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 April 28, 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
Governor Balderston	x	
Governor Shepardson	x	
Governor King	x	

A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the Board Room of the Federal Reserve Building in Washington, D. C., on Tuesday, April 28, 1959, at 10:30 a.m.

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

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Brace, Sienkiewicz, Hays, Livingston, McDonnell, Murray, McClintock, and Frankland, members of the Federal Advisory Council from the First, Third, Fourth, Seventh, Eighth, Ninth, Tenth, and Twelfth Federal Reserve Districts, respectively

Mr. Adrian M. Massie, Chairman of the Board, New York Trust Company, New York, New York, alternate for the member from the Second District
Mr. Comer J. Kimball, Chairman of the Board, The First National Bank of Miami, Miami, Florida, alternate for the member from the Sixth District
Mr. George G. Matkin, President, The State National Bank of El Paso, El Paso, Texas, alternate for the member from the Eleventh District

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 Board would appreciate receiving the views of the Council regarding the current business situation and the prospects for business activity during approximately the next six months, along with reports from the individual members of the Council regarding current or prospective developments in their districts having special significance to the total picture for the country as a whole.

The Council believes that business currently is moving upward on an expanding front. Among the most favorable factors in the economy are the high levels of industrial production, consumer spending and construction. Assuming that we shall not experience a prolonged strike in steel or any other major industry, the prospects are for a further expansion of business activity during approximately the next six months, despite the persistence of unemployment in particular areas.

In supplementation of the Council's summary statement, comprehensive reports were made with respect to current and prospective developments in the respective districts.

Business conditions were reported to be good, with an upward trend continuing. In some instances, the extent of improvement since the last meeting of the Council was indicated to have been substantial, and practically all statistical comparisons, particularly with year-ago levels, were on the plus side. Some segments of economic activity that were lagging earlier, such as textiles and iron ore mining, had now begun to participate in the general advance. The machine-tool industry, while still not strong, was reported to have bettered its position somewhat, and bituminous coal stood out as perhaps the only major industry where a declining trend was continuing. Consumer spending, as evidenced by retail sales, was said to be particularly strong, the recent trend of automobile sales was regarded as encouraging, and construction activity was at a high level, with rising costs noted.

Reports with regard to agriculture were somewhat mixed, although in general the situation was regarded as quite satisfactory. In certain parts of the midwest, the outlook was clouded by lack of adequate moisture thus far this year; it was pointed out that a continuation of drought conditions might affect adversely the general economy of the areas concerned. On the whole, it appeared that somewhat lower prices were being largely offset by increased marketings, and spring plantings of most crops were reported to be heavy.

The district summaries showed that employment was increasing. However, unemployment remained relatively large in most of the districts and substantial in numerous local areas. Among the contributory factors mentioned were increasing labor immobility, a tendency on the part of employers to lengthen hours worked rather than to add new employees, and increased machine productivity. In view of these factors, it was the general opinion that unemployment in certain areas might continue to present a substantial problem for some time to come.

On the financial side, credit demand in most parts of the country was reported to be heavy, with emphasis in some districts on real estate and consumer instalment credit. While the pressure for business and commercial loans at the present time was uneven, a further strengthening of demand over the next several months was indicated in view of the general upward trend of business activity, a tendency toward inventory accumulation, and recent surveys which showed that plans for business capital expenditures were being revised upward.

The psychology of the businessman and the general public was reported to be good, with attitudes colored by rather strong optimism regarding future prospects. The current trend in business activity was expected to continue through the remainder of the year, except for some possible slowdown in the third quarter depending on what might develop with respect to strikes in the steel and other industries. In some agricultural sections of the midwest, the favorable outlook was contingent upon improved moisture conditions.

2. How strong are the current demands for credit and what is the prospective demand for bank loans during the remainder of this year?

Although the volume of loans in some of the largest banks in the money centers continues to be slightly below the corresponding period last year, total loans in all commercial banks are above a year ago. The accumulation of inventories, the anticipated improvement in business generally, a probable increase in capital spending, and an expansion in consumer borrowing are factors indicating a more than seasonal rise in the demand for bank loans during the remainder of the year.

After presenting the statement of the Council, President Livingston commented that there were a number of members, including himself, who believed the demand for credit during the remainder of 1959 would prove to be extremely heavy.

3. What are the views of the Council regarding appropriate credit policy between now and the next meeting of the Council?

The Council believes that appropriate credit policy between now and its next meeting would be to maintain the present degree of credit restraint. The members of the Council would be pleased to discuss this important question with the Board.

President Livingston said that the Council regarded this as a critical period from the standpoint of determining appropriate credit policy. The reports from the respective districts had sounded a note of considerable optimism, with a steadily increasing volume of business and expansion indicated on a wide front. The Council was aware of discussion among bankers and businessmen about the possibility of further increases in the discount rate and other possible steps to offset inflationary pressures. The Council likewise was aware of the problem of the Treasury, as exemplified by the refunding operation to be announced shortly, and this all added up to difficulty in formulating a response concerning appropriate credit policy during the period until the next meeting of the Council.

Mr. Brace commented that the problem of the Treasury had become so severe as in his opinion to be almost insuperable without additional assistance from the Federal Reserve System. Should the Treasury's problem be neglected, he felt that the System might defeat its own purposes. To the extent that Treasury securities were held by corporations on a short-term basis, he was afraid that the picture might be rather misleading, because the corporations would tend to feed the securities into the banking system as their own financing needs developed. Therefore, the System might wish to consider giving more support to the Treasury than it had during the past two or three years in order to preclude the possibility of a spiral that would move fast and result in the normal policy actions of the System having little effect.

Chairman Martin replied that this raised a question as to how the System could give the Treasury any greater support without increasing the money supply. During the recession, he noted, the money supply had been expanded considerably--to a greater extent than some persons felt was desirable--and now the country had come to a period of business recovery and expansion. While the System wished to do everything it could to help the Treasury, any assistance given on a piecemeal or temporary basis might only prolong the difficulty.

Mr. Brace suggested that the System perhaps did not give enough weight to the rate situation a year or two years ago, and possibly was not giving as much attention to that factor at the present time as might be desirable. When the Treasury bill rate went to a very low point last year, that might have been a signal that no further ease was required, or perhaps that more ease had been produced than necessary. Conversely, the present rate level might be a signal that no further restraint was required. The question was not only one of degree but of timing, and further tightening at the present time might only add to the problem of the Treasury without restraining inflation. He did not feel that a further increase in the discount rate was indicated, particularly because each rate increase revived comments to the effect that the situation was getting tighter and this tended to make the Treasury's problem more acute.

In response to a question by Governor Mills, President Livingston said he did not feel that the situation had yet reached the point where existing System policy would cause the banks to limit their extensions of credit. During the period of credit ease, most banks invested heavily in Government securities, and most of them would have to take losses if they wished to reduce their portfolios. Nevertheless, he felt that the banks would elect to reduce their portfolios, if necessary, in order to be able to meet the needs of their customers. In view of the trend of economic developments and the heavy demand for credit that he saw ahead, he felt personally that some consideration might be given to an increase in the discount rate.

Mr. Massie suggested that the banking structure was much more heavily loaned than many bankers seemed to care to admit. Despite the recession last year, loans were already back to an all-time high, and a good part of the banks' liquidity had gotten frozen in longer-term security holdings. Seasonal upturn in the demand for loans could be expected in the second half of the year, and he feared that an increase in demand much beyond the usual seasonal proportions might create an explosive situation with respect to rates. Already, with optimism building up and signs of increased industrial building appearing, many bank customers were seeking to establish larger lines of credit. Assuming that the current optimism was well founded and at some point would become translated into a heavier demand for bank credit, he wondered whether the System would not be better off to move earlier toward a tightening up of rates. To move fast and get the program into better shape, he suggested, might also mean that the Treasury's problem would be better served. In response to a question, Mr. Massie referred to the increase in the money supply last year and the present high level of bank loans as causes for concern. If the velocity of deposit turnover should increase, he foresaw the possibility of conditions being generated which would result in a running up of prices with bank credit.

Mr. Hays said he anticipated an increase in the demand for loans that would result in higher loan totals at year-end. However, he saw nothing of a speculative character in the Fourth District that would justify a move to contract credit, and the one real answer to the unemployment problem appeared to be an expanding economy. With a heavy demand for funds, corporations would be likely to sell some of their short-term securities, which would come to the commercial banks or go to the Federal Reserve System. Within that general pattern, however, he saw nothing unsound in the supplying of a reasonable amount of money to a vigorous economy.

4. The Board would be glad to receive any comments or suggestions that the Council may have concerning the proposals contained in the attached memorandum regarding improvements of available statistical data through the weekly reporting member bank and call report series. (The Federal Deposit Insurance Corporation has indicated that it is agreeable to the proposals and the Office of the Comptroller of the Currency is now studying the matter. It is hoped that the time schedule set forth in the memorandum may be met.)

The members of the Council favor the proposals relative to improvements of available statistical data through the weekly reporting member bank and call report series.

After reading the Council's statement, President Livingston commented that in the view of the members the proposed changes would make the data more meaningful for users and at the same time create little additional work for the reporting banks.

5. The Board would appreciate receiving the views of the Council regarding bank merger legislation now under consideration by the Congress.

The Council believes that the authority for the approval or disapproval of mergers and consolidations, howsoever accomplished, should rest exclusively with the appropriate bank supervisory agency. The Council therefore favors the enactment of S. 1062, as originally introduced, provided that the phrase "and in such a case the appropriate agency may also request the opinion of the Attorney General," is deleted.

President Livingston said it was the view of the Council that the authority to approve bank mergers should rest solely with the respective bank supervisory authorities and that there should be no statutory requirement, or even an authorization, for the supervisory agencies to consult the Department of Justice. For this reason the Council would not look with favor upon legislation in the form of the bill reported by the Senate Banking and Currency Committee, and it wished to place its opinion on record with the Board.

Mr. McDonnell withdrew at this point and two members of the Board's staff, Mr. Solomon, Assistant General Counsel, and Mr. Brill, Chief, Capital Markets Section, Division of Research and Statistics, were invited to join the meeting.

6. The Board would appreciate the Council's views on the proposed amendments to Regulation U.

Before reading the Council's comments concerning the individual proposals, President Livingston called attention to the complicated nature of Regulation U and the amendments now under consideration. The Council, he said, had found it difficult to express views regarding some of the proposed amendments because it did not understand clearly what was sought to be accomplished. He added that among bankers in general there was also a lack of understanding.

a. The proposed formula in respect of withdrawals and substitutions of collateral is acceptable.

President Livingston stated that the proposed formula reflected precisely the procedure that most banks already were following.

b. The requirement that each loaning officer prepare and sign a memorandum of supporting facts to justify his classification of each loan and the further tests of "diligence and alertness" outlined in the memorandum are objectionable. The Council sees no objection to a requirement that the identity of the loaning officer accepting the borrower's statement of purpose be disclosed by the records of the bank.

President Livingston said this proposed amendment was regarded among bankers as reflecting a feeling on the part of the Board of Governors that the banks had not made an honest effort at policing. While there may have been some instances where eyes were closed, it was his belief that the banks, generally speaking, had been diligent. After commenting that he had received more telephone calls from bankers with respect to this proposed amendment than all of the others combined, he noted that further comments would be made by banker representatives at the hearings to be held by the Board tomorrow.

c. The proposed broadening of the definition of "carrying" a stock to include the restoration of working capital is not favored.

After President Livingston had cited an example to indicate the degree of harshness with which the proposed definition might be construed, inquiry was made as to whether he would favor elimination of the "carrying" definition entirely and Mr. Livingston replied that he did not think so. However, the Council did not favor the proposed definition.

Question then was raised whether a definition containing a time limitation would have any bearing on the view of the Council, and Mr. Livingston responded that this again involved difficulties of interpretation. There could be a sequence of transactions unrelated to each other which, taken together, could be said to involve a restoration of working capital. However, if it should be the Board's decision to provide a broadened definition of "carrying", he felt that a suitable time limitation should be included.

d. Although the Council in general does not favor subjecting additional areas of the economy to regulation, it favors the extension of Regulation U to include, in addition to banks, all persons engaged in the business of making loans for a regulated purpose.

There were no further comments with respect to this proposal.

e. The prohibition against the use of collateral to secure a regulated loan, and in addition, a nonregulated loan, while perhaps necessary to enforce the regulation, tends to deny borrowers the proper use of their credit for appropriate purposes.

After comments by President Livingston on certain types of cases to which it would appear that such a prohibition might apply and thereby work an unwarranted hardship, Mr. Solomon clarified the intent of the proposal, and it was agreed that such a clarification would be helpful to interested parties.

f. The language of Section 6 on mimeographed pages 7 and 8 of the Notice of Proposed Rule Making (Reg. U) is not clear to the Council, and the Council is therefore unable to comment on the Section.

Mr. Solomon explained an inadvertent error in the proposed amendment, as published for comment, and pointed out that the proposed amendment would merely incorporate in the Regulation a Board interpretation that had been outstanding for some time.

g. As outlined in Paragraph 4 above, the Council favors the extension of the Regulation to wholly unsecured loans to open-end investment companies and companies and persons principally or importantly engaged in the business of making loans for a regulated purpose.

Question was raised by the Council as to the coverage envisaged by this extension. After an explanation had been provided, members of the Council expressed the view that unsecured loans to such parties should be brought within the purview of the Regulation. While no specific language was suggested, the comment was made that it would be helpful if the Board could clarify the definition before adopting an amendment of this kind.

h. The Council questions the wisdom of extending the Regulation to loans to purchase convertible bonds, as this might prevent many corporations from using this form of debt obligation.

Concern was expressed by the Council with regard to certain situations, of which examples were cited, that would be likely to develop, particularly at a time when margin requirements were high. The Council raised the question whether the amendment would be desirable if the result was to produce situations of that kind.

i. In the opinion of the Council loans to exercise employee stock options should not be subject to Regulation U.

President Livingston said the Council considered this device an important one to corporations in attracting and holding management personnel. The Council noted that the use of stock options had been recognized by the Congress by way of preferential treatment under the income tax laws. It seemed to the Council that a valid distinction might be drawn between the use of credit to exercise stock options and the usual buying of stocks and borrowing of money for that purpose.

At the request of Chairman Martin, Mr. Solomon reviewed the background of the situation, including the circumstances under which special provisions relating to the extension of credit for the exercise of stock options were deleted from Regulation U during the World War II period. He also summarized the arguments that led the Board to conclude against granting special privileges in this respect on a number of occasions when the question had been raised during the past several years. In response to a comment regarding the lack of importance of credit granted for the exercise of such options in relation to the total amount of credit outstanding for the purchasing and carrying of securities, Mr. Solomon observed that, irrespective of the amount of credit involved, any liberalization presumably would have to be justified in terms of principle.

Further comments by members of the Council included the statement that in most cases the exercise of stock options would result in the issuance of additional stock and that it would seem desirable to remove as many obstacles as possible from the issuance of equity securities. It was again noted that special treatment had already been accorded for stock options under the provisions of the Internal Revenue Code.

President Livingston stated that the next meeting of the Federal Advisory Council had been scheduled tentatively for September 14-15, 1959, and Chairman Martin indicated that those dates would be agreeable to the Board.

The meeting then adjourned.

Secretary