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 15, 1955, at 10:30 a.m.

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

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary

Messrs. Ireland, Alexander, Mitchell, Denton, 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

President Brown reported that 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. Ireland, Alexander, and Denton were elected to serve, with Messrs. Brown and Fleming, ex officio, as members of the executive committee of the Council.

Before this meeting the 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 business and economic outlook throughout the winter and spring months and the probable demand for bank loans in that period compared with the same period in 1954.

Business activity generally is at a high level in all the districts. The automobile and construction industries, which affect the production of many other major industries, especially steel, are in a significant measure responsible for the increased volume of business in recent weeks. Retail sales are good. Inventory accumulation is moderate. Consumer demand is strong, and business sentiment is favorable.

The members of the Council believe that the business and economic outlook for the winter and spring months is good. In most of the districts it is expected that loans for business and commercial purposes will be slightly less than in the first half of 1954. But an increase in loans on real estate, for consumer credit, to investment dealers, and to mortgage bankers to finance new construction will more than offset any decrease in business and commercial loans so that total bank loans for the winter and spring months will be slightly above the preceding year, with some variation probable from district to district.

President Brown said that in the 19 years he had served on the Federal Advisory Council, he had never known of a situation when the members were as unanimous in predicting good business in the months immediately ahead as they were at this time. All of the members were very thankful, he said, that the Board had not asked about the second half of 1955 since many of them had severe doubts as to what would happen in that period. This feeling principally centered around the fact that they felt there would be a severe reduction in automobile production, either because of a strike or because the industry could not sell as many automobiles during the year 1955 as would be built if the current rate of production continued. Such a reduction in production, whether as a result of a strike or because more cars were being produced than could be sold, would affect the steel and other supplier industries. The Council believed that this was almost certain to occur by mid-year, President Brown said. With respect to the construction industry, President Brown recalled that at its meeting last November, the Council felt that activity might begin to subside by mid-1955. Now the Council felt that the high current level of construction might continue throughout 1955.

Turning to demand for loans, President Brown said that Council members from one or two districts thought the demand for commercial and business loans during the first half of 1955 would be greater than a year ago, but all others thought that commercial and business loans this year would be slightly less than in the first half of 1954. All but one member thought that demand for real estate loans, consumer credit loans, and particularly loans to mortgage bankers for use in financing new construction, plus loans to investment dealers, would more than offset the expected decrease in business and commercial loans so that total bank loans during 1955 up to July 1 would probably be above those for a year ago.

Chairman Martin asked for comments of the Council on the significance of the recovery in automobile production in terms of its impact on the overall picture of industrial recovery. He noted that the Board's industrial production index was now around 132 on a seasonally adjusted basis, and said that there had been discussion as to whether the marked shift which had taken place in automobile production had been properly allowed for in arriving at this adjusted index.

Mr. Alexander said that certainly the automobile situation was a very major factor in the upturn of the last few months. Production at the current rate of 165,000 cars a week would give a total of over 8,000,000 passenger cars if continued through the year, but he knew of no one predicting that this rate would be maintained through the year. In fact, those in the industry thought that production of passenger cars might run to around 5,700,000 for this year. Mr. Alexander said that although he felt the industry would have large sales this year, the December 1954-January 1955 rate of output was very abnormal. He was not sure that the old seasonal pattern existed. In any event, manufacturers had turned out large numbers of cars and put them in the hands of dealers, and even with the spring selling season and the use of every conceivable instrument of advertising and salesmanship, it was likely that current output had fully anticipated the need for cars during the coming spring. Dealers' inventories of new automobiles, Mr. Alexander said, were building up although they were not yet particularly large. However, the public was not taking all the cars being produced and by summertime, strike or no strike, the rate of output would have to be lowered substantially. This would affect the industrial production index, not only because of the weight given the automobile industry, but because the effects of changes in that industry ran so far through the whole fabric of industry. Mr. Alexander also commented on forthcoming negotiations of the principal automobile manufacturers and unions for new agreements, stating that he felt these negotiations would present some very difficult problems this year.

Mr. Fleming remarked that in the Fifth District people were "buying their heads off" on automobiles. He cited figures of automobile sales increases ranging from 80 to more than 100 per cent as compared with a year ago in some of the States of the district.

Chairman Martin inquired whether the members of the Council felt that the active selling of automobiles at this season represented large-scale borrowing from business that would ordinarily be done in the spring months.

Mr. Denton stated that in the Cleveland District, there was more concern regarding the materials that went into automobiles than with the actual manufacture of the cars, noting that that district contained large suppliers of steel, glass, tires, and other materials of major importance in automobile production. He was extremely concerned about the situation after the early spring months. He stated that even now sales of automobiles were generally being made at substantial discounts from quoted prices and managements of supplier industries were concerned as to how long the present rate of activity could last. He was definitely of the view that current automobile sales represented substantial borrowing from spring and summer sales.

Mr. Alexander commented that automobile sales would be helped by easier instalment credit terms, some of which already had appeared.

There would be an expansion in aggregate instalment credit, reflecting not only larger sales but also greater credit extensions per unit as a result of the easing of terms.

Chairman Martin said that President Brown had mentioned that in one district the member of the Council felt that demand for bank loans would not hold up.

Mr. Denton said that he anticipated that loans in the first half of the year would rise a little, largely due to consumer credit, real estate credit, and brokers' loans but that he did not think the aggregate of these loans would equal the volume of the same period in 1954.

Governor Vardaman inquired whether there was any inclination on the part of small merchants to increase their inventories, and he inquired whether banks were willing to lend to such merchants for the purpose of increasing inventories.

Mr. Alexander stated that the general tone of businessmen was one of definite optimism and that this feeling was almost unanimous. He had not observed any definite inclination on the part of merchants to increase inventories beyond what they needed to run their businesses currently; they were cautious about moving in that direction notwithstanding conditions in the Far East. As to the attitude of bankers, he said that bankers were still out after loans. He had not detected any firmness in their attitude toward making any kind of loan and would say that bankers were just as anxious to lend now as they were last summer. He described in some detail the readiness with which bankers were making term loans in the New York area, giving large borrowers with good credit standing commitments with the understanding that, within a period of, say, two years they could obtain substantial amounts in the form of 10- or 12-year term loans.

President Brown said that department stores had stopped decreasing their inventories as they had been doing up to the Christmas season and were now trying to hold them steady. Virtually everything the department store sells is now in good supply, he said, and stores generally were trying to operate with what they regarded as "normal" inventories, whereas in the spring of 1953 their inventories were above normal because of fears of shortages of goods. There was a tendency for retail automobile dealers to increase their inventories, not because they wanted to but because they would lose their agencies if they did not do so. President Brown said that he would echo what Mr. Alexander had said about the increasing demand for term loans: banks were very anxious to make such loans to good credit risks, and were willing to make commitments on a standby basis for up to two years for a fee of 1/4 of one per cent, with the understanding that if the business firm needed the funds it could then obtain them on a 10-year loan at 3-1/8 per cent. Such an arrangement was very attractive to the customer, and individual banks felt that if they did not make such commitments they might lose a long-established customer to some other bank willing to make the loan on similar or better terms. President Brown stated, however, that there was no indication of a break in the prime rate of 3 per cent.

2. In addition to the views of the Council on the general business situation, the Board is interested in knowing the thinking of the members of the Council with respect to the following matters:

   a. The Board would like to have the views of the Council with respect to arrangements recently made by insurance companies under which they place temporarily with banks mortgages acquired by the companies.

For a number of years, it has been customary for mortgage brokers representing insurance companies to borrow temporarily from local banks for the purpose of carrying mortgages to be acquired by the insurance companies under commitments given by them. In many cases the carry is for a period beyond the date on which the insurance companies had originally planned or contracted to take up the mortgages. Such extended carrying arrangements are ordinarily made by the mortgage broker after a request by the insurance company to him. Occasionally the insurance company will make a direct request to a bank for such a carry.

The Council is aware of one important recent case in which an insurance company has arranged for banks to carry mortgages already owned by it under a repurchase agreement. The Council understands that in this instance the insurance company does not operate primarily through mortgage brokers, but through its own direct agents. The transaction to which reference is made is obviously neither illegal nor improper.

There have been in banks over the years many types of carrying arrangements, and they have been helpful in the desirable objective of evening out the flow of savings into investment. The increase at present in the volume of such carrying arrangements stems in part from the housing boom, and may be an indication of a possible inadequacy of savings, or capital formation, to meet current capital expenditures. Any sustained tendency for capital expenditures to outrun capital formation will result in inflation with its attendant economic problems.

President Brown said that as far as members of the Council were concerned none of them knew of any arrangements for borrowing on mortgages by insurance companies other than the recent $350 million 1-1/2 year loan arranged by Prudential Insurance Company of America. He described the procedure under which mortgage brokers usually make commitments for loans and where they often need to borrow funds to assist during construction periods. The Prudential arrangement was unusual, he said, in that the amount was very large and it was for a period of 1-1/2 years, which was much longer than the usual loan of that type. The most surprising thing about that loan, he said, was that the insurance company was willing to pay 3-1/2 per cent. The feeling among the members of the Council, President Brown said, was that an arrangement of this type might indicate that capital formation was not keeping pace with capital expenditure. If deficits in capital were to be made up through borrowing from banks or from Governmental agencies, such as the Federal National Mortgage Association, it might be inflationary. He inquired whether the Board knew of any other arrangements similar to that for Prudential Insurance Company of America.

Chairman Martin stated that there were other cases and that there had been enough discussion of the subject to cause some concern as to whether it represented a tendency of mortgage lenders to borrow against mortgages for the purpose of making additional loans which would be inflationary. He hoped that members of the Council would continue to watch the situation. It was the sort of thing which he felt might be unsound, and the Board would find it helpful to have comments from the Council on any further development of this type of borrowing.

Mr. Denton inquired whether there was any substantial difference between an arrangement such as Prudential had made, and an arrangement whereby a group of mortgage bankers borrowed in order to provide construction money.

Chairman Martin responded that if the borrowing by an insurance company reflected a tendency on the insurance company's part to accumulate savings, place such savings in mortgages, and then pledge the mortgages to borrow more funds in order to make more mortgages, it would represent a pyramiding operation which could be very unsound. This had given the Board some concern, he said, and it felt that it should be alert to the development of such a financial device. Chairman Martin also commented that the Board had been somewhat concerned by developments in the stock market and the suggestion of an "entrepreneur tendency" that might be developing in the country.

Governor Vardaman stated that he felt borrowing of the type under discussion represented a dangerous development in terms of what might happen among the smaller insurance companies operating on a local or neighborhood basis. He did not see the danger if it was confined to large companies operating over the country as a whole.

Mr. Fleming stated that the answer to the volume of funds going into the mortgage market may lie in the adoption of stricter credit terms, as suggested in another topic commented on in the Council's memorandum.

President Brown said that while he had seen no evidences of pyramiding loans in the way Chairman Martin suggested, he thought this type of borrowing might reflect a tendency by insurance companies, particularly smaller ones, to over-commit themselves.

Mr. Alexander stated that throughout the country banks were carrying mortgages for mortgage brokers who in turn were turning them over to savings institutions. The flow of mortgages has been very heavy, he said, and this was true not only of large insurance companies but also of savings banks. He felt that part of the process of evening out the flow of mortgage funds came about when the mortgage bankers temporarily obtained funds from banks during periods of construction and to help in facilitating the movement of capital being placed with insurance companies before it was put to work in the economy. This mechanism was good and constructive. Some of the insurance companies had been called upon to make good on commitments to large industrial concerns, and this might explain why some of them had sought funds against mortgages they also held in their portfolios. This was no more than a smoothing operation to facilitate the flow of investment funds into capital. However, Mr. Alexander said, it would be a different thing, as Chairman Martin had indicated, if insurance companies were "borrowing to buy". Mr. Alexander felt that it would be undesirable if a process of that sort were started.

Mr. Ireland said that in the Boston District he was familiar with one instance similar to that under discussion and that it had been very disturbing to the insurance company. The insurance company had no desire to anticipate the accumulation of savings, but it was being deluged with demands to make good on commitments.

Mr. Mitchell stated that in the Philadelphia District there had been no forward buying of mortgages beyond what might be described as a proper area, as Mr. Alexander had described the moves of "evening up" the flow of savings into investment. Banks had always loaned for periods of three or four months pending the taking up of mortgages by insurance companies, and they considered it proper. He had seen no evidence of these loans "backing up".

Mr. Denton said that the instances of borrowing on mortgages which he knew of in the Cleveland District did not emanate from insurance companies but rather from the mortgage brokers who had gotten commitments from insurance companies for future dates, and who were complaining bitterly of their inability to get funds in the meantime to carry the projects during construction periods.

b. To what extent is money borrowed from banks in the form of "non-purpose" loans being used to purchase stocks? What could be done by bank supervisory authorities to restrict such borrowing should it become excessive?

The members of the Council believe that the amount of "non-purpose" loans which have been made to purchase stocks is relatively insignificant, and that no recent important increase in such loans has occurred. However, it is difficult and often impossible clearly to trace the ultimate use made of borrowed funds. In the case of "non-purpose" loans, there does not appear to be any satisfactory and effective way of policing such loans which policing would not involve banks in constant and continuing harassment of their customers. The Council does not believe that there is any present or threatened situation which would warrant further action by the supervisory authorities.

President Brown stated that none of the members of the Advisory Council could see any increase in non-purpose loans being made to evade the restrictions placed on loans for the purpose of purchasing listed stocks.

Mr. Fleming inquired whether there was authority for the Board to regulate "non-purpose" loans made by bankers collateralled by securities, and Governor Szymczak discussed the legal authority of the Board, pointing out differences between the regulation covering margin requirements for brokers and the regulation covering loans made by banks for the purpose of purchasing or carrying listed stocks.

After a brief discussion, Mr. Fleming commented that while there might be isolated cases in which funds advanced on non-purpose loans were actually used for purchasing stocks, members of the Council were convinced that such loans were not significant in amount.

c. Concern continues to be expressed in some quarters as to the soundness of current developments in the residential construction and mortgage field. To what extent do the members of the Council share this concern?

The housing boom which was experienced in 1954, and is continuing into 1955, has been a major influence in sustaining the entire economy. However, the present extraordinary rate of housing starts is in a large measure the result of the exceptionally liberal terms established by legislation last year. With the current upturn in business, the Council is concerned that the continuing encouragement to a further expansion in the housing boom, due to the present legislation, will ultimately have unfortunate repercussions in the economy. The members of the Council therefore believe that present legislation should be changed to provide (1) that reasonable down payments be made on FHA and VA mortgages and (2) that maturities be shortened.

President Brown said that each member of the Council was concerned over the present housing boom. The Council felt that the reason for this concern was obvious: like automobiles, the present rate of housing production could not be continued indefinitely. Houses were now being created in excess of family formation. The fact that no down payments were required on VA guaranteed loans and that those required on FHA insured mortgages were very small had undoubtedly stimulated the boom, President Brown said, and the Council felt that there was no question but that it was "bound to bust". If the present boom were to accelerate it would mean that the "bust" when it does come would be that much more severe and would leave repercussions on the whole economy. The credit terms now available were encouraging many persons to buy houses who never would be able to pay out and, while the Federal guarantee or insurance gave protection, some of the lenders would find themselves in difficulty in connection with the loans and the Federal Government would ultimately have very heavy losses which would be reflected in the Government's budget. President Brown stated that Mr. Fleming had suggested at the Council's meeting that the relaxed credit terms for VA and FHA guaranteed and insured mortgages may have had a good effect at the time of the recession in activity in 1953, but all of the Council members now felt that the economy having picked up, the continuation of the excessively easy credit terms was unfortunate. He also mentioned that since the VA no-down-payment terms were due to expire in 1957, it had been suggested that many were rushing to "get in under the wire" and that it would be a good idea to continue the existing terms indefinitely so as to avoid this rush. However, President Brown did not agree with that view. He also stated that the Council's concern over the housing boom was as great as over the high rate of automobile production for the reason that when a housing boom "busted" it took a lot longer to get production started up again than it did in the case of the automobile industry.

Mr. Fleming commented that the situation was very difficult, that in his view the liberalization of terms on VA and FHA guaranteed mortgages in the fall of 1953 was a stabilizing influence at that time, but that it should now be toned down. Mr. Fleming felt that that could and should be done through moral suasion.

Mr. Chandler said that in the Tenth District the housing boom was running ahead of the national situation, that it was extending into small towns, and that it seemed that almost everyone with any experience in building was now putting up houses largely to be sold with no down payments. He felt this could bring on a very serious condition, not only for the reasons already mentioned but also because it was having and would have a great effect on values and sales of older houses. The new no-down-payment houses, he noted, could be bought on much easier monthly payments than the older houses.

Chairman Martin inquired whether the Council felt that an "over-housed" situation was imminent. He cited instances such as in Baton Rouge, Louisiana, where he had been informed that even though building of new houses was proceeding at a high rate, it was generally considered that it would be several years before the supply of houses would catch up with the demand.

Mr. Davis said that there was still a shortage of houses in areas like Baton Rouge and particularly in New Orleans. This matter had been a subject of considerable discussion among banks and other lenders in the area and it was the consensus that the current deficit in housing reflected division of families, creation of new family units, and other factors which would call for large additional numbers of housing units. Mr. Davis was not so concerned about the number of units being constructed as he was about the quality of some which were being placed under Federal Government guaranteed or insured mortgages having longer maturity than the probable life of the properties. Mr. Davis commented that the absence of down payments and the low monthly carrying costs on these new houses also placed rental property and older housing at a great disadvantage.

Mr. Wallace expressed the view that a 20-25 year mortgage represented the maximum term for individuals to acquire true equities in houses. When the term was extended out beyond 25 years, it placed the purchase of houses in something like the same category as the purchase of an automobile. In other words, present financing terms for 30 years with no down payment meant that individuals readily bought houses and as readily moved out of them when they found a reason for changing location, without any of the true ties of home ownership. Another side of the picture, Mr. Wallace said, was that the 30-year maturity with no down payment meant that there was no practical limitation to the amount of housing that might be built.

Governor Balderston inquired whether the Council had considered the impact on the economy of a slowing down in housing activity and the possible accompanying pressure on financial institutions such as building and loan associations, which might create serious problems for the banks in such an event.

President Brown said that savings and loan associations invested their funds primarily in non-insured or non-guaranteed mortgages. While these mortgages were fraught with danger, the building and loan associations were not the worst offenders; smaller banks and insurance companies were buying large amounts of VA and FHA mortgages simply on the basis that they were Federally guaranteed obligations. President Brown then inquired whether the Board thought anything could be done in the way of bringing about a change in present housing legislation which would make for sounder credit in this field.

Chairman Martin stated that the Board had not taken a position on this question although his own feeling was that in the absence of legislation there was not a great deal to be done unless there was real concern with an over-housed situation. The problem dealt with the quality of housing and the mores of the people, and he thought that an attempt to inject general monetary and credit policy into that sort of atmosphere would be a mistake unless it appeared certain that there was danger of an over-housed situation. In other words, it would be a mistake to reduce the total supply of money and credit and bring about a tightening in the general situation in an effort to correct unsound credit conditions in the housing area. In response to a question from Mr. Ireland as to whether the Home Loan Bank Board was taking a position on this question, Chairman Martin stated that while he had heard some expressions of apprehension on the part of individuals he knew of no position being taken. He noted that great effort had been made to get the field offices of the Federal Housing Administration and the Veterans Administration to build up a larger volume of housing, and that the problem under discussion really involved a reversal of those efforts. Chairman Martin felt the situation was difficult and he compared the situation in the United States with that in Great Britain where a more "conservative" government had followed a more "liberal" government and one of the results was a more liberalized housing program.

President Brown stated that he felt this situation represented the greatest threat to the economy over the next two or three years, and

Chairman Martin responded that the members of the Board were concerned with the situation, that the comments of the Council were very helpful, and that at the present time his feeling was that the only way to handle the problem was through Government housing policy rather than through general monetary controls.

d. What will be the trends in consumer credit and particularly in consumer instalment credit during the next six months?

The members of the Council believe that consumer credit and consumer instalment credit will increase during the next six months, because of the high rate of automobile sales, and the increase in housing completions with the demand new houses create for various types of household equipment. The liberalized provisions of Title I may also tend to increase the volume of instalment credit.

President Brown said that automobiles could not be sold in large volume except on credit, and the rate at which they were being sold would result in an increase in the volume of instalment credit. Some of this spilled over into small loans, partly because some people found it easier and cheaper to borrow from such companies than from finance companies. There is also a strong demand for instalment credit as a result of the housing boom and the resulting demand for appliances, he said. President Brown felt that while there would be a large increase in the volume of business and many finance companies would sell additional securities in order to increase their funds, the views earlier expressed that automobile production was bound to slacken within three to six months would have a bearing on the situation. In the meantime, instalment credit would certainly increase.

In response to Chairman Martin's question as to whether this caused any real concern, Mr. Alexander said that he had some concern.

Governor Robertson inquired whether the members of the Council thought that excessive production of automobiles might bring about unsound financing by pushing out terms on instalment credit, and some of the members of the Council indicated that there was a tendency for unsound financing practices to develop. President Brown stated, however, that he personally would not be prepared to recommend at this time that the Board ask for authority to institute the regulation of consumer credit. Mr. Alexander commented that he would like to have the Board have power to issue such a regulation, as he had indicated at the meeting in February 1953, but that he assumed he was still the only member of the Council who felt that way.

During the discussion of this topic Governor Balderston left the meeting to keep another appointment.

3. What have been the effects of System credit policies since the last meeting of the Council? Should these policies be changed in any way in the light of the business and economic situation in the foreseeable future?

System credit policies since the last meeting of the Council have been extremely well handled and have been helpful to the economy. The Council is in accord with the actions of the System in open market operations, in leaving the rediscount rate unchanged, and in raising margin requirements on stocks. The main effect of raising margin requirements was psychological, but was constructive.

The Council has no change to suggest in System credit policies under present conditions. However, if stock market prices should have a further rapid rise, even if it involves no appreciable further use of credit, the Council believes consideration should be given to an additional increase in margin requirements.

President Brown said that the Council felt that open market operations had been well handled since its meeting last November. He commented that bill rates had risen and then declined recently but that the Council felt that in view of the Treasury financing that had just taken place, and in view of the fact that since many of the new 3 per cent bonds had to be shifted out of the banks to other investors, the System was justified in assisting the market by buying bills as it had during the last two weeks--a factor which had let the bill rate get down from the 1.40 area to around 1.04-1.13. President Brown said that once the redistribution of the 3's had been substantially accomplished, a higher bill rate than the present level would seem to be indicated. The Council felt that in this kind of a period there was danger in making money too cheap. Thus, while the Government financing period justified the System's action, that period would not last long. He also felt that if the stock market continued its rise, and particularly if there seemed to be increasing speculation in commodities, the discount rate at the Federal Reserve Banks should be increased. At the present time, however, the Council did not feel there was any reason for such an increase.

President Brown went on to say that all members of the Council were concerned with the stock market, that prices had gone up from 40 to 50 per cent in a year's time, that yields on stocks had not gone up, and that there was apprehension concerning what widespread speculation in stocks and commodities might do to the economy. The recent increase in margin requirements from 50 to 60 per cent was largely psychological in its effect and had very little actual effect in dampening purchases of stocks. The Council approved the increase and would favor a further increase if the stock market should show another rapid rise.

Mr. Alexander said that as far as he was concerned, open market operations recently had been excellent. He agreed with the increase in margin requirements and felt that if there was a further rise in the stock market another increase should be made. The new Treasury 3 per cent bonds were well handled and the timing was good. Mr. Alexander thought that the Federal Reserve did not have to decide whether the stock market was too high or too low, and he said that it was difficult to say when the amount of credit was excessive. However, the amount of credit in the market had risen sharply, almost perpendicularly, within the last few months and, Congress having given the Board jurisdiction in that area, Mr. Alexander felt that it was right and proper for the Board to watch the situation carefully to see whether another rise in margin requirements would seem to be called for. He reiterated the view that open market operations had been handled excellently and added that he had no quarrels at this time with credit policy.

President Brown stated that if there should be clear evidence that capital formation was lagging behind capital expenditures, serious consideration should be given to raising the discount rate not by a quarter of a per cent but by half a per cent. There is a great danger, he said, of the country getting into a psychological mood where it was spending more money than it was saving, and the experience of other countries illustrated the dangers of an inflationary character that could flow from this attitude.

Chairman Martin stated that this had been an unusually productive and helpful meeting with the Council.

Governor Szymczak mentioned that Representative Patman had introduced a bill, H. R. 2643, which would direct the Comptroller General of the United States to audit the Board of Governors of the Federal Reserve System, the Federal Open Market Committee, and the Federal Reserve Banks for the period commencing with the enactment of the Federal Reserve Act, December 23, 1913, and ending December 31, 1954. There was brief comment on that bill and possible action that might be taken in the event it appeared likely to receive serious consideration.

Governor Vardaman said that he was very much opposed to the General Accounting Office being given the right to audit the Board or the Federal Reserve Banks. The primary reason for this opposition was that the Congress had delegated to the Board the power to "create money" and designated the Board as the agency to supervise the Federal Reserve Banks. If the Congress were to set up between the Board and the Congress another bureau such as the General Accounting Office, the Congress would lose its direct control and there would be a tendency on the part of the Board to pay more attention to the General Accounting Office and less to the Congress. Governor Vardaman also said that he had discussed this matter quite seriously with Representative Patman and was urging him to substitute something which, if the Congress desired to direct an audit of the Federal Reserve System, would provide that it be done by a subcommittee of the Congress. He said that he had pointed out that this Board now employed a firm of outside auditors which made a very thorough audit of the Board and which also observed the Board's examinations of the Federal Reserve Banks. The Board audits have been sent to the Congress, he said, and with that information the necessity for the action proposed by the bill has been partially eliminated.

Governor Vardaman went on to say that he had great respect for the Congress and that, in his opinion, the Board was partly responsible for Representative Patman's proposal because of its failure in the past to furnish the Congress detailed information on its expenditures. He said that he thought that since the Board was the arbiter of System income, it should not be the sole agent approving System expenditures; and it would be a good idea to have the Congress look into expenditures, probably through an independent outside accountant.

Governor Vardaman concluded his comments with the statement that he did not believe that the risk involved in Representative Patman's proposal was so great as some of his colleagues on the Board felt. He expressed the belief that an appropriate showing to the Congress would convince it of the lack of need for the proposed audit. The most effective argument, he said, would be to point out that if the Congress wanted to lose control of the Federal Reserve, it should put it under the General Accounting Office. Governor Vardaman felt that the only sound argument the System had against audit by the General Accounting Office was that it was a creature of Congress and once it was put under the General Accounting Office, it would become a creature of that Office.

Governor Robertson then made a statement with respect to proposed bank holding company legislation, stating that there were identical holding company bills pending in the House (by Representative Spence) and in the Senate. In his description of the content of the bill proposed by Representative Spence, Governor Robertson characterized it as probably the most severe piece of legislation that had been introduced since 1941. While it was not a "death sentence", it was a freeze bill and would eventually mean a death sentence. He indicated that the Board's position on holding company legislation would probably be about the same as it took two years ago, namely, that such legislation should be minimum rather than maximum legislation and should be as simple as possible, should be adequate to cover those companies that ought to be covered, and should not provide discretion to the administering agency to declare other companies subject to the legislation. Governor Robertson noted that the Board had been requested to submit a report on this bill and to testify before the House Committee on Banking and Currency regarding it about February 28. He also commented on possible provisions with respect to divestment of non-banking business from banking as well as on provisions for making exceptions in cases where it was not felt that divestment was essential. Governor Robertson stated in response to a question that he thought there was a better chance for enactment of holding company legislation this year than at any time in several years, that there might be something like a 50-50 chance.

President Brown stated that the next meeting of the Federal Advisory Council would be held on May 15, 1955, with a joint meeting with the Board on Tuesday, May 17, unless the Board preferred that another date be set.

There was agreement that the meeting should be scheduled for that day.

Thereupon, the meeting adjourned.

Secretary