MINUTES OF MEETING

of the

FEDERAL ADVISORY COUNCIL

November 20-21, 1935

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

November 20, 1935.

The fourth statutory meeting of the Federal Advisory Council in Washington and the fifth meeting of the year was convened in Room 836 of the Mayflower Hotel, Washington, D. C. on Wednesday, November 20, 1935, at 10:15 A. M., the President, Mr. Smith, in the Chair.

Present:

Mr. Thomas M. Steele	District No. 1
Mr. James H. Perkins	District No. 2
Mr. Howard A. Loeb	District No. 3
Mr. Arthur E. Braun	District No. 4
Mr. C. M. Gohen	District No. 5
Mr. H. Lane Young	District No. 6
Mr. Edward Eagle Brown (Alternate for Mr. S. A. Smith)	District No. 7
Mr. Walter W. Smith	District No. 8
Mr. Theodore Wold	District No. 9
Mr. W. T. Kemper	District No. 10
Mr. Joseph H. Frost	District No. 11
Mr. M. A. Arnold	District No. 12
Mr. Walter Lichtenstein	Secretary

On motion, duly made and seconded, the minutes of the Council meeting of September 23-24, 1935, copies of which had been previously sent to the members, were approved.

The Secretary read the letter of the Secretary of the Board of Governors of the Federal Reserve System dated October 30, 1935, in which it was requested that "if the Council has any proposals to make with respect to the operation of the open market account of the Federal Reserve System" the Board would be glad to receive and consider such proposals.

Mr. Frost thereupon read an exhaustive statement dealing with the matter of the large bond holdings of the Federal Reserve System and the large excess reserves of member banks. A copy of this statement was filed as a permanent part of the records of the Council.

Mr. Frost thereupon moved the adoption of the resolution appended to these minutes as Recommendation No. 1. The motion was seconded by Mr. Loeb. After considerable discussion it was voted unanimously to adopt the resolution in question.

From 11:15 A. M. until 12:45 P. M. Dr. Goldenweiser discussed the present business situation and other factors of importance in respect to the Federal Reserve System.

At 1:00 P. M. the Council adjourned to Room 875 for luncheon at which Chairman Eccles was present and at which he discussed matters of importance relating to the Federal Reserve System and the banking situation generally.

At 4:20 P. M. the Council reconvened in Room 836.

There was considerable discussion regarding the question whether the Council should demand that the Board publish its recommendation regarding open market operations, etc. It was decided, however, merely to add a letter of transmittal to the recommendation, and this appears as the introductory paragraph to Recommendation No. 1 attached to these minutes.

The Secretary of the Council read the letter of the Secretary of the Board of Governors of the Federal Reserve System dated November 12, 1935, in which the Board requested the advice of the Council in reference to asking some of the larger member banks for certain statistical information. It was voted that a statement be made to the Board as follows:

"The Federal Advisory Council acknowledges receipt of the letter of the Secretary of the Board of Governors of the Federal Reserve System dated November 12, 1935, in which the Board asks the advice of the Council in reference to 'the desirability of asking a small group of the larger member banks to fill out a schedule showing in each case the deposits of the bank's fifty or one hundred largest depositors on four dates in each year for the past six years, classified by a broad classification,' etc.

"The members of the Council as individuals see no objection to banks giving the information, but the Council as such does not desire to express an opinion on this subject."

The question was raised regarding the tentative draft of a regulation prepared by the staff of the Board of Governors of the Federal Reserve System dealing with the ratio of bank capital to deposit liabilities. The Council in view of certain information given to it by some of its members decided that it would not be desirable at this time to have any discussion with the Board regarding this subject.

Discussion took place regarding contemplated regulations by the Board of Governors of the Federal Reserve System in respect to margin requirements of collateral loans to banks. It was unanimously voted to make a recommendation to the Board which is attached to these minutes as Recommendation No. 2.

The meeting adjourned at 6:00 P. M.

WALTER LICHTENSTEIN,

Secretary.

MINUTES OF JOINT CONFERENCE OF THE FEDERAL ADVISORY COUNCIL AND THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

November 21, 1935.

At 10:00 A. M. a joint conference of the Federal Advisory Council and the Board of Governors of the Federal Reserve System was held in the Federal Reserve Board Room, Washington Building, Washington, D. C.

Present: Members of the Board of Governors of the Federal Reserve System:

Chairman Marriner S. Eccles; Vice Chairman J. J. Thomas; Messrs. C. S. Hamlin, A. C. Miller, and M. S. Szymczak; also Messrs. Lawrence Clayton, Assistant to the Chairman of the Board of Governors of the Federal Reserve System; Walter Wyatt, General Counsel for the Board; Chester Morrill, Secretary of the Board; L. P. Bethea and S. A. Carpenter, Assistant Secretaries of the Board; Dr. E. A. Goldenweiser, Director, Division of Research and Statistics, Board of Governors; Laughlin Currie, Assistant Director, Division of Research and Statistics; and Carl E. Parry, Chief of Division of Security Loans, Board of Governors.

Present: Members of the Federal Advisory Council:

Mr. Walter W. Smith, President; Mr. H. A. Loeb, Vice President; Messrs. T. M. Steele, J. H. Perkins, A. E. Braun, C. M. Gohen, H. L. Young, E. E. Brown, Theodore Wold, W. T. Kemper, J. H. Frost, M. A. Arnold, and Walter Lichtenstein, Secretary.

The Secretary of the Council read the answer made to the letter of the Secretary of the Board of Governors of the Federal Reserve System dated November 12, 1935. (The answer will be found in the minutes of the preceding day.)

Dr. Currie made a detailed statement about the need of the information for which the request was made.

At 10:30 A. M. Dr. Currie left the meeting.

The Secretary of the Council read Recommendation No. 2, attached hereto and made a part of these minutes.

Dr. Parry thereupon made a statement of why he thought it necessary to have some regulations respecting margin requirements for collateral loans of banks. It was pointed out that there was no immediate necessity for these regulations at this time.

A discussion took place regarding the reasons for the recent rise in stock prices and on the whole the view was that:

(a) It was due to a belief that the country was on the road to real recovery, and

(b) That there was large European buying as evidenced, in part at least, by the large influx of gold from European countries in recent months.

Six months ago there was still great fear of inflation, but in most districts, according to statements made by members of the Council, this fear seems to be diminishing and it is not now a very important factor in the rise of stock prices.

The view was expressed that it might be well for the Board to formulate its regulations and have them ready if need should arise, but not issue any regulations at the present time. The Chairman of the Board of Governors stated that consideration would be given by the Board to this suggestion.

The Secretary of the Council read Recommendation No. 1, which is attached hereto and made a part of these minutes.

Two members of the Board of Governors (Messrs. Eccles and Miller) stated that they were opposed to any action at this time.

Mr. Perkins left the meeting at 12:30 P. M.

At the suggestion of the Chairman of the Board of Governors Dr. Goldenweiser made a statement regarding his view of the situation, and made it clear that only eight hundred to nine hundred million dollars of the excess reserves of member banks are due to the purchase of Government securities, while the balance is due to the influx of gold largely from Europe.

Chairman Eccles read a confidential letter addressed to the Open Market Committee.

The view was expressed that there was nothing in the business or credit situation which necessitated at this stage any measures for absorbing excess reserves. The Board would act when there was danger of undue expansion of credit.

President Smith of the Council stated that any publicity regarding this meeting of the Council should come through the Board, though if there was to be any release in respect to Recommendation No. 1, it should be given out completely and not in part.

The Chairman of the Board of Governors stated that he would release this recommendation only if at the same time he was able to release a reply of the Board.

The meeting adjourned at 1:05 P. M.

WALTER LICHTENSTEIN,

Secretary.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

November 21, 1935.

At 1:10 P. M. the Federal Advisory Council reconvened in the Federal Reserve Board Room, Washington Building, Washington, D. C., the President, Mr. W. W. Smith, in the Chair.

Present: Mr. W. W. Smith, President; Mr. H. A. Loeb, Vice President; Messrs. T. M. Steele, A. E. Braun, C. M. Gohen, H. L. Young, E. E. Brown, Theodore Wold, W. T. Kemper, J. H. Frost, M. A. Arnold, and Walter Lichtenstein, Secretary.

After some discussion it was suggested to Mr. Frost that he send a copy of his detailed statement, presenting the arguments upon which Recommendation No. 1 is based, to each individual member of the Board of Governors of the Federal Reserve System, but that this statement had better come from Mr. Frost personally rather than from the Council.

After further discussion regarding possible publication of its findings, it was voted that the President of the Council present to the Chairman of the Board of Governors of the Federal Reserve System the following memorandum:

"After the joint meeting of the Board of Governors of the Federal Reserve System and the Federal Advisory Council adjourned at 1:05 P. M., the Federal Advisory Council met and adopted the following:

" 'The Council believes that its recommendation number 1 of November 21, 1935, dealing with open market operations and excess reserves of member banks should be published on or before December 20, 1935, which will give ample time for consideration of this recommendation by the Open Market Committee of the Federal Reserve System.' "

The meeting adjourned at 1:30 P. M.

WALTER LICHTENSTEIN,

Secretary.

NOTE: The above memorandum was left at the office of the Chairman of the Board of Governors by the President of the Council and a copy was also handed to Mr. Szymczak, the latter being requested to convey orally to the Chairman the fact that the Council had fixed the date of December 20 as the limit of time within which its recommendation should be published in the belief that this would give ample time not merely for the Open Market Committee of the Federal Reserve System to consider the matter, but that by that time the Government financing for December would be out of the way.

The oral statement made to Mr. Szymczak was not part of the written and formal memorandum, but is added here simply as a matter of record.

RECOMMENDATIONS OF THE FEDERAL ADVISORY COUNCIL TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

November 21, 1935.

TOPIC No. 1. Open Market Operations and the Excess Reserves.

RECOMMENDATION: The Federal Advisory Council, in view of the fact that it has been advised by the Chairman of the Board of Governors of the Federal Reserve System that the Board does not have the authority to initiate open market operations, requests the Board to submit the following recommendation to the Open Market Committee and to call for that purpose a special meeting of said Committee at an early date.

The Federal Advisory Council of the Federal Reserve System has received the communication of the Board of Governors of the System, wherein reference is made to the statement of the Council made to the Board at its meeting of September 24, 1935, concerning the amount of Government securities held by the System, which has not varied for a long time, and calling the attention of the Board to the basic theory of open market operations: that there should at all times prevail sufficient flexibility to prevent undue expansion and contraction in the credit structure of the country. The Council enquired whether the Board agreed with the principle enunciated.

The present communication of the Board recognizes "the necessity for the consideration of the factors referred to in the statement as elements in the determination of open market policy" and closes with the statement that "if the Council has any proposals to make with respect to the operation of the open market account of the Federal Reserve System, which it believes to be pertinent in the existing situation, all factors considered, the Board will, as in the past, be glad to receive them and consider them."

The Council is fully cognizant of and thoroughly appreciates the importance and significance of the obligation imposed upon it by law "to confer directly with the Federal Reserve Board" and "to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various districts, the purchase and sale of gold or securities by reserve banks, *open market operations by said banks*, and the general affairs of the reserve banking system," and it has given its most careful and earnest consideration to the suggestion by the Board that it will be glad to receive from the Council such proposals as it may make with respect to the open market account of the system.

As a result of this consideration the Council desires to call the attention of the Board to the fact that, since the discontinuance, more than two years ago, of open market purchases by the System, excess reserves of member banks held by the System have now reached the unprecedented total of more than three billion dollars, which may well be considered as a base upon which additional bank credit can be extended to the extent of at least thirty billion dollars with a corresponding increase of bank deposit liabilities.

The Council believes that there have now been some considerable evidences of recovery in business, of an increase in prices generally, and particularly in the security markets of the country, with the possibility, at least, that a too rapid advance of security prices could easily develop into a new wave of speculation such as preceded the market collapse of 1929. The constant pressure of the very large excess reserves of the member banks creating a plethora of the available supply of bank credit has a very distinct tendency to foster and encourage speculative activity, increase prices, and raise the living cost of the population. The Council believes that, even with the practically complete elimination of excess reserves, the banking system of the country would still be prepared and ardently desirous of meeting any and all legitimate and proper demands for bank credit, and the Council is strongly of the opinion that, in order to obviate the probability of an undue and dangerous credit inflation, it is desirable from every point of view to eliminate or at least greatly reduce the excess reserves now being carried in the System.

Since the enactment of the Banking Act of 1935, there exist two methods by which this can be accomplished. 1. The selling or "permitting to run off" of a portion or all of the System holdings of Government securities. 2. Raising of reserve requirements.

The Council has most earnestly considered the question as to which of these two methods might be the more desirable under the present circumstances and has determined to recommend as strongly as possible the first method.

The controlling reason for this is the indisputable fact that so long as Government bonds are held under the ownership of the System, either the currency of the country or the reserves of member banks, to a corresponding extent, are dependent entirely upon a Government obligation. The world history of currency and banking has demonstrated the dangers inherent in such a system or policy too many times to make it necessary for them to be elaborated upon in this communication.

There is, however, another reason for preferring the first method, namely, the ease and flexibility with which it may be administered. Under that method, Government security holdings may be permitted to run off or may be sold, rapidly or gradually, as in the judgment of the Open Market Committee, may seem to be feasible or advisable. If at any time, the effects seem to be too severe, it is possible to suspend or even temporarily to reverse the policy.

Under the second method, namely, increase of reserve requirements, rigidity is substituted for flexibility, since it must be entirely apparent to any one that frequent changes in reserve requirements would create a chaotic condition in planning for the future by member bank management.

Finally, the Council wishes to make perfectly clear to the Board that, after Government security holdings of the System have been eliminated or greatly reduced, and if, then, further curbs upon speculation should seem to be desirable, there would certainly be no possible objection to an increase in reserve requirements. On the contrary, it would become the clear and plain duty of the Board fearlessly and promptly to take such action.

TOPIC No. 2. Regulations in Respect to Margin Requirements on Collateral Loans of Banks.

RECOMMENDATION: The Federal Advisory Council understands that the Board of Governors of the Federal Reserve System is contemplating issuing regulations to deal with the control of collateral loans to be made by banks. The Council, therefore, reaffirms herewith its recommendation of May 15, 1934, reading as follows:

> "The members of the Federal Advisory Council are of the opinion that the Federal Reserve Board before issuing regulations under this bill [Stock Exchange Bill, S. 3420], provided it is enacted into law, should make a careful study as regards the needs of the situation. It should be pointed out that the power conferred on the Board is to be permissive and not mandatory. Consequently, there is no need for the Board to issue any regulations until there is evidence that there is necessity for them. In general the members of the Council feel that if the Board conscientiously can refrain from adding unnecessarily to the innumerable regulations, orders, and laws of all kinds under which banks are at present compelled to operate it will be doing a distinct service.
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> "If and when the Federal Reserve Board deems it necessary and advisable to issue regulations under this provision of the proposed law then it is to be hoped that the Board will bear in mind the need for maintaining adequate markets not merely for securities listed on the more important exchanges of the country but also for securities which have merely a restricted local market and those which are sold over the counter and not listed. Stringent regulations may result in destroying the market for the securities of small worthy industries and thereby possibly destroy these industries themselves by making it impossible for them to obtain needed capital."