A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the offices of the Board of Governors in Washington on Tuesday, May 18, 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

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 is the attitude of the Board of Governors of the Federal Reserve System on the question of using Federal Reserve funds for standby credits, as indicated in the Report of the Commission on Foreign Economic Policy (Randall Commission Report)?

The members of the Council would appreciate an expression of the Board's current views on this subject, although the Council understands that the opinion of the Board at a later date might well depend upon such factors as world political and economic conditions, the amount of the standby credits requested, and the terms of the credits suggested at the time when definite proposals were under actual consideration.

All members of the Council believe that under present world conditions it would be unwise for the Federal Reserve System to participate in standby credits for amounts as large as have been suggested. A majority of the Council believes that if standby credits are sought in excess of the amount available through the International Monetary Fund, the additional credits should not be obtained from the Federal Reserve System, but from the Treasury or some other source.

After reading the above question and the Council's statement, President Brown commented on his understanding with respect to the suggestion made in the report of the Commission on Foreign Economic Policy (Randall Commission) regarding the possibility of standby credits by the Federal Reserve Banks to assist in the attainment of general currency convertibility. He referred to a suggestion that, if such credits were extended, the amount might run to as much as $1.5 billion which would exceed substantially the total capital accounts of the twelve Federal Reserve Banks of around $1 billion. President Brown said that the Council felt that extension of standby credits to foreign central banks in anything like the amount mentioned might be misunderstood by bankers and the public generally with the result that there would be an impairment of confidence in the Federal Reserve System, and he inquired as to the Board's views on the matter.

Chairman Martin responded by stating that the Board had not taken a position with respect to such credits, that it had deliberately and carefully refrained from taking a position on the matter and had kept an open mind on the question. He stated that in view of the suggestion made in the report of the Randall Commission, there had been discussion of the subject, particularly consideration of whether there was legal authority for such credits. Chairman Martin went on to say that while the Board had taken no position either opposing or favoring credits of the type suggested in the Randall Commission report, he personally was inclined at this time to take a dim view of the proposal and had expressed that view to others with whom he had discussed the matter although he had not discussed it with Mr. Randall or with members of that Commission.

At Chairman Martin's request, Governor Szymczak commented upon the studies made by members of the Board's staff and the staff of the Federal Reserve Bank of New York regarding the historical and legal aspects of such credits. He reviewed the experience of the Federal Reserve System in granting certain credits in the 1920s to foreign central banks, none of which were used, and stated that staff studies indicated four means by which the System could be considered to have legal authority for granting such credits. Governor Szymczak went on to describe the situation now existing as compared with the situation which existed in the 1920s, calling attention to the fact that in view of the establishment of the International Monetary Fund and the arrangement whereby the United States Executive Director of that Fund receives general instructions from the National Advisory Council, the question of any position to be taken by the Fund on assisting in currency convertibility would come before the National Advisory Council.

Chairman Martin stated that he had taken the position that before the Board would discuss with representatives of any foreign central bank the question of any credits of the type proposed it would wish to be assured that the program of the country in question was sound and that appropriate persons in the United States Government felt it desirable for the Federal Reserve System to go forward with such discussions.

Mr. Alexander stated that he was not shocked by the proposal for credits such as were mentioned in the Randall Commission report. He felt sure the Board would not consider such credits if they were objectionable to the United States Government any more than a commercial bank would consider making such credits available if they would be objectionable to the Government. If, however, the establishment of some form of foreign credits were not objectionable to the United States Government and if the Federal Reserve System were to think in terms of a credit in a proper amount with proper safeguards, he would not be averse to their consideration. Mr. Alexander pointed out that the objective of currency convertibility would aid United States trade and he felt that if credits needed in establishing convertibility were handled by the central bank rather than directly by the

Federal Government, the likelihood of considerations of a political nature might be reduced.

Mr. Fleming felt certain that if the Congress were unwilling to authorize the Treasury to make credits available along the lines proposed it would be undesirable for the Federal Reserve System to grant such credits without some form of authorization by the Congress.

President Brown said the Council would be assured by the discussion that the Board of Governors would not act precipitately in the matter.

2. What are the views of the Council with respect to (a) prospective business and economic conditions during the next six months and (b) probable changes in the total volume and purposes of bank loans in that period?

(a) Economic trends vary somewhat from district to district and from industry to industry. However, the members of the Council believe that the rate of business decline over the country generally has lessened, and there are indications that the decline is leveling out. The sentiment of businessmen as to future prospects has improved markedly in the period since the last meeting of the Board and the Council, and there is much more optimism.

Better moisture conditions over a wide area have materially brightened the prospects for farmers, and in turn for the many concerns from which they buy. Construction activity has been greater than was anticipated and continues to be one of the strongest single factors supporting the economy. With the increased optimism over business prospects, construction promises to continue at a high rate, offering encouragement for the future. The Council believes that business activity in the next six months will probably not change greatly from present levels, and that changes will mainly reflect seasonal trends.

(b) The volume of bank loans has been better maintained than was expected by the banks earlier in the year. Apart from seasonal trends, the Council does not anticipate any major change in the total volume of bank loans in the next six months. The Council also does not expect any major change in the purpose of bank loans, other than an increase in the proportion of credit extended for construction.

The foregoing views on business conditions and on bank loans are necessarily predicated on the assumption that there will be no significant change in world affairs. Should a situation develop similar to that which occurred in Korea, it would probably result in another burst of feverish business activity.

President Brown stated that the Council's review of the economic situation brought out the feeling that the decline recently had not been as severe as would be indicated by statements of proponents of immediate action by the Federal Government to stem the decline. The members of the Council believed the decline in activity was still continuing, but it was at a reduced rate and some members believed it had reached a bottom. Barring some unfortunate international development, President Brown stated, the Council felt that in another six months or so the economy would definitely begin to turn upward. The outstanding feature of the economic situation was the widespread strength in construction activity - residential, business, and public - which had been much greater than had been anticipated a few months ago, even by persons in the construction industry. He added that businessmen generally in all parts of the United States were very much more optimistic at the present time than they were 30 to 60 days ago. This, he felt, had an important bearing for the future in that it encouraged management to go ahead with expansion plans. President Brown noted that rains had occurred in a large part of the south, mid-west, and southwest during the last two months, and that these had had an important influence in improving the outlook in the agricultural areas. As to the volume of bank loans, President Brown stated that the Council felt that any contraction in loan volume resulting from repayment of Commodity Credit Corporation loans would be offset by other loan demands. While he personally would be glad to see some further reduction in instalment loan credit, there was a general feeling that credit for use in connection with construction and business generally appeared likely to increase.

Chairman Martin stated that a year ago the Board was attempting to make a projection of the additional bank reserves that would be required between then and the end of the year in order to meet needs of the Treasury, seasonal requirements of business, and the growth factor in the economy. He noted that last year the Board had projected the increased need for reserves between May and the end of the year at around $2.5 to $3 billion and that the funds put into the market by the System during that period were partly responsible for a marked decline in interest rates for the reason that loans did not expand as much as anticipated. He added that the Board was working on a similar projection at the present time but that the problem was extremely difficult because of the shifting factors involved. He felt it hazardous at this point to attempt to make any firm projections of reserve requirements for the rest of 1954, but he stated that it was helpful to have the views of the members of the Council with respect to the attitude of businessmen and the elements of strength or weakness in the economy. In response to a question from Mr. Fleming, Chairman Martin said he had the impression that the level of defense expenditures of the United States had about reached a bottom and that, if anything, they would be apt to increase in the months ahead.

In response to a question from Mr. Chandler as to liquidation of inventories and whether this liquidation had progressed more or less rapidly than he had anticipated last February, Chairman Martin stated that he still felt that inventories were too high and that prices had not been reduced as much as might be expected in a period of liquidation of excess inventories. However, the downward trend was in the right direction.

Mr. Fleming expressed the view that psychology played a large part in the business outlook and he commented that whereas economic indicators showed a decline from the levels of the spring of 1953, it should be noted that many of the indicators were above the levels of 1951 or 1952.

In response to Chairman Martin's question as to whether there were any areas in the country in which there was a shortage of mortgage funds, several of the members of the Council expressed the view that there was no such shortage in their areas or other areas with which they were familiar and, in fact in some cases mortgage loans, both large and small, were being granted at lower rates of interest and on more liberal terms than at any time in the past.

Mr. Matkin commented that while this general situation with respect to real estate loans was true in the Eleventh District, there was some evidence of shortage in construction loans growing out of the limitations placed on such loans in relation to capital of national banks.

Mr. Davis stated that there was plenty of mortgage money available in the Atlanta District. Returning to the question of inventories, however, he expressed the view that the optimism and confidence in the business outlook, to which reference had been made, was a factor which was encouraging some manufacturers to build inventories rather than close their plants and was resulting in maintenance of higher inventories than might be desirable, especially in view of the negligible adjustments that had been made in prices of many goods for which inventories were heavy.

Chairman Martin stated that this expressed well the views he had in mind in responding to Mr. Chandler's inquiry.

3. Does the Council have any suggestions to make with respect to (a) existing System credit policies, (b) the policies that might be followed during the next several months, or (c) the manner in which these policies should be carried out?

(a) The Council believes that existing System credit policies are sound and helpful to the economy. However, the Council is of the opinion that it is desirable to so conduct open market operations that the rates on bills will not fall to as low levels as have prevailed recently.

(b) Before the end of calendar 1954 the Treasury will require a substantial amount of new funds. If the greater part of this new financing is to be done by the banks, as now seems inevitable, it will be necessary to supply the banks with considerable additional reserves. These reserves can be provided by open market operations, by a reduction in reserve requirements, or by a combination of the two methods. A reduction in the rediscount rate would not accomplish the objective, as banks generally would not borrow funds in the amounts that will be required.

To the extent that the banks will be expected to purchase the new issues, the Council believes that the additional reserves required should be provided mainly through reductions in reserve requirements appropriately timed with Treasury offerings for new money. Any small differences between the amount of the additional reserves required by the banks, and the amount made available by a reduction in reserve requirements, should be handled by open market operations.

Any reduction in reserve requirements should be kept as nearly as possible to the amount of additional reserves required by the banks to enable them to absorb the new issues so as not to increase the money supply unduly.

How the suggested reduction in reserves should be made, as between central reserve city, reserve city, and country banks, is a matter for the Board to determine.

(c) The manner in which these policies should be carried out is largely covered by the Council's answer to part (b) of this item of the agenda. The Council believes that for the present at least, and unless conditions materially change, the Federal Reserve System should continue the policy it has been following of confining its open market operations to short-term Government securities.

President Brown stated that it was the view of the Council that under the present economic system the policy of the Federal Reserve in making money easy was sound, and that it was helpful in stopping the decline in and improving the prospects for business. Realizing the difficulties in timing of open market operations, President Brown felt that money should not be made so cheap as to be a drug on the market. While the Council favored low bill rates, President Brown felt that a rate as low as .71 per cent was too low. The Council would not care to have the rate go back up above 2 per cent as it had a year ago but felt that operations in the open market might be conducted in a manner to have the rate higher than recently has been the case.

President Brown then commented on prospective Treasury needs which he felt would probably call for a large cash offering by the Treasury in late summer and another in mid-fall, aggregating around $10 to $11 billion, most of which would have to be taken by banks of the country. It was his view that if banks were to handle the Treasury financing it would be necessary that they be supplied with somewhere around $1 billion of reserves, in addition to $1 billion to meet seasonal withdrawals of currency, that most of this should be supplied through a reduction in reserve requirements of member banks, and that the System's open market operations should be prepared to absorb any excess reserves that got into the market or to supply additional reserves that might be required if the reduction in reserve requirements were not sufficient to meet the needs of the Treasury. President Brown then stated that while the Council had taken no position with respect to how reserve requirements, if reduced by the Board, should be changed, it had discussed possible changes and whether reduction should come at central reserve city, reserve city, or country banks. After commenting upon various methods by which reserves might be changed, President Brown expressed the view that it would probably be necessary in the event of a reduction in reserve requirements to change the level at each class of banks even though it appeared that central reserve and reserve city banks would be the ones which would carry the bulk of the burden of meeting the Treasury's financing requirements.

Mr. Wallace said that if new Government issues were not designed for country bank investment, their funds would go to correspondent banks which would buy the issues offered; however, country banks would like to have an opportunity to take a substantial part of the financing and would want a release of reserve funds to the country banks as well as other banks.

Mr. Alexander concurred in general with the comments made by President Brown and said he would not be afraid of letting a reduction in reserve requirements "spill over a bit" and thus provide the market with some additional reserves. He also referred to the statement in the Council's memorandum to the effect that unless conditions changed materially, the Council felt that the Federal Reserve System should continue the policy it has been following of confining its open market operations to short-term Government securities, and stated that, while he felt this appropriate under present conditions, he also thought there was merit to the point of view that the Federal Open Market Committee should not be bound by a decision that under any and all conceivable conditions open market transactions must be limited to the short end of the market.

Chairman Martin inquired of Mr. Alexander as to how the System could distinguish between operations which would produce "active ease" and those which would bring about undesirable "sloppiness" in the money market.

Mr. Alexander stated that he recognized the difficulty of carrying on open market operations, that as he had said before, he felt the action of the System in reducing reserve requirements and in making reserve funds available in 1953 was almost perfectly timed, that the handling of the discount operations and open market operations during the fall of 1953 was just about right, and that the fall requirements for additional credit simply did not come up to the expectations on which the Federal Reserve had based its operations. Conditions in the money market in late fall had been too easy but it was not possible to calculate with exact precision the needs of the market. Mr. Alexander stated that, taking the situation as a whole, he felt a great deal better about the outlook at the present time than at the time of the meeting of the Council in February, that the decline in economic activity had been slower than he had then feared, and that inventory adjustments had been at a slower rate than had seemed possible. Mr. Alexander added the comment that he felt the international situation was becoming a very important factor in the economic outlook, that it was causing many businessmen to feel that it might be desirable to have some inventory on hand, and that it was having an effect on public thinking. As to the credit policy that should be followed, Mr. Alexander concurred in the views expressed in the Council's memorandum and by President Brown, feeling that any rough spots which might develop in the money market could be smoothed out through appropriate open market operations.

Mr. Campbell expressed the view that country banks would understand that a reduction in reserve requirements later this year was for some definite reason and that they would wish to take their relative proportion of any Treasury financing that might be expected to be carried by the banks of the country.

Mr. Ringland stated that, while he was sympathetic to the view that central reserve city banks had their problems, it was difficult for him to understand why they needed any more relief from present reserve requirements than reserve city banks.

Mr. Chandler referred to the comment made regarding open market procedures, stating that he heartily supported the procedure of confining purchases for the System open market account to the short end of the market, and that only under very unusual circumstances would it be desirable to depart from that procedure.

Governor Robertson said that he wished to correct an implication in Mr. Alexander's comment that he agreed with the position, recently expressed publicly by Mr. Sproul, Vice Chairman of the Federal Open Market Committee, that the Federal Open Market Committee should not have a mandate prohibiting the Committee from operating in any but the short end of the Government securities market. Governor Robertson stated that, in fact, the Federal Open Market Committee had not adopted any such mandate, but merely an operational procedure which was subject to change at any time by the Committee. He said that this feature was not only clearly expressed in the resolution to which Mr. Alexander and Mr. Sproul referred, but that it was expounded on at length at the meeting at which the resolution was adopted.

Chairman Martin stated that he had not intended to comment on this point but that since it had been brought up he would like to make it clear that there was no intention in the actions of the Federal Open Market Committee, published in the record of policy actions contained in the Board's Annual Report for 1953, to adopt a fixed and unchangeable policy of confining transactions to the short end of the market. The real problem, Chairman Martin said, was the degree of authority to be given by the Federal Open Market Committee to the securities desk of the bank executing transactions for the System account. The Federal Open Market Committee, he noted, could meet at any time and change any of its policy decisions, including the procedure to be followed in carrying out open market policy.

Mr. Fleming referred to a copy of a letter which he had received from Mr. Horbett, Assistant Director of the Board's Division of Bank Operations, dated May 4, 1954, transmitting copies of memoranda for the use of Dr. E. Sherman Adams, Deputy Manager of the American Bankers Association, in connection with a study of reserve requirements being made by the Association's Credit Policy Commission. He noted that the letter which Mr. Horbett had written indicated that the matter would be reported on at the next meeting of the Federal Advisory Council with the Board.

Governor Mills stated that information regarding uniform reserve requirement proposals had been furnished to Dr. Adams to assist in his study and that it was felt appropriate to inform the Federal Advisory Council that the Board was cooperating with the American Bankers Association by providing this information.

Governor Szymczak commented further that in past years it had been felt that matters which might affect banks or banking would be of interest to the members of the Federal Advisory Council and that this was brought to their attention for that purpose.

Mr. Fleming then suggested that copies of the tabulations furnished to Dr. Adams by Mr. Horbett would be of interest to the members of the

Federal Advisory Council who had not previously had the benefit of discussions of the uniform reserve requirement proposals and that all members would be interested in receiving copies of the most recent tabulations contained in Mr. Horbett's letter.

Chairman Martin stated that the Board would be glad to furnish material relating to the problem of uniform reserve requirement proposals to members of the Federal Advisory Council in advance of the Council's next meeting. In a further comment, Chairman Martin expressed the view that the System should go forward with a study of the whole problem of reserve requirements, and it was his hope that the Board would be in a position to present something to Congress early in the next session.

President Brown stated that the next meeting of the Council would be held on Sunday, September 19, 1954, and that it would plan to meet with the Board on Tuesday, September 21, 1954.

Thereupon the meeting adjourned.

Secretary