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 February 18, 1958.

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 R
Gov. Balderston	x CCB	
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 of Governors in Washington on Tuesday, February 18, 1958, at 10:30 a.m.

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

Mr. Carpenter, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Brace, Massie, Sienkiewicz, Denton, Alfriend, Sibley, Livingston, McDonnell, Murray, Kemper, Jacobs, and King, 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 and Mr. Korsvik, Secretary and Assistant Secretary of the Federal Advisory Council, respectively.

Mr. Denton reported that at its earlier separate meeting the Federal Advisory Council elected him as President of the Council, Mr. Livingston as Vice President, and Mr. Prochnow and Mr. Korsvik as Secretary and Assistant Secretary, respectively. Messrs. Brace, Massie, and Sienkiewicz were elected as directors to serve with Messrs. Denton and Livingston, ex officio, as members of the executive committee of the Council.

Mr. Denton then introduced the new members of the Council, Messrs. Sienkiewicz, Alfriend, Sibley, and McDonnell, and Chairman Martin extended them a welcome on behalf of the Board. In his comments Chairman Martin said that the Board had appreciated the Council's advice in the past and wanted to continue to rely on its contributions. He asked that the members express themselves frankly on all matters, and in as critical a vein as they cared to, so that the Board might have the full benefit of their views.

The Council had submitted to the Board a memorandum setting forth its views on the subjects to be discussed at this meeting. The topics, the Council's views, and the discussion were as follows:

1. What are the views of the Council regarding the current business situation and the prospects for business activity during the next six months?

The members of the Council believe that the current downward trend of business is likely to continue for the next six months. Construction activity, Federal, State and local spending and the present relatively high level of consumer expenditures are sustaining factors tending to moderate the decline. The eventual reversal of present inventory liquidation policies and increased Federal expenditures may provide the basis for an improvement in business activity later this year. There are at present no significant factors which indicate a probable quick reversal of the business decline.

A substantial reduction in taxes and a sharp acceleration in the rate and magnitude of government expenditures might curtail and soon reverse the continued downtrend in business which the Council anticipates. However, the ultimate cost to the economy of such extreme measures might be significantly greater than the short-run advantages.

Mr. Brace reported that in the First District the downward trend of activity was continuing, although it could not be said that the trend was accelerating. The shipyards were booming and the electronics field was sound but the metals trade was running out of backlog business rapidly and there was little sign of pickup. The textile business perhaps was optimistic simply because it could not go any lower, but at any rate there was some anticipation of a pickup in volume if not in profits. Consumer expenditures were holding up very well in soft goods lines but were disappointing in hard goods lines. The rate of savings was well maintained and was increasing in some areas, which provided an element of strength for the future but on the other hand detracted from current activity. In summary, Mr. Brace felt that the drift downward in business activity would continue and that activity would be at a lower level for several months to come.

Mr. Massie said that business activity in the Second District was quite well maintained until near the end of 1957, following which there was a rather sharp drop which was particularly noticeable in January. A lot of this was due to a slowing down of orders in the capital goods field. Employment was down quite a bit and a number of industries, such as the apparel industry, which would ordinarily have layoffs at this time had laid off more workers than expected. Reductions in defense orders were just now being felt although some of the cancellations took place previously. Several areas in the District were now rated as surplus labor areas, with nothing being done about the situation so far. Average wage rates had risen to a new peak of $2.13 an hour but the total hours worked were down, with the result that actual take-home pay was down somewhat. Consumer spending continued to be a sustaining influence on the economy; even the January figures showed the same or possibly a little better than the same month a year ago. Department store sales looked quite good. Nonresidential construction figures were holding up well and there would probably be a continuation of the construction of office buildings in New York City as well as a lot of construction in upper New York State in connection with the St. Lawrence Waterway and power projects, in addition to quite a heavy road building program all over the State. Residential construction seemed to have stopped moving downward about September or October but it would not be possible to tell until this spring whether there would be any substantial change in trend.

In summary, Mr. Massie said, the Second District went along at a very high rate until just recently. However, the ensuing drop was rather severe and it appeared that the trend would continue for some time. At present it was not possible to tell just how bad the situation might become.

Governor Vardaman inquired of Mr. Massie concerning the prospect for occupancy of the large office buildings constructed in New York City and the latter replied that rentals were good, at least up to the present time, despite the heavy rate of new building. He understood that something like 25 additional buildings were now contemplated. As a general rule, he said, it is difficult to finance such a structure until evidence can be shown of a substantial number of good leases running until at least the termination of the mortgage and in most cases ground is not broken until the leases are all buttoned up and permanent financing is available. In a few cases, the parties had been taking a chance on the basis that the mortgage market might open up further this spring but generally speaking it had been possible to fill the buildings with good lessees. One factor had been that large corporations with offices scattered around the city were consolidating their offices in the new buildings.

Mr. Sienkiewicz reported that activity in the Third District had continued downward steadily since the spring of last year through January of this year. This had been marked by production cutbacks, heavy layoffs of personnel, and a shorter work week, these developments being most pronounced in durable goods industries. The curtailments in nondurables had been less extensive and less severe; in fact, there had been improvement in some nondurable goods lines. Reductions in building activity had been due primarily to bad weather conditions since the demand for multi-family dwellings and small houses continued in good volume and the demand for other types of buildings was quite strong. Plans for capital expenditures had been revised downward for all industries except public utilities and the rate of spending for plant and equipment was estimated at about 15 per cent below a year ago. However, the extent of obsolescence in plant and equipment in Philadelphia, particularly in nondurable goods industries, was still large and would require more capital. In mid-January, unemployment in the district was running about 7 or 8 per cent of the total civilian labor force. The demand for all classes of workers, including professional men and those with technical skills, had slackened considerably and many were now on relief. Unemployment compensation claims had been increasing substantially since last fall and it was estimated that at the turn of the year 265,000 workers in Pennsylvania were receiving unemployment insurance benefits. The broad effect had been to cut personal income and reduce spending, and the degree of caution in consumer spending was becoming more pervasive. This was being aggravated by statements from various sources which tended to undermine general confidence.

Mr. Sienkiewicz said that the present business letdown seemed to be an inevitable consequence of a period of boom activity during which excesses developed and that the current slump showed all of the earmarks of an inventory readjustment. Stocks of goods, including automobiles, had been growing almost steadily since 1956 and production cutbacks followed, along with inventory liquidation. The most rapid reduction of inventories at present seemed to be in raw materials and unfinished goods while stocks of finished goods were larger than last year. However, the point might be approaching when buying would be resumed. In addition to the usual seasonal pickup in production and employment during the spring season, there seemed to be a good chance for gradual recovery in the second half of the year. This, he felt, would depend primarily on the attitude of consumers. Current incomes continued large and could be expanded by consumer credit if confidence was maintained. Increasing expenditures by Federal and local governments and for private residential and commercial construction were among the strong factors. He expected little change in prices due to the rigidities which had been built into the price structure. Automatic wage increases this summer might stimulate some buying and it seemed doubtful whether additional demands for wage increases and fringe benefits would be resisted strongly by employers. The inflationary implications of such a situation were obvious. An unfortunate aspect of the matter, he said, was political interference with natural processes of adjustment. If certain things were done in an effort to restore the business boom regardless of the consequences, the result might be renewed inflation with a vengeance.

Mr. Denton said that business in the Fourth District was bad in relation to what it had been previously, although good in relation to the bottom of a depression. The amount of unemployment was growing and was quite substantial. In order to appraise the current situation and the outlook in diverse fields of activity, he had checked groups of companies in various lines of business. In alloy steel the three companies that he checked showed a similar pattern, with business having started to decline last spring and a little upturn in incoming orders in November. January appeared to be a bit ahead of November, and February was continuing about as good as January, although minor variations appeared to be on the down side. One company said that it did not feel the bottom had yet been reached as far as its own business was concerned. Companies supplying the steel industry found incoming orders down about 50 per cent and the construction business, including road building equipment, saw no signs of an upturn. As to the aluminum industry, incoming orders showed no improvement but neither were they worse. The downward trend started for them about last July and continued quite sharply into November, following which things had been quite even, with no signs of an upturn. The price structure on the production side had broken materially. Companies in the carbon steel industry reported that their business had flattened out at about the November-December level. As yet there was no pickup but the trend of inquiries had increased recently and they believed that there might be a little upturn through the spring months. The oil business was poor with demand off, inventories high, and product prices softening. In the chemical field the companies were all pessimistic and there was surplus capacity for the ingredients used in making up plastics. The coal business had dropped off sharply, with even the demand on the part of utilities down somewhat, and no upturn was seen. The railroads saw no prospect for improvement and their business was down sharply from a year ago. In electrical goods, orders were off, while incoming orders for heavy equipment were declining. The latter development might have an effect continuing into 1959 and 1960 due to the lead time involved in this business.

In general, Mr. Denton said, practically no upturn of any significance was foreseen in the Fourth District for the next six months. Perhaps after Labor Day, with the normal fall pickup in business, there might be a turn. He concluded by saying that the forecast did not take into account the possibility of extreme Governmental action such as a drastic tax reduction.

Mr. Alfriend reported that the situation in the Fifth District was a little bit different because agriculture was such a large influence in that district. Industrially, bad times in Eastern Carolina and Eastern Virginia had definitely affected sales of new and used automobiles and appliances, with the percentage of repossessions up sharply in those areas. The improvement which had been hoped for in the textile field did not materialize and cautious buying was the order of the day. In bituminous coal there had been a sharp decline in November and December, as well as in shipbuilding at Baltimore and Hampton Roads. There was, however, a good backlog of shipbuilding orders in Newport News.

To date, Mr. Alfriend said, there had not been too much laying off of workers in the district but rather a reduction in manhours, and this was somewhat in contrast with the more highly industrialized areas. However, in talking with various people in the district he found the same feeling of uncertainty and unhappiness which had been expressed by others at this meeting. In his bank's annual report and in his report to the bank's shareholders, he had gone as far as predicting no upturn until the last quarter of the year. Now he was not too certain of his own forecast, but he felt that certainly there would not be any substantial pickup before that time. The stable points in the district were largely those places where military installations are located. In general, the downward trend in the district was continuing.

Mr. Sibley said he could go along with the general statement that business had turned down. As to employment, however, the Sixth District had not been hit as hard as the nation generally. Employment hit a peak about last June and since that time there had been a gradual slackening off, running about one per cent as compared with 1.8 per cent for the country as a whole. This appeared to be due to the composition of the district's economy, since 54 per cent of the employment is in about 36 per cent of the industries that make up total employment and only 14 per cent is in those industries where unemployment throughout the country is now greatest. Tennessee and some parts of Alabama had been hit quite hard by unemployment, but the Sixth District, taken as a whole, was in better shape than other parts of the United States. There had been some slackening off in construction; in 1957 residential construction dropped off somewhat but it now had picked up a little. This had an effect on the lumber industry, which is one of the district's basic industries. Textiles had been down for a number of years, they hit a low point in the latter part of 1957, and if there had been any improvement since then it was not noticeable yet. The lumber business was showing some improvement while the paper and pulp industry, which was among the last to be hit, had shown some slackening off over the last few months. In general, sales held up well through the end of 1957 but there was a little more difficulty in making collections in the latter part of the year. Agriculture appeared to be off considerably.

Mr. Sibley went on to say that Florida was one of the States holding the district up and that business had been hard hit by the recent weather. He could not say at this time just how severe the results would be. In summary, he felt it could be said that the Sixth District was probably in better shape than the nation as a whole. At the same time it was feeling the downtrend of activity which other members of the Council had described at this meeting.

Mr. Livingston pointed out that the picture in the Seventh District economy can be divided between agriculture on the one hand and manufacturing and transportation on the other hand. The agricultural situation could be termed satisfactory, if that statement can ever be made about agriculture, but manufacturing and transportation presented a different picture, considerably worse than last November. While retail sales had held up surprisingly well except in durable goods, car loadings were down, dealer stocks of automobiles were high, and sales of cars were very disappointing. Unemployment in the district was increasing generally and in Detroit the situation was somewhat critical, with upward of 120,000 people, or about 11-12 per cent of the total labor force, now unemployed. In Chicago there were about 100,000 unemployed. The construction business was fairly good, with more office buildings built and being built in Chicago than in the preceding 40 years. The oil business was not good and there was a large oversupply of gas due to the fact that last year was a good one for burning oils and the refineries wanted to be sure that they had enough this year.

Mr. McDonnell said that the Eighth District seemed to represent a fair cross section of the country. Manufacturing activity, rail freight movement, and coal mining had contracted at levels well below last year. Unemployment was increasing and St. Louis and Louisville now had substantial labor surpluses. Construction activity continued at a relatively high level and retail trade was holding up quite well. Also, the two industries for which St. Louis is best known (beer and shoes) were holding up quite well. In agriculture the most serious problem derived from the damage to the 1957 cotton crop, which is the most important cash crop in the area and accounts for about 75 per cent of cash farm income. Last year this dropped to 67 per cent of the previous year and well below the ten-year average, with Southeastern Mississippi particularly hard hit. However, farmers can come back quickly and one good crop could correct the situation. In other respects, conditions were just about average, with business still being done at high levels. These levels, he pointed out, only looked bad when compared with the earlier boom situation, and he considered the current movement as more in the nature of an adjustment than a serious recession.

Mr. Murray reported that the situation in the Ninth District may have started to level off in February. In Montana, the current decline had been felt quite seriously as long ago as early last year. Now it was the feeling in that area that activity was probably at the bottom, but no substantial upturn was foreseen in the near future. In Michigan, ore shipments were probably down further from last year. Unemployment was moderate throughout the district and weekly earnings in December were higher than in December 1956. Construction was down somewhat but the volume of building permits filed in December was up. There was some indication that residential construction would perform a little better in 1958 than 1957, with more money available for home financing and some reduction in interest rates. Retail sales were holding up well, not only in the cities but also in the rural areas, and were running a little bit better than the national average. Another strong point was the agricultural picture, with estimated farm income last year up one percentage point more than the nation as a whole. There had been a good moisture situation and quite an open winter so that range conditions were good. The feed situation also was good and agricultural prices had held up well.

Over-all the decline in the Ninth District seemed less severe than in many of the highly industrialized sections of the country and a number of people seemed to think that the decline had reached bottom. On the other hand, few businessmen were found to be very optimistic and there was still some inventory reduction to take place. Mr. Murray did not look for much pickup until fall. However, if there should be a good crop this year the district should have good fall business.

Mr. Kemper said that in the Tenth District agricultural conditions looked better than in several years. There had been good moisture all through the district and a good crop in 1957. Acreage was 26 per cent higher for winter wheat than in 1957, and estimates at this time were to the effect that there would be almost a 50 per cent better wheat crop than last year. In general, prices had been very good, although there was some decline in corn and oats since the first of the year, and in price terms there was a very good livestock-feed ratio. Cattle numbers as of the first of the year were 2 per cent higher than a year earlier although cattle numbers throughout the nation were down. In summary, it looked as though both the farmers and cattlemen would be very prosperous over the next year.

Mr. Kemper then said that employment was off substantially throughout the district, although the rate of unemploymment was lower than for the nation as a whole. In particular, there was unemployment in Wichita due to layoffs in the aircraft industry, there had been quite a few layoffs in Kansas City, and New Mexico was the only part of the district showing an increase in factory employment. Retail trade had held up fairly well, the volume being down only about one per cent, but this relatively good picture was due largely to sales of soft goods as sales had been slow for hard goods. Automobiles had been stacking up substantially and contractors' equipment was not moving. Retail stocks were up generally and merchandisers had not been able to correct the situation. The level of construction awards in the district had been excellent, with a gain in December of about 10 per cent over the previous year, largely in public works and utilities and to a lesser extent in residential construction. Poor weather had affected retail trade to some extent. The milling business had not been particularly good; some large mills were considering closing down and confining their business to storage only.

Mr. Kemper concluded by saying that, as compared with the national outlook, the outlook in the Tenth District was excellent even though some developments, such as the decision of a large manufacturer to defer a plant expansion program, did not make the district too happy.

Mr. Jacobs summarized a survey that he had made of bankers and businessmen in the Eleventh District by saying that as a whole they expected business in 1958 to be as good as or better than in 1957. He went on to say that it is impossible for those who have not seen drought areas to know what continued good rains mean. With the better rainfall the ranchers and farmers in the western part of the district felt that 1958 would be a much better year than 1957, and even so the last part of 1957 was not too bad. The only bad part of the agricultural picture was in the eastern part of the district, which experienced one of the earliest freezes on record and continuous rains thereafter, with the result that a great deal of the cotton crop was lost. It now appeared that there would be about the same amount of land put into the reserve program in 1958 as in 1957. Business inventories were fairly stable and, while some felt that inventories were a little large in comparison to sales, they did not appear to be overly burdensome. In construction the reports were mixed. Industrial building seemed likely to show a decrease but the residential construction outlook was very good. There was an overhang of excess residential construction in only two areas, Fort Worth and Houston. In the area of credit, the demand for loans continued strong and for the first time in many months insurance companies were taking warehoused loans as fast as the banks could get them together. The oil situation showed little change since the last meeting of the Council, although it might be a little worse. The pipelines were not taking even the proration but the situation had not yet created a great deal of unemployment.

As a whole, Mr. Jacobs said, the sentiment of the people appeared to be better than last September. It was the general feeling that the Federal Reserve had done a good job but that a little more monetary ease might be in order. Without exception, the bankers felt that now was the time for the Federal Reserve to go to Congress for legislation on reserve requirements.

Mr. King stated that the Twelfth District to a large extent was following the national pattern. The aircraft industry, which accounts for 23 per cent of the wage and salary payments of the district against a national figure of about 7 per cent, started down in volume and employment late last year and the downward trend in employment was continuing. The industry did not think that any action on the part of the Government would reverse that trend before the latter part of the year. The lumber industry, which in combination with the aircraft industry represents about 1/3 of the value of manufactured products in the district, had been depressed for a longer period of time than the aircraft industry. However, more optimism was noted in that area, some people feeling that the situation had hit bottom and was starting up. Construction continued strong, even through January, and many anticipated that more housing would be built in the district this year than last year.

Mr. King said that he was surprised how little unemployment there was in an area like Los Angeles, the estimate in January being only about 5 per cent. Two areas, Portland and Spokane, reported substantial unemployment. Department store sales were following the national pattern. A good deal of pessimism was found in the oil industry and there was also a low spot in the metals area, including aluminum, copper, and some of the less important metals. Partly because of the predominance of the aircraft industry, it did not seem likely that the economy in the Twelfth District would turn around before late in the year.

Mr. Carpenter withdrew from the meeting at this point.

2. How does the demand for credit at the present time compare with demands at this season a year ago? If an increase in demand is anticipated during the next three months, in what fields of activity is this most likely to arise? What is the credit demand outlook for the last half of the year?

All members of the Council report that the present demand for credit is considerably less than the demand at this season a year ago.

Although there may be some borrowing for tax purposes, there appears to be little likelihood of any important increase in the demand for bank loans in the next three months.

The credit demand for the last half of the year is likely to show some increase, reflecting the usual fall borrowing, inventory restocking following the present liquidation, and greater business activity resulting from larger Federal expenditures.

Mr. Mills referred to the concern which had been expressed several months ago about the impact on the aircraft industry of cutbacks in progress payments by the Defense Department and the burden that this would put on banking facilities.

Mr. King commented that most of the borrowing in the aircraft industry was in the East. He was aware of the concern expressed when the cutbacks in progress payments were inaugurated but he did not know of any concern at the present time about inability to obtain sufficient money for the financing of operations.

Mr. Massie said that at first everyone was greatly concerned, for estimates indicated that the cash needed to finance contracts might not be available. After about three weeks, however, the rules were changed and although in some cases arrangements had to be made for somewhat higher credit lines, there were means of getting necessary financing. Unless something unforeseen should develop, it appeared that the situation had straightened itself out satisfactorily.

Mr. Shepardson then inquired about the agricultural situation in the Sixth District in the light of recent weather conditions, and Mr. Sibley said he was quite sure that a great deal of the peanut crop had been lost. Likewise, the citrus and vegetable crop losses in Florida were bound to have created distress, especially where people were not entitled on their credit rating to bank credit.

Mr. Jacobs reported that there was only one serious incident of distress in the Louisiana area and that was in a section where five large plantations experienced two floods which ruined the crop. Financial assistance had been extended through Government sources working with the commercial banks.

Mr. Vardaman inquired about reports on the cattle situation in Florida in view of the cold weather and asked whether this would have a serious effect on the over-all economy of the Sixth District.

Mr. Sibley responded that in Florida people had always depended on carrying cattle through the winter on pasture, so that the present situation was quite a hardship for them. There was some question, he said, about conditions under which aid could be given, and in certain sections there was unquestionably a good deal of distress.

3. The Board would appreciate the views of the Council as to what would be an appropriate credit policy over the next three months.

The Council believes that appropriate credit policy over the next three months would provide for moderately easier credit. The implementation of this policy should include some reduction now in required reserves.

Mr. Balderston inquired of Mr. Denton what use the banks would make of reserves released through a reduction in reserve requirements, to which the latter replied that although there were excess reserves in the banking system as a whole the distribution was not even and there continued to be points of pressure. While a lot of banks in his area, particularly smaller banks, had an easy reserve position at present, the pressure on certain institutions for loans was such that it was not a bit unusual for those banks to be borrowing money. This was true, for example, in the case of his own bank.

Mr. Livingston said that banks could make more loans if reserve requirements were reduced, and that this was exactly what would happen in the case of his own bank. Temporarily, his bank was in a relatively easy reserve position. However, this reflected the fact that the bank had adopted a policy when its reserve position was tight of not making certain loans which it would ordinarily make and the restrictions embodied in that policy had not been removed.

Mr. Massie said that for the last one and a half years many banks had struggled with a volume of loans greater than the volume which would have prevailed if there had been nothing more in the picture than operations under the established policies of those institutions. During this period, however, it was necessary to take care of the heavy demands of customers. The current reduction of loan demand was not sufficient to permit the banks to get back to the point where there was any freedom of action, for they had had to undermine their secondary reserve positions to carry the large volume of loans for the last year and a half. At some time these secondary reserve positions would have to be rebuilt because the banks had gotten down to a point where they had barely enough liquidity to take care of what they were handling and yet were faced with unused commitments which, if used, would have put them in terrible shape. This all meant that these banks must get some additional money or shrink up their loans to rebuild the secondary reserve position.

In response to a further question by Mr. Balderston, Mr. Massie said that additional reserves would be used both to rebuild liquidity and to make loans. If any kind of upturn in business should start, the banks at present would not be in shape to handle the additional loan demand unless they got some more money.

In reply to a question from Mr. Vardaman about loan participations Mr. Massie said that the large corporations had been borrowing in such volume that practically every loan was a syndicate arrangement. When credit was very tight, it was necessary to refuse to make brokers' loans in participation with correspondents in areas that did not generate their own loans. The syndicating of big loans, he said, is really done by the large corporations themselves. The corporations have gotten so large that their demands for credit are beyond the legal limitations for any one bank.

With further reference to Mr. Balderston's questions, Mr. King said that in the Twelfth District he felt that more interest would be shown by the banks in interim real estate construction loans if more reserves were available.

Mr. Sienkiewicz said that the Federal Reserve had contributed to lowering the cost of credit through reduction of the discount rate but that nothing as important had been done to contribute to the greater availability of credit. Therefore, it might be a wise move to show that the banking system stood ready to provide all of the credit needed. This might help to stop the drive for tax reduction and other measures now being discussed in some quarters and it might make it easier to stimulate the adjustment of the economy.

With reference to Mr. Vardaman's question, Mr. Jacobs said that at present it is hard to find anybody who wants to borrow for 30 days and that instead the demand is for credit for two or three years. He did not think that the banks, in the event of a reduction in reserve requirements, were going to do any bad financing but he felt that it would be helpful if they had a little more money with which to operate.

Mr. Szymczak noted that this posed a problem. On the one hand the banks wanted to get into longer-term loans to help the economy while on the other hand they wished to improve their liquidity.

Mr. Livingston stated that in the case of his bank the volume of loans was about the same as in February last year. The bank was still heavily loaned and the lending officers were "under wraps," with certain definite limitations having been imposed. Thus in his case, at least, the bank would make more loans if reserve requirements were reduced.

Mr. Denton stated that in his bank loans were higher than a year ago and the bank would be in bad shape to take care of any additional demand which might come. The situation had been so tight in the last one and a half years that if the economy should require anything more in the form of credit it would be difficult to take care of the situation.

4. How should monetary policy be adapted to make its maximum contribution to the solution of the longer-range problems of the foreseeable future?

Maintaining the value of the currency and providing an expansion of credit required for the continued and orderly growth of the economy are two longer-range problems of the foreseeable future. Monetary policy can make its maximum contribution by a continuous reappraisal of the credit required for the long-run growth of the economy and by the necessary flexibility in policy to meet recurring short-run fluctuations of the economy. An adequate supply of credit over the long-run can be best assured by a gradual reduction of the required reserves of the banking system. The Council believes that the present time is especially opportune for the introduction of legislation designed to overhaul and modernize the present system of reserve requirements. As the Council has heretofore stated, the recent A.B.A. study provides a comprehensive basis for this reform.

President Denton recalled that in 1957 the Council on two occasions raised with the Board the question of a basic change in the structure of member bank reserve requirements. On one of those occasions the Council suggested that although economic conditions at the time did not appear to be appropriate for an actual reduction of reserve requirements, it seemed that it would be desirable to look forward to that kind of an action. Now, to some degree at least, the situation was reversed. If conditions previously were not suitable to making a start in that direction, present conditions might make it a good time to go forward.

Chairman Martin responded that the Board had been giving a great deal of thought to the longer-range problem and was prepared to present its tentative conclusions to the Council. He said that personally he felt some sense of responsibility in this field because he had encouraged the American Bankers Association to make a study of reserve requirements. Such a study had now been made and it represented a useful and valuable contribution. Since then the Board had been struggling with the problem and, as always, the element of timing presented a difficult question. In this connection, he emphasized that the remarks which he would make were directed toward the longer-run problem, whereas most of the comment in the press recently had been directed toward the short-run aspects of the matter.

Chairman Martin went on to say that personally he saw a need for a lower level of reserve requirements and that the actions taken by the Board in 1953 and 1954 had constituted moves in that direction. He said that the Board had analyzed the proposal of the American Bankers Association to the best of its ability and that this proposal might well represent an ideal plan if the Board "had a clean slate on which to write." However, the proposal could not be considered without thinking of the world in which we are operating and the many uncertainties that are involved.

Proceeding to the several basic points in the ABA plan, Chairman Martin said there was full agreement within the Board regarding permissive legislation which would allow vault cash to be counted as part of a member bank's required reserves. Here again, however, he was not referring to the question of timing but to the desirability of permissive legislation. On the other hand, regardless of the long-run objectives which were sought, the Board found unpersuasive the part of the ABA plan which would set up a target date for completion of the transition to a new level of reserve requirements, since progress toward objectives must be fitted in with the needs of monetary policy and other considerations and it would be unfortunate to bring about a situation where progress would be measured frequently in terms of the specific target date.

At the same time, Chairman Martin continued, it must be recognized that the Board already had considerable latitude for movement under present statutory authority. Therefore, while the Board had approached the problem with the definite conviction that the present law should be modified, it wondered how much additional authority was actually needed. It seemed to the Board that the most desirable approach was in terms of presenting as simple a legislative recommendation as possible consistent with moving in its discretion toward agreed upon objectives. In this connection, the Board observed that the minima of the reserve requirement ranges fixed by the present law were such as to permit moving almost all of the distance toward the levels that the American Bankers Association had suggested.

In substance, Chairman Martin said, the Board had come out in its tentative thinking to the feeling that it would like to present the simplest possible type of suggested legislation to the Congress fairly shortly. It had not committed itself to any specific kind of legislation and the Council's views would be appreciated. However, it was only fair to let the Council know that the Board had devoted a lot of thought to the subject and had now come to some fairly firm views.

The legislation which the Chairman then described to the Council would consist, in addition to provisions relating to vault cash, of provisions which would broaden the exemptive power of the Board in such a way as to permit it to reclassify any member bank from the reserve classification into which it would otherwise fall, on the basis of the character of business transacted. As the Chairman noted, the Board now had authority to permit a bank in an outlying section of a central reserve or reserve city to carry lower reserve balances, and the proposal would broaden that authority. He then said that the Board had been discussing two alternative forms of possible legislation in this respect. Under the first alternative a bank could be permitted to carry reserves applicable to a bank in one of the lower reserve classifications now prescribed by statute. Under the second alternative the Board would be authorized to establish additional gradations of reserve requirements. For example, instead of moving a bank from the reserve city direct to the country bank classification, the Board could move the bank to an intermediate level. The Board was aware that this would create a certain amount of administrative difficulties but it would help to eliminate some of the inequities in the existing structure, or at least move in that direction. In this connection, the Board did not find that any of the plans thus far presented would remove all inequities.

Chairman Martin also said that the Board had had some lengthy discussions about savings and other time deposits, with the thought of requesting legislation which would permit distinguishing between such deposits for reserve purposes, but it had just about come to the conclusion that such legislation should not be sought at this time.

The Chairman commented that the Board had scheduled a meeting with the special committee on reserve requirements of the American Bankers Association on February 21. While the Board wanted to have the benefit of suggestions and comments, he was hopeful that publicity could be avoided for the present and that attention could be focussed on broad aspects of the problem rather than on details. He concluded by saying that he wished to make it entirely clear that the Board retained its right to take any action which it might deem appropriate under its present statutory authority.

In response to a question, Chairman Martin reiterated that his remarks had been directed toward possible legislation and the longer-range problem and that he wished to have no misunderstanding on that score.

President Denton indicated that he was somewhat concerned about the possibility of having one or more additional reserve classifications, and Chairman Martin responded that the Board itself was divided in its thinking on that point. Some of the members felt that it would be preferable not to get away any more than necessary from the present system while others felt that the more liberal authority under the alternative form of legislation would permit more progress in moving away from geographical distinctions and toward reduced levels of reserve requirements. He added, however, that when the discussion within the Board came to the question of uniformity in reserve requirements it was not possible to reach agreement on what the basis of uniformity would be, some feeling that the basis should be size while others thought in terms of velocity of deposits or other criteria.

President Denton then stated that a formula based on velocity of deposits would bother him very much. He said that there had evolved in the banking business a concept of dealing with customers which had activity as an objective and that every effort was now being made to obtain activity in the accounts. This provided service to the community and tended to make the bank closer to its customers. To put a penalty on deposit activity therefore would fly in the face of standard banking practice. In other words, it would seem unfortunate to put a penalty on a bank's success in getting active customers as opposed to dormant accounts.

Mr. Massie said that as a member of the American Bankers Association's Economic Policy Commission he was one who pleaded strongly against including any target date in the reserve requirement plan, because he felt that it should be within the power of the Board to move in its discretion in the light of open market policy and other considerations. With regard to velocity, he brought out that the situation was somewhat different in New York City than elsewhere. In that city the current demand deposit totals were about the same as in 1948, with only a modest increase in time deposits, while for the country as a whole bank deposits were up considerably over that period. This meant that the New York City banks had been trying to meet the loan volume incident to a boom period with a limited amount of money, and therefore the available money had been turning over rapidly. In such circumstances, he did not think that a penalty on velocity would be justified. Mr. Massie concurred in Mr. Denton's comments about seeking activity in accounts and pointed out that dormant accounts were the first to be closed when the money market tightened. With regard to the possibility of establishing additional gradations of reserve requirements, he suggested that in thinking of the problem as a whole one must think of practicalities. The establishment of additional gradations, he thought, would increase administrative problems quite a bit. In a further comment, he said it was true, as Chairman Martin had pointed out, that plenty could be done within the framework of present statutory authority.

Mr. Sienkiewicz also expressed the view that additional gradations would complicate the problem. He suggested that if the present ranges of reserve classifications could be narrowed it might be possible to use this policy instrument more effectively, offsetting any ill effects of a change in requirements through open market operations. At present, he said, the instrument was more in the nature of a blunderbuss and the current ranges tended to create too much uncertainty.

Mr. Szymczak then made a statement in which he recalled conditions at times in the past and suggested possible situations in the future when limitations on open market policy were or could be such as to necessitate increased reliance on reserve requirements in the execution of System policy. After Mr. Szymczak's comment, Mr. McDonnell raised the question whether action on individual applications was a responsibility which the Board would want to assume, since he envisaged that pressures would be brought to bear.

The Chairman replied that upon reviewing the list of member banks it appeared to the Board that there would not be more than about 200 questionable or borderline cases. While there would no doubt be pressure in some cases, the Board would be able to break out of its present frozen status and start to move in the right direction.

Mr. Murray inquired whether classifications of banks would be made public, to which Chairman Martin replied affirmatively. He went on to say that the vault cash situation deserved consideration in thinking of the problem as a whole, since country banks as a group maintain a higher percentage of vault cash than reserve city banks and the latter a higher percentage than central reserve city banks.

Mr. Massie said that it had been his view that it would not be desirable to seek legislative action on vault cash until that situation could be studied in relation to other aspects of the whole problem of reserve requirements, since he felt that to get favorable action on any broad plan would almost require having vault cash as a part of the plan.

Mr. Livingston then inquired whether, if a plan of the kind outlined by Chairman Martin were to be agreed upon by the Board, the Council would be given an opportunity to look at the proposal in precise form before a bill was introduced.

Chairman Martin replied that the Board certainly would try to give the Council a little time but that the Board was struggling with a time factor at this point and could not commit itself to meet again with the Council. If desired, however, arrangements perhaps could be made for a meeting with the executive committee.

With further regard to the time factor, Mr. Vardaman commented that any proposal submitted to the Congress after the fifteenth of March would have very little chance of passage at this session, particularly if it was the least bit controversial. With reference to the manner in which the plan would be intended to operate, he said that the classification of banks might not cause a great deal of difficulty because the character of business of most banks would make their classification almost obvious and changes within individual banks take place gradually. However, the Board would be able to take care of a situation where a small bank is located in the downtown section of a large city and also a situation involving one or a few large banking organizations in a relatively small city. Mr. Vardaman then went on to suggest why it seemed necessary for the Board and the banking profession to work together as harmoniously as possible if any legislation was to be obtained.

With reference to his previous question, Mr. Livingston said that as a member of the Council's executive committee he would not be enthusiastic about a study of legislation such as described at this meeting if the time for consideration of it was to be severely limited. If the discussion at this meeting was intended to be the extent of the Council's exposure to the plan, he felt that it should be understood that the Council would have the right subsequently to disagree with the plan if it so desired.

Mr. Balderston said that he was impressed by the fact that the country was now in a period of recession the severity and duration of which could not be foreseen. It was a time, he suggested, which called for the maximum in business statesmanship and one when he, as a member of the Board, felt humble in his position because of the difficulty in knowing the right move to make at any particular time. In the area of reserve requirement legislation it seemed to him that the Board might be well advised to put forward the simplest kind of proposal consistent with enabling it to move over a period of time to the fundamental objectives on which there was mutual agreement. Personally, he did not think that it would be socially or competitively desirable for all banks, large and small, to have exactly the same reserve requirements simply because they happened to be in the same location geographically, but to him this was more or less of a detail. The general objectives were to make the whole banking system more efficient and to use such funds as were available to foster the economic growth of the country without stumbling into inflation or deflation. If there was agreement with these general objectives, it would appear that the simplest possible form of legislative proposal consistent with their achievement would stand the greatest chance of success in the Congress. As Chairman Martin had indicated, vault cash legislation would represent a partial solution to the problem, and perhaps the Congress would be willing to approve such legislation. However, as Mr. Vardaman had suggested, the whole matter must be approached with delicacy, for misunderstandings could easily arise in the Congress regarding the purpose of reserve requirement legislation, as exemplified by certain statements found recently in the Congressional Record which had as their basis a rather carelessly written article in the press.

Mr. Balderston went on to express concern that at this time, particularly, the whole banking fraternity exhibit the maximum of business statesmanship and not present a posture that might seem to critics to display selfish motives. In the current dilemma of falling employment while the price level was not receding, he considered it very important for the leadership in the banking profession to see that the public was properly informed, that its economic literacy was improved, and that the most careful explanations of the national problem were presented.

Returning to the manner in which the Board's reserve requirement proposal would operate, Mr. Brace asked whether it was envisaged that there might be four or even more classifications for banks in the same city, and Chairman Martin replied that theoretically this was a possibility. However, he did not know whether it would work out that way in practice.

There followed questions relating to the possibility of upward classification, and the responses were in terms that cities might be classified upward in certain circumstances following which exemptions could be granted for applicant banks in those cities if the character of their business did not warrant the higher classification. The discussion then turned to the standards of classification which might be established by the Board, and it was explained that the proposal had not yet progressed to the stage where decisions had been made on the weight that should be given to various factors, at least in precise terms. In the course of this discussion Mr. Shepardson brought out that whenever there is a change in long-established practices the ensuing period of transition is bound to involve problems and perhaps temporary inequities. However, the flexibility inherent in the Board's plan should make it possible to meet problems as they arose more easily than under a program containing rigid requirements. Of course, giving this much flexibility for action to the Board would call for confidence on the part of the banking profession that the Board was going to use this flexibility in an equitable manner as the situation required. This general philosophy would naturally have to be worked into a formula at some point but for the moment the Board was not prepared to spell out such a formula.

Chairman Martin assured the Council that the plan was not being put forward as a "take it or leave it" operation on the part of the Board. The Board wanted to share with the Council the difficulties it had experienced in working out a plan and it would welcome the Council's reaction and comment. The plan, he said, had not been arrived at easily but the Board had gradually firmed its thinking in the direction of a program such as outlined. He then emphasized again the distinction between the short-run and the longer-range problems.

Chairman Martin made the further comment that if the Council should decide it did not want its executive committee to consider the proposal, that was perfectly all right. The Board would like any help but it recognized the right to disagree with the plan and was not pleading for support of it.

5. Does the Council have any comments on the Bill, H.R. 10345, introduced by Congressman Patman on January 29, and the companion bill by Senator Johnson, S. 3191, to create a Small Business Capital Banking System?

The members of the Council believe that the creation of a Small Business Capital Banking System as proposed in H.R. 10345 and S. 3191 would be contrary to the public interest. The Council understands that the Federal Reserve System is making a study to determine whether there is a need for small business capital. If the study indicates that the need exists, consideration should be given to measures which would enable the present banking system to satisfy the need.

In a private enterprise economy, capital flows to enterprises in which the return is commensurate with the risk. If capital fails to flow to certain enterprises, it indicates that the return is inadequate in relation to the risk. It is a serious question whether uneconomic enterprises, which do not attract capital, should be encouraged by public funds, with the risks assumed by the community, and the losses borne by the public generally.

Following comments by President Denton to the effect that the Council did not believe that another banking system ought to be set up and that there were too many at present, Chairman Martin said that some of the preliminary results of the Board's current study of small business financing problems indicated the possibility that the report would contain material of such a nature as to lend encouragement to proponents of legislation of the kind in question. He agreed with the statement of the Council that consideration should be given to measures that would enable the present banking system to satisfy the financing needs of small business to the extent that such a need existed, and he recognized that the bills were not satisfactorily drawn in certain respects. Nevertheless, he felt that the problem ought to be given serious thought and that it would be difficult just to say that no system should be established to provide financial assistance to small business because it would compete with private capital.

Mr. Brace observed that there appeared to be some confusion due to a lack of proper definitions. In practice, he said, most cases where small businesses needed financing appeared to involve a need for equity capital rather than shorter-term money, and it was not clear whether there was a sufficient understanding of the problem in the Congress.

President Denton then said that the Council was concerned about the fact that over the years there had evolved a number of different types of financial systems, all of which were separate from the commercial banking system. This perhaps pointed to the need for a thorough study of the nation's financial mechanism. The easy method of setting up a new office for each kind of financing activity was one that the Council hesitated to see continued.

6. The report required by section 5(b) of the Bank Holding Company Act to be made by the Board will have to be submitted before May 9, 1958, which will be prior to the May meeting of the Council. Accordingly, if the Council has further comments with respect to the Act which it wishes to discuss with the Board prior to the submission of this report, they should be presented at the February meeting.

The Council has no comments, other than those previously submitted, on the Bank Holding Company Act.

There was no discussion of this topic and it was noted that this was the last time that the item would appear on the agenda in view of the deadline for submission of the Board's report to the Congress.

Chairman Martin stated that it was of great help to the Board to have the advice of the Council. He urged each member of the Council to keep in touch with the Board and to let the Board know whenever it was felt that the policies of the Board were in error.

President Denton said that the next meeting of the Council would be scheduled for May 18-20, 1958, if agreeable to the Board, with the joint meeting of the Council and the Board on May 20.

Chairman Martin indicated that this was satisfactory to the Board, and it was understood that the meeting would be so scheduled.

The meeting then adjourned.

Secretary