Minutes for May 19, 1959

To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

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. Mills	x	
Gov. Robertson	x	
Gov. Balderston	x	
Gov. Shepardson	x	
Gov. King	x	

Minutes of the Board of Governors of the Federal Reserve System on Tuesday, May 19, 1959. The Board met in the Board Room at 2:00 p.m.

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

Mr. Sherman, Secretary

Governor Balderston raised certain questions regarding the procedure that might be followed in connection with a change in the discount rate if such a change were to be considered in the near future.

During the ensuing discussion, Governor Mills stated that he would be opposed to an increase in the discount rates at the Federal Reserve Banks at the present time. He then read the following statement of his reasons for this conclusion:

> In the light of money market and economic considerations, approval of an increase in the discount rate of the Federal Reserve Banks should be denied at this time. The only persuasive justification for a higher discount rate would be that such action might conceivably tend to stabilize the present unsettled market for U. S. Government securities by confirming widespread anticipations of a discount rate change. However, the plausibility of that justification does not stand up against the majority sentiment at the last meeting of the System Open Market Committee, which clearly called for an increasingly restrictive monetary and credit policy.
>
> Under these circumstances, any temporary stability recorded in U. S. Government securities prices will be short-lived when it becomes evident that Federal Reserve System policy is exerting increasing pressure on the supply of reserves. Upon public recognition of the direction of

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1/ Withdrew from meeting at point indicated in minutes.

System policy, an increase in the discount rate would then be interpreted as having been a signal of System intentions to restrict the expansion of credit more severely, whereupon a further break in U. S. Government securities prices presumably would eventuate.

The rising number of member banks, especially in the country bank classification, that are becoming steady borrowers at the Federal Reserve Banks suggests that the time is approaching when the Federal Reserve Banks, in fairness to their temporary member bank borrowers, will feel obliged to police steady borrowings and require their liquidation as promptly as possible. Policing action by the Federal Reserve Banks over member bank borrowings, taken in conjunction with a more restrictive credit and monetary policy, can put commercial banks under intolerable pressure to dispose of U. S. Government securities on a falling market and at the expense of a heavy depreciation that risks impinging on their capital funds.

All told, the effect of the combination of pressures that are inherent in the Federal Reserve System's policy intentions threatens to produce a repetition of the 1953 situation which culminated in a disorderly market and the need for the Federal Reserve System to undertake massive remedial actions. The damage that would be suffered by the U. S. Government securities market under such circumstances might be almost irreparable because of the doubt that might be cast on the credit of the United States. Any loss of confidence in the credit of the United States could, in turn, react in loss of confidence in the United States dollar as the key currency acceptable in international trade. All in all, the reasoning set out adds up to a strong argument against an increase in the discount rate at this time.

With securities markets set to one side, economic considerations remain as a possible overriding justification for an increase in the discount rate at the Federal Reserve Banks. Measuring the assumed need of a Federal Reserve System monetary and credit policy aimed at aggressively subduing inflationary potentials against the harm that such a policy could wreak on the U. S. Government securities markets and the national credit, leaves no doubt in my mind that the latter risks are paramount and must be avoided. Moreover, the grounds for rationalizing a more restrictive Federal Reserve System monetary and credit

policy are difficult to substantiate if credence can be given to the theory that within reason an expanding gross national product should be paced by an increase in the money supply. The present rate of increase in the money supply seems scarcely to be such as to need drastic curbing through Federal Reserve System monetary and credit policy actions. And, for that matter, measuring an increase in the money supply against the level of the money supply a year ago may be illusory when it is noted that last year's major expansion in the money supply occurred after the mid-summer reversal of Federal Reserve System monetary policy from active ease to restraint, thereby indicating the lag that occurs between the initiation of a policy and the ultimate appearance of its effects.

Applying the same possibilities to the existing situation suggests that the pressures of the Federal Reserve System's current monetary and credit policy are cumulative in their effects and may before long produce destructive securities markets and economic effects, especially if they are aggravated by still more credit restrictive actions. If the increase that has taken place in the money supply is figured back to the time in 1958 at which the money supply experienced its greatest growth, the rate of increase since then will have been moderate and perhaps in the light of historical perspective may be found to have been inadequate to nourish a proper degree of economic expansion that of itself should not be viewed from the bottom point at which economic recovery began but rather from the high point of economic activity reached in 1957. Seemingly that high point should be taken as the starting point for a new period of economic growth and subsequent expansion of all economic factors related thereto.

Governor Robertson said that he would be very much in favor of an increase in the discount rate if there were not in the immediate picture the fact that the prime rate had been increased by commercial banks within the past few days. In his view, inflationary pressures were strong and, regardless of the effect that an increase in the discount rate might have on the Government securities market, his feelings were that the Federal Reserve should take action to stay on

top of the inflationary situation. However, he disliked the idea of moving on the discount rate at a time when such action was generally expected. This was for the reason that the main effect of a discount rate change nowadays was psychological, and if a change were made in accordance with expectations of the banking and financial community the psychological effect would be negligible. Consequently, he did not have a firm view at this time as to the proper course to be followed. It had occurred to him that possibly an increase by an amount greater than that which might be expected by the financial community would result in appropriate attention to and psychological reaction from such a change. This would indicate that the Federal Reserve was actively concerned with inflationary pressures. He did not believe that the situation at present warranted determination by the Board of a rate for the Federal Reserve Banks and thus was inclined to feel that in the absence of a proposal by a Reserve Bank that would result in appropriate impact from a rate change, nothing should be done in the immediate future.

Governor Shepardson said that he was in a quandary. The points that Governor Mills made were ones to be kept in mind. There should be further study of the growth in money supply and its relationship to sustainable growth in the economy. However, he felt that the inflationary pressures were building up at this time and that there was an overenthusiastic optimism as to where business might go.

Because of the inflationary potential that could erupt at any time, his view was that the Federal Reserve should try to keep ahead of developments rather than to wait until a new inflationary push had gotten up full steam. In effect, his question was how the System could provide the money necessary for the normal financing of the economy and at the same time keep some brake on the inflationary factors.

Governor King said that he would dislike moving on the discount rate immediately after the prime rate had been increased for the reasons indicated by others. He did not like the idea of having the Federal Reserve follow the dictates of others. Personally, he doubted that today or tomorrow offered the best time for a rate change, although he agreed generally that such a change should be made when the best psychological effect could be gotten.

Governor Szymczak said that when the prime rate was increased his first reaction was that the discount rate also should be increased as soon as possible. It would not matter whether the immediate reason for a change in the discount rate was that the prime rate had increased. He agreed with Governor Mills that the Government securities market presented a very difficult problem. An increase in the rate of, say, 3/4 per cent might indicate a tighter money policy than he, personally, would be willing to subscribe to at this time. Because of the uncertainties and because of what had taken place regarding the prime

rate, his present inclination was to wait for a few days and then to take up the question of the discount rate.

After further discussion, during which Governor Szymczak withdrew from the meeting, Governor Balderston stated that he gathered that the sentiment of the Board was to make no change at this time as to procedures for considering discount rate matters and that nothing should be done to indicate to the Reserve Banks that the Board was considering the matter at the present time.

At this point Messrs. Thomas, Economic Adviser, and Shay, Legislative Counsel, entered the room.

At Governor Balderston's request, Governor Robertson reported a telephone call that he had received from Congressman Clarence Kilburn, of New York, this morning. The substance of the call was that Congressman Reuss had sent a letter to members of the Banking and Currency Committee expressing views regarding the effects of reserve requirement legislation embodied in H.R. 5237 if such legislation were enacted and describing an amendment that he proposed to offer retaining the present 26 per cent maximum for central reserve city banks. Congressman Kilburn had asked for the Board's views on the proposal in Mr. Reuss' letter, copies of which had been distributed to members of the Board before this meeting.

At Governor Balderston's request, Mr. Thomas commented on a memorandum, copies of which were distributed, that he had prepared as

a possible response to Congressman Kilburn's inquiry. Following discussion, it was agreed that a letter in a form satisfactory to Governor Balderston should be sent to Congressman Kilburn this afternoon, and that copies also would be sent to Mr. Spence, Chairman of the House Committee on Banking and Currency, and Mr. Paul Brown, Chairman of Subcommittee No. 2 of the House Committee on Banking and Currency. A copy of the letter sent to Congressman Kilburn later in the day is attached to these minutes as Item No. 1.

The meeting then adjourned.

Secretary's Note: Pursuant to the understanding at the meeting on May 15, 1959, a letter was sent today to Mr. Eugene B. Crowe, St. Louis, Missouri, in the form attached as Item No. 2, with a copy to the Federal Reserve Bank of St. Louis.

Secretary

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 1
5/19/59

OFFICE OF THE VICE CHAIRMAN

May 19, 1959.

The Honorable Clarence E. Kilburn,
House of Representatives,
Washington 25, D. C.

Dear Mr. Kilburn:

This is in response to your request for comments on Congressman Reuss' proposed amendment to H.R. 5237 which would retain the present 26 per cent maximum reserve requirement against demand deposits at central reserve city banks.

In the bill as originally introduced and as supported by the Board of Governors, permissible requirements against demand deposits at central reserve city banks would be reduced from a range of 13 to 26 per cent to a range of 10 to 20 per cent, or the same as the range prescribed for reserve city banks. The Board expressed the view, however, that the central reserve city classification should be retained. The bill as approved by the Senate would eliminate the central reserve city classification.

The Board believes that the maximum limit on reserve requirements is not an important feature of the legislation. The level of reserve requirements will need to be adjusted to the credit needs of a growing economy and, in the judgment of the Board, the future long-run growth of the economy is likely to call for some gradual reduction in reserve requirements to meet the reserve needs for additional bank credit expansion, rather than for increases in reserve requirements.

The Board does believe, however, that for effective operation of the banking system, it would be desirable to retain the three classifications of banks as provided in the bill originally introduced.

Sincerely yours,

C C Balderston

C. Canby Balderston,
Vice Chairman.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 2
5/19/59

OFFICE OF THE VICE CHAIRMAN

May 19, 1959

Mr. Eugene B. Crowe,
Apartmant 808,
4166 Lindell Boulevard,
St. Louis 8, Missouri.

Dear Mr. Crowe:

Your letter of May 4, 1959, regarding a certain V-loan guarantee with respect to which the Federal Reserve Bank of St. Louis acted as fiscal agent for the guaranteeing Government agency, has been brought to my attention in the absence of Chairman Martin.

While I understand that this matter has been the subject of considerable previous correspondence, it appears that your most recent letter is concerned only with the extent of the authority of the Board of Governors in V-loan cases of this kind. Specifically you ask for direct advice as to the correctness of your conclusion that the Chairman's letter to you of June 24, 1958, contained a "patent misrepresentation of fact." That letter stated that the Board "has no direct authority in connection with V-loans under the Defense Production Act and, in fact, is not mentioned in the Act." It also stated that "the Board would not be in a position to intervene in any particular case or cases."

That letter was in no sense intended to convey any misrepresentation of the facts. The Board was given no direct authority by the statute with respect to V-loans. Later, however, certain authority conferred by the statute upon the President was delegated by him to the Board of Governors; and the President, also by executive order, designated the Federal Reserve Banks to act as fiscal agents of the United States in connection with V-loans. I believe that since the date of the Chairman's letter of June 24, 1958, this has fully been explained to you in a number of letters addressed to you by Mr. Gardner Boothe, Administrator of the Office of Defense

Loans of the Board. I trust, therefore, that any misunderstanding that may have originally been created in your mind with respect to this letter has now been clarified.

As has been stated in previous letters to you from Mr. Boothe, the Board has felt that it should not intervene in any V-loan case except on the basis of complaints received from a party directly involved. However, after reviewing the correspondence regarding this matter, the Board has concluded that, if you will assemble such specific information as you wish to present and advise the Board when it will be convenient for you to present such information, arrangements will be made for you to meet in St. Louis with a member of the Board's staff who will then transmit such information to the Board.

Sincerely yours,

C C Balderston

C. Canby Balderston,
Vice Chairman.