2/17/53 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, February 17, 1953, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Szymczak
Mr. Evans
Mr. Vardaman
Mr. Mills
Mr. Robertson

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary

Messrs. Clayton, Henry C. Alexander, Smith, Gund, Davis, Brown, V. J. Alexander, Ringland, Chandler, Ray, and Wallace, Members of the Federal Advisory Council from the First, Second, Third, Fourth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively.

Mr. Prochnow, Secretary of the Federal Advisory Council

At its earlier separate meeting the Federal Advisory Council reelected Mr. Edward E. Brown as President of the Council, Mr. Fleming of the Fifth Federal Reserve District as Vice President, and Mr. Prochnow as Secretary. Messrs. H. C. Alexander, G. S. Smith, and George Gund were elected to serve with Messrs. Brown and Fleming, ex officio members, as members of the executive committee of the Council.

Before this meeting the Federal Advisory Council submitted to the Board of Governors 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. Consideration of a modification of the United States Bureau of Internal Revenue regulation having for its purpose an increase in the permitted loss reserves in commercial banks to an amount more realistic with possible potential loss should a serious business depression occur.

The Bureau of Internal Revenue formula, which fixes the maximum permissible additions to loss reserves that can be deducted from the taxable income of commercial banks, was fair when it was first adopted, and it operated satisfactorily for several years. However, the heavy losses of 1929 and the early 1930's cannot be taken into consideration under the present formula, and few banks have had any considerable losses in recent years. The volume of loans is at an all-time high level, but the present formula does not permit banks to deduct for income tax purposes additions to reserves in an amount bearing a sound relationship to probable losses, based on past experience.

Tax policy should encourage additions to loss reserves at this time in order to strengthen the banking system and protect bank depositors. The Council would appreciate any assistance which the Board might find it possible to give in working out a formula with the Bureau of Internal Revenue which would meet present conditions. A committee of the American Bankers Association has suggested a formula which the Board of Governors might find helpful in its consideration of this problem.

President Brown stated that the American Bankers Association had suggested to the Bureau of Internal Revenue a revised formula which in effect would permit banks to take up to 1/2 of 1 per cent of the volume of loans as a deduction from taxable income each year for additions to loss reserves with a flat ceiling of 5 per cent of total loans but that whether that proposal or some other was adopted, the Federal Advisory Council would greatly appreciate any representations which the Board might make to the Treasury as to the need for amendment of the present ruling of the Bureau of Internal Revenue.

Chairman Martin stated that the Board appreciated the problem outlined by President Brown but that it was the Board's feeling that it ought not be in the position of suggesting or advocating a change in the existing regulations of the Bureau of Internal Revenue unless requested by the Treasury Department to express its views. The Board should not, he said, be a substitute for the American Bankers Association or for other interested groups in advocating changes in various Governmental regulations. If, however, the Treasury or the Bureau of Internal Revenue were to make a request of the Board, Chairman Martin felt sure that the Board would be glad to express whatever views it had on the matter.

At President Brown's request, Mr. Ray described the work being done by a subcommittee of the American Bankers Association on tax legislation which had been working closely with the Bureau of Internal Revenue and interested committees of Congress. Mr. Ray went on to say that yesterday he suggested to Mr. Brott, General Counsel of the American Bankers Association, that he send to the Board a copy of the report that had been prepared by the subcommittee with respect to permissible additions to loss reserves that could be deducted from taxable income of banks, and that he understood Mr. Brott would do this shortly.

President Brown stated that the Council fully understood the position of the Board as outlined by Chairman Martin and agreed that it would be proper for the Treasury first to request the Board's views. He then called upon Mr. Wallace who reviewed the situation in the Twelfth Federal Reserve District, particularly the relative positions of banks and Federal savings and loan associations. Mr. Wallace felt that it would be equitable, desirable, and in the public interest for banks to be permitted to build up loss reserves on the same relative basis as savings and loan associations.

2. What are the views of the Council on the prospective business and economic situation during the next six months and the probable changes in the volume of bank loans during that period? What problems, if any, does the Council foresee in the substantial growth of consumer and real estate credit that has taken place?

Business is operating at a high level, and industrial production, wages and personal income are setting peacetime records. Unemployment is low. Retail sales over the country as a whole are good. Despite spottiness in certain industries, businessmen are generally optimistic regarding the economic outlook for the next six months. The Council believes this optimism is justified. In some sections of the country in which agriculture is of major importance, and where drouth conditions now threaten, the continuance of the present high rate of business activity will depend on the weather. For months there has been a gradual decline in the prices of various basic commodities, especially farm products. These price declines will result in a decrease in farm purchasing power and will affect some industries adversely. However, these price declines may serve a constructive purpose if they temper excessive business optimism and restrain increases in other prices.

The Council believes that the present volume of bank loans, except for normal seasonal fluctuations, will show little change in the next six months. All members of the Council are concerned with the growth of consumer credit. The demands on banks for this type of credit, whether by finance and small loan companies, retail stores, mail order concerns, or directly by consumers, show no immediate sign of abatement. A strong minority of the Council believes that legislation should now be adopted permitting the reimposition of Regulation W. A majority of the Council is opposed to such legislation now, but favors reviewing the matter at a later date when developments in the economy should make clearer whether any legislation is desirable.

The Council does not believe present conditions justify reimposing Regulation X. There is some evidence that housing construction is showing a tendency to level off. A policy of stricter and more realistic appraisals, not only by those approving Government-guaranteed loans, but also by officials supervising the savings and loan associations, is highly desirable and should be helpful in restricting the growth in the volume of unsound real estate credit.

President Brown stated that the Council felt the Board probably had more information as to the present condition of business in the country as a whole than the Federal Advisory Council, but that some of the members of the Council might be able to add something concerning conditions in their respective districts. He referred to the less than normal precipitation in much of the middle west area, stating that some of the members of the Council felt that the Board might not give as much weight to the effects of lack of rainfall on the agricultural outlook and other business activities in some areas as was warranted.

With respect to the volume of bank loans, President Brown said that the Council felt that industrial and commercial loan demand is wholly normal and not excessive. In the case of instalment credit, however, the Council was concerned with the rise that had already taken place and with the growth in the volume of credit being used to finance consumer purchases on an instalment basis but often reflected in borrowings of retailers who carried their own paper, a classification not shown separately in figures available to the Board. President Brown went on to say that the opposition of a majority of the Council to the reimposition of Regulation W covering terms of consumer instalment credit or to passage of any legislation which would allow reimposition of such regulation was based on the thought that a restriction of that type should be applied only under conditions of actual warfare or great stress such as that immediately following the outbreak of war in Korea in 1950. He noted, however, that whereas in past years only one or two members of the Council had favored Regulation W in peacetime, at present a strong minority of five members of the Council favored reimposition of such controls at this time. A majority of those who opposed legislation permitting regulation at this time did so on principle, believing that the remedy was worse than the disease. However, some of those in the majority group felt that conditions might get sufficiently worse so that at a future date, say six months from now, consideration should be given to whether there was need for legislation authorizing such controls. Thus, it could be said that a majority either favored legislation at this time or favored considering the matter further at a later date.

With respect to real estate credit, President Brown said that such growth as was taking place at banks was in loans guaranteed or insured by the Federal Government. The greatest growth in possible unsound loans was occurring at savings and loan associations as a result of very liberal appraisal policies, with associations persistently making 75 to 80 per cent loans on excessive valuations. The Council does not believe reimposition of Regulation X would do any good in preventing an unsound growth in real estate credit, President Brown said, since control of that situation rested with supervisory authorities for savings and loan associations and those in charge of Government guarantees.

Mr. Henry C. Alexander stated that he was among the minority of the Council on the consumer credit issue, that he felt such credit had been growing too rapidly, that the Federal Reserve System had jurisdiction over many forms of credit, that this was one form of credit which usually came to a peak near the top of a boom and, therefore, exaggerated the boom, and that similarly a contraction of consumer credit when a boom turned downward would exaggerate and make a recession more critical. He felt that consumer credit had grown to such proportions that it was a threat, that with more consumer goods becoming available it would continue to grow, and that the time had already arrived for it to be regulated directly along the lines formerly used under Regulation W. He also said that stand-by power for such regulation was not enough, that he was in favor of this type of regulation in principle, that he felt it should be adopted immediately, and that if Congress should pass new legislation which provided authority he hoped the Board would immediately issue a regulation.

In response to a question from Chairman Martin as to how Mr. Alexander would differentiate between the need for the regulation of consumer credit and of real estate credit, Mr. Alexander stated that the Board's authority to regulate real estate credit had been quite limited in the past, that unless such authority could cover the whole real estate credit field it would have a very limited effect, and that he did not believe the fluctuations in real estate credit of the type that Regulation X previously covered were likely to be as dangerous to economic stability as in the case of consumer credit.

Governor Vardaman stated that he had not been able to get an answer to his question how much instalment credit was too much and in that connection he presented certain statistics on consumer credit growth in recent years in relation to bank loans and disposable income.

Mr. Alexander responded that he did not believe there was any rule or combination of rules that would test the proper volume of consumer credit in relation to national income or any other over-all measure, and that he thought the question whether consumer credit was too high was a matter of judgment in the light of the whole economic situation. He also stated that he felt the rest of the credit field could be pretty well controlled with indirect methods although, as indicated before, he felt in the case of consumer credit a selective regulation was needed.

President Brown stated that Mr. Fleming, who had been delayed in joining this meeting by an appointment at the White House, had expressed the view that growth in consumer credit at this stage reflected the movement of population from urban to surburban areas, that such moves involved buying and furnishing houses and acquiring automobiles and various labor-saving appliances, and that in Mr. Fleming's opinion some expansion of consumer credit was proper but that it probably was a temporary rise to take care of the type of needs described. President Brown emphasized that in the case of some members of the Council, opposition to the selective regulation of consumer credit was based on principle, that some were old-fashioned enough to believe that an individual had a constitutional right to "go broke" if he wanted to do so, that if a banker or dealer was foolish enough to extend instalment credit too rapidly it was his right to do so, and that a control of the type of Regulation W should not be authorized in peacetime even at the expense of failing to iron out a boom. In other words, these members of the Council would rely on the over-all controls at this time.

Chairman Martin stated that he sympathized with the point of view expressed by President Brown but that he thought it was a question whether too many dealers might go broke at the same time, especially if that was at the upper end of expansion in the business cycle. Chairman Martin went on to say that he believed in the general credit controls and that he thought they would work; if selective credit controls were to be used, they should be removed from the political atmosphere they had been in and should be put in the same framework as the other credit instruments provided in the Federal Reserve Act. The agency given such authority, he said, should have it on a basis where it could exercise the authority in terms of the problem it was trying to deal with and before damage had been done, rather than after the credit expansion had taken place. Chairman Martin went on to say that he had expressed this point of view in a talk with Senator Capehart, Chairman of the Senate Banking and Currency Committee, within the past few days in response to a question as to how he (Chairman Martin) would testify on S. 753, a bill cited as the "Emergency Stabilization Act of 1953" which would provide for stand-by authority for controls. While he could not say how the Board would feel, Chairman Martin added he had given Senator Capehart his personal opinion that he would be reluctant to reject stand-by authority if the Congress wished to provide for it, but that that was a far cry from saying that stand-by controls of the type proposed in the bill were needed or wanted.

Mr. Fleming joined the meeting at this point.

President Brown stated that speaking for himself he believed the only time Regulation W ought to be imposed was when the Federal Government wanted to restrict the manufacture of various types of goods in a situation such as that which occurred during World War II and immediately after the outbreak of war in Korea in 1950.

President Brown then called upon Mr. Fleming who stated his views regarding the need for consumer credit in connection with the growth of suburban housing as previously expressed for him by President Brown. Mr. Fleming added the comment that he thought consumers were building up their supplies rapidly and that perhaps a big fraction of the expansion for the purposes he had in mind had taken place and the situation would come into balance.

Mr. Ringland stated that his views regarding regulation of consumer credit coincided with those of President Brown; Mr. Smith stated that he agreed with Mr. Henry C. Alexander.

Governor Evans stated that an official of a finance company recently expressed to him the view that many of the banks which had gone into the consumer instalment credit field in recent years were not aware of the pitfalls in handling such paper. This official had cited an instance in which an automobile dealer stated that he would take poorer paper which the finance company had rejected to a bank which would accept it, without recourse, and Governor Evans inquired whether the members of the Council felt such instances were common.

Several of the Council members indicated their feeling that banks generally were well qualified to handle instalment paper.

Mr. Davis stated that while his bank was adhering to the terms permitted by Regulation W when last in effect, many of its customers were not doing so. He added that he was of the minority of the Council on this point, believing Regulation W should be reimposed. Mr. Davis also stated that he suspected there was a good deal to the comment of a finance company official reported by Mr. Evans, that many banks had entered the instalment credit field without the experience in handling this particular type of credit which had enabled finance companies to keep losses on their receivables at relatively low levels.

Mr. Fleming said that he did not think there was any chance that Congress would authorize consumer credit controls at this time and that this was one reason he felt another look should be taken at the situation a few months from now.

Chairman Martin reiterated the statement that the consumer credit regulation had been in politics, that in order to be used effectively, whether in peacetime or in wartime, the authority had to be put on a flexible basis in some agency which would have the authority to operate it on a longer range basis applying terms without interference from Congress or various other groups, and that otherwise the administering agency would spend most of its time making compromises on terms and failing to accomplish the real purpose of the regulation.

3. Does the Council have any comments or suggestions to make with respect to System credit policies during the recent period and what these policies should be in the months ahead?

In view of the fact that bank loans increased more than seasonally in the last few weeks of 1952, the Council believes that the recent increase in the rediscount rate from 1-3/4 per cent to 2 per cent was justified. The 2 per cent rediscount rate is also more nearly in accord with present money market rates. Other than its psychological influence, the increase in the rediscount rate had little effect. The Council believes that no increases should be made in present reserve requirements, and that unless there is an important change in the economic outlook the present rediscount rate should be continued. If conditions in the next few months should make tighter money desirable, the Council suggests the use of open market operations for that purpose.

President Brown stated that there had been a good deal of discussion of what the effect would be of a further increase in the rediscount rate on the Government bond market and that all members of the Council believed that open market operations could be used to bring about as much additional tightening as was necessary without further use of the discount rate in the near future. In response to a question from Chairman Martin as to whether the Council felt the present level of loans was about right or too high, President Brown stated that while he could not speak for the Council, he himself did not feel that loans were too high except as they reflected an increase in the growth of consumer credit.

Mr. Henry C. Alexander felt that bank loans were too high for the whole economy at the present time and that the System's credit policy should be tighter than it is.

Governor Szymczak suggested the possibility of a change in the Board's Regulation A, Discounts and Advances to Member Banks, which would make it more restrictive, adding that the Reserve Banks gave consideration not only to the purpose for which member banks borrowed but also to the length of time for which borrowing was continued in considering whether a proper use was being made of discount facilities.

Mr. V. J. Alexander said that the cotton crop was moving very slowly this year and that because cotton growers had found it impossible to get their loans under the terms of Commodity Credit Corporation they had gone to banks to borrow against the crop. As a result, Mr. Alexander said, his bank had been discounting heavily at the Reserve Bank for a considerable period of time and expected to continue to do so until April 30.

Mr. Fleming stated that his bank had borrowed rather heavily for a period in December because of the lack of market for Treasury bills and because it did not wish to disturb its regular portfolio holdings.

President Brown commented upon the situation in which the Chicago banks find themselves as a result of Treasury bill purchases in connection with the personal property tax assessment as of April 1, stating that they were now borrowing around $170 million to carry bills that would mature April 2, that they would not be sold to persons who wish to get out of cash and into securities until just before the April 1 tax assessment date, and that until that time they would continue heavily in debt at the Federal Reserve Bank. President Brown also said that he hoped the Board would not make the mistake of telling all Federal Reserve Banks that they should reduce the volume of discounts by any flat percentage, and that if a restriction of discounting activity was desired, it should be left to the directors of the individual Reserve Banks to determine how much reduction should be brought about in the individual districts.

Mr. Ray said that banks in the Dallas District were using the Federal Reserve discount facilities rather generously, that he thought they would need to discount still more this spring, but that he thought it was the responsibility of the Reserve Bank to provide financing in a season when credit would be needed for planting following a winter of extraordinarily dry weather conditions with the result that much of the fall seeding would have to be done over in the spring.

Chairman Martin stated that, although the topic was not on the agenda, he would like to have Governor Mills bring the Council up to date on the proposed study to be made by the Board of the excess profits tax liability incurred by banks during 1952.

Governor Mills stated that a proposed questionnaire had been sent to President Brown as well as to the American Bankers Association, and that the Association had raised the question whether the information which would be developed by the questionnaire on borrowing by banks might be used in connection with the policing of the discount privilege at the Federal Reserve Banks. Governor Mills said that the information would not be used for that purpose. He also said that it was now contemplated that the questionnaire would be distributed to around 1300 banks early in March. Governor Mills went on to say that he thought it was desirable to carry forward the study so that the information would be available in the event it was needed by the banks in connection with legislation.

President Brown stated that the Council appreciated very much the work the Board had done in connection with this study.

Governor Mills left the meeting at this point.

4. The Board has not yet finally formulated its views as to definite recommendations with respect to legislation during the present session of the Congress and would like to have the comments of the Council as to the proposals that might be made.

The Council understands the Federal Reserve System has exhausted its authorization for expanding and modernizing the facilities of its branches. The Council would favor legislation giving the System $15 million to $20 million with which to expand its branch facilities to handle the increasing volume of business of the System.

The Council would also favor legislation permitting the reissuance without penalty of all Federal Reserve Notes by any of the Federal Reserve Banks, regardless of which Bank issued the Notes. This would save present costs in shipping Notes.

The Council does not know what legislation the Board may contemplate proposing at the present session of the Congress. The Council would be pleased to discuss with the Board any legislation it is considering proposing.

President Brown stated that he did not see how there could be any argument about either of the legislative proposals noted above, but that if the Board had any idea of introducing proposals on branch banking, reserve requirements, or bank holding company legislation, on which the Council had definite opinions the members would like to hear of the proposals.

Chairman Martin said that the Board did not have any such proposals in mind at the present time although that did not mean it would not have something later on. He added, in response to a question from President Brown, that the Board did not contemplate asking for authority to regulate consumer credit, that as indicated earlier in the meeting it was presently working on testimony to be presented at the hearings of the Senate Banking and Currency Committee on Senator Capehart's proposal for stand-by controls, and that while it was not asking for authority it did not feel that it should oppose the proposals in the bill introduced by Senator Capehart. In response to a question from Mr. Ray, Chairman

Martin stated that he knew of no proposals at this time to amend the Mills Plan relating to payment of corporation taxes, and that while he did not have an opinion on whether this was an appropriate time for such legislation, the matter was one for which the Treasury would have responsibility.

During a further discussion of other legislative matters, Mr. Fleming suggested that if the Board wished to take up specific proposals with the Council before its next meeting which would ordinarily be in mid-May, they might be sent to the individual members of the Council for study.

Chairman Martin stated that he felt this would be very desirable, and that the Board would try to distribute any proposals it might have in the manner suggested by Mr. Fleming.

In response to a question from Governor Vardaman, Mr. Fleming stated that he had always felt that the Voluntary Credit Restraint Program was a good instrument, and particularly good when formulated through the Federal Reserve System,and that he felt it had been an effective instrument against inflation although he did not think it was the sort of program that could be carried on for more than a few months without becoming ineffective.

President Brown stated that stand-by authority for such a program might be desirable in the event there was a sudden upsurge of credit expansion but that he did not think it was a program which should be put into effect now even if there were authority for it.

It was agreed that the next meeting of the Federal Advisory Council would be held May 17-19, 1953.

Thereupon the meeting adjourned.

Secretary