal.

President Brown stated that the next meeting of the Council would be held on February 17-19, 1952.

Thereupon the meeting adjourned.

  
Secretary.