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 16, 1954, 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. Ireland, Alexander, Smith, Gund, Fleming, Davis, Brown, Campbell, Ringland, Chandler, Matkin, and Wallace, 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

At its earlier separate meeting, the Federal Advisory Council re-elected Mr. Brown as President of the Council, Mr. Fleming as Vice President, and Mr. Prochnow as Secretary. Messrs. Alexander, Smith, and Gund were elected to serve with Messrs. Brown and Fleming, ex officio members, as members of the executive committee of the Council.

President Brown stated that about 20 years ago the Secretary of the Federal Advisory Council was authorized to draw $350 a year from each of the Federal Reserve Banks for the purpose of defraying the costs of the Secretary's office of the Council and that this annual payment had remained unchanged up to the present time. Most of this sum represented salary paid to the Secretary of the Council, but other costs included postage, telephone and telegraph service, printing, and expenses of meetings of the Council four times each year. After commenting briefly on some of the increases in costs that had taken place since the earlier authorization was given, President Brown stated that the Council recommended that the Board authorize each Federal Reserve Bank to honor a draft in the amount of $450 annually to cover the costs of the Secretary's office of the Council, beginning with the year 1954.

Chairman Martin stated that the Board would give consideration to this request.

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. The Board would like to have the comments of the members of the Council on the prospective business and economic situation during the next six months and the probable volume of bank loans during the period. What are the principal reasons for the large reduction in bank loans since the turn of the year?

There are some differences in the prospective business and economic situation in the various Federal Reserve districts, but the major economic trends are essentially similar.

The rapid rate of inventory accumulation in the first half of 1953 came to an end in the final quarter of the year. Virtually all categories of goods are now in full supply, and most businesses are endeavoring to reduce inventories. A leveling off of the present economic downtrend, or any upturn in over-all business activity, will depend largely upon when the present liquidation of inventories ends.

The increase in unemployment, especially in manufacturing, is reflecting itself in lower payrolls. Carloadings are down considerably, which results in the postponement of purchases of equipment and of other capital expenditures by the railroads. A generally expected lower automobile production is an additional factor emphasizing the probable continuance of the present downturn through the first half of 1954. Retail sales recently have shown some decline, but generally they have held up well. Should the demand for goods, especially as expressed in consumer buying, markedly decline, the rate of business downturn would accelerate. Over-all new construction, despite some decline in residential building, has held up well, and is a strong factor in sustaining business.

The members of the Council expect business activity to continue to decline in the first half of 1954. There is at present no significant evidence either of a leveling off in the rate of the present downtrend, or of the rate of decline increasing sharply or spiraling.

The large reduction in loans since the turn of the year is the outgrowth of a number of economic forces in addition to those which normally result in a seasonal decline in bank credit. A year ago, inventories were being substantially increased, whereas they are now being reduced. Early last year, business also was more active and required more bank credit. Lower agricultural and livestock prices, compared to a year ago, have likewise lessened the demand for loans. Present low interest rates are causing some large borrowers to refund short-term bank credit into long-term loans.

A minor factor in the reduction of bank loans has been the termination of the excess profits tax. Some business concerns borrowed more freely than normally to increase their tax base. This incentive no longer exists.

In view of the probable continuance of the downtrend in business activity in the first half of 1954, members of the Council anticipate a further decrease in the volume of bank credit for commercial, industrial and agricultural purposes, and no increase in total of other types of loans.

President Brown commented along the lines of the Council's written answer to the question regarding prospective business and economic conditions. He stated that in the judgment of the Council there would be very little spring rise in business activity this year and that the members of the Council did not believe that an up-turn from the current recession would take place during the first half of 1954. The Council members from the Boston and Minneapolis districts reported that the decline did not appear to be increasing in their areas, he said, but the members from the other 10 districts indicated the decline was continuing at an arithmetical rate - not at a geometrical rate. President Brown went on to say that the Council did not believe that the economy would reach a plateau in activity until there had been some solution to the farm problem. He noted that unemployment had not been very severe to date, stating that cut-backs in production for the most part had taken the form of reductions in overtime rather than complete lay-offs of large numbers of workers. Larger lay-offs would occur, the Council felt, and further reductions in take-home pay would follow. President Brown commented that virtually every category of goods was in ample supply and most manufacturing and retailing establishments were trying to reduce inventories. There was no incentive for either retailers or manufacturers to buy at this time, he said, but if consumer buying holds up, sooner or later inventories will get down to a point where replenishment would cause an up-turn in orders and production.

President Brown stated that while the Council did not feel that an up-turn would occur during the first half of this year, he would not wish to have the Board understand that the Council was pessimistic about the outlook. None of the members of the Council felt that there was any danger of the decline increasing very markedly or rapidly. With respect to the probable volume of bank loans, President Brown stated that the liquidation of inventories had been a factor causing loans to go down, that there was nothing now to indicate that commercial or industrial loans would rise in the near future, that in fact they probably would decrease with a continuance of the downward movement in business, that consumer credit is likely to decline further, and that loans for residential building may be expected to show little change.

Mr. Alexander stated that he was more pessimistic now than in mid-November of 1953 and a little more so than at the beginning of this year. He did not wish to be a "fear dealer" but felt it necessary to discuss the situation frankly. He felt the situation was one with which the Council should feel concerned, the basis for this feeling being the substantial increase in unemployment figures. He cited several industries in which unemployment appeared to be quite serious, noting that it was becoming worse rather than better and that considerable unfavorable publicity was being given to some situations. Mr. Alexander cited the automobile industry as one which was having a disappointing experience in comparison with the expectations at the beginning of this year. It was his view that the sustaining elements of defense expenditures and industrial spending for plant improvement would be helpful but would not give the forward push that would lift the economy out of what seems to be a tendency to lead a normal course of inventory liquidation, production cut-backs, and unemployment. Mr. Alexander stated that aggregates might show that activity was fairly well sustained but that they would cover up some areas in which conditions were quite bad, and he felt especial concern about publicity that may develop regarding sore spots in the economy, particularly unemployment. While he did not expect the economy to get into a downward spiral, Mr. Alexander felt there was enough chance of such a development to warrant the use of Governmental influence, including the instruments of monetary policy, to guard against the possibility.

Mr. Wallace then made a statement with respect to conditions in the West Coast area in which he stressed the importance of the raw materials industries of that region. He stated reasons why he felt it would be desirable as a matter of national policy if the Federal Government would support the extractive industries of the country, at least some of which are now faced with further substantial curtailment in output with accompanying reductions in payrolls and shifting of workers formerly employed by such industries as zinc, lead, and copper mining.

Mr. Ireland said that while the decline in New England had not stopped, there seemed to be some evidence that it might be leveling off.

President Brown inquired as to the views of the Board's staff regarding the economic outlook and Chairman Martin responded that he did not think that anyone in the Board's organization was an "alarmist" as to the current decline in activity, that the recession had gone about as might have been expected, and that as far as he personally was concerned, he saw no danger signs of a spiraling downward movement such as Mr. Alexander mentioned as a possibility. Chairman Martin emphasized that on the whole the adjustments had been healthy even though there were sore spots in the economy and these might be expected to increase. He noted that waste, extravagance, and inefficiency were bound to develop in an economy which had worked at the high levels that had existed for some years in this country, that people had come to accept these developments, and that adjustments to eliminate them were not readily accepted. He felt that consumer savings and resources were still adequate to sustain a high level of economic activity, adding, however, that it was impossible to gauge psychological factors. His judgment was that the momentum of the economy was still good and he, personally, was sincerely optimistic about the outlook even though it might be necessary for the economy to run through a period with substantially larger figures of unemployment.

Mr. Fleming then inquired as to Governor Evans' views on the agricultural situation.

Governor Evans made a statement in which he reviewed some of the background of the agricultural price support program and commented upon recent changes in this program. It was his view that if farmers were encouraged to increase production to meet a need such as that arising out of the war in Korea, it was proper and desirable for the Government to take surplus production off the market by storing it or using it in such a way that it would not interfere with normal marketing operations.

2. What are the views of the Council with respect to the System's credit policy since the preceding meeting of the Council? Does the Council have any suggestions as to what the System's policies should be in the months immediately ahead? Does the Council foresee a situation in the near future which would call for a reduction in the discount rate or a further reduction in reserve requirements?

The members of the Council believe that the Open Market operations of the System since the preceding meeting of the Council and through the greater part of January were helpful to the economy. The Council appreciates the difficulties which confronted the Open Market Committee in January as a result of the exceptionally heavy flow of currency to the banks, the unusually large contraction in loans, and the substantial increase in float because of weather conditions. However, since the latter part of January, Open Market operations seem to the members of the Council not to have been timed as effectively, nor to have produced results as satisfactory, as on other occasions in recent months.

At a time when bank loans are decreasing, the Council is of the opinion that it would be proper policy to sell bills to an amount approximately offsetting the decline in loans. The action of the Open Market Committee in the latter part of January seemed to be in accord with this viewpoint. The policy later of accumulating bills despite the decline in loans was the principal factor in the bill rate going to yields which the Council believes represent undesirably cheap money. The Council would like to reiterate the views it expressed in November that the danger of disturbing the economy by making money unduly and artificially cheap is as great as the danger of restricting business by too high interest rates, and a consequent reduction in the use of credit.

The members of the Council believe that with business continuing to decline, an easy money policy making credit readily available to desirable borrowers at reasonable rates is advisable. However, we reiterate that the economy should not be disturbed by making money unduly and artificially cheap.

The Council is sharply divided in its opinion as to whether the recent reduction in the discount rate was desirable. However, the Council is of the belief that there is no situation foreseeable in the near future which would call for a further reduction in the discount rate. The large majority of the Council does not foresee a situation in the near future which would call for a further reduction in reserve requirements.

President Brown stated that the Council agreed with pursuit of an easy money policy in this period, but that it questioned how low interest rates should be permitted to go. He knew of no business that was being held back because of costs of credit or difficulty of getting it at this time. The Council believed that excessively cheap money would encourage speculation in real estate, securities, and consumer goods. President Brown said that Mr. Alexander would express himself separately on reserve requirements but that, generally speaking, the Council felt that with money as easy as at present, a reduction in reserve requirements might be misconstrued as indicating that the Board felt the business decline was much more serious than was indicated. In response to a question from Chairman Martin, President Brown went on to say that he felt the present discount rate of 1-3/4 per cent was not a penalty rate.

Chairman Martin, in response to a question from Mr. Chandler, reviewed the background of the recent reduction in discount rates of the Federal Reserve Banks, noting that the suggestion for such a decrease came originally from an interior Federal Reserve Bank, that the matter was discussed at considerable length and that the reason for the reduction in the rate was largely to bring it into line with market rates. He also stated that the purpose of the reduction in discount rates was not to put pressure on the prime lending rate of commercial banks.

Mr. Gund inquired whether the Board had given consideration to consulting the Federal Advisory Council before it took action to approve a change in the discount rate, and Chairman Martin responded that this was a difficult operation which already involved the directors of twelve Federal Reserve Banks. He explained that discussions might extend over a period of weeks before a decision was made as to whether something should be done. Once a decision had been reached, it was desirable to get the announcement to the press and to the public as promptly as possible. While he had considered advising President Brown of the intended action, he had decided against doing so.

Mr. Smith stated that while the decrease in the discount rate may have been of some psychological importance, he did not think, in view of the supply of reserves in the market, that it was sound for the discount rate to have been reduced just for the purpose of bringing it into line with the bill rate.

During a further discussion of this question, Mr. Davis stated that flexibility in open market operations was desirable but that he felt this was a good time for more stability than the market has had. He agreed with Mr. Smith and stated that there was plenty of money available for banks to lend, that every effort was being made to lend it, and that while the lowering of the discount rate may have been well intended, any further reduction could have a bad result. He hoped that for some time to come the money market would not be upset or changed radically.

Chairman Martin responded by stating that he did not wish to give the impression that the reduction in the discount rate was purely for psychological reasons; the old rate was badly out of line with the money market and an adjustment was in order to restore its relationship to other rates.

Mr. Alexander stated that he felt the reduction in the discount rate was proper, although he did not think it was a very important factor in so far as actual discounts were concerned. Treasury bills had gone to a very low yield and there was an artificial situation which gave a confused indication of policy with such a large differential between that rate and the discount rate. Mr. Alexander said that he would go a little farther than other members of the Council in connection with reserve requirements. He felt, generally speaking, that reserve requirements were too high and if this position were corrected and if there was anything to the potential value of cheap and easy money in the economy, the time to have an easy money policy was when deflation started in. He did not think that only one instrument or two instruments of credit policy should be used; he would take a good look at use of all three major instruments, including change in reserve requirements. If the economy continued its present trend downward even at a fairly orderly rate, Mr. Alexander was inclined to give serious consideration to a reduction in reserve requirements. At certain times, it was better to put additional funds into the market by reducing reserve requirements rather than by open market operations, because such a reduction had a widespread and instantaneous effect on improving the position of banks throughout the country. Mr. Alexander stated that he did not believe in taking any chances on the current down turn, that while he was not a long-term pessimist in any sense, and while he felt the economy would come along all right, he did not believe it desirable to have the current adjustment too deep or too wide. He would lean in the direction of keeping the money and credit situation easy and felt it preferable for the System to be ahead of the need in using its credit instruments rather than too late. This was true, he said, even though he realized these actions would have an effect on the rate structures of the commercial banks. It had been at his insistence, he said, that the Council had included the reference to reserve requirements in the answer to this question and for his part he thought it might well be that in the foreseeable future the Federal Reserve should take a step toward reducing reserve requirements. If that were done and the situation became too easy, the System could readily tighten it through the open market.

Mr. Fleming stated that he found himself in disagreement with Mr. Alexander at this time, that he could not now see a need for a reduction in reserve requirements, that loans had declined and there was no legitimate demand for credit that was not being met so far as he was aware. While he could see no useful purpose in reducing reserve requirements presently, he recognized that the time may come when a reduction in reserve requirements might be considered, even though it would have a further effect on the rate structure.

Mr. Gund felt very strongly that reserve requirements should not be reduced at this time, indicating that he concurred in the approach of Mr. Fleming to the effect that while the matter should be studied, any action to reduce reserve requirements at present would be misinterpreted as reflecting a feeling on the part of the Board that the situation was more serious that it really was. Mr. Smith concurred in this statement.

Mr. Campbell commented that he felt the Board should use its power to make money available for lending and to avoid having bankers feel uneasy about making sound, liquid advances.

Mr. Matkin expressed views similar to those stated by Messrs. Fleming and Gund, although he said he could still understand Mr. Alexander's point of view.

During a further discussion, Mr. Alexander stated again the view that it was important that the psychology of the country be one of wanting to produce and of having the funds available for production. He felt a decrease in reserve requirements might be a helpful factor in producing this psychology. There should be not only a stable but a growing economy, he said. The argument that a reduction in reserve requirements might have an unfavorable psychological effect amounted to saying that reserve requirements should never be reduced in a period of deflation since such a reduction would aggravate the recession.

President Brown stated that the next meeting of the Federal Advisory Council would be on May 16, 17, and 18, 1954.

Thereupon the meeting adjourned.

S Carpenter
Secretary