

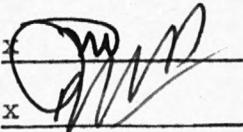
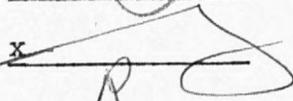
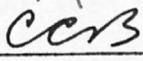
To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council held on November 20, 1956.

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, if you were present at the meeting, please initial in column A below to indicate that you approve the minutes. If you were not present, please initial in column B below to indicate that you have seen the minutes.

	A	B
Chm. Martin	x 	_____
Gov. Szymczak	x _____	_____
Gov. Vardaman	x 	_____
Gov. Mills	x 	_____
Gov. Robertson	x 	_____
Gov. Balderston	x 	_____
Gov. Shepardson	x 	_____

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 on Tuesday, November 20, 1956, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman  
 Mr. Balderston, Vice Chairman  
 Mr. Szymczak  
 Mr. Vardaman  
 Mr. Mills  
 Mr. Robertson 1/  
 Mr. Shepardson

Mr. Carpenter, Secretary  
 Mr. Sherman, Assistant Secretary

Messrs. Ireland, Massie, Mitchell, Denton, Fleming, Kimball, Livingston, Baird, Kemper, Matkin, and King, members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Ninth, Tenth, Eleventh, and Twelfth Districts, respectively

Mr. Walter B. Jacobs, President, First National Bank of Shreveport, Shreveport, Louisiana, member-elect from the Eleventh District

Mr. Herbert V. Prochnow, Secretary of the Federal Advisory Council

Mr. William J. Korsvik, Assistant Secretary of the Federal Advisory Council

President Fleming reported that at the meeting of the Federal Advisory Council on November 18, 1956, Mr. Prochnow was re-elected Secretary and Mr. Korsvik was elected Assistant Secretary of the Council.

Before this meeting there had been sent to the members of the Board a memorandum prepared by the Federal Advisory Council regarding topics that had been placed on the agenda for the joint meeting. The

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1/ Entered meeting at point indicated in minutes.

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statement of topics, the comments by the Council, and the discussion of the respective topics are set forth below:

1. What changes are expected in the business situation during the remainder of this year and the first six months of 1957? The Board would be glad to have information on any problems confronting industry, commerce and agriculture in these periods.

All members of the Council expect the present high level of business activity to continue for the balance of the year, and through the first quarter of 1957, despite some spotty situations in the economy. Some members of the Council believe that business will continue to be good through the first six months of 1957, while others are less certain about the second quarter of the new year. The level of business, in the months immediately ahead, may be greatly influenced by developments abroad, such as the economic and financial problems arising out of the situation in the Middle East.

Some of the problems confronting industry, commerce and agriculture are the narrowing profit margins in an increasing number of businesses, the threat of excessive inventory accumulation, and the drought which extends over relatively wide areas of the country.

Chairman Martin said that the Board would appreciate having the members of the Council include in their remarks comments as to the influence on domestic business in the months immediately ahead of developments abroad.

Mr. Ireland reported that in the First District business was still at a very high level, and he expected this to continue during the rest of this year and the first half of 1957. This applied to all segments of the economy with the possible exception of residential building in which there had been some decline. After commenting on conditions in several individual industries, Mr. Ireland summarized his views as reflecting

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"mild optimism" regarding the outlook, although he expected profit margins to be reduced, perhaps to the extent that the total dollar volume might be lower next year than this.

Mr. Massie said that in the Second District a high level of activity was anticipated to the end of this year. Unemployment was the lowest since 1946, and retail trade was running well above that of last year with excellent Christmas trade anticipated. He noted improved conditions in the garment industry but stated that profits were still low. Non-residential construction was very strong but residential construction was showing no signs of pick-up and was down about 20 per cent from a year ago. Savings had increased appreciably. Loan demand was still strong and, with the loss of deposits by New York banks, it had been difficult to satisfy demand. However, Mr. Massie said that he felt credit needs were being satisfied as far as good business judgment would indicate, but at higher rates and with tighter terms. Profit margins seemed to be dropping in spite of increased value of sales, Mr. Massie said, but aggregate dollar profits remained quite good.

Mr. Massie felt that it was too early to draw conclusions as to the situation in the Middle East and its effects on domestic developments, but it had already caused nervousness in this country. He said it would be normal to expect an increase in the tendency, already evident for some time, to accumulate inventories, particularly in the case of raw materials obtained abroad. Mr. Massie stated that the net of his position was that business should be good through the end of this year and the first half

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of 1957, but he recognized that developments in the Middle East might cause a change in this outlook.

Mr. Mitchell described business activity in the Third District as at peak levels. The steel industry was very active with shortages reported for some important items; the textile industry had been showing improvement compared with the situation two or three months ago; residential construction was off but industrial construction was up; employment generally was at high levels in most parts of the district; and wages were increasing and personal income rising all along the line. Department store sales had been good up until last month but had fallen off recently, perhaps because of weather conditions. With low inventories of new automobiles, dealers were in good position to handle the new models. In some lines there was a tendency to build up inventories perhaps because of the Middle East difficulties.

Looking ahead, Mr. Mitchell said that a good many businessmen felt that the backlog of unfilled orders had reached a peak and was starting to drop off. There was also some feeling that the new model automobiles would not meet as good acceptance as the automobile industry anticipated. Some businessmen were beginning to feel for the first time that an over supply of production facilities may be in the making, and Mr. Mitchell cited the nylon industry as an illustration. Profit margins were shrinking throughout business. As against these reservations, Mr. Mitchell said that outlays for defense purposes were expected to increase and that State, municipal, and county financing might rise. In summary, there seemed to

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be a general feeling that business would be excellent to the end of this year and good during the first half of 1957. Volume might increase next year, but that was more likely to be the result of price increases than of greater physical volumes. Money was still tight in the Philadelphia area, Mr. Mitchell said, and recently loans in that area had risen less than the national average. In the last two or three months money had been a little less tight than it was during the summer months and borrowings from the Reserve Bank recently had been about where they should be in comparison with other districts, whereas six months ago Philadelphia banks were borrowing more heavily than banks in other parts of the country.

Mr. Denton said that conditions in the Cleveland District did not differ materially from those described for other areas. Business was excellent for the moment. Demand for money was still strong and loans of reporting member banks were increasing every week. Deposits had risen slightly. It would appear that during the immediate future activity would continue at a high level, Mr. Denton said, but we were reaching a point where many industries with larger sales would find that profit margins were smaller. He commented on several competitive conditions, particularly in the appliance field, and stated that the cumulative results of various developments made him less and less sure how much longer activity would continue to rise. Everything was fine at the moment, Mr. Denton said, and he expected a good first quarter of 1957; beyond that, the picture was less clear.

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President Fleming stated that Fifth District retail trade had declined recently but stores anticipated large Christmas sales. Coal production was up but textile activity was down. Farm prices had declined and demand for bank credit had diminished slightly. Employment was full. Shipbuilding in the Newport News area was a bright spot. President Fleming also commented on employment conditions in different parts of the Fifth District, noting that in general employees had worked more hours this year than last.

Mr. Kimball said that the over-all economy of the Sixth District was at a high level although the rate of increase had slowed down recently, reflecting principally weakness in agricultural income. Gains in district economic activity were coming principally from mining, construction, and other non-agricultural activities, and non-residential construction was particularly strong. Bank deposits had shown a steady growth but loan expansion this autumn had been less than anticipated. While agriculture continued to act as a drag on the Sixth District economy, Mr. Kimball noted that industrialization of the district was increasing, and he cited data showing that in recent years total income had risen despite reductions in agricultural income. Mr. Kimball also commented on a survey of agricultural loans made by banks in the Sixth District and said that in some areas which were formerly exclusively cotton producing sections diversification of agriculture was developing. Summing up, Mr. Kimball said that he would anticipate good business the balance of this year and into 1957 but he could not look much farther ahead than the first quarter of next year.

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Mr. Livingston stated that business in the Seventh District was very good. There was over-employment, particularly in the Chicago area, and the automobile industry anticipated good reception of the new model cars. Retail sales generally had been very good and a large Christmas trade was anticipated. Steel mills were operating at capacity. The farming business continued to be poor, Mr. Livingston said, partly because of the drought this past year. Profit margins were shrinking and, in Mr. Livingston's view, this situation should be watched closely. The drought in some sections of the Great Plains had placed ranchers in an uncertain position, but in Iowa, where the corn crop this year was large, farmers had been anxious to purchase animals to feed. He noted that banks tend to lend to farmers 100 per cent of the costs of range animals and the interest rate is still 5 per cent. Mr. Livingston said he looked for good business to the end of the current year and through the first six months of 1957. He did not believe the situation in the Middle East had developed to the point where we could have a clear opinion as to its effects on our business outlook.

Mr. Baird said that conditions in the Ninth District were not materially at variance with those described for other districts. High employment and shortages of certain types of labor were reported in the cities. However, persons now located on the farms were not being attracted to the cities and there continued to be a surplus of population in the farming areas. Retail trade recently had not been good, but colder weather might bring a pick-up. Farm income would be up about 2 per cent

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from last year, reflecting large crops in the eastern part of the Ninth District. Recent moisture had improved the outlook for grazing and for winter and spring wheat next year.

As to the money situation, Mr. Baird said that demand for credit at city banks this fall had not been as high as a few months ago nor as high as was anticipated for this period, and borrowings at the Reserve Bank had been down. Mr. Baird reported a good outlook for the balance of the year and for the first quarter of 1957. It was difficult to see how the expansion of plant investment could continue indefinitely, Mr. Baird said, and he was unable to see any other factor that would counter-balance a reduction in this force. He thought some recession in the second quarter of 1957 might be anticipated and, in his opinion, this might be a wholesome development. Mr. Baird concluded his remarks with a description of developments in the iron ore industry that could be expected to have a favorable effect on the outlook.

Mr. Kemper characterized business in the Tenth District as surprisingly good, considering the drought that had persisted for years. Recent rains gave some moisture but not enough to assure crops next year. Hay and forage were particularly short and cattlemen were moving breeding herds from the drought sections of the Tenth District into the corn belt. Mr. Kemper also commented on industrial conditions in different parts of the Tenth District, noting that there was unemployment in some areas. Demand for credit continued strong and deposits were off. Inability to

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obtain mortgage money also was an unfavorable factor in the district and Mr. Kemper noted that increased bond yields had made those securities a more attractive investment for insurance companies than mortgages. Profit margins had narrowed recently but most businesses in the Tenth District appeared to be making a net profit. Mr. Kemper said that he felt business would be good for the balance of this year and, if the drought situation could be relieved, the outlook for 1957 would be good.

Mr. Matkin said that business in the Eleventh District was good, notwithstanding the unfavorable conditions for farmers and cattlemen resulting from the drought. Some other spotty conditions also existed. Non-agricultural employment was down somewhat and construction, both housing and other, also had declined recently. Cattlemen were facing the problem whether to try to feed herds through the winter or to sell breeding cows, and Mr. Matkin stated that cows which sold for \$300 to \$350 a few years ago would not bring more than \$50 to \$60 a head now. Loan demand continued fairly active and money was still tight, particularly for mortgages. Mr. Matkin expressed the view that business would be good through the end of this year and during the first quarter of next year, and possibly during the second quarter of 1957. Except for the drought, the Eleventh District was getting along nicely.

At President Fleming's request, Mr. Matkin also summarized a report that he had presented at the separate meeting of the Council on the domestic oil situation as it might be affected by Middle East developments.

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Governor Robertson joined the meeting at this point.

Mr. King said that the developments regarding Middle East oil supplies had helped relieve what was threatening to become an inventory problem for the petroleum industry in the Twelfth Federal Reserve District. Twelfth District business generally was very strong, he said, with aircraft and electronics especially active. The motion picture industry was doing very well. Shortages of both skilled and nonskilled labor existed. Automobile dealers anticipate that sales of new model automobiles will be satisfactory but Mr. King stated that they had already started **cutting** profit margins in order to move cars, as had been the case when the 1956 models were introduced. In commenting on the real estate situation, Mr. King pointed out that in some sections of southern California housing starts were down more than half as compared with a year ago and that some builders in local areas had been unable to move houses that had been completed for as much as a year. This was ascribed partly to the shortage of mortgage money. Mr. King stated that he anticipated that business would be good during the remainder of this year and, in the Twelfth District, at least during the first half of 1957. He concluded his comments with an analysis of the outlook for loans in the Twelfth District which pointed to smaller increases in the spring of 1957 than in the spring of 1956.

President Fleming referred to Chairman Martin's suggestion that members of the Council comment on the possible effects of developments in the Middle East, stating that there appeared to have been little or no immediate effect on business conditions in this country.

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Mr. Ireland reported views expressed at a meeting of New England economists recently at which he understood there was agreement that developments in the Middle East would result in attempts to accumulate inventories which might be a factor sustaining a high level of economic activity in this country during the first half of 1957.

Mr. Mitchell said that it was rather surprising that the Middle East developments had not had more effect on commodity markets than had been observed.

Mr. Matkin noted that developments in Egypt would be a favorable factor from the standpoint of producers of long staple cotton in Texas who expected to increase plantings of that type of cotton, previously imported largely from Egypt.

Mr. Denton said that the Middle East situation as a whole could not be evaluated with certainty at this time. He also suggested that the uncertainty in this country was shared by those living in the Middle East and that these uncertainties were reflected not only in connection with the use of the Suez Canal and pipe lines but that they also reached back to the production of oil. It was his view that the situation in that area was fluid and that the possible effects on this country and on Board actions with respect to monetary policy had not yet developed.

President Fleming commented on the poor standards of living and health of much of the Arab population, stating that whereas there was friendliness on their part toward the United States a few years ago, there was now a considerable feeling of bitterness toward the western

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world. It was his view that even if the present difficulties were settled promptly a period of several months would elapse before a substantial flow of oil from the Middle East to Western Europe would be resumed.

In response to a question from Governor Vardaman as to how the movement of new automobiles would be financed during the coming year, President Fleming said that the Council did not believe there would be difficulties in supplying such credit needs. There was considerable run off from repayments of old automobile loans, he said, which would permit the banks and other financing agencies to extend new credit in connection with automobile sales.

Governor Balderston referred to Mr. Massie's comments and inquired whether, in view of the construction of a considerable number of new office buildings in New York City, there was evidence of excess office space. He also inquired whether there was evidence of excess housing production.

President Fleming said that in the Washington area there continued to be a great shortage of office space and that this recently had been aggravated by the removal of some of the temporary Government buildings.

Mr. Denton said that in the Pittsburgh area a number of new office buildings had been erected over a period of years but that new shortages of office space already had developed. As to housing, the situation differed, he said, and there was some difficulty in disposing of houses in the medium or lower-priced group, partly attributable to difficulties in obtaining mortgage money but also perhaps the result to some extent of reduced demand for houses.

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Mr. Kemper said that in the Kansas City area there had been a considerable movement of office quarters from downtown areas to outlying sections with the result that vacancies in downtown office buildings had risen. He noted, however, that this rise in vacancies did not reflect an over-all reduction in demand for office space in the area.

Mr. Livingston said that in Chicago there appeared to be neither a surplus of office space nor a shortage.

Mr. Mitchell estimated that in Philadelphia there was a 5 to 10 per cent surplus of office space but said that most of this was in second-grade type buildings, and new buildings were being filled rapidly.

Mr. Ireland said that office space in the Boston area was at a premium.

2. What will be the probable changes in the volume of bank loans (a) during the remainder of 1956 and (b) during the first six months of 1957? As was the case last year, the Board will be interested in a full report on developments and prospects in the field of real estate credit. It will also appreciate a report on the prospects with respect to automobile credit.

(a) The Council believes that the volume of bank loans will increase during the remainder of 1956. (b) The Council also believes that the volume of bank loans will increase during the first six months of 1957, but at a slower rate than during the corresponding period of 1956.

The Council stated at its September meeting, in response to a question on real estate credit, that mortgage loan demand was outrunning the supply of savings, that the rates on mortgages had risen, and that lenders had become more selective. This trend has continued. Less money is now available for mortgages, interest rates are higher and lenders are exercising greater selectivity.

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Rates on VA and FHA mortgages are now so unrealistic that this type of investment is becoming increasingly unattractive to lenders. Because of attractive rates, an increasing proportion of savings is being invested in corporate, state and municipal obligations rather than in mortgages.

The Council believes there is and will be adequate credit available for automobile financing, even with an anticipated increase in automobile sales in the months ahead.

President Fleming said that the difficulty in the mortgage situation rested largely on Government programs and the retention of the rates on FHA and VA mortgages below the market.

Chairman Martin said that one of the matters of real interest to the Board was what might happen in connection with loans during the forthcoming tax period. He noted that the volume of loans for use in paying taxes in March of 1956 had risen much more sharply than had been expected and stated that it would be helpful to the Board to have the views of the members of the Council on whether a similar situation would develop in 1957.

Mr. Denton indicated reasons why he felt a substantial increase in loans for tax payments would develop early in 1957. Many corporations had been using their tax reserves for normal activities of the business and, while they might be borrowing at the present time, an increase in borrowings could be expected during the first half of 1957. He did not think it so certain that real estate loans would be up, stating that institutional lenders were less willing to make commitments than they were earlier; as a result, builders were "dragging their feet".

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3. To what extent are reduced ratios of liquid assets and capital to risk assets deterring banks from making loans?

The present reduced ratios are acting as an appreciable deterrent to the expansion of loans, particularly in some areas of the country. This is especially true in connection with loans for longer terms.

President Fleming said that this question was related to the liquidity position of banks, and he presented figures which showed changes in their liquidity ratios. It was evident, he said, that the liquidity positions of reserve and central reserve city banks had been materially reduced. He also pointed out that for some time corporation treasurers had been keeping only those deposits that were needed to service their accounts and were putting remaining funds into short-term Government securities. This was a direct outgrowth of the rise in interest rates.

4. Does the Council have any comments with respect to the System's current credit policies? What, if any, changes should be made to meet developments during the balance of this calendar year and during the first three or four months of 1957?

The members of the Council believe that the System's credit policies have been appropriate and well executed, especially in view of the difficulties which are always present in evaluating economic trends. Assuming a continuance of present economic conditions, the Council suggests that current credit policies be maintained with the same degree of restraint for the balance of this calendar year and during the first three or four months of 1957. The policy of keeping the discount window available should be continued.

President Fleming said that the Council assumed that, in anticipation of the Christmas season, the Open Market Committee would be prepared to supply the necessary reserves to the market between now and the end

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of the year. None of the members of the Council felt that the situation should be permitted to get any tighter, he said, and if the demand for credit rises without having additional reserves supplied, the situation would automatically become tighter. President Fleming also said that none of the members of the Council felt that a further increase in the discount rate would be desirable at this time even though the level of the short-term rate on Treasury securities was presently above the discount rate.

Chairman Martin said that it was with particular reference to this question that he had suggested the Board would like to receive comments of the Council on the effects of developments in the Middle East. He had received suggestions that those developments called for a relaxation of credit policy, he said, while other suggestions had indicated that they called for increased restraint.

President Fleming responded by stating that the Council felt the System had done an excellent job in present circumstances and that it did not believe that any further increase in the discount rates now would add to the effectiveness of credit policy.

5. It is understood that the Executive Committee of the Federal Advisory Council and such other members of the Council as are available will meet on October 31 to discuss the suggested amendments to the Federal banking laws sent to Senator Robertson with the Board's letter of September 28. Although the hearings which are scheduled for November 9-10, 1956, will be over by the time of the Council's meeting, the Board will be glad to have any comments on this subject that the members might wish to make.

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The Council has approved unanimously the report transmitted to the Board by President Fleming's letter of November 5, 1956, and will be pleased to discuss with the Board any aspect of the report.

Chairman Martin stated that the Board had transmitted the Council's views on the Board's legislative suggestions to the Congress, and President Fleming responded that the Council was very appreciative of the Board's action in making its views available to Senator Robertson's Committee. He noted that Governor Robertson had presented the Board's views at the hearing held on November 9.

Mr. Livingston said that he had been present at the hearing and that Governor Robertson had made an especially effective witness in his appearance before Senator Robertson's Committee.

In a brief discussion of the hearings, Chairman Martin stated that the Board appreciated the work the Council members had done in reviewing the Board's proposals and that he felt the results of the study had been worth while.

President Fleming said that for the most part the Council had no comments with respect to the Board's suggested changes but that it did feel an affirmative vote on the part of not less than four members of the Board should be required before a change was made in reserve requirements of member banks.

Chairman Martin said that this matter had not been discussed by the Board since receipt of the Council's views although he personally did not think it was a matter of great importance, especially since the

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operating procedure of the Board would have a bearing on whether action would ever be taken with less than an affirmative vote of four members.

President Fleming also noted that the Council did not favor making Federal Reserve Bank stock issued prior to 1942 taxable, and he stated that the Council would oppose any legislative proposal to bring that about.

6. The Administrative Committee of the ABA has authorized the publication of a study on reserve requirements prepared by the Economic Policy Commission of the ABA. The Council would appreciate having the Board's comments on this study.

The Council believes that a revision of the statutory provisions pertaining to reserve requirements is long overdue. In the Council's opinion, the report of the ABA is a valuable contribution to the study of this problem. Because of the importance of reserve requirements to all banks in the System, the Council would find the Board's views on this study of value.

President Fleming said that the Council felt that the study of reserve requirements made by the American Bankers Association was a valuable contribution and that the Council would like to discuss the subject when the Board was prepared to do so.

Chairman Martin responded that the Board was not adequately prepared to discuss the subject of changes in the system of reserve requirements this morning although it had considered the subject off and on over the years. He noted that the Board had worked with the group of American Bankers Association's representatives under Mr. Evans Woollen and that it had repeatedly encouraged a study such as the Association's representatives had made. He did not feel that this was a matter on which any of those who had studied it had yet come to a clear and definite position as to the

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best way to adjust reserve requirements. It was his view that the various studies and memoranda should be made available to and considered by interested groups, and with this thought in mind he said that the Board was ready to make available to the members of the Council material that had been prepared in the System regarding the subject. He noted that a memorandum prepared by Mr. Thomas, Economic Adviser to the Board, had been distributed to the Council yesterday, and he suggested that there might be other memoranda in the files that could be furnished to the Council for its study. The Board did not wish to endorse the American Bankers Association's study at this time nor did it now wish to endorse any other proposal, Chairman Martin said, although it was in agreement that a review of the statutory requirements pertaining to reserve requirements was long overdue.

In response to a question from Mr. King, Chairman Martin said that the Board was familiar with a study known as the Norton-Jacoby study made by Messrs. Frank Norton and Neil Jacoby for a group of California bankers, and in response to a suggestion by Mr. King that the Council might find that study interesting, Chairman Martin said that the Board would look into the question of whether it could be so distributed. After a further discussion of this question, Chairman Martin said that the Board would be glad to have individual members of the Council make suggestions on any aspect of the reserve problem that might occur to them.

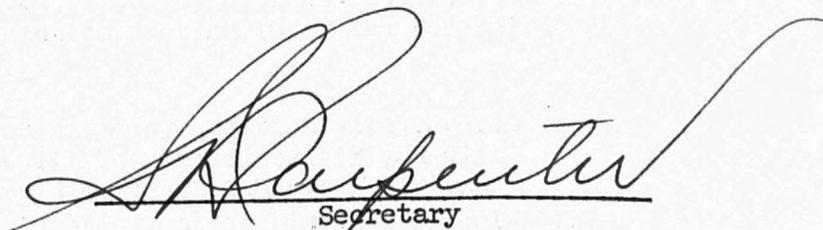
President Fleming stated that the next meeting of the Council was scheduled for February 17, 1957, with the understanding that the joint

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meeting of the Board and the Council would be held on Tuesday, February 19, 1957, and there was agreement that this arrangement would be satisfactory.

Thereupon the meeting adjourned.



A. Carpenter  
Secretary