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 17, 1959.

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
Chairman Martin	x	
Governor Szymczak	x	
Governor Mills	x	
Governor Robertson	x R	
Governor Balderston	x CCB	
Governor 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 17, 1959, at 10:30 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Brace, McCloy, Sienkiewicz, Hays, Alfriend, Sibley, Livingston, Murray, McClintock, Jacobs, and Frankland, Members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Seventh, 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. The Council understands that there will shortly be introduced in this Congress bills substantially identical with H.R. 11781 and S. 3603 which were introduced at the last session of the Congress at the request of the Board of Governors. The bills would provide for amending Section 19 of the Federal Reserve Act governing member bank reserve requirements. Would it be desirable to include in this proposed legislation a provision eliminating the central reserve city classification?

The Council favors the general objectives of the proposed legislation but it should include an amendment eliminating the central reserve city classification.

Chairman Martin referred to the long history of the study of reserve requirements by the Federal Reserve System, the contributions made to the study of that subject by the American Bankers Association, and the meetings held last year by the Board with representatives of the Association. He noted that the bill finally developed by the Board met with the approval of the American Bankers Association and that in May of last year the Federal Advisory Council, as then constituted, unanimously endorsed the bill. Thereafter, with the permission of Mr. Denton, then President of the Council, he had informed the Chairmen of the Senate and House Banking and Currency Committees of the Council's position.

Chairman Martin went on to say that the Board had reviewed the matter toward the end of last year, found its position unchanged, and so indicated to the Banking and Currency Committees in requesting reintroduction of the proposed legislation at this session of the Congress. The Board understood that the American Bankers Association continued to list the proposal among the legislation that it intended to support.

Chairman Martin then stated that there would be distributed to each member of the Council at the conclusion of this meeting a copy of a paper prepared by the Board's staff under date of January 29, 1959, which provided background information on the proposed legislation for revision of reserve requirements. There would also be distributed copies of a brief memorandum prepared by Mr. Thomas of the Board's staff under date of February 3, 1959, commenting on a memorandum from Mr. James J. Saxon which constituted a brief for elimination of any differential in reserve requirements for central reserve and reserve city banks.

Asked by Mr. McCloy whether the Board would go along if it developed that the Banking and Currency Committees were willing to amend the bill so as to eliminate the central reserve city classification, Chairman Martin repeated that the Board had reviewed its position at the end of last year, found its position to be the same as before, and reaffirmed that position in requesting that the bill be reintroduced in this session of the Congress. In the circumstances, the Board would be opposed to such a change in the bill.

In further discussion, President Livingston remarked that the Federal Advisory Council still favored the bill, but with an amendment to eliminate the central reserve city classification.

To this, Chairman Martin replied that, however the matter might be stated, the Council's present position was different from that reported before, with the permission of the President of the Council, to the Chairmen of the Banking and Currency Committees. While this change in position would not necessarily cause any embarrassment to the Board, it might complicate the obtaining of legislation.

Mr. Hays inquired whether, if an amendment to the bill to eliminate the central reserve city classification were introduced by other parties, the Board would oppose it, and Chairman Martin replied in the affirmative. When asked for the reasons, he said that the basic thinking of the Board was set forth fully in the staff memorandum to be distributed at the end of the meeting. In summary, the present bill had been hammered out after long study and consultation, the Board requested its introduction last year, and the Board had recently reaffirmed its position.

> 2. The Council understands that the Board of Governors is considering a change in the time schedules published by the local Federal Reserve Banks under Section 4 (l) of Regulation J. Under the proposal, credit for items on so-called "country points" would become available after three days instead of the present two. The Council would like to discuss this proposal with the Board of Governors.
>
> If the Board of Governors is considering changes in the time schedules published by the local Federal Reserve Banks under Section 4 (l) of Regulation J, the Council would welcome the opportunity to discuss such changes with the Board of Governors.

After making preliminary comments regarding the origin and nature of the proposal, Chairman Martin turned to Governor Robertson who had served as Chairman of the System Committee to study the problem of float.

Governor Robertson explained that the System, being concerned about the substantial increase in the volume of float in recent years and the effects of float fluctuation on the conduct of open market operations, had instituted a comprehensive study of various methods, including changes in Reserve Bank operating procedures, by which the volume of Federal Reserve credit provided through the existence of float might be reduced. In the course of that study, question was raised regarding the two-day maximum deferment, the reasons for and against increasing it were explored at the technical level, and the matter was later discussed by the Board and the Presidents of the Federal Reserve Banks. Three-day maximum deferment would be more realistic from the point of view of the time actually incurred in the collection of certain items and it appeared, although one could not tell precisely, that a change to a three-day maximum deferment would result in reducing the volume of float by approximately one-third. The question was still under consideration, however, and no decision had yet been reached.

President Livingston stated, in response to a question by Chairman Martin, that the Federal Advisory Council was unanimous in its opposition to the proposal.

Mr. McCloy then inquired about the possibility of reducing the volume of float through improvements in mechanical operations at the Federal Reserve Banks over a period of time, and Governor Robertson replied that this was part of the whole study of float. Some steps in this direction already had been taken, he said, and continuing attention was being given to various possibilities. In this connection, he observed that to the extent that Federal Reserve credit might be reduced through a change in the check collection time schedule, the System would have to give consideration to providing in some other way the amount of reserves appropriate to the economic situation.

Mr. Hays suggested the possibility of adoption by the Federal Reserve Banks of the practice followed generally by commercial banks of charging the accounts of their correspondents on the day that items sent to such correspondents normally would be received, and Mr. Brace expressed the view that the Federal Reserve System might not be justified in making the suggested change in maximum deferment until it was clear that the best efforts of all of the Federal Reserve Banks, on a uniform basis, still left the volume of float too high.

Following additional comments regarding Federal Reserve Bank check collection operations, during which reference was made to limitations on service posed by the cost factor, Chairman Martin repeated that all aspects of the float problem were being reviewed and that no decision had yet been reached on the suggested change in maximum deferment.

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

The Council believes that business has continued to improve moderately since the last meeting with the Board. In recent weeks, the metal industry, especially steel, has reported increased buying, in part at least in anticipation of a possible strike. Retail sales are continuing at a high level. Although automobile sales are above totals of a year ago, they are somewhat below earlier expectations. The farm equipment industry has reported an increased volume of business as a result of the rise in farm income. Construction, a buoyant force in the economy last year, continues an upward trend. Employment is lagging behind the improvement in production, reflecting (1) an improvement in productivity, owing largely to the use of more efficient plants, and (2) a longer workweek with overtime rather than an increase in the number of workers.

The members of the Council anticipate that business generally during the next six months will move to somewhat higher levels. The outlook for farm income in general would appear to be satisfactory though in some areas there may be some softening of farm prices.

In supplementation of the summary statement of the Council, the individual members presented detailed reports on business and financial developments in their respective districts. In response to a question raised by Chairman Martin, several of the members included in their reports comments regarding factors that appeared to be contributing to the current level of unemployment, and some of the members responded to a question raised by Governor Balderston regarding the extent to which it appeared that American producers might be pricing themselves out of the foreign market.

During his remarks concerning First District conditions, Mr. Brace reported that the general expectation was for a rather gradual improvement in business during the next six months, with the rate of improvement somewhat slower than during the last six months of 1958. The prevailing attitude of caution reflected in part a feeling that some of the increasing level of activity was being brought about artificially through Government spending. In summary, it might be said that there was mild optimism but no expectation of any spectacular increase in activity. In the machine tool industry there was evidence of foreign suppliers underpricing American items, and this trend was beginning to be noted also in other industries, including optical glass. While this was admittedly not yet a major consideration in relation to the unemployment problem, it seemed to be a developing trend.

Mr. McCloy reported that activity in the Second District was just about at the prerecession level. While the pace of recovery appeared to be a little slower than the pace of recovery from the previous recession, last year's downturn was not quite as severe. Perhaps the biggest question that must be faced was whether excess productive capacity would be filled out in the course of the current year, and the answer was not yet obvious. It seemed quite certain that the year would be a fairly solid one, but whether it was going to be a boom year or not remained to be seen. As to the employment situation, the Second District appeared to be running a little below the rest of the country. While increased productivity appeared to be due mainly to improved plant and machinery, it seemed probable that those retained on the payroll during the recession were the better employees and that this factor likewise was being reflected in increased productivity.

Mr. Sienkiewicz said that conditions in the Third District had recovered sharply from the low point of the recession and that the present level of activity was higher than in the corresponding period of 1958. The lag in employment appeared to have been the result of cost-streaming, increased productivity, use of more efficient plant facilities, and a reluctance to hire people before those already on the payroll were working full time. The unemployment problem in the Third District was quite serious and had been complicated in the larger cities by an influx of unskilled workers. All in all, the prospects for the next six months seemed quite good except for the unemployment situation.

Mr. Hayes reported a general belief in the Fourth District that business in the first half of 1959 would be at a higher level than in the first half of 1958. In June or July of last year there had begun a slow but gradual improvement that had continued through the last half of the year, and present indications were that the improvement would continue through the first half of 1959. On the matter of foreign competition, he had heard of several instances recently where machinery had been purchased abroad although it could have been produced in this country. In the machine tool industry, this development apparently was being regarded as important enough to cause manufacturers to establish relationships in European countries. Of more importance than the effect on the overall employment picture might be the effect from the standpoint of defense production.

Mr. Alfriend reported that in the Fifth District, where economic fluctuations tend to be less pronounced than in other areas, the trends had been mixed recently. The District was making a comeback from the recession but not at as fast a pace as the more highly industrialized areas. The general feeling was much better than in September and about the same as in November. All in all, conditions were much improved over six months ago, and it was felt that improvement would continue during the next six months.

Mr. Sibley said that the Sixth District had been making solid but slow progress in the last two months. The business community felt that the recession was over and a great deal of attention was being devoted to the streamlining of operations in order to be able to compete effectively in the future. Since September there appeared to have been little improvement in the employment situation although there had been considerable improvement in manufacturing payrolls. This might be attributable to an inclination on the part of employees to appreciate their jobs more, to cost studies that had been made, and to the money spent on development of labor-saving machinery. Manufacturers were making liaison agreements and going into partnership with capital in other countries in order to meet the problem of foreign competition, which might tend in an indirect way to keep the domestic labor force from developing.

President Livingston commented that the Seventh District had an excellent year in 1958 from the standpoint of farm income and that the prospects were for a somewhat lesser year in 1959, due principally to increased livestock marketings at substantially lower prices. Generally speaking, business conditions in the District were good, and the unemployment problem, while still serious, appeared to be easing. The attitude of businessmen was one of cautious optimism; they expected the first six months of 1959 to show moderate improvement.

It would be a mistake to attribute the numbers of unemployed at the present time in any substantial measure to the inroads of foreign competition. While that might be one contributing factor, it was by no means the entire answer.

Mr. Murray reported that conditions in the Ninth District were continuing to improve somewhat. Because of the importance of agriculture to the economy, the District had felt the recession less than other parts of the country, and purchasing power resulting from last year's agricultural operations should spill over into the first six months of this year. Looking at the year 1959 as a whole, some reduction in farm income seemed probable, and the psychology of the farmer as to spending could change rather quickly if moisture conditions did not develop favorably in the spring. Generally speaking, the atmosphere in the Ninth District at present seemed to be one of optimism. The lag in employment appeared to be due to a closer look at expense accounts on the part of a number of companies during the recession, and increase in the efficiency of operations, a better attitude on the part of workers, and some lengthening of the workweek.

Mr. McClintock reported that the winter wheat crop probably would be down from last year. Cattle prices continued good, and probably would through the first half of this year, but herds were being built up and there was likely to be a fall in prices when the larger numbers of cattle came to market. The oil industry was characterized by "a little bit too much of everything." Most producers and refiners were now feeling the effect of imports, which suggested the possibility of more governmental control of the oil business. In the Tulsa area, the employment situation appeared to be improving.

Mr. Jacobs reported that economic conditions in the Eleventh District had shown marked improvement in the last few months, with the employment and unemployment trends quite favorable. In the farming areas, a great deal of unemployment had no doubt resulted from a withdrawal of individuals from active farming due to technological improvements. These persons had found their way to the cities but many of them had not yet been able to locate jobs.

Mr. Frankland stated that the economic picture in the Twelfth District followed generally the pattern reflected by the reports from the other districts. It seemed safe to say that business conditions were good in the District, although within this large area there were great differences as to economic progress and problems. After summarizing significant developments in various parts of the Twelfth District, Mr. Frankland concluded with a reference to fiscal and commercial problems being encountered by the new State of Alaska.

4. How does the demand for credit at the present time compare with demands at this season in previous years of high activity, such as 1957? Is an increase in demand anticipated during the spring months of the year and, if so, in what areas of activity is it likely to be concentrated?

Although the volume of loans in some areas is exceptionally high, the demand for credit at the present time is not as great, over the country generally, as it was at this season in previous years of high business activity. However, the current demand for term loans is very strong. The members of the Council expect some increase in the demand for credit in the spring months of the year. This demand probably will reflect an increase in borrowing by consumers and sales finance companies. In addition, a probable increase in inventories, especially by the metal using industries, may add further to the demand.

In reply to a question by Governor Mills as to whether the demand for term loans appeared to reflect an inability of borrowers to enter the capital market or an unwillingness to go into that market because of the cost of funds, President Livingston said that money was available through the capital market provided the borrower was willing to pay a rate sufficient to attract investors, as demonstrated by the success of several recent issues. While there might be some feeling of reluctance on the theory that interest rates were high at present and might decline later, businessmen generally seemed to think that there would be no substantial decline in the foreseeable future. Hence, a principal reason for recourse to term loans appeared to be the desire to use a single bank, or two or three banks, as the source of funds, with the possibility of amending the contractual arrangement from time to time. Although the rate for funds might be comparable, this more flexible arrangement was considered advantageous.

In response to a further question, President Livingston said that as a general rule a five-year limit on term loans was customary and banks were reluctant to go beyond that limit, although some larger banks might occasionally extend the period to as long as seven or even eight years.

Governor Balderston asked whether, if inventories should be replenished at a rapid rate and the loan demand occasioned thereby were superimposed on the demand for term loans, this would cause difficulty for the banks.

President Livingston replied that there was already a high level of loans in the banking system. With a loan demand for inventory accumulation superimposed on that volume, a rising level of business activity, the needs of the Treasury in the picture, and the Federal Reserve System properly concerned about the restraint of credit, it appeared likely that money would become less available and more costly.

Governor Robertson then inquired concerning allegations of a leakage of bank credit into the stock market.

In discussion of this question, Mr. McCloy noted indications that savings were being withdrawn from banks in rather substantial measure and were finding their way into the stock market. Mr. Brace referred to his knowledge of some situations where banks were lending on an unsecured basis to permit the exercise of stock options, subject to an understanding that the stocks acquired would be held inviolate until the borrowing was repaid. President Livingston acknowledged the possibility of minor leakages of bank credit into the stock market through the medium of unsecured loans but expressed doubt that there was any substantial volume. He commented on the diligence displayed by commercial banks generally in endeavoring to satisfy themselves that the nonpurpose statement of the borrower represented no falsification of the intended use of the loan.

5. Reports reaching the Board from various sources indicate some undercurrent of feeling on the part of business as well as individuals that further inflation is an inevitability. The Board would appreciate the Council's analysis of the extent to which such an attitude may exist; of the effect that it may have with respect to price levels over the next year and over the next several years; and of the steps that bankers and businessmen may be taking toward combating or fostering the factors that are responsible for the attitude described to the extent that it exists.

The members of the Council believe that there is an increasingly widespread feeling that an inflationary trend in the economy is unavoidable. This defeatist attitude is one of the most difficult facets of the problem and is aggravated by the belief in certain quarters that some inflation is desirable for the growth of the economy.

Factors contributing to the foregoing attitude include (1) the strong upward pressure on wages, (2) the continuing budget deficits, (3) steadily increasing demand for Government projects and services, and (4) the reluctance to reduce Government subsidies for agriculture and stockpiling. There is a strong demand for Government expenditures in many sectors of the economy without a commensurate willingness to provide revenue for the expenditures. Should these pressures persist, a rise in prices seems probable over the next several years.

Although there is considerable discussion regarding inflation and its evils, there is little evidence that any segment of the economy is willing to take the steps necessary--including some measure of austerity such as higher taxes--to combat the inflationary trend. Until members of the community are persuaded that it is in their own self-interest that inflation be prevented, it is not likely that they will moderate their demands on Government. The solution suggested, therefore, is one of education. The attitude of the Board of Governors and the strong public statements by the Chairman are constructive steps in this direction.

During the discussion of this topic, question was raised by Chairman Martin as to whether unlimited discussion, for public consumption, of the inflationary potential in the economy might have the effect of creating a degree of apprehension such as to motivate decisions that would only increase the problem.

While it was noted that apprehension about the inevitability of inflation on the part of the public might be reflected in decisions affecting the stock market and the Government securities market, the view was expressed that only when the public became aroused was there likely to be pressure for constructive steps toward combating inflationary tendencies, including limitation of Government expenditures. In this connection, it was noted that the current degree of stability in the consumer price index was deceptive since it tended to conceal divergent trends, including an upward movement of industrial prices and a decline in agricultural prices.

6. The Board would appreciate the views of the Council as to appropriate credit policy for approximately the next three months.

The Council believes that appropriate credit policy for approximately the next three months would be the maintenance of essentially the current degree of restraint.

Except for a statement by President Livingston confirming endorsement by the Council of the policies being pursued by the Federal Reserve System, there was no discussion of this topic.

It was indicated that the time of the next meeting of the Federal Advisory Council would be decided upon after further exploration of alternative dates to determine which would be most convenient from the standpoint of the Council and the Board.

The meeting then adjourned.

Secretary