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, September 15, 1953, at 10:30 a.m.

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

Mr. Sherman, Assistant Secretary


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 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. What are the views of the Council with respect to the prospective business situation during the next 3 to 6 months and the probable changes in the volume and purposes of bank loans in that period?

Business activity in the last few months has held at high levels. Consumer income and spending have been maintained. Unemployment has remained very low. Industrial production has been high. Disposable personal income has been large. The
number of nonfarm housing starts has been substantial. Retail sales have compared favorably with those of 1952. However, impressive as the factors are which now support the economy, some significant weaknesses have become apparent. For example, large farm surpluses are already creating serious problems, which will increase in the next few months. Farm prices and farm income have fallen, accompanied by a very severe decline in the sale of farm machinery. Steel production has begun to turn downward, and indications are that it will decline considerably by the end of the year. Production of household appliances and automobiles is outrunning demand. Business inventories in many lines have accumulated beyond desirable levels.

The Council believes that the peak of the boom has passed and that in the next three to six months the course of business will be moderately downward.

This Fall the banking system will experience the usual seasonal demand for credit, but the Council believes the increase in the total volume of bank loans will not be as great as it was in 1952. Should business activity decline in the next few months, as the Council anticipates, the time necessary for the liquidation of excess inventories will tend to maintain temporarily the volume of bank loans.

President Brown said that, although complete statistics were not yet available covering the past few weeks, business activity has held at high levels. However, some significant weaknesses were becoming apparent as indicated by accumulations of inventories of household appliances, the situation with respect to farm machinery, and private comments of persons in the steel business suggesting that that industry might be operating at 75 to 80 per cent of capacity before the end of this year. With respect to the outlook for bank loans, President Brown said that while conditions would vary from district to district, the fall
movement of crops was getting under way and there was bound to be a substantial increase in bank loans for that purpose. Although it did not seem probable that the increase this fall would be as large as a year ago, the Council felt that the over-all volume of bank loans in most districts by the end of 1953 would be higher than at the end of 1952. Most members of the Council believed that the volume of consumer credit loans would level off with rapidity from now on and there was a general indication that sales of real estate were slowing up, particularly in the case of higher priced houses, which left considerable doubt as to whether real estate loans would continue to increase. President Brown noted, however, that most members of the Council reported that demand for low priced houses is still active and that financing of such houses is proceeding under FHA and Veterans Administration financing.

In response to a question from Chairman Martin as to the outlook for expenditures for plant and equipment, President Brown stated that there was considerable feeling that utility expenditures in both the electrical and telephone industries would continue very heavy but that there would be some dropping off in industrial plant and equipment demand. He cited the steel industry which was probably faced with a reduction in output, and the petroleum industry which now found that it had excess refining capacity. President Brown noted that no programs under way were being cancelled and he stated that the Council would not
wish to be understood as feeling that there would be a sudden or severe decline in business; in fact, the view was that some readjustment such as had been indicated would be healthy and desirable for the economy.

Mr. Henry C. Alexander referred to discussions with officers of the Federal Reserve Bank of New York recently who had described the situation a few weeks ago as "a state of balance between inflation and deflation" but who felt that it had changed to where it was now "a balance between stability and deflation". Mr. Alexander felt that the situation actually had moved a little farther than that, that the forces of deflation are now slightly in the ascendency as against stability, although he did not believe this was yet fully reflected in the statistics. He noted that a canvass of banks in New York indicated that loans would increase seasonally, perhaps to the extent of 90% of the increase last year, and that the banks had not had an increase in consumer credit this year as large as occurred in 1952. Mr. Alexander also commented that as business slackens off, demand for working capital could not be expected to accumulate to the extent that it did last fall. While business is still good, the factors of uncertainty are the ones being discussed by many men in the business and financial world. Mr. Alexander felt that such cutbacks as were currently taking place in production might well offer a chance to work off excessive inventories, and he
cited the situation among certain automobile manufacturers who had cut-back assembly schedules from those set as late as July because cars were pressing too severely on dealers, many of whom were having considerable trouble in moving them.

Mr. Wallace stated that on the Pacific coast business volumes were ahead of last year but that the consensus was that some weakness is developing. The foreign trade situation is weakening substantially, partly because exports from the Pacific coast, which are currently well below a year ago, are suffering from the tremendous amount of foreign products which have been shipped over and are now available in the Orient. Mr. Wallace also mentioned the labor situation stating that in the raw materials industries, such as copper, wage rates had increased to a point where no further rise could be handled on the basis of existing prices and distribution. He anticipated some strikes in the next several months and felt there would be a readjustment in output as a result of production shut-downs.

Mr. Davis stated that in the Sixth District employment during recent months had been at record levels, that there was virtually no unemployment, and that new industries were continuing to come into the area. Utilities were still planning further expansion programs. While there had been some drought and the farm situation did not look particularly good at present, there would be a good cotton crop with a surplus over probable consumption during this year. Mr. Davis did not think
that banks would have the volume of loans this fall that developed in 1952. On the whole, however, he did not think readjustments in business would be very serious.

Mr. Ray stated that, compared with the situation last June or July, the southwest was much improved as far as rainfall was concerned. There had been considerable moisture in about 2/3 of the drought area of the Eleventh District during the past six weeks or two months and except for the western part of Texas the situation was greatly improved. Smaller cattle operators had in many cases been forced out of business, particularly individuals who had gone into the raising or feeding of a few cattle as a side line activity, but large operators were being sustained partly as a result of oil lease royalties or income from oil production and generally were getting along all right.

Mr. Ray said that it looked as though the price level for range cattle had become pretty well stabilized. Most of the cotton crop would go under loan to the Commodity Credit Corporation, he said. As for business generally, Mr. Ray believed that the trend would be downward from here on out, that business had passed the peak of this boom, and that this would be reflected in figures of department store sales, automobile sales, and other measures of consumption during the coming winter and spring. As to building, Mr. Ray felt that unless large insurance companies entered the area with a view to making loans on smaller houses
much more liberally than has been the case, actual construction by many builders would be curtailed sharply next spring from levels that had been experienced this year.

Mr. V. J. Alexander said that cotton loans in the Memphis area were pretty well cleared up and that if the Commodity Credit Corporation would encourage banks to carry cotton loans this fall it would be very helpful. He felt that a margin of 1 per cent would be enough to interest banks in carrying such loans. Mr. Alexander did not think there was much latent buying power going unused in his area, that people were not only more conscious of threatened readjustments in economic activity but many of them who had experienced three bad crop years in a row no longer have the surplus funds which enabled them to buy in other years.

Mr. Fleming commented on the situation with respect to Commodity Credit Corporation loans, stating that the matter had been brought to the attention of the American Bankers Association Committee on Government Borrowing at a meeting in the latter part of August in view of the fact that the public debt was approaching the statutory limit of $275 billion dollars. Mr. Fleming said that while the rate charged farmers on Commodity Credit Corporation loans would not need to be changed, it was felt that the rate allowed banks could be increased so as to encourage banks to carry such loans, which would help reduce demands on the Treasury this fall.

Mr. Chandler said that conditions in the Kansas City District, particularly in the livestock industry, were probably slower than in
any other district largely because of the lack of moisture during the current year. Stock loan demand was following a definite pattern and banks were not permitting such loans to increase very much. Consumer credit loans in the Kansas City District were also tending downward, Mr. Chandler said, although business in most rural areas was still relatively good.

Mr. Ringland said that the Ninth District had had splendid moisture conditions this year, in fact a little too much in some areas. The corn crop would be good, the wheat crop would be better than last year although slightly below 1951, and the flax crop is excellent. In the case of flax, much of the crop would go under loan because the cash price is below the loan value. Whereas in normal years there would be considerable contracting for stocker and feeder cattle during the summer months, there has been virtually none this year. Although feeder prices are low, cattle feeders are waiting for some clarification of the situation before making further commitments. While many people are cautious, general trade and business conditions in the area continue good. The only thing on the other side, Mr. Ringland said, was that some people are disturbed about the accumulation of farm machinery inventories in dealers' hands, that practically every dealer is over-inventoried and has stocks of machinery which he should not be carrying at this time of the year.
President Brown stated, in response to a question from Governor Robertson, that the Council did not feel that readjustments taking place were unhealthy; rather, they were healthy, they were coming serially, they were not all in one spot, and they were not chaotic. Most members of the Council felt it desirable to have these readjustments, provided, of course, they were not overdone.

2. What comments does the Council have to make with respect to the System's recent and current credit policies, and what modifications of those policies does the Council believe might be desirable during the balance of the year?

The Council thinks the Board's actions in the last few months in giving relief to the money market, both by open market operations and by the reduction in reserve requirements, were highly constructive. The Board's policy helped stabilize the economy at a time when the money market had become unduly tight, and materially helped the Treasury in its financing.

As stated in the answer to the first item of the agenda, the Council believes that the peak of the boom has passed and that a moderate downward trend in business will continue for a time. In view of this belief, the money market should not be kept so tight as to accelerate the decline in business, but should be eased in the direction of moderating the decline. On the other hand, money should not be made so easy as to create the danger of further inflation. If the decline in business activity is not too severe, the Council believes that open market operations would be adequate to meet the situation. If, contrary to the expectations of the Council, the rate of business decline threatens to accelerate substantially, the Council believes the Board should again reduce reserve requirements.

President Brown likened the current situation in bank loans to that of a balloon which had been over-expanded and was in danger of bursting: it would be desirable to get rid of some of the excess gas in order
to keep the balloon from bursting, but it should not be allowed to escape so rapidly as to cause the balloon to collapse. Some lines of loans were getting pretty well cleaned up, he said. Nevertheless, the Council felt strongly that, in view of the way inventories were accumulating in some of the lines in which over-production had occurred, interest rates should not be so high as to result in further price cutting. The Council felt that the System should tend toward growing ease in credit policy, he said, but not so much ease as to keep from having further adjustments. If a readjustment did occur, he did not feel that the System should exert pressure to get the volume of business back up to levels which recently had been reached since that would only result in a return of the spiral of inflation.

In response to Governor Mills' question as to whether member banks felt adequate reserves had been supplied to enable them to meet fall credit needs, President Brown said that for a period prior to June of this year, there was a good deal of feeling that the Federal Reserve had not supplied a sufficient amount of reserves through the Open Market operation. Also, the feeling had gotten around last April and May, among larger banks at least, that the Federal Reserve was resisting borrowing by member banks to take care of seasonal needs, and this had caused disturbance of a psychological nature. This feeling, however, had now changed to one in which the banks felt that if they
needed a moderate amount of Reserve Bank credit, it would be available.

Governor Robertson inquired whether there was any feeling that the System would put so much into the market as to result in a renewed spiral of credit expansion, and President Brown stated that he had not heard any comments to that effect; at least, not that the Federal Reserve would take such action intentionally. There is a certain amount of fear, however, that the Board under pressure from the Administration or from Congress might put too much reserves in for the good of member banks.

Chairman Martin stated that he would be glad to have comments on the relative merits of changing reserve requirements and of using Open Market operations, both in connection with the credit policies followed during June and July of this year and with respect to any future movements.

Mr. Fleming felt that the use to which these different instruments should be put was a matter of degree, that in June it had been necessary to do both in order to meet the economic situation including the needs of Treasury financing. If a gradual decline in economic activity took place, Mr. Fleming's view was that open market operations should take care of the situation. However, if there had not been a reduction in reserve requirements in June, he doubted whether the situation would have been such as to permit the Treasury to have a successful financing.
Governor Evans referred to President Brown's comment regarding the risk of a return of inflation if the money supply should be made too plentiful, asking whether such a comment was consistent with other statements made about the inventory situation, the gradual decline in demand, some falling off in employment, loss of farm purchasing power, and the great productive capacity of the economy at a time defense expenditures were declining.

President Brown said that the Council felt that making money too cheap would not be effective in stemming a decline in economic activity; also, it might encourage wasteful expenditures by public bodies. The whole question of a decline in business is a factor in the reduction in inventories and the need for money to carry them, he said, and in the longer run it was a question of interest rates. Higher interest rates on longer term capital would screen off expansion which might otherwise take place. It was difficult to judge what ought to be done while the current is in motion, he said, but after it is over it is relatively easy to look back and see the mistakes of action or inaction. None of the members of the Council felt that monetary policy by itself could prevent a decline in business, but on the other hand one of the elements in maintaining a stable commodity price level and purchasing power of the dollar was the volume of money and credit available. There had been considerable discussion in the meeting of the
Council, he said, of the question whether the Board should pursue a neutral policy in the present situation, let interest rates stay where they are, and let the money supply stay about as it is; or whether it should press deliberately for the adoption of a policy that would look toward easing conditions in the money markets. The Council felt, he said, that the time for a neutral situation had passed, that a decline in business was sufficiently threatening to call for open market operations of an easing character between now and the end of the year, that other policies of the System should be definitely in the direction of an easing tendency.

Mr. H. C. Alexander recalled the view he had expressed at the meetings of the Council in February and May of this year, noting that he had been concerned about expansion in February and felt the situation should be continued tight, whereas in May he felt that the situation had gotten too tight and he was glad that open market operations had moved somewhat in the direction of easing the situation. He noted that he then suggested a reduction in reserve requirements and he felt that the step taken by the Board in June was almost as perfect a step as could be described in the execution of monetary and credit policy. Since then, he felt that conditions generally have developed satisfactorily, that the System has made it clear that the limitations on credit expansion will be the demand for credit rather than the supply,
and that banks have a comfortable feeling about being able to get Reserve Bank credit if they need it to help them carry seasonal needs this fall. He did not think he could make a case for a reduction in reserve requirements at the present time but the situation should be watched carefully and if conditions change and a seasonal increase in credit because of large crops and the carrying of inventories should develop, and particularly if the Treasury were to come into the market for another $2 to 2-1/2 billions of new money, then a repetition of a "one-shot" action of reducing reserve requirements would be better than an attempt to handle the situation through open market operations. Mr. Alexander felt that the story in this respect could be told within a month or six weeks and he was inclined to feel that developments would be such as to make a good case for reducing reserve requirements. His view was that the Board should not wait too long if the situation needed to be "touched-up"; if a decline in business appeared to be coming, that was when the Board should act rather than waiting until the decline actually appeared.

In response to a further question from Chairman Martin as to the dramatics of a reduction in reserve requirements as compared with open market operations, Mr. Alexander went on to say that the change in reserve requirements would be more dramatic, that it not only would indicate the Board's judgment that something was needed but would be evidence that the System was taking action to do something about the situation.
While he recognized that a reduction in reserve requirements might be looked upon by some members of the business community as an indication that the Board felt that there was danger in the situation, on the other hand, if there were signs of dramatic action being needed, a moderate reduction in reserve requirements would not be interpreted as evidence that the Board believed the situation was critical but rather as a step of a moderate character that would make for stability rather than drastic decline. On balance, he would favor the use of reserve requirements under the conditions he described.

Mr. Ringland agreed with Mr. Alexander's feeling that over the country as a whole, and particularly in the business community outside the banks, a reduction in reserve requirements would have a greater psychological effect than open market operations.

In response to a question from Governor Evans, Mr. Fleming noted that the Council's reply to this question indicated that the System should take the lead in easing the situation by first using open market operations, but that it should be ready to move on reserve requirements if that seemed necessary. He did not think that outside the financial community much attention was paid to open market operations but a move to change reserve requirements would be on the front page of the papers and would have considerable effect on other parts of the business community.
Mr. Gund felt, on the other hand, that the Board should be cautious in changing reserve requirements, that just because the move in June had been successful the Board should not "rush to the fire too quickly again". He felt that it would be a mistake to have changes in reserve requirements come too quickly and that, in fact, frequent changes might have a negative and bad psychological effect.

Mr. Smith agreed generally with Mr. H. C. Alexander that a case could not be made for a reduction in reserve requirements at this time but he felt that such action should be kept in mind for possible use later on.

Mr. Wallace felt that it would be of considerable help if banks could be given some indication that, if a situation developed during the fall months where they needed funds, they would be able to borrow from the Federal Reserve on a reasonable basis. He was inclined to think that a further reduction in reserve requirements should be held in reserve until the banks had exhausted intermediate steps such as use of discount facilities.

Mr. H. C. Alexander expressed the view that if the Board were to consider that a reduction in reserve requirements would create a psychology of fear, it would never reduce them. He reiterated the view that such a reduction would generate confidence rather than fear because it would indicate that the situation was in hand and, while at the moment he could not make a case for it, he felt that it might well be that he
would be able to do so as the fall progressed.

Chairman Martin said that the matter could be debated on both sides, that it was clear that monetary actions alone could not do the job, either in restraining inflation or stemming deflation.

At the conclusion of the discussion, Chairman Martin made the statement that the comments which had been made by the members of the Council at this meeting and at other meetings had been of great value to him and to the other members of the Board in getting the feel of things throughout the country in a way which otherwise could only have been gotten by large numbers of interviews with many bankers and others in all parts of the country.

Governor Vardaman stated that this meeting had been particularly helpful to him and that he appreciated greatly the frank manner in which the members of the Council expressed their views with respect to the matters discussed with the Board. He added that this was an indication to him that the working relations of the Council and the Board were on a more effective and cooperative basis than had been the case at times in the past.

Governor Vardaman withdrew from the meeting at this point.

3. What, if any, suggestions does the Council have as to legislation that the Board might support or sponsor in the forthcoming session of the Congress?

A similar item appeared on the agenda at the meeting of the Board and the Council in February. At that time, the Council stated that it would favor legislation (subsequently passed) 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 also stated that it would 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.

The Council does not know what legislation the Board may wish to support or sponsor in the forthcoming session of the Congress. If the Board will advise the Council as to what legislation it contemplates proposing, the Council will be pleased to express its views regarding the legislation at the meeting with the Board in November.

President Brown said that the Council did not know of any legislation of importance that was up for serious consideration and which would have a chance of passage unless, possibly, it would be bank holding company legislation. There were as many views in the Council on holding company legislation, he said, as there were members of the Council. He also noted that the Council had recorded its specific opposition to reinstating authority for regulation by the Board of Governors of consumer credit.

Chairman Martin stated that the Board's question was intended to get any views of the Council as to legislation it might be desirable for the System to attempt to obtain. He went on to say that the Board had no proposals for legislation at this time and he did not know whether it would have, but if and when it developed a legislative program, it would be submitted promptly to the Federal Advisory Council for comment. Chairman Martin also said that the Council had been very helpful in getting additional authority for building and modernization of Federal Reserve Bank branch buildings at the last session of Congress and that the program for such construction was going ahead. With respect to any possible new legislation, Chairman Martin mentioned that, although the Board had no proposals at this time for legislation, he personally thought it might
be time to consider legislation with respect to salaries of members of the Board of Governors so as to bring them better into line with salaries paid other Government officials.

Mr. Fleming stated that the Advisory Council would be very happy to have something done to restore the position of the Board members' salaries to a more satisfactory level in relation to other Government agencies, that it was very much opposed to placing the Board members' salaries at the level provided in legislation enacted in 1949 (Public Law 359, 81st Congress). Mr. Fleming said that he understood legislation might be proposed at the next session of Congress increasing salaries of Federal judges and retirement benefits for their widows, and he mentioned that in that event it might be possible to do something about salaries of members of the Board of Governors at the same time.

President Brown said it would be helpful, if the Board decided on legislation concerning which it wished the Council's views, to send copies of the proposals to the members of the Council sufficiently in advance of the Council meeting so that the members would have an opportunity to consider the proposals before they met for a discussion in Washington.

Chairman Martin responded that the Board would follow this procedure as far as it was possible to do so. He also said that while the Board was making a general study of reserve requirements, there was no unanimity of views at this time regarding changes that would
be desirable and no proposal for legislation had been considered by the Board.

President Brown stated that the next meeting of the Advisory Council would be held on November 15, 16, and 17.

Thereupon the meeting adjourned.