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 September 16, 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 1/		x
Gov. Mills	x	
Gov. Robertson	x	
Gov. Balderston	x	
Gov. Shepardson	x	

1/ In accordance with Governor Shepardson's memorandum of March 8, 1957, these minutes are not being sent to Governor Vardaman for initial.

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, September 16, 1958, at 10:30 a.m.

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

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

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

1. What are the views of the Council regarding (a) the current business situation, and (b) prospects for the next six months? Does the Council find the evidences of business recovery general or confined to a relatively few sectors or areas?

The Council believes that the current business situation has improved since its last meeting with the Board. In general, the prospects for the next six months are for a moderate improvement in business. However, there are some problems, such as,

the relatively large volume of unemployment and the uncertainty of the automobile outlook which may adversely affect business recovery in the months ahead. The evidences of business recovery are comparatively widespread and include many economic sectors and most of the nation.

In his introductory comments President Denton stated that the situation varied somewhat from district to district and that each member of the Council therefore would summarize developments in his particular area.

Mr. Brace said that conditions in the First District continued to follow a pattern similar to that which existed at the time of the last meeting of the Federal Advisory Council. A few areas of activity, including electronics and shipyards, were doing well, but they were offset by a series of soft spots. The machine tool industry was far below year-ago levels and the pulp and paper industry, with overcapacity, was running at unsatisfactory levels from the standpoint of volume and prices. Therefore, there tended to be a leveling off of conflicting factors within the district. While over-all improvement was very minor, nevertheless the decline in activity appeared to have been checked and any movement was upward. At the same time, he did not expect that there would be any noticeable change on the upside in the next two or three months. Similarly, although unemployment in the worst spots throughout the district appeared to have been checked to some extent, he did not look for any substantial improvement in the next six months. The feeling on the part of consumers seemed to be reasonably satisfactory and the building trades were showing some improvement, although not as much as in some of the other sections of the country. Basically, the position of the district

appeared to be a strong one from which to improve, and there was cautious optimism. Conditions seemed to have bottomed out and there should be gradual improvement, but he did not get the impression that thus far conditions had improved as much as in some of the other districts.

Speaking for the Second District, Mr. Massie said that business seemed to have shown a slight upturn, particularly since July. Previously--that is, from April to July--there did not seem to have been much improvement. At present the district seemed to be waiting for the automobile, appliance, and apparel industries, all of which had been in rather bad shape. One of the biggest problems in the district was unemployment, and it appeared that the pickup in activity was being handled generally by increasing the number of hours in the workweek rather than by employing additional personnel. However, it now looked as though the apparel business would add some people to take care of the fall and winter trade. Although durable goods employment, probably the worst hit of all, had leveled off, no substantial upturn had taken place as yet. In finance and trade, the situation was a little on the sloppy side but employment in those sectors had not previously gone so far down. Here also, the lack of improvement reflected efforts on the part of management to tighten up on expenses and operate with less people. As compared with the week of July 5, the week of August 3 showed a substantially lower number of claims for unemployment compensation, so conditions seemed to be moving up in the July-August period whereas there had not been very much improvement before that. Improvement in New Jersey and Connecticut was probably a little

slower than in New York State and heavy unemployment was noted in places in all three States where heavy industries predominate. For the first time New York City was showing a rather substantial rate of unemployment, again reflecting the efforts of the finance and service industries to get along with less personnel. On the other hand, personal income had continued to be good and this was reflected in department store sales which, even in cities badly affected by the recession, were running about even with last year. Throughout the district department store sales in July and August were up 4 per cent from a year ago, compared with minus 1 per cent for the first quarter and plus 1/2 per cent for the second quarter, and it must be remembered that last year was a good year.

Continuing, Mr. Massie said that construction was a strong factor in the district. In the second quarter, activity was about even with the year-ago rate, but for July it was up 15 per cent with the greatest strength in public utilities and public works. For them the rise was 27 per cent in the second quarter and 40 per cent in July; in New Jersey public works and public utilities were up 100 per cent from last year. Residential construction also was going along very well, being up 18 per cent in July against last year, compared with plus 12 per cent in the second quarter and minus 2 per cent in the first quarter.

Altogether, Mr. Massie said, things seem to be moving up in the district but on a little slower schedule than in some of the other districts. Sentiment in the Second District seemed quite good and reflected itself in the stock market. The rise in market prices, he thought, would

tend to make people feel a little more prosperous and in a better mood to purchase durable goods and other commodities. In summary, things seemed to be headed in the right direction, for activity had reached bottom and had started up in a modest way. He looked for further improvement during the remainder of this year.

Mr. Sienkiewicz reported that in the Third District business activity and sentiment had improved rather sharply since the low point early last spring, but that generally the levels of activity continued well below the peaks reached in 1957. He judged that probably half of the decline had been recovered in a number of important industries, and the rate of operations in factories had shown a marked upturn. Output of steel and steel products was running about 74 per cent of capacity compared with a rate of 64 per cent throughout the country, while the textile plants were busier than for some time. Construction activity likewise had turned upward, although not to the same extent as in the country as a whole. Freight carloadings were showing some improvement after a heavy decline. While the employment situation had improved somewhat it was still unsatisfactory, particularly in the several surplus labor areas within the district. However, new and continued claims for unemployment benefits had been declining. Earlier downward estimates of capital expenditures were now being revised and in several industries increased outlays were reported. With a fairly large volume of obsolescence in the district, there was substantial need to overhaul plant and equipment.

Mr. Sienkiewicz went on to say that consumer income and

expenditures continued to be substantial and that retail trade was well maintained despite the decline in automobile sales reflected by new-car registrations in Pennsylvania which were running one-fifth below last year. The rate of inventory liquidation appeared to be slowing down.

As to prospects for the next six months, Mr. Sienkiewicz felt that the improvement was likely to continue, but at a slower rate than had prevailed since last spring. Inventory buying would sustain demand and would offset a modest relative decline in capital outlays. The demand for bank credit in the district did not yet indicate any great spurt in buying except at retail, with business loans running at a rate 5 per cent below last year. This, he felt, might reflect a strong cash position on the part of business units. Deposits were about 10 per cent higher than last year. In a concluding comment, Mr. Sienkiewicz expressed the view that the present recovery was quite general and not confined to any particular sector or area of the economy.

Mr. Denton said that he thought business in general had turned upward and would continue to improve over the next six months. One item supporting the improvement would be a change to an accumulative trend with respect to inventories, and it seemed to him that this change was likely to take place within the next six months. Mr. Denton then summarized reports regarding business trends and prospects that had been obtained through a check with companies in the district representative of a cross section of the principal industries. While these reports reflected substantial differences in the timing and extent of the upturn as well as

in sentiment regarding future prospects, nearly all respondents indicated at least gradual improvement, although in some cases from unusually low levels. In general, expectations for the fourth quarter of the year appeared to be decidedly on the optimistic side, with variations in the forecasts about the date of recovery to earlier peak levels.

Mr. Alfriend stated that the Fifth District does not tend to be as spectacular, either on the upside or on the downside, as the more heavily industrialized districts. Unemployment in the district was below the national level except in West Virginia. Durable goods manufacturing had continued at about a level rate since June and a slight upward trend was noted in nondurable goods. Department store sales followed generally the pattern evident all over the country, there having been a strong rise in July and the attainment in August of an all-time high for that month. To a certain extent this development seemed attributable to a better feeling -- with layoffs stopping and people thinking their jobs were not in danger -- rather than to any real improvement in business. In shipbuilding the picture was mixed, with Newport News in good shape but lower employment and the prospect of a strike in Maryland. In August an improved demand in the textile industry was noted, particularly for cloth for commercial purposes. As to bituminous coal, export coal dumpings at ports showed improvement but were down 29 per cent from last year and the European stockpile continued to grow. However, the pickup at steel mills was helping the sale of coal.

Construction, Mr. Alfriend said, was a very bright spot in the district, contract awards being up 34 per cent in July from June and up

64 per cent from July 1957, as compared with a 24 per cent gain nationally. After reviewing some of the large construction projects in the district, he discussed briefly the impact on the Roanoke area of layoffs in railroading and manufacturing but said that on the other hand some firms were beginning to call back workers in various parts of the general area. In agriculture the district had been having an excellent growing season despite the fact that earlier in the year there had been a collision of seasons because of cold weather, with the result that in many instances crops were left in the fields because it was not feasible to ship them. At present, however, crops all looked very good, including a particularly favorable peanut crop.

Summarizing, Mr. Alfriend said that the Fifth District had been experiencing improvement since early in May but that it was not yet out of the woods. He felt that it might be well into 1959 before activity could hope to be back at the levels which existed prior to the recession.

Mr. Sibley said that he had undertaken to communicate with some 100 persons in the Sixth District, including bankers, industrialists, and others, in order to obtain a cross section of business sentiment. He was very much surprised, he said, to find the uniformity of optimism that prevailed in all quarters. Many of the letters started with the statement that the Sixth District had not been hit as hard by the recession as other districts. Whether this was true factually, he did not know; perhaps so much had been written about the recession in other places that this had made an impact on the thinking of the people in the Sixth District. In any event, there was a general feeling that business had

picked up materially since about the month of May and that it would continue to improve. Although some felt that it would be as late as 1960 before business reached the levels of 1957, many felt that by about the middle of 1959 the district would be on a plateau of economic development equal to the high point of 1957. In agriculture, which accounts for about 6 per cent of total income in the district, it was estimated that 1958 income would be as much as 18 per cent above 1957. Reports from Florida suggested that agricultural income this year would equal that of 1957 notwithstanding difficulties encountered by reason of the freezes of last winter, due largely to price increases. High cattle prices, it was felt, would overcome the loss of livestock due to weather conditions and the deficiencies resulting from poor feeding conditions last winter. In Tennessee, larger income from agriculture was expected because cattle and hog prices would offset possible declines in other lines. The only State from which less optimistic agricultural reports were received was Alabama where one million acres had been allotted for cotton but only 53 per cent of that had been planted.

Reports from virtually all parts of the district, Mr. Sibley said, indicated that business was improving somewhat from the low point to which it dropped last spring. In banking, loans were up slightly in August over the year-ago level, investments in bonds and other securities were up materially, and deposits throughout the district were up about 10 per cent. In manufacturing, the textile industry had experienced some increase in volume but little increase in prices; sentiment there was less optimistic than in other phases of manufacturing. In the Sixth District, Mr. Sibley

noted, manufacturing is not as important as nationally, accounting for only about 17 per cent of total income, and it was this lesser role of manufacturing that gave the impression that the Sixth District had suffered less from the recession than the nation as a whole. He went on to say that the lumber and paper industries, among other phases of district activity, seemed to be on the upgrade. Department store sales were higher in August than at any other time in history and sales in June, July, and August had more than overcome the minus signs that occurred earlier in the year.

In concluding comments, Mr. Sibley said that the sentiment of people in all phases of economic life indicated a belief that things were definitely on the upgrade. While there were facts to support that sentiment, probably the feeling was stronger than the facts.

Mr. Livingston stated that in the Seventh District unemployment continued to be very substantial, due principally to the fact that the district includes Detroit, Flint, and other important automotive manufacturing centers. Department store sales continued somewhat below the national average, again reflecting the lack of improvement in the unemployment situation. In the steel industry the out-turn of ingots nationally ran about 65 per cent of January 1, 1958, rated capacity during the first week of September, but in the area around Chicago operations were running about 75 per cent of capacity, with those at Inland Steel up to 85 per cent. The prospects for increased output seemed very bright. A check with major steel warehousing companies indicated that they had

about reached the floor in their stocks, so there should be substantially increased purchasing from the mills. Furthermore, present operations did not reflect any very substantial buying from the automotive industry.

Turning to agriculture, Mr. Livingston said that this year would produce the largest wheat crop on record in the district and the second largest corn crop. The income situation of farmers was satisfactory and the farm implement companies were doing much better. Construction was another very bright spot in the district, with home building particularly strong and commercial construction reflecting the building of many shopping centers. While freight car loadings continued substantially under year-ago levels, they had been picking up substantially, due particularly to the very large crops. The heads of railroads appeared quite optimistic because of the movement of crops and also because a number of them reported evidence of additional industrial construction along their lines.

In general, Mr. Livingston concluded, it could be said that business was now better and that it gave every promise of continuing to be better in the period ahead. Sentiment was infinitely stronger than at the time of the last meeting of the Federal Advisory Council.

Mr. McDonnell suggested that if one were to look at the national averages he would have a fair picture of conditions in the Eighth District due to the diversity of activities in that district. It could be said that the district was participating in the national revival of business activity. Conditions were somewhat better than those indicated by reports from the Northeast and East, but not quite as good as those indicated by

the reports from the Western part of the country. In the district, production of lumber, coal, steel, and appliances had picked up and the increase in construction appeared to be somewhat greater than the national average. Southern pine output in August was at a higher level than the previous year and the output of hardwood had returned to the level of last summer. Coal production in southern Illinois got down in April to a level only 40 per cent of a year ago but since then had experienced a substantial increase and in July got back to the year-ago level. District steel production, which never did get as low as the national average, was now running 9 per cent higher. Employment was still off, however, and unemployment remained higher than last year. In agricultural pursuits, the district was participating in the general improvement found throughout the country as a whole. To summarize, there had been a general revival in all sectors rather than the rolling readjustment which characterized the recovery after the 1953-54 recession.

Mr. McDonnell said that he would feel a little bit happier about the recovery if it were accompanied by a greater consumer interest in durable goods and a greater resumption of capital expenditures by corporations. The patient was beginning to look healthier but might have a slight false flush to its countenance induced by Government expenditures, agricultural subsidies, and a fear of inflation. Nevertheless, the picture was definitely better and he felt that one could look forward to more improvement in the next six months.

Mr. Murray said that the Ninth District had just finished

harvesting a record small grain crop. The agricultural part of the economy had contributed to holding up the district during the recession and the small grain crop would help further. On the other hand, because of dry weather in Minnesota the corn crop there would be poor and soy beans were also affected. South Dakota had experienced better spring weather this year than in many years but in that State the corn also was very poor. This was causing some concern in that area and retail sales in the State had turned down a little. Cattle and hog prices were still high but some concern was expressed about the possible trend in the latter part of next spring. In Montana, which had benefited from good weather, there was very little change in the copper industry thus far but the lumber industry, which suffered severely during the earlier part of this year, was beginning to show some pickup. From the standpoint of unemployment, the worst part of the district was the Northern part of Minnesota, which depends on mining. In that area there was little change in conditions but a report from Michigan indicated a little improvement in the Northern Peninsula. Earlier this year retail sales in the district had been running consistently better than the national average but in August and September they ran a little behind the average. Except in North Dakota, total bank deposits in each State were still up from year-ago levels, but in every State they showed some downturn in August. The summer had not been a particularly good one for tourist trade because of cold weather, and the weather had also had some effect on department store sales as far as summer items were concerned, particularly in the larger

cities. Construction was still holding up well, particularly residential construction.

Mr. Murray said that there was quite a good demand for loans in the district. For the first six months of this year the increase was larger than last year and in the last few weeks there had been quite a substantial increase in loans, particularly at city banks.

Mr. Murray concluded by saying that generally speaking the feeling of the people in the Ninth District was better. Conditions in the district had never gone as far down as in other sections of the country and there had been an improvement in business during the last months. With the over-all strengthening of the agricultural economy, that should continue over the next several months.

Mr. Kemper reported that conditions in the Tenth District were most favorable and that the district was one of the bright spots in the national economy. There had been adequate moisture in all parts of the district except the area west of the Continental Divide. On the other hand, some of the eastern parts of the district were suffering because of floods. For the district as a whole, wheat production had been terrific. Despite cutbacks in acreage, the use of fertilizer and more intensive cultivation resulted in producing a bigger crop. Winter wheat showed a production of 633 million bushels, twice the production in 1957, while cotton production, although about 15 per cent under the 10-year average, was about 15 per cent higher than in 1957. Although the index of prices received by farmers had declined about 5 per cent after

reaching a 5-year peak, the showing was still an excellent one. Pasture and range conditions were splendid and a lot of livestock was being put on winter wheat, which had been very lush. In short, the livestock situation was excellent, almost too good, and most cattlemen felt that there would be a break in cattle prices at some point.

Continuing his resume of business conditions, Mr. Kemper said that retail sales were excellent, with department store sales above the 1957 levels. While new-car registrations were about 14 per cent below 1957, inventory buying was being stepped up. Nonfarm employment was still about 2 per cent below a year ago with the greatest decline in manufacturing. The banks had been getting along in good shape and had experienced an unusually good deposit increase amounting to about 8.9 per cent over last year. Loan demand, particularly from farmers, was very good. Commodity Credit Corporation certificates of interest purchased by banks rose about $36 million during August but recently the banks were turning them over to the Corporation because of the increased yields available from bills. The real estate situation in the district was good with farms moving very rapidly. Due to feelings with regard to the prospect of inflation, the demand for farms and ranges was very great. There appeared to have been quite a little pickup in hard-goods sales because of the prosperous conditions in the district and, as Mr. Livingston had reported for the Seventh District, farm implement sales were excellent. The extent of Government activity in the Tenth District contributed to high levels in all types of construction. Public utilities

were building plants, military installations were picking up, and residential building was very good because of the new regulations. However, under the rules pertaining to FHA and VA mortgages, it was becoming a little harder to market those mortgages because of the yields available on corporate bonds and tax-free obligations. The oil situation in the district was not good, with overproduction of gasoline and price-cutting.

Over all, Mr. Kemper said, the Tenth District was probably one of the most prosperous districts in the nation. The outlook was favorable and everyone was feeling a good deal better.

Mr. Jacobs recalled that at the last meeting of the Council and the Board he reported a good condition in the Eleventh District. The same report, he said, could be continued at this meeting. The agricultural situation was very favorable, current estimates indicating that the production of every crop except pecans would be at an all-time peak. Despite 9 per cent less acreage, the latest estimates indicated that 15 per cent more cotton would be raised and if there were a late frost the estimate would be exceeded considerably. As to livestock, weather conditions had been favorable, with rainfall and pasture very good. A lot of cattle had not been marketed, Mr. Jacobs commented, that possibly should have gone to market with the prevailing high prices. The weak part of this segment of business was the chicken industry, where prices were below the point at which producers could hope to make any money.

Department store sales, Mr. Jacobs said, continued strong and sales in August reached an all-time peak. Inventories appeared to be somewhat smaller. Those he talked to in the department stores were very optimistic about the remainder of the year and anticipated a noticeable increase in both sales and profits. While automobile sales continued weak, sources of information expressed the belief that dealers would be able to clean out 1958 models so as to be ready for the 1959 cars. In the oil industry, which had been weak, people were now much happier. In Texas the authorities had placed production on a 12-day allowable basis instead of the 8-day basis in effect at the time of the last Council meeting. A major difficulty was imbalance between excessive gasoline stocks and small fuel oil stocks. The paper industry, important particularly in Louisiana, was operating almost at capacity at the present time, and there was a much better feeling in that industry. Nonagricultural employment showed a modest increase although not as marked as in 1957. Construction contract awards had improved further in both the residential and nonresidential sectors and the figures were now reaching new high levels. For the three months ending with July, awards were up 42 per cent above the previous three months and 28 per cent over a year earlier. There appeared to be plenty of money to take care of FHA mortgages and there was less warehousing of mortgages than for a long time. These mortgages tended to go out fast to insurance companies. Continuation of industrial expansion along the Mississippi River between Baton Rouge and New Orleans was described by Mr. Jacobs as almost

fantastic. Loan demand at district banks remained strong, with many banks having loan totals higher than last year. Investments and deposits had reached all-time records for this time of the year.

All in all, Mr. Jacobs said, the Eleventh District was one of the bright spots of the nation.

Mr. King commented that much had been said in the previous district summaries that would apply to the Twelfth District, particularly the comments on the agricultural situation. Therefore, he would limit his remarks to a few of the factors considered especially significant in the Twelfth District. The continued high rate of unemployment, he said, was probably the matter of greatest concern. In California the rate was down a little and employment had shown some improvement in the lumber industry in the Northwest. However, unemployment was still as high as 9 per cent of the labor force in Washington and Oregon. In construction, a matter of some concern--particularly in southern California--was the increasing number of vacancies in multi-unit dwellings. A part of the difficulty was in obtaining purchasers but most of the difficulty was with the money situation. Many such dwellings had been purchased with a note for the full amount of the cost of the dwelling, with insurance companies, savings and loan associations, and the FHA supplying the money, and it seemed doubtful whether there was enough money around to continue that type of financing. Some signs of weakening were detected, based on rate factors primarily.

In manufacturing, Mr. King said, the aircraft and electronics companies were both hiring people. More ads were appearing in newspapers and apparently difficulty was being experienced in finding enough engineers. In the Northwest, one large aluminum company had expanded capacity somewhat, as had two large copper companies in the Southwest. Most recent figures on department store sales were expected to reflect a gain of 5 per cent over a year ago, and good business was expected for the rest of the year.

In summary, Mr. King said, there had been a pickup in business and it had been quite general. While it was expected to continue, he had heard the comment several times that much would depend on the success of the new-model automobiles.

2. Comment in the financial, real estate, and other press suggests a mounting public concern about inflation, especially about longer run loss of purchasing power of the dollar. How widespread is the feeling that further inflation is inevitable? Does the Council feel that a developing inflationary psychology is a threat to sustainable recovery? If so, what steps might best be taken to counter this psychology?

The members of the Council believe that the feeling that further inflation is inevitable is spreading. The sharp rise in stock prices is one evidence of this concern. This view of inflation is probably held at present largely by investors, businessmen and persons whose salary or income is relatively fixed.

A substantial segment of the labor force has received wage and salary increases in recent years, which have more than offset the rise in prices. Consequently, the fear of inflation in this group has not yet become so widespread or intense that it has led to greatly increased buying of durable goods, commodities and real estate, or to any flight from savings and insurance.

The Council believes that a developing inflationary psychology would be a threat to sustainable recovery.

Many inflationary forces, such as the wage demands of organized labor beyond increased productivity, budget deficits of government, and pressure groups urging projects involving government expenditures without a corresponding increase in taxes, operate in areas in which the Federal Reserve System has no power to act. However, the System can exert a strong influence toward maintaining relatively stable prices through the full exercise of its powers and the widespread dissemination of information regarding the causes and consequences of inflation.

Supplementing the Council's comments, President Denton said it seemed to the members that there was a wide difference in the understanding of inflation between, on the one hand, those responsible for operating businesses, those making substantial investments, and those with relatively fixed incomes and, on the other hand, the segment of the population that has to some degree been insulated from the impact of the deterioration of the purchasing power of the dollar. It seemed quite clear to the Council that the development of inflationary psychology was reflected in the bullish sentiment now evident in the stock market. It appeared, however, that the various elements contributing to the current psychology were to a large extent outside of the province of the Federal Reserve System insofar as direct action to deal with them was concerned. Other parts of the political body of the United States were the controlling factors. This was said with full realization that the Federal Reserve System could of course create monetary conditions that would result in certain things being impossible of achievement because, practically speaking, there was a question how far the Board could go in

the light of the apparent desires of the public. At the same time it would be desirable that the System provide as much education as possible to the public.

Governor Mills referred to Mr. Denton's comment about speculation in the stock market and stated that the Federal Reserve System had been very much concerned about the degree of speculation that occurred in the Government securities market within the past few months. He asked if the Council wished to express any views about the volume of such speculation, its effect on the Government securities market, and whether such speculation would result in any substantial impediment to Treasury financing. He asked whether it was likely to bring about an unwillingness on the part of investors to go into Treasury securities and whether the disturbance in the market had reduced the ability of the banks to participate in the Treasury financing program.

In reply, President Denton said that the situation in the stock market reflected a willingness to speculate in the face of prices not warranted by existing earnings. It appeared that future earnings had been substantially discounted. The situation with respect to participation by commercial banks in Treasury financing over the next few months seemed to him to be of a different nature. The banks, he said, were going to be in a very bad position to take on much of the financing under current conditions. He then turned to Mr. Livingston, who serves as a member of the Committee on Government Borrowing of the American Bankers Association.

Mr. Livingston said that he regarded the situation in the stock market as a manifestation of concern about inflation rather than the causes. He did not see any direct connection between the impending flotation of Treasury securities and the level of stock market prices except to the extent that the latter indicated a growing inclination on the part of investors to regard fixed-income securities with disfavor because of fear of inflation. He did not believe that those parties to whom the forthcoming Treasury offerings would be addressed were likely to be those who would be going into the stock market. If that were true, however, it would be extremely difficult for the Treasury financing to be successful. As he saw it, the Treasury would have to offer types of securities whose sale would not be dependent upon those who are buying stocks.

Chairman Martin expressed agreement with the comment that some phases of the current problem are outside the province of the Federal Reserve System. For example, the wage-cost problem is outside the central bank's province. However, he said, there is an area which must be of very much concern to both the Federal Reserve and the banking community; that is, whether the Government's debt will be financed just by creating money. The deficit that appeared to be a boon in February and March had now become the major liability of the country, and there appeared to be a growing conviction on the part of many investors and businessmen that there was no alternative to printing money for the financing of the Governmental deficit. Chairman Martin said he did not

know at what level the Treasury could float securities that would attract nonbank investors, but obviously it must find a way of financing a deficit which might run to $12 billion. This deficit, he noted, could have been as high as $25 billion if the tax cuts for which there was much sentiment earlier in the year had been made. The aftermath of that had built up the inflationary psychology with which it was now necessary to deal. It was a problem which could not be dealt with by rule of thumb and he did not pretend to know the answer. It might be that at present the Treasury must do its financing largely through the commercial banks and in the short-term area, but it would be extremely unfortunate if enough people made the assumption that nothing could be done about the situation except to finance the debt by printing money. If the banking community and the Federal Reserve were to take that attitude, he said, they would be digging their own graves. Perhaps the country might have six months or so of happiness, with the recovery not yet having reached boom level, but it would certainly not be a solution simply to take up the check and print money to the tune of $12 billion.

Chairman Martin recalled that at the last meeting of the Federal Open Market Committee he had made a comment somewhat as follows: "The longer I am in this business, the more I see that people are more willing to face up to disagreeable facts that will have effects in the future than to a disagreeable remedy in the present." If it were not possible to overcome that element of human nature to some extent, he said, the country was going to be up against inflation in a big way. It was an insidious

process that had been going on for about 10 years in one degree or another and some of the more serious aspects of the problem were just beginning to be realized.

President Denton said he had not meant to infer that the Federal Reserve could not be very effective in many ways, and he went on to say that the Council still had considerable hope for a solution to the problem. He then referred to the impact on bankers and business groups of economic presentations such as are made available by the Federal Reserve Bank of Cleveland. Many, he said, are "against inflation" and presentations of this kind make them better armed to spread the gospel. Another channel, he pointed out, is Federal Reserve testimony before Congressional committees. In the continuing struggle against inflation, he said, the Council stood ready to assist in any way that it could.

Mr. Livingston said that he regarded the problem under discussion as the foremost problem of the day. He would regard it as deplorable if the money that must be raised by the Treasury had to be obtained through the commercial banking system. Mr. Livingston then referred to the recent Sears Roebuck offering as evidence that corporate securities can be sold if the price is right. The same principle, he said, pertains also to Government securities.

Mr. Denton commented that in view of current interest rate levels he understood that a number of corporate trustees were moving into the bond field as opposed to stocks. In other words, they were diverting what was commonly known as pension fund stock money into fixed income

investments because of the available yields.

Chairman Martin then commented that if it were not possible to finance the Government debt except by printing money, at some point he felt sure the American people would become aware of the situation and would demand that it be corrected. After referring to Mr. Livingston's Sears Roebuck illustration, he went on to say that one can not be a defeatist and must try to work toward a solution. Turning to the recent trend of rates, he noted that the recovery had progressed far enough so that one-half of the decline in the index of industrial production had already been recouped. Many people, when speaking of monetary policy, are inclined to say that it is fine to go down and that monetary policy must be flexible, but when the Reserve Bank discount rate was raised by one-quarter of one per cent the view was heard that this would destroy the process of recovery. A 2 per cent discount rate, Chairman Martin noted, is far from the rate of 3-1/2 per cent that prevailed in August 1957. Yet a number of people were talking about destroying the entire economy and shutting off recovery just through a modest rate adjustment.

3. What influences account for the very rapid rate of increase in time deposits at commercial banks? Are there any indications that this rate of increase may be slowing down?

The Council believes that the very rapid rate of increase in time deposits at commercial banks may be accounted for primarily by the following developments:

(a) Lower yields on Treasury bills led foreign banks and some domestic corporations to shift funds to time deposits at higher rates;

(b) The movement of some demand deposits to time accounts because of attractive rates;

(c) Increased interest rates on savings in some areas of the country and the fear of possible unemployment stimulated savings.

There are indications that the rate of increase may be slowing down.

There is an apparent lack of full information regarding foreign central bank and corporate time deposits, and it might be helpful to the System if more data were available.

President Denton stated that, except as to the institutions with which its members were affiliated, the Council was unable to provide a breakdown of time money as between the category of normal savings accounts and the category of time money at interest which comes from foreign banks, from corporations, and from individuals to some degree. Therefore, except for the experience of individual institutions it was difficult for the Council to know what segments accounted for the substantial upturn in time deposits. It would be helpful, he said, if such information were available and the problem could be better defined. He went on to say that the Council members knew of cases where, following the increase in time deposit rates in 1957, bona fide savings accounts increased materially. In his own institution, for example, the increase was in the area of 25 per cent. As to money at interest on time, the Council was convinced that this largely came from foreign central banks and other foreign banks which had put such money in New York City and certain other places. In some sections of the country, corporation money had been taken at interest and that had been partially responsible for the growth in time deposits in those sections.

4. What are the Council's views as to an appropriate credit policy between now and the next meeting of the Federal Advisory Council?

The Council believes that the appropriate credit policy between now and the next meeting with the Board would be to maintain essentially the present degree of restraint. This implies that the System will provide any reserves that may be required for the forthcoming Treasury financing and for normal seasonal demands.

President Denton said that the Council, despite its modest reply, had had a long discussion of this question. He thought it was clearly the consensus that the Federal Reserve was wise in taking the steps that it had taken toward restraint. In the Council's opinion these were salutary actions, and the Council would commend the System if it were asked. On the other hand, the question how much tighter to go--and when--is one which gives rise to numerous individual opinions on various aspects of the problem.

Governor Balderston inquired whether the Council felt that corporate and bank liquidity was greater or less than a year ago.

While all of the members of the Council who responded agreed that corporate liquidity was greater, there were differences of opinion with respect to bank liquidity, some members suggesting that the statistical appearance of improved liquidity was deceptive because many banks had moved into investments in which they were frozen because of reduced price levels unless they were willing to take losses. Mr. Kemper commented that in view of increased bill rates it was possible that corporate trustees might transfer time deposit money to bills, in which event the

liquidity of the banking system would decline to some extent. He said that there was a lot of such money in the banks at present. Mr. Massey noted that the comparison was being made with an earlier period when banks were seriously strained for liquidity and when it appeared that there might be some tapering off in business. While this tapering off had occurred, it resulted in a decline in total loans of only around $2.5 billion. Now it appeared that the country was just at the beginning of the period of substantial business recovery. The liquidity position of banks therefore might be regarded as very much impaired if one looked ahead to a boom over any sustained period, and the problem was now even more difficult than before because previously there had been an opportunity to adjust investment portfolios. No such opportunity was now available because rates had changed so fast as to produce a situation of investment portfolios being frozen. Taking into account that business recovery was starting from a high price level, he was inclined to agree with those who felt that the banks were now relatively more frozen than they were at the time when there was an expectation of a tapering off in business.

Governor Balderston said that he had asked the question because actions had been taken in the past year that might result in overspending the Federal Government's income by as much as $14 billion. In a situation which did not involve actual warfare, the Government would be competing to the extent of that deficit with the private sector of the economy, and this accentuated the point that Chairman Martin had made in

his comments earlier during this meeting; namely, that in addition to an economic problem to which parties were accustomed, there was a new problem--the financial one. The circumstances were such that he felt the present time might almost be described as a crisis situation. The question was how the Treasury could get the necessary money without endangering the private sector of the economy or without printing money.

Mr. McDonnell suggested that the question might be put somewhat as follows: "Can a democracy fight a cold war without resorting to hot war controls?" He noted that the country was spending more money on the cold war than it had in the past in times of actual warfare, and at those times it was necessary to resort to direct controls to keep inflation in check. This raised the question whether the country could fight a cold war on a global basis and still enjoy the luxuries of a free market system. Unless it was possible to stop the demands and excesses of monopolistic labor unions, he felt that it might be necessary to resort to controls.

5. Would the Council care to express any views with regard to the status of the commercial bank emergency preparedness program and how that program might best be encouraged?

The Council believes that few banks have an adequate emergency preparedness program. The Council is of the opinion that the Advisory Committee on Commercial Bank Preparedness and the associated working committee should be encouraged to develop and promote a simplified plan which would be economical and practical for banks of all sizes.

President Denton referred to the work being carried on by the Advisory Committee on Commercial Bank Preparedness and the Banking

Committee on Emergency Operations and noted that two members of the Council, namely, Mr. Livingston and Mr. King, are members of the former committee. After referring to the substantial amount of work done by the two committees, Mr. Denton said it was now a question of selling to the commercial banks the importance of instituting the recommended steps. He said there are many who believe that this amounts only to play-acting and represents a waste of time. The question was one of selling the program to the banks on the basis that they could and should participate, at least to some degree.

Governor Robertson said that he agreed wholeheartedly. He added that he expected to deal with the subject in his address before the convention of the American Bankers Association next week.

It was stated that the next meeting of the Federal Advisory Council would be held on November 17 and 18, 1958, with the joint meeting of the Board and the Council on the latter date.

The meeting then adjourned.

Kenneth A. Kenyon
Assistant Secretary