

MINUTES OF MEETINGS
of the
FEDERAL ADVISORY COUNCIL

February 15-17, 1948

April 25-27, 1948

September 19-21, 1948

November 14-16, 1948

OFFICERS AND MEMBERS OF THE FEDERAL ADVISORY COUNCIL

For the Year 1948

OFFICERS:

President, Edward E. Brown
First Vice President, Charles E. Spencer, Jr.
Second Vice President, Robert V. Fleming
Director, W. Randolph Burgess
Director, David E. Williams
Director, John H. McCoy
Secretary, Walter Lichtenstein
Associate Secretary, Herbert V. Prochnow

EXECUTIVE COMMITTEE:

Edward E. Brown
Charles E. Spencer, Jr.
Robert V. Fleming
W. Randolph Burgess
David E. Williams
John H. McCoy

MEMBERS:

Charles E. Spencer, Jr.	District No. 1
W. Randolph Burgess	District No. 2
David E. Williams	District No. 3
John H. McCoy	District No. 4
Robert V. Fleming	District No. 5
J. T. Brown	District No. 6
Edward E. Brown	District No. 7
James H. Penick	District No. 8
Henry E. Atwood	District No. 9
James M. Kemper	District No. 10
J. E. Woods	District No. 11
Reno Odlin	District No. 12

BY-LAWS OF THE FEDERAL ADVISORY COUNCIL

ARTICLE I. OFFICERS

The officers of this Council shall be a President, First Vice President, Second Vice President, three Directors, a Secretary and an Associate Secretary, all of whom, except the Secretary and Associate Secretary, shall also serve as the Executive Committee.

ARTICLE II. PRESIDENT AND VICE PRESIDENT

The duties of the President shall be such as usually pertain to the office; in his absence the Vice President shall serve.

ARTICLE III. SECRETARY AND ASSOCIATE SECRETARY

The Secretary shall be a salaried officer of the Council, and his duties and compensation shall be fixed by the Council. The Associate Secretary shall serve without compensation, except for remuneration for expenses incurred, and his duties shall be fixed by the Council.

ARTICLE IV. EXECUTIVE COMMITTEE

The Executive Committee, as indicated in Article I of the by-laws, shall consist of the President, First Vice President, Second Vice President and the three Directors.

ARTICLE V. DUTIES OF THE EXECUTIVE COMMITTEE

It shall be the duty of the Executive Committee to keep in close touch with the Board of Governors of the Federal Reserve System and with their regulations and promulgations, and communicate the same to the members of the Council, and to suggest to the Council, from time to time, special matters for consideration.

The Executive Committee shall have the power to fix the time and place of holding its regular and special meetings and methods of giving notice thereof.

The Executive Committee shall have full power, as officers of the Council, to act for the Council between meetings of the Council.

Minutes of all meetings of the Executive Committee shall be kept and such minutes or digest thereof shall be immediately forwarded to each member of the Council.

A majority of the Executive Committee shall constitute a quorum, and action of the Committee shall be by majority of those present at any meeting.

ARTICLE VI. MEETINGS

Regular meetings of the Federal Advisory Council shall be held in the City of Washington on the third Tuesday of the months of February, May, September, and November of each year, unless otherwise directed by the Executive Committee.

A preliminary meeting of the Federal Advisory Council shall be called by the Secretary in accordance with instructions to be given by the President of the Council.

Special meetings may be called at any time and place by the President or the Executive Committee, and shall be called by the President upon written request of any three members of the Council.

ARTICLE VII. ALTERNATES

In the absence of the regular representative of any Federal Reserve District, the Board of Directors of the Federal Reserve Bank of that District may appoint an alternate. The alternate so appointed shall have the right to be present at all the meetings of the Council for which he has been appointed. He shall have the right to take part in all discussions of the Council but shall not be entitled to vote.

ARTICLE VIII. AMENDMENTS

These by-laws may be changed or amended at any regular or special meeting by a vote of a majority of the members of the Federal Advisory Council.

February 15, 1948

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

February 15, 1948

The first and organizational meeting of the Federal Advisory Council for the year 1948 was convened in Room 932 of the Mayflower Hotel, Washington, D. C., on Sunday, February 15, 1948, at 2:20 P.M.

Present:

Walter S. Bucklin (Alternate for Mr. Charles E. Spencer, Jr.)	District No. 1
W. Randolph Burgess	District No. 2
David E. Williams	District No. 3
John H. McCoy	District No. 4
Robert V. Fleming	District No. 5
J. T. Brown	District No. 6
Edward E. Brown	District No. 7
James H. Penick	District No. 8
Henry E. Atwood	District No. 9
James M. Kemper	District No. 10
J. E. Woods	District No. 11
Reno Odlin	District No. 12
Walter Lichtenstein	Secretary

Absent:

Charles E. Spencer, Jr.

Dr. W. Randolph Burgess was elected Chairman *pro tem* and Mr. Walter Lichtenstein, Secretary *pro tem*.

The Secretary *pro tem* stated that communications had been received from the twelve Federal Reserve banks, certifying to the election of their respective representatives on the Council for the year 1948.

The following officers were nominated and unanimously elected:

Edward E. Brown, President
Charles E. Spencer, Jr., First Vice President
Robert V. Fleming, Second Vice President
W. Randolph Burgess, Director
David E. Williams, Director
John H. McCoy, Director
Walter Lichtenstein, Secretary
Herbert V. Prochnow, Associate Secretary

On motion, duly made and seconded, the salary of the Secretary was fixed at \$2,500, which has been the Secretary's salary in previous years, and it was agreed that the Associate Secretary should serve without stipend but be paid his expenses.

On motion, duly made and seconded, the Council adopted the existing by-laws as amended, which are a part of these minutes.

The Secretary presented his financial report for the year 1947, which had been audited by Mr. J. J. Buechner, Assistant Auditor of The First National Bank of Chicago. Copies of the report had been sent previously to the members of the Council. The report was approved and ordered placed on file. A copy of the report is attached and made a part of these minutes.

On motion, duly made and seconded, the mimeographed minutes of the meetings of the Council on November 16-17-18, 1947, and the printed minutes for the meetings held on March 9-10-11, 1947, May 18-19-20, 1947, September 21-22-23, 1947, and November 16-17-18, 1947, copies of which had been sent previously to the members of the Council, were approved.

On motion, duly made and seconded, a resolution was adopted authorizing the Secretary to ask each Federal Reserve bank to contribute \$350.00 toward the secretarial and incidental expenses of the Federal Advisory Council for the year 1948 and to draw upon it for that purpose.

A complete list of the items on the Agenda for the meeting and the conclusions of the Council are to be found in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council*, which follows on pages 8, 9 and 10.

The meeting adjourned at 5:50 P.M.

WALTER LICHTENSTEIN
Secretary.

REPORT OF THE SECRETARY OF THE FEDERAL ADVISORY COUNCIL

For the Year Ended December 31, 1947

Balance on hand December 31, 1946	\$ 6,150.88	Salaries	\$ 2,500.00
		Conference Expenses	838.91
		Printing and stationery	226.50
Assessments— 12 Federal Reserve banks	4,200.00	Postage, telephone and telegraph	214.74
		Balance on hand December 31, 1947	6,570.73
	<u>\$10,350.88</u>		<u>\$10,350.88</u>

Chicago, Illinois
February 1, 1948

To the Federal Advisory Council:

I have audited the books, vouchers, and accounts of the Secretary of the Federal Advisory Council for the year ended December 31, 1947, and certify that the above statement agrees therewith.

Respectfully,

THE FIRST NATIONAL BANK OF CHICAGO,
(Signed) J. J. Buechner
Assistant Auditor

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

February 16, 1948

At 10:20 A.M., the Federal Advisory Council reconvened in Room 932 of the Mayflower Hotel, Washington, D. C.

Present: Mr. Edward E. Brown, President; Mr. Walter S. Bucklin (Alternate for Mr. Charles E. Spencer, Jr.); Messrs. Robert V. Fleming, W. Randolph Burgess, David E. Williams, John H. McCoy, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, J. E. Woods, Reno Odlin, Walter Lichtenstein, Secretary, and Herbert V. Prochnow, Associate Secretary.

Absent: Mr. Charles E. Spencer, Jr.

The Council reviewed its conclusions of the previous day regarding the items on the agenda and sent to the Secretary of the Board of Governors the *Confidential Memorandum* which follows on pages 8, 9, and 10, listing the agenda items with the conclusions reached by the Council. The *Memorandum* was delivered to the Secretary of the Board of Governors at 11:58 A.M. on February 16, 1948.

The meeting adjourned at 11:45 A.M.

WALTER LICHTENSTEIN
Secretary.

MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL
ADVISORY COUNCIL RELATIVE TO THE AGENDA FOR THE JOINT MEET-
ING ON FEBRUARY 17, 1948

1. A discussion of recent rulings by the Treasury with respect to turning foreign funds over to the Alien Property Custodian.

The Federal Advisory Council has noted the statement of the National Advisory Council, of which the Chairman of the Board is a member, to Senator Vandenberg. It feels that the proposal made by the National Advisory Council, if adopted, would impair the tradition that foreign property in the United States is under the protection of American law and banking practice and would lessen the confidence of foreign depositors in the safety of their funds when placed in American banks. This might prove a dangerous precedent as to the treatment by foreign countries of American capital which, at the present time, is being asked to invest abroad. If we are to maintain a leading position in international banking, we should be very careful in any action we take affecting foreign deposits. The Council therefore believes that it would be inadvisable to carry out the recommendation of the National Advisory Council.

2. The effect that gold imports are having on the financial structure of this country, and steps which might be taken to counteract their inflationary influence.

Items 2, 3, and 4 of the agenda are closely related and the conclusions of the Council on these items are given following Item 4.

3. It is estimated that after the first quarter of this calendar year, the Treasury will pay into the market for current expenditures and debt redemption more than it will receive from taxes and sales of securities. This excess of payments, which may amount to as much as \$2 billion in the second quarter, together with a continued gold inflow, which may equal half a billion dollars a quarter, and purchases by the Federal Reserve Banks of additional securities from non-bank investors and from banks needing reserves, will add considerably to bank reserves.

In the opinion of the Council, what measures should be adopted to restrict the use of these additional reserves for further expansion of bank credit:

- a. Should Congress grant authority to raise existing reserve requirements (as distinguished from the special reserve plan) of member banks and to impose correspondingly higher reserve requirements on non-member banks, with the understanding that the additional reserves required of non-member banks will be held with the Federal Reserve Banks? The Federal Advisory Council joined in a similar recommendation on December 31, 1940.
- b. Should the present policy with respect to support of the Government securities market be maintained regardless of further inflationary developments?
- c. Or, should the Federal Open Market Committee sell securities in the market in an amount sufficient to absorb additional reserves which will come into the market after the first quarter and permit Government bonds to decline to whatever extent may be necessary?

4. Should discount rates be increased further? If so, how much? What should be the timing of such action?

Since the last meeting and since the Board sent the Council its questions, there has been a great change in the economic situation. It is too early to determine whether the recent break in commodity prices may develop into a recession but there are some evidences of this sort. Until the trend is clearer we suggest the following broad credit policies.

- A. That the Board and Treasury carry through the measures now in process, namely:

1. That the Treasury continue to use the surplus from tax receipts to redeem debt held by the Federal Reserve and the banks, but proceeding gradually and spreading the operation over 6 months.
2. That the Federal Reserve should not withdraw but carry into effect the increase of 2 per cent in reserve requirements of Central Reserve City banks.
3. That the Treasury go forward with the special effort to sell savings bonds.

- B. That further steps in credit restraint be held in suspense until the trend becomes clearer, namely:

1. That there should be no further increase in discount rates.
2. That reserve requirements of Central Reserve City banks should not be further increased.
3. That the Board should not ask Congress for any additional power over reserve requirements. In this connection it should be pointed out that the prewar Joint Recommendation of December 31, 1940, was made under entirely different circumstances and does not apply to the present situation. At that time the banks had over 6 billion dollars of excess reserves; today they have practically none and are borrowing from the Reserve Banks. Then bill rates were at less than 1/10 of 1%; today they are at 1%. Then the Federal Reserve System had no adequate holdings of Governments to sell to offset gold imports; today they have over 20 billion dollars. There are other vital differences.

- C. That under existing conditions and foreseeable circumstances longer term Government bonds should be supported at par.

5. What measures are being taken by banks to restrict credit under the A.B.A. voluntary program and what results are being obtained?

Meetings are now in progress in each district under the auspices of the A.B.A. and according to all reports these are resulting in a fuller understanding of the present situation by the banks and the public generally. These pilot meetings will be followed by meetings at local levels and an advertising program. Referring to the question asked it should be noted that the purpose of the A.B.A. program is not "to restrict credit" but to assure the soundest and most productive use of credit and to encourage savings.

6. Are there any areas in which loans being made by banks involve greater credit risks than have been the case in the period since the war?

In answering this question, the Council assumes that "areas" does not refer to geographical areas. Increased costs, higher break-even points in the operation of businesses, some slowing of collections, and higher priced inventories have all tended to make credit risks somewhat greater in many cases. The most doubtful loans from a broad economic point of view are those made under Government guaranty.

7. It appears that recently there has been a resumption of the practice by certain large depositors of requesting that the depository banks furnish them more detailed information regarding the condition of the banks than is given to depositors generally. This matter was discussed at the meeting of the Board with the Council on May 14, 1945, at which time differing views were expressed by members of the Council concerning the imposition of a prohibition by law or regulation upon banks giving such information. The Board would appreciate it if the Council would discuss this matter again and advise the Board as to (1) the desirability of the supervisory agencies joining in a statement to banks in their respective jurisdictions which would suggest that banks adopt a practice of not making available to large depositors information which was not given to their depositors generally; (2) what, if any, other action might be taken by the supervisory agencies, and (3) the considerations that should prompt the supervisory agencies in any action that they might take.

The Council is of the unanimous opinion that no request should be made by the Federal Reserve System or other supervisory authorities to have banks refuse information to depositors and the Council would be even more opposed to a regulation intended to enforce such a request.

8. A further discussion of consumer credit.

The Council is opposed to legislation restoring controls over consumer credit. It feels the recent growth in the amount of consumer credit is chiefly due to the increase in the supply of goods such as automobiles customarily sold on time payments. The banks and the finance companies are generally following a restrained policy in the terms required. The Council believes the effort should be continued to get the voluntary cooperation of institutions extending consumer credit to maintain conservative standards.

9. The bank holding company bill has been under consideration or discussion for several months. Apparently a fairly general agreement has now been reached among the interested groups favoring such legislation, and a bill is presently in the Senate Banking and Currency Committee. An objection to its consideration a few days ago resulted in its being left on the calendar without action to date. What further action should be taken by the Council and the Board in relation to this legislation?

The Council reaffirms the position it took on May 20, 1947, in respect to the holding company bill. It urges the Board of Governors to continue to press for its enactment at this session.

10. What is the attitude of the Board of Governors toward the listing of bank stocks on the recognized security exchanges?

The Council withdraws this item from the agenda.

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

February 16, 1948

At 2:00 P.M., the Federal Advisory Council convened in the Board Room of the Federal Reserve Building, Washington, D. C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Mr. Walter S. Bucklin (Alternate for Charles E. Spencer, Jr.); Messrs. Robert V. Fleming, W. Randolph Burgess, David E. Williams, John H. McCoy, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, J. E. Woods, Reno Odlin, Walter Lichtenstein, Secretary, and Herbert V. Prochnow, Associate Secretary.

Absent: Mr. Charles E. Spencer, Jr.

Dr. Woodlief Thomas, Director of the Division of Research and Statistics, spoke on the subject, "Inflation and Bank Credit."

The meeting adjourned at 3:45 P.M.

WALTER LICHTENSTEIN
Secretary.

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

February 17, 1948

At 10:10 A.M., the Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building, Washington, D. C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Mr. Walter S. Bucklin (Alternate for Charles E. Spencer, Jr.); Messrs. W. Randolph Burgess, David E. Williams, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, J. E. Woods, Walter Lichtenstein, Secretary, and Herbert V. Prochnow, Associate Secretary.

Absent: Messrs Charles E. Spencer, Jr., Robert V. Fleming, John H. McCoy and Reno Odlin.

A discussion took place regarding the date for the next Council meeting. It was decided to ask the Board to have the joint meeting with the Council on either April 27, or May 25.

The meeting adjourned at 10:25 A.M.

WALTER LICHTENSTEIN
Secretary.

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

February 17, 1948

At 10:30 A.M., a joint conference of the Federal Advisory Council and the Board of Governors of the Federal Reserve System was held in the Board Room of the Federal Reserve Building, Washington, D. C.

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

Chairman Marriner S. Eccles; Governors M. S. Szymczak, Ernest G. Draper, R. M. Evans, James K. Vardaman, Jr., Lawrence Clayton; also Mr. S. R. Carpenter, Secretary of the Board of Governors; also Mr. Thomas B. McCabe, whose name had been submitted to the Senate of the United States for confirmation as a member and Chairman of the Board of Governors of the Federal Reserve System by the President of the United States.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Mr. Walter S. Bucklin (Alternate for Charles E. Spencer, Jr.); Messrs. Robert V. Fleming, W. Randolph Burgess, David E. Williams, John H. McCoy, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, J. E. Woods, Reno Odlin, Walter Lichtenstein, Secretary, and Herbert V. Prochnow, Associate Secretary.

Absent: Mr. Charles E. Spencer, Jr.

The President of the Council read the first item on the agenda and the conclusions of the Council as given in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council* as printed on pages 8, 9 and 10 of these minutes. President Brown then asked Chairman Eccles why the recommendation in question had been made by the National Advisory Council.

Chairman Eccles replied that the Board was unanimous in its approval of the recommendation made by the National Advisory Council, but would have been glad to have had an alternate solution to the problem. The National Advisory Council, Chairman Eccles reported, invited proposals but received none.

Dr. Burgess stated that he believed Mr. Sproul had given an alternate proposal to the Secretary of the Treasury on this matter, and he also suggested that it would be helpful if the Board would consult with the banks concerned, and particularly with the Federal Reserve banks, before making a final decision.

President Brown read the second, third, and fourth items on the agenda and the conclusions of the Council as found in the *Confidential Memorandum* on pages 8, 9 and 10 of these minutes. There was a lengthy discussion by members of the Council and the Board on these items.

President Brown read the fifth item on the agenda, and the conclusions of the Council as given in the *Confidential Memorandum* previously mentioned.

Chairman Eccles stated that the Board would like authority to raise reserve requirements, if necessary, to 25, 30 and 35 per cent for country banks, reserve city banks and central reserve city banks, respectively.

President Brown read the seventh item on the agenda and the conclusions of the Council, as given in the *Confidential Memorandum* mentioned above.

Chairman Eccles stated that this item originated with the banks since they were writing to the Board and asking what they should do. The Chairman of the Board believed that if a large depositor was entitled to such information, then the call reports should give to the public the same information which the large depositor received. He reported certain insurance companies requested that banks give them the information submitted by the banks in their confidential reports to the Comptroller of the Currency. The Chairman of the Board stated that this definitely was not permissible.

The President of the Council read the eighth item of the agenda with the conclusion of the Council, as given in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council*. There was a very brief discussion of this item.

The President of the Council read the ninth item of the agenda and the conclusion of the Council as given in the aforementioned *Confidential Memorandum*.

Chairman Eccles suggested that it would be helpful if the Council would pass a strong resolution in support of the Bank Holding Company Bill. He suggested that the resolution be sent to Senator Taft.

The meeting adjourned at 1:45 P.M.

WALTER LICHTENSTEIN
Secretary.

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

February 17, 1948

At 2:50 P.M. the Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building, Washington, D. C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Mr. Walter S. Bucklin (Alternate for Charles E. Spencer, Jr.); Messrs. Robert V. Fleming, W. Randolph Burgess, David E. Williams, John H. McCoy, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, J. E. Woods, Reno Odlin, Walter Lichtenstein, Secretary, and Herbert V. Prochnow, Associate Secretary.

Absent: Mr. Charles E. Spencer, Jr.

After some discussion, the Council approved the following resolution relative to the Bank Holding Company Bill, with instructions to the Secretary to transmit the resolution to the Secretary of the Board of Governors:

RESOLUTION

The Federal Advisory Council has approved by resolution the Bank Holding Company legislation. It believes that Senate Bill No. 829 with the amendments suggested by the Council in its resolution of May 20, 1947, should be passed at this session of the Congress and that action by the Congress should not be delayed.

The Federal Advisory Council urges the Board of Governors of the Federal Reserve System to use its best efforts to secure the passage of the bill, with the amendments suggested by the Council, and asks that this resolution be transmitted to the members of the Senate and House Banking and Currency Committees.

The meeting adjourned at 3:25 P.M.

WALTER LICHTENSTEIN
Secretary.

NOTE: This transcript of the Secretary's notes is not to be regarded as complete or necessarily entirely accurate. The transcript should be considered as being strictly for the sole use of the members of the Federal Advisory Council.

W. L.

The Secretary's notes on the meeting of the Federal Advisory Council on February 15, 1948, at 2:20 p.m., in Room 932 of the Mayflower Hotel, Washington, D. C.

All members of the Federal Advisory Council were present.

Mr. W. Randolph Burgess was elected Chairman pro tem and Mr. Walter Lichtenstein, Secretary pro tem.

The Secretary stated that communications had been received from the twelve Federal Reserve Banks, certifying to the election of their respective representatives on the Council for the year 1948.

BY-LAWS

On motion duly made and seconded Articles I and III of the by-laws were amended to read as follows:

Article I. Officers

The officers of this Council shall be a President, First Vice President, Second Vice President, three Directors, a Secretary and an Associate Secretary, all of whom except the Secretary and Associate Secretary, shall also serve as the Executive Committee.

Article III. Secretary and Associate Secretary

The Secretary shall be a salaried officer of the Council, and his duties and compensation shall be fixed by the Council. The Associate Secretary shall serve without compensation, except for remuneration for expenses incurred, and his duties shall be fixed by the Council.

The following officers were elected unanimously:

- Mr. E. E. Brown, President
- Mr. Charles E. Spencer, Jr., First Vice President
- Mr. Robert V. Fleming, Second Vice President
- Mr. Walter Lichtenstein, Secretary
- Mr. Herbert V. Prochnow, Associate Secretary

The following three members were elected directors to serve on the Executive Committee together with Messrs. Brown, Spencer, and Fleming, members ex officio:

- Mr. W. Randolph Burgess
- Mr. David E. Williams
- Mr. John H. McCoy

The salary of the Secretary was fixed at \$2,500, as in previous years, and it was agreed that the Associate Secretary should serve without stipend but be paid his expenses.

The Council readopted the existing by-laws as amended which will be printed and attached to the formal printed minutes.

The Secretary presented his financial report for the year 1947, copies of which had been previously sent to the members of the Council. The report was approved and ordered placed on file. It will be printed and attached to the formal printed minutes.

The mimeographed minutes of the meeting on November 16-18, 1947, and the printed minutes for the four meetings held in 1947, copies of which had been sent previously to the members of the Council, were approved.

A resolution was adopted authorizing the Secretary to draw upon each Federal Reserve Bank for \$350.00 toward the secretarial and incidental expenses of the Federal Advisory Council for the year 1948.

There is attached hereto a memorandum listing the subjects on the agenda together with the conclusions of the Council. This memorandum was handed to the Secretary of the Board of Governors on February 16, 1948.

A DISCUSSION OF RECENT RULINGS BY THE TREASURY WITH RESPECT TO TURNING FOREIGN FUNDS OVER TO THE ALIEN PROPERTY CUSTODIAN.

BURGESS. The discussion of the Council in respect to this item will be found in the attached memorandum previously referred to. The National Advisory Council has made certain recommendations respective to foreign funds deposited in this country. It is estimated that there are about \$5 billion of such funds in this country of which about \$4 billion have been unfrozen, but the remainder amounting to about \$1 billion is still frozen. In so far as it develops that the frozen funds belong to enemy nationals they should be turned over to the Alien Property Custodian. About 30 nationalities are involved. There is a feeling by some in this country that foreign money deposited in this country should make its contribution to the Marshall Plan. The Treasury has issued a statement that it is planned to issue a ruling that no action will be taken with respect to the \$4 billion which are actually invested productively in this country, but that the other billion dollars of frozen funds shall be turned over to the Alien Property Custodian, who will notify the governments concerned. Much of this money bears no taint and is private enterprise money, but some of it consists of funds which while nominally owned by neutral or allied nationals in reality is the property of citizens

of enemy countries. Still other funds are those which had been sent over here in order to evade taxes or other legislative action taken by the governments of such nationals. The procedure suggested by the Treasury would mean a new relationship between the banks and customers. It is generally understood that people coming to this country are subject to our laws and the same should apply to the funds deposited in this country. New York banks have entered a protest against the proposed ruling on the ground that there is no reason why privately owned funds deposited in banks in this country should be turned back to foreign governments.

E. E. BROWN pointed out that the difficulty is that some of the people having funds in this country may have supported in their own country some government hostile to the present one and they have placed their funds in this country in order to find a safe haven for them. For example, a Frenchman may have supported the Vichy Government and a Belgian may have supported the King. He raises the question whether this matter is really within the province of the Council.

FLEMING asks what will be done with funds deposited here to protect the Dutch loan.

BURGESS replied that the Dutch have not taken over any of the funds of their nationals.

E. E. BROWN states his belief that it would set a bad example and that it would affect adversely Latin Americans who have deposited funds in this country.

Agreement was reached as to what answer should be made by the Council, which is given in full in the attached memorandum.

THE EFFECT THAT GOLD IMPORTS ARE HAVING ON THE FINANCIAL STRUCTURE OF THIS COUNTRY, AND STEPS WHICH MIGHT BE TAKEN TO COUNTERACT THEIR INFLATIONARY INFLUENCE.

PENICK says that the importation of gold is tending to produce an unsettling effect on inflation here and some effective action should be taken by the System to neutralize the effect of gold importations. He points out that the gold required to cover deposits and Federal Reserve notes had been reduced from 40 per cent to 25 per cent and it might be desirable to raise the required gold reserves again.

E. E. BROWN points out that at present there is a considerable amount of gold in the System above the requirements and that the Wolcott proposal does not have any effect. If gold began to flow out it might have the effect of preventing the Federal Reserve System from buying bonds and notes from the banks. This is most unlikely to be the case in the visible future.

BURGESS. If the System were to let certificates and bonds run off, it would neutralize the effect of the importation of gold.

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E. E. BROWN suggested that this is really a part of the following questions all of which deal with the same problem.

BURGESS thinks it would be an advantage in again requiring large gold reserves because of the psychological effect.

E. E. BROWN thinks that the Wolcott Bill is simply a notice that we intend to stay on the gold standard.

IT IS ESTIMATED THAT AFTER THE FIRST QUARTER OF THIS CALENDAR YEAR, THE TREASURY WILL PAY INTO THE MARKET FOR CURRENT EXPENDITURES AND DEBT REDEMPTION MORE THAN IT WILL RECEIVE FROM TAXES AND SALES OF SECURITIES. THIS EXCESS OF PAYMENTS, WHICH MAY AMOUNT TO AS MUCH AS \$2 BILLION IN THE SECOND QUARTER, TOGETHER WITH A CONTINUED GOLD INFLOW, WHICH MAY EQUAL HALF A BILLION DOLLARS A QUARTER, AND PURCHASES BY THE FEDERAL RESERVE BANKS OF ADDITIONAL SECURITIES FROM NONBANK INVESTORS AND FROM BANKS NEEDING RESERVES, WILL ADD CONSIDERABLY TO BANK RESERVES.

SHOULD DISCOUNT RATES BE INCREASED FURTHER? IF SO, HOW MUCH? WHAT SHOULD BE THE TIMING OF SUCH ACTION?

BURGESS states that the reference of the Board of Governors to the Joint Resolution of December 31, 1940, does not take into account the fact that the present underlying conditions have changed.

E. E. BROWN states that Chairman Eccles suggested using the whole seven billions to retire Government obligations and also wished to raise reserve requirements. In other words, Chairman Eccles wanted to use a meat axe.

PENICK states that he does not believe any action would be advisable at the present time.

BURGESS believes the Treasury should continue in an orderly manner to redeem debts held by banks. There is danger of overdoing and for the time being the System ought to sit tight and see what the immediate developments will be.

J. T. BROWN feels that the former Joint Statement of December 31, 1940, including recommendations should be explained.

E. E. BROWN stated that before February 4 he would have advised an increase in reserve requirements. He does not believe there is much sense in the large differentiation of required reserves made by the banks located in central reserve cities and reserve cities as contrasted with country banks. Furthermore, the System still is able to increase reserve requirements in New York and Chicago. The private banking system might be in serious difficulties if the 2-1/2's went, let us say, to 90.

BURGESS says that the market must be supported to a point but he does not think that the present support has been handled wisely.

FLEMING is confident the Treasury will not allow long-term bonds to go below par.

ODLIN says the banks have become much more cautious since the break.

E. E. BROWN feels that he would not have been averse in December and January to a raise of reserve requirements in central reserve cities to 30 per cent and others proportionally. Now, however, such action would be unwise.

BURGESS states that Mr. Sproul has made a proposal regarding reserve requirements. Burgess will send the members of the Council copies of the speech.

E. E. BROWN sees little sense in the present distinction existing between the reserve requirements in central reserve cities, reserve cities, and country banks. However, he points out that an account maintained by a department store in some distant city will be withdrawn in times of pressure much sooner than that of a department store located in the same city as the bank in question. He points out at length the difference in the situation existing at the time of the Joint Resolution of December 31, 1940, and the present situation. He believes that before any changes are made in reserve requirements of member banks it would be well to await developments.

WOODS. The small banks in the country and at the grass roots have noticed the discussion that has been going on regarding the maintenance of bond prices, and it has created uneasiness and hurt morale. It must be remembered that even these small people have become bond-minded. As money accumulated they bought bonds, and consequently they are vitally interested in these problems. He has no objections if bonds go to par but they ought not to be allowed to go below that point.

ATWOOD points out that trusts have been selling long-term and buying short-term bonds.

After some further discussion it was decided to combine the answers to items 2, 3, and 4 of the agenda as they are closely related. The conclusions of the Council on these items will be found in the attached memorandum following item 4.

WHAT MEASURES ARE BEING TAKEN BY BANKS TO RESTRICT CREDIT UNDER THE A.B.A. VOLUNTARY PROGRAM AND WHAT RESULTS ARE BEING OBTAINED?

FLEMING reported that the meetings so far held have been very satisfactory and similar reports were made by several other members of the Council. However, nearly all the meetings held have been so called "pilot meetings".

The answer of the Council to this question will be found in the attached memorandum.

ARE THERE ANY AREAS IN WHICH LOANS BEING MADE BY BANKS INVOLVE GREATER CREDIT RISKS THAN HAVE BEEN THE CASE IN THE PERIOD SINCE THE WAR?

The answer of the Council to this inquiry will be found in the attached memorandum.

IT APPEARS THAT RECENTLY THERE HAS BEEN A RESUMPTION OF THE PRACTICE BY CERTAIN LARGE DEPOSITORS OF REQUESTING THAT THE DEPOSITORY BANKS FURNISH THEM MORE DETAILED INFORMATION REGARDING THE CONDITION OF THE BANKS THAN IS GIVEN TO DEPOSITORS GENERALLY. THIS MATTER WAS DISCUSSED AT THE MEETING OF THE BOARD WITH THE COUNCIL ON MAY 14, 1945, AT WHICH TIME DIFFERING VIEWS WERE EXPRESSED BY MEMBERS OF THE COUNCIL CONCERNING THE IMPOSITION OF A PROHIBITION BY LAW OR REGULATION UPON BANKS GIVING SUCH INFORMATION. THE BOARD WOULD APPRECIATE IT IF THE COUNCIL WOULD DISCUSS THIS MATTER AGAIN AND ADVISE THE BOARD AS TO (1) THE DESIRABILITY OF THE SUPERVISORY AGENCIES JOINING IN A STATEMENT TO BANKS IN THEIR RESPECTIVE JURISDICTIONS WHICH WOULD SUGGEST THAT BANKS ADOPT A PRACTICE OF NOT MAKING AVAILABLE TO LARGE DEPOSITORS INFORMATION WHICH WAS NOT GIVEN TO THEIR DEPOSITORS GENERALLY; (2) WHAT, IF ANY, OTHER ACTION MIGHT BE TAKEN BY THE SUPERVISORY AGENCIES; AND (3) THE CONSIDERATIONS THAT SHOULD PROMPT THE SUPERVISORY AGENCIES IN ANY ACTION THAT THEY MIGHT TAKE.

E. E. BROWN points out that some banks may be carrying bonds above their market value. Insurance companies may be becoming apprehensive in situations where their local agents are depositing funds in small banks. In the case of the First National Bank of Chicago, a number of the insurance companies located in Hartford are stockholders as well as depositors and it would be impossible to refuse information to a stockholder. It would obviously create distrust if banks refused to give out information.

BURGESS says that this problem is one of bank management and there should be no interference in such matters on the part of officials.

The answer of the Council to this item appears in the attached memorandum.

A FURTHER DISCUSSION OF CONSUMER CREDIT.

The answer of the Council to this inquiry appears in the attached memorandum.

THE BANK HOLDING COMPANY BILL HAS BEEN UNDER CONSIDERATION OR DISCUSSION FOR SEVERAL MONTHS. APPARENTLY A FAIRLY GENERAL AGREEMENT HAS NOW BEEN REACHED AMONG THE INTERESTED GROUPS FAVORING SUCH LEGISLATION, AND A BILL IS PRESENTLY IN THE SENATE BANKING AND CURRENCY COMMITTEE. AN OBJECTION TO ITS CONSIDERATION A FEW DAYS AGO RESULTED IN ITS BEING LEFT ON THE CALENDAR WITHOUT ACTION TO DATE. WHAT FURTHER ACTION SHOULD BE TAKEN BY THE COUNCIL AND THE BOARD IN RELATION TO THIS LEGISLATION?

A lengthy discussion took place. The final answer of the Council appears in the attached memorandum but it should be noted that originally Mr. Odlin was asked to draft a resolution on this subject. It might also be noted that such a resolution was drafted at a later meeting and will be

given in full in these minutes. A copy of the resolution was handed by the Secretary of the Council to the Secretary of the Board of Governors.

WHAT IS THE ATTITUDE OF THE BOARD OF GOVERNORS TOWARD THE LISTING OF BANK STOCKS ON THE RECOGNIZED SECURITY EXCHANGES?

The Council unanimously agreed to withdraw the item from the agenda.

The meeting adjourned at 5:50 p.m.

The Council reconvened at 10:20 a.m. on February 16, 1948, in Room 932 of the Mayflower Hotel, Washington, D. C.

All members were present except that Mr. Walter S. Bucklin served as alternate for Mr. Charles E. Spencer, Jr.

The Council approved the attached memorandum which it prepared to be sent to the Board of Governors relative to the agenda for the joint meeting of the Board and the Council on February 17, 1948. The memorandum was delivered to the Secretary of the Board of Governors at 11:58 a.m. on February 16, 1948. It will be noted that each item of the agenda is listed with the comments of the Council on the item.

The meeting adjourned at 11:45 a.m.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON FEBRUARY 17, 1948

- 1. A discussion of recent rulings by the Treasury with respect to turning foreign funds over to the Alien Property Custodian.

The Federal Advisory Council has noted the statement of the National Advisory Council, of which the Chairman of the Board is a member, to Senator Vandenberg. It feels that the proposal made by the National Advisory Council, if adopted, would impair the tradition that foreign property in the United States is under the protection of American law and banking practice and would lessen the confidence of foreign depositors in the safety of their funds when placed in American banks. This might prove a dangerous precedent as to the treatment by foreign countries of American capital which, at the present time, is being asked to invest abroad. If we are to maintain a leading position in international banking, we should be very careful in any action we take affecting foreign deposits. The Council therefore believes that it would be inadvisable to carry out the recommendation of the National Advisory Council.

- 2. The effect that gold imports are having on the financial structure of this country, and steps which might be taken to counteract their inflationary influence.

Items 2, 3, and 4 of the agenda are closely related and the conclusions of the Council on these items are given following item 4.

- 3. It is estimated that after the first quarter of this calendar year, the Treasury will pay into the market for current expenditures and debt redemption more than it will receive from taxes and sales of securities. This excess of payments, which may amount to as much as \$2 billion in the second quarter, together with a continued gold inflow, which may equal half a billion dollars a quarter, and purchases by the Federal Reserve Banks of additional securities from non-bank investors and from banks needing reserves, will add considerably to bank reserves.

In the opinion of the Council, what measures should be adopted to restrict the use of these additional reserves for further expansion of bank credit:

- a. Should Congress grant authority to raise existing reserve requirements (as distinguished from the special reserve plan) of member banks and to impose correspondingly higher reserve requirements on nonmember banks, with the understanding that the additional reserves required of nonmember banks will be held with the Federal Reserve Banks? The Federal Advisory Council joined in a similar recommendation on December 31, 1940.
 - b. Should the present policy with respect to support of the Government securities market be maintained regardless of further inflationary developments?
 - c. Or, should the Federal Open Market Committee sell securities in the market in an amount sufficient to absorb additional reserves which will come into the market after the first quarter and permit Government bonds to decline to whatever extent may be necessary?
4. Should discount rates be increased further? If so, how much? What should be the timing of such action?

Since the last meeting and since the Board sent the Council its questions, there has been a great change in the economic situation. It is too early to determine whether the recent break in commodity prices may develop into a recession but there are some evidences of this sort. Until the trend is clearer we suggest the following broad credit policies.

- A. That the Board and Treasury carry through the measures now in process, namely:
 1. That the Treasury continue to use the surplus from tax receipts to redeem debt held by the Federal Reserve and the banks, but proceeding gradually and spreading the operation over 6 months.
 2. That the Federal Reserve should not withdraw but carry into effect the increase of 2 per cent in reserve requirements of Central Reserve City banks.
 3. That the Treasury go forward with the special effort to sell savings bonds.
- B. That further steps in credit restraint be held in suspense until the trend becomes clearer, namely:
 1. That there should be no further increase in discount rates.
 2. That reserve requirements of Central Reserve City banks should not be further increased.

3. That the Board should not ask Congress for any additional power over reserve requirements. In this connection it should be pointed out that the prewar Joint Recommendation of December 31, 1940, was made under entirely different circumstances and does not apply to the present situation. At that time the banks had over 6 billion dollars of excess reserves; today they have practically none and are borrowing from the Reserve Banks. Then bill rates were at less than 1/10 of 1%; today they are at 1%. Then the Federal Reserve System had no adequate holdings of Governments to sell to offset gold imports; today they have over 20 billion dollars. There are other vital differences.

C. That under existing conditions and foreseeable circumstances longer term Government bonds should be supported at par.

5. What measures are being taken by banks to restrict credit under the A.B.A. voluntary program and what results are being obtained?

Meetings are now in progress in each district under the auspices of the ABA and according to all reports these are resulting in a fuller understanding of the present situation by the banks and the public generally. These pilot meetings will be followed by meetings at local levels and an advertising program. Referring to the question asked it should be noted that the purpose of the ABA program is not "to restrict credit" but to assure the soundest and most productive use of credit and to encourage savings.

6. Are there any areas in which loans being made by banks involve greater credit risks than have been the case in the period since the war?

In answering this question, the Council assumes that "areas" does not refer to geographical areas. Increased costs, higher break-even points in the operation of businesses, some slowing of collections, and higher priced inventories have all tended to make credit risks somewhat greater in many cases. The most doubtful loans from a broad economic point of view are those made under Government guaranty.

7. It appears that recently there has been a resumption of the practice by certain large depositors of requesting that the depository banks furnish them more detailed information regarding the condition of the banks than is given to depositors generally. This matter was discussed at the meeting of the Board with the Council on May 14, 1945, at which time differing views were expressed by members of the Council concerning the imposition of a prohibition by law or regulation upon banks giving such information.

The Board would appreciate it if the Council would discuss this matter again and advise the Board as to (1) the desirability of the supervisory agencies joining in a statement to banks in their respective jurisdictions which would suggest that banks adopt a practice of not making available to large depositors information which was not given to their depositors generally; (2) what, if any, other action might be taken by the supervisory agencies; and (3) the considerations that should prompt the supervisory agencies in any action that they might take.

The Council is of the unanimous opinion that no request should be made by the Federal Reserve System or other supervisory authorities to have banks refuse information to depositors and the Council would be even more opposed to a regulation intended to enforce such a request.

8. A further discussion of consumer credit.

The Council is opposed to legislation restoring controls over consumer credit. It feels the recent growth in the amount of consumer credit is chiefly due to the increase in the supply of goods such as automobiles customarily sold on time payments. The banks and the finance companies are generally following a restrained policy in the terms required. The Council believes the effort should be continued to get the voluntary cooperation of institutions extending consumer credit to maintain conservative standards.

9. The bank holding company bill has been under consideration or discussion for several months. Apparently a fairly general agreement has now been reached among the interested groups favoring such legislation, and a bill is presently in the Senate Banking and Currency Committee. An objection to its consideration a few days ago resulted in its being left on the calendar without action to date. What further action should be taken by the Council and the Board in relation to this legislation?

The Council reaffirms the position it took on May 20, 1947, in respect to the holding company bill. It urges the Board of Governors to continue to press for its enactment at this session.

10. What is the attitude of the Board of Governors toward the listing of bank stocks on the recognized security exchanges?

The Council withdraws this item from the agenda.

The Council reconvened in the Board Room of the Federal Reserve Building at 2 p.m. on February 16, 1948, to hear Mr. Woodlief Thomas, Director of the Division of Research and Statistics of the Federal Reserve System.

All members of the Council were present except Mr. Charles E. Spencer, Jr., for whom Mr. Walter S. Bucklin served as alternate.

Mr. Woodlief Thomas spoke to the Council on the subject of inflation and bank credit which was the summary of a speech Mr. Thomas delivered at the Minnesota Bankers Conference on February 13, 1948. A copy of his speech as well as certain statistics are herewith attached.

The meeting adjourned at 3:45 p.m.

INFLATION AND BANK CREDIT

Speech by Woodlief Thomas
at the Minnesota Bankers Conference
Minneapolis, Minnesota
Dinner, Friday, February 13, 1948

Bankers have a special interest in inflation, which has been the dominant economic force of recent years, because banking and inflation are both concerned with money. In modern economies, banks create the money that makes inflation possible. This does not mean that bankers are to be held responsible for inflation. Banks are not the instigators of our present inflationary developments, but they are the instruments of inflation, and they can help to continue inflation or bring it to an end.

Basic causes of inflation were in war.—The basic reason why we have been having, and may continue to have, inflation is that effective demand is in excess of the supply of goods available for purchase. The origin of inflation lies in the wartime developments. These were partly physical and partly monetary. In the absence of drastic countermeasures, inflation is inevitable in war because resources are diverted from supplying consumers' and producers' goods to supplying the materials of war, and people are paid large salaries for producing goods and providing services which they cannot purchase with their incomes. The shortages of consumer goods, as well as widespread destruction and disarrangement of resources, led to the accumulation of large deferred demands. At the same time the excess of incomes that could not be spent or invested resulted in the building up of savings held in the form of liquid assets, i.e., cash balances and Government securities.

The wartime accumulations of liquid assets were the result of war finance. They were the direct outgrowth of the large Government expenditures, which had to be met as much as possible through taxation and through borrowing from the savings of the people, and the remainder obtained by selling securities to banks. The Federal Reserve System by buying Government securities supplied the commercial banks with needed reserves to meet wartime currency demands and expand their holdings of Government securities.

The country's aggregate money supply, as measured by currency in circulation and privately-held demand, time, and savings deposits, is now two and a half times as large as at the beginning of the defense program—about 170 billion dollars, compared with 66 billion in June 1940. In addition, the general public, outside of banks, insurance companies, and Government agencies, has increased its holdings of Government securities to about 90 billion dollars, or seven times as much as in June of 1940. These Government securities in the hands of the public are practically the equivalent of money because they are readily convertible into cash. In sum total, this stock of purchasing power available to buy the current output of goods and services amounts to about 260 billion dollars, compared with a stock of about 80 billion in 1940—more than a threefold increase. The over-all physical volume of production of goods and services, so far as it can be measured, is probably between a third and a half larger than in 1940. Prices on the average have risen by more than two-thirds. The dollar value of the total national product is nearly two and a half times the prewar maximum.

Current Inflationary Developments due to Large-scale Spending

In the war period inflationary forces were prevented from expressing themselves to some extent by the imposition and maintenance of high taxes, but more largely by allocations and price controls. At the end of the war these various restrictive measures were either removed or reduced in effectiveness. This action was premature, because under the conditions existing, it was impossible for demand and supply to be in balance, and the subsequent sharp rise in prices was inevitable. But the public clearly wanted restrictions removed.

Offsetting the rapid postwar decline in Government expenditures, consumer and business spending increased sharply. The over-all volume of current expenditures by all groups has been in excess of the available supplies of goods and services because individuals and businesses have not only used rising current incomes but have also drawn on past savings and have borrowed to augment their buying power. In the meantime production has practically reached maximum capacity. The heavy demands and the higher prices do not bring forth more production. Notwithstanding all of the demands, there was little further growth in the physical volume of production during 1947 and not much can be expected in 1948.

The question that faces the country is in a sense a simple one. Do we want to hold down consumption in order to be able to divert resources for the time being to the expansion of productive capacity and to assisting wartorn countries in restoring their productive capacities, not to mention the maintenance of a very large volume of Government expenditures for national defense and for aid to veterans? It is not possible to satisfy all of these existing effective demands at once. To attempt to do so can only lead to rising prices. Although the question is simple, to decide what to cut back and how to do it is a very complex and difficult problem. It cannot be solved without many sacrifices.

Rising prices cannot be relied upon to bring about a condition of equilibrium that will end the inflationary development and maintain prosperous conditions. They have only led to the development of a self-generating spiral. Higher prices means higher profits and incomes and pressures for higher wages, which are granted. Thus, the effects of the high prices are broadly distributed among farmers, workers, and entrepreneurs, large and small. Spending can, therefore, be further increased, with resulting greater pressures on available supplies and further price increases. No particular group is to be blamed for this development. High prices and high profits and pressures for wage increases are the normal manifestations of inflationary forces in a free enterprise, competitive price system. Serious distortions in prices and incomes have resulted, but so far persons profiting by inflation have exceeded those suffering by it. Therefore the spiral of rising prices and incomes has continued.

Financial Basis of Current Inflation

Government finance, which was largely responsible for the wartime process of monetary and income expansion, has been completely reversed in its effect during the postwar period. The Government is still spending much more than in previous peacetime years but is now collecting in cash more than it is paying out by a margin that is close to 10 billion dollars a year. This excess has been used to retire the public debt--to some extent securities held by businesses and individuals, but mostly those held by banks and more recently almost entirely those held by the Federal Reserve Banks. Thus bank deposits and bank reserves are being contracted. This is in effect a powerful anti-inflationary process, but its effect is being offset by other developments. It may be said that although governmental activities utilize a large part of available manpower and resources of the country and thus contribute to inflationary forces, Government receipts are withdrawing funds from the current flow of income, and that governmental transactions on balance are exercising an anti-inflationary influence.

Individual consumers account for the bulk of current expenditures for goods and services. Consumer expenditures are now at an annual rate of about 170 billion dollars a year, two and a half times the prewar maximum. Individuals also hold the bulk of the liquid assets accumulated during the war. These holdings now aggregate 160 billion dollars. Cash balances, in currency and deposits, exceed 100 billion or two and a half times prewar amounts, while Government securities are six times prewar holdings. These assets are widely distributed throughout the population; farmers, wage earners, professional people and small businessmen have shown especially large increases. The half of the families with medium-size incomes hold nearly half of the liquid assets; most of these families before the war had little or no such accumulations.

With the growing availability of consumer goods since the end of the war, consumer expenditures have naturally expanded more rapidly than have consumer incomes. As a result, personal savings, which during the war were at the abnormal rate of 35 billion dollars a year, have declined to a net amount of about 10 billion. It should be recognized, however, that this volume of net current savings is not small as compared with prewar standards, either in dollar amount or relative to personal incomes. Moreover, gross savings are much larger, because withdrawals from past savings and borrowings, which are deducted to obtain the figure of net savings, are much greater than in prewar years. In other words, there could be a further decline in the current volume of personal saving and a corresponding increase in consumer spending, even without an increase in personal income.

More of personal savings are going into capital investment and less into liquid assets than during the war, which means that they are being used in a manner that contributes to, rather than works against, inflationary pressures. Individuals are buying more durable goods and investing more in housing than they did in the immediate prewar years,

and are borrowing more for these and other purposes, as well as drawing upon past savings. On the basis of data published by the Securities and Exchange Commission, it may be estimated that individuals in the aggregate invested about 5 billion dollars in housing during 1947 and in the same period increased their mortgage indebtedness by about 4 billion. Consumer borrowing for other purposes increased by approximately 3 billion.

At the same time other individuals have been increasing their savings in more liquid forms. It is estimated that individuals increased their deposits in banks and shares in savings and loan associations by 4 to 5 billion, saved about 6-1/2 billion dollars in 1947 through increases in insurance and pension reserves, and added over 3 billion dollars to their holdings of securities, notwithstanding liquidation of about a billion of armed forces leave bonds. These amounts are generally smaller than in the war years but some of them are double estimates for 1940.

It may be concluded that individuals are freely spending and investing not only their current incomes but also their past savings and the proceeds of borrowings, but at the same time on balance are still adding to their holdings of liquid assets. Thus they continue to have large amounts to spend and invest. There is no reason to conclude that these holdings are becoming more concentrated to any appreciable extent into the hands of a few large owners. They remain potentially a highly inflationary influence.

Business, which as a group accumulated liquid assets during the war, because of an excess of receipts over current disbursements, has been paying out more than it has received in the postwar period. Business has drawn down its wartime accumulations of liquid assets and increased its borrowings. The excess of expenditures reflects large-scale capital expansion, generally needed to fill in wartime deferments and to provide productive capacity to meet expanding postwar demands. The present rate of private domestic investment, including residential construction, is exceptionally large, being about 13 per cent of the gross national product compared with a prewar average of 11 per cent. Current expenditures are probably sufficient for replacement and normal growth and to cover some of the wartime deficiency. To attempt to make up all the wartime deficiency in a period such as this would add to current inflationary pressures, intensify the boom, and make more difficult the subsequent readjustment.

According to information compiled by the Department of Commerce and presented by Secretary Harriman to a Congressional committee, corporations in 1947 expended about 14-1/2 billion dollars on plant and equipment, 7 billion on enlarging their inventories, and added roughly 5 billion to their trade receivables. This aggregate of over 26 billion was financed by approximately 15 billion dollars of retained profits and additions to depreciation reserves, 4 billion of net new capital issues, and 3-1/2 billion of bank loans, with some increase in other payables and a small reduction in liquid assets.

The decrease in liquid assets, i.e., bank deposits and Government securities, of about a billion dollars was in contrast to a sharp decline of 6-1/2 billions during 1946, which had reflected reduction in tax liabilities. To some extent the small decline is due to the fact that many of the corporations holding large amounts of liquid assets do not need additional funds, but it no doubt also reflects the need by corporations for larger working balances. Corporate borrowings through new security issues were much larger in 1947 than in 1946 and the increase in bank loans was about the same in both years.

The conclusion that may be drawn from this analysis of the current financial position of the three broad groups in the economy is of particular significance from the standpoint of inflationary forces. Government, although spending heavily, is nevertheless saving by drawing funds from the public and paying off debt. Consumers are saving on balance but many of them are drawing upon past savings and are also borrowing considerably in order to maintain a high level of expenditures and capital investment. Business is borrowing heavily. It may be said that the anti-inflationary effect of the Government surplus is being more than offset by the effect of business and consumer borrowing.

The Role of Bank Credit in Inflation

The preceding analysis of current inflationary forces brings us to the question of the role played by the banking system. It has been pointed out that existing inflationary pressures are due to an excess of over-all expenditures by the various groups in the economy over the available supplies of goods and services. The fact that there is an excess is due in part to ability to draw on past savings and in part to expansion in borrowing.

Bank credit has played an important part in postwar inflationary developments. Our commercial banking system is fundamentally a mechanism for allowing borrowers to obtain newly-created money, as well as to put to use money that has been saved. As long as production can be expanded on an economically sound basis, this creation of money through the banking system is useful and desirable. When, however, the economy is producing a maximum volume of goods and services, the only effect that further creation of money through the banking system can have is to increase total demand and thereby raise prices.

As our banking system operates, the legal requirement that banks must hold cash reserves in some proportion of their deposits sets a limit on the amount of credit which banks can create. The deposits themselves are largely the result of loans and investments. Reserves are the heart of commercial banking. Control over the total volume of commercial bank credit is accomplished in this country by limitation on the availability of reserves. The Federal Reserve System was created by the Congress as

a public agency to administer such limitations and adjust them to the needs of the economy. Before the Federal Reserve System, gold and a rigidly limited note issue privilege were practically the only sources of new reserves. Such a banking mechanism did not provide sufficient flexibility or capacity for expansion and often resulted in serious monetary panics of catastrophic nature. The Federal Reserve System was organized to remedy this situation and was given power to create additional bank reserves. At the same time it was given responsibility for regulating the supply of reserves to the needs of the economy in order to avoid excessive inflationary or deflationary developments.

The Reserve System has available three techniques of regulating the supply of reserves: (1) making loans to member banks and varying the rate of interest, i.e., the rediscount rate, at which these advances may be made; (2) buying or selling Government securities or certain types of bills in the open market; and (3) adjusting the level of member bank reserve requirements within statutory limitation.

Because of wartime developments, these techniques for influencing the availability of bank reserves are not so effective as they once were. During the war the Government had to sell a certain amount of securities to finance the war. As many as possible were sold to nonbank investors but the remainder had to be purchased by banks. The Federal Reserve System, by buying securities in the market, supplied commercial banks with funds needed to buy the additional Government securities. As a result commercial banks expanded their holdings of Government securities from 16 billion to 90 billion dollars during the war period. After substantial debt retirement during the past two years, these holdings are now about 70 billion dollars. At the same time banks have been able to increase their loans. The Government securities purchased were in effect added to the previously existing volume of bank assets.

Under present conditions banks can readily sell securities if they want funds to expand loans. Since the demand for Government securities is limited, it is likely that the bulk of any sales will be purchased by the Federal Reserve System. This results in an increase in bank reserves, on the basis of which the banking system can expand loans to more than six times the amount of reserves originally created. This, it should be recognized, is a situation that is entirely new in monetary history. It means that new reserves can be created at the initiative of the banks, not in accordance with the decision of the Federal Reserve authorities. In fact, insurance companies and other holders of Government securities can also readily create reserves by selling securities on the market in such volume that the Federal Reserve finds it necessary to buy them in order to maintain an orderly and stable market.

Instruments of regulation available to the Federal Reserve authorities are not adequate to deal with this situation. A higher discount rate is not effective when banks do not need to borrow. The power that the System has to raise reserve requirements of member banks is practically exhausted. Finally, the System is not able to absorb reserves by selling Government securities in a market where there are no buyers.

Bank Credit Demand under Continued Inflation

Continued expansion of bank credit under present conditions would contribute to a further upward spiral of inflation. It is theoretically possible, in view of the large holdings of bank deposits and other liquid assets, for an inflationary spiral to continue even with no expansion in bank credit and perhaps with some contraction of the total volume of bank credit. The danger that restraint in credit expansion will bring on an unwanted recession is much less to be feared than the effects of continued expansion.

Unless there is some marked change in outlook, business, as well as home owners and consumers, will want to continue to expand their borrowings in order to finance current expenditures. Prospective programs for additions to plant and equipment indicate a level of business demands that cannot be financed out of funds available to them. It is also questionable whether business will be willing or able to raise sufficient amounts through the issuance of new securities. Demands for real estate loans also may continue large not only to finance new construction but also to finance the purchase of existing homes at higher prices. Consumer credit will no doubt expand further as increased supplies of durable goods become available, especially if credit terms are relaxed. The abandonment of consumer credit regulation has been followed by some easing of terms, which may proceed further under the pressure of competition among sellers of durable goods and among lending agencies.

It may be roughly estimated that continuation of the present level of activity, with a further rise in prices, may result in the demand for as much as 20 billion dollars of borrowing by businesses, farmers, and individuals during 1948. Of this amount, not much more than half might be obtained from financial institutions other than banks. Individuals will have funds to lend, but will they lend it, or will they increase their expenditures and thus drive up prices? If banks are called upon to lend the balance needed, new money will be created and further inflation will thus be financed.

Bank lending where soundly based is necessary for the maintenance of production. It is not to be expected that banks should stop making loans. It would be practically impossible for maturing loans to be paid off without some new loans being made to other borrowers. It should be recognized, however, that over-all expansion in the total volume of bank credit, especially when production cannot be increased, only enables the new borrowers to bid against someone else for a limited supply of goods. It results in rising prices and not in increased output. It adds to the total supply of money and continues to be an inflationary factor.

Banks can readily obtain funds to increase their loans. The inflow of gold from other countries, which amounted to about 3 billion dollars last year and is currently at a rate of about 2 billion dollars a year, will supply enough reserves to permit an expansion of 10 billion dollars or more in bank credit. In addition, banks can obtain additional funds by selling government securities.

What Can Be Done to Check Inflationary Credit Expansion?

It is not the purpose of this paper to present a comprehensive program for stopping inflation. There are many measures that may be adopted in many fields. Inflationary forces may sooner or later lead to the development of their own correctives. The danger, however, is that the longer the spiral of inflation continues, the more severe the subsequent and inevitable collapse is likely to be. A downturn following a period of expanding loans to businesses and individuals can be particularly disastrous, because credit liquidation will accelerate the rapidity of the decline. This will also endanger the safety of banks and other financial institutions.

Limiting the discussion of anti-inflationary measures to the field of credit, there are various lines of action that may be followed.

Permit Government securities prices to decline.--The first possibility that has been suggested by a number of people is for the Federal Reserve System to stop buying Government securities and endeavor to sell securities where necessary to restrict the supply of reserves. This would mean abandonment by the System of its policy of stabilizing the Government securities market and a return to the earlier policy of regulating the supply of bank reserves. This would mean that the System would buy only such Government securities as are needed to maintain reserves at some desired level and would sell securities if necessary to contract reserves or to offset other factors that may be added to reserves, such as the gold inflow. It would mean that prices of Government bonds and therefore the level of interest rates would be determined by the elements of supply and demand that operate outside of the Federal Reserve System. The resulting changes in interest rates would be counted upon to exercise an influence toward restricting demand when it is in excess of the available supply of funds in the market and perhaps encourage borrowing when the supply of savings exceeds the demands of investors.

One of the principal difficulties of following this line of action is that in view of the present great magnitude of the public debt there can be no orderly Government security market without active Federal Reserve participation. The normal shifting of funds among banks and other investors involves a tremendous volume of transactions almost every day. Large-scale and continuous Federal Reserve open market operations are essential for the maintenance of an orderly and stable market for Government securities and are a necessary adjunct of the Treasury program for managing the huge public debt. The Federal Reserve System has been buying securities amounting to hundreds of millions of dollars a week and purchases and sales in a single day often exceed a hundred million. The Federal Reserve System is the only agency with the power and resources sufficient to provide the support that this vast market requires.

It is sometimes suggested that complete abandonment of market support is unnecessary but that a gradual decline in bond prices and rise in interest rates might be permitted. Some moves in this direction have already been taken. One has to face the question, however, as to whether

any moderate movement can be sufficiently effective. Would a small rise in interest rates, with a decline in bond prices of one or two points below par, stop banks from selling securities if they wanted funds to make loans? Or, would it simply bring about a similar rise in other interest rates and a continuation of lending? A danger of attempting such a policy is that holders of Government bonds in anticipation of further declines in prices would sell large amounts which the System would have to purchase. In this event, more reserves would be created than if confidence in the stability of Government bond prices was maintained.

With respect to the view that the bond market should be permitted to find its own level without support from the Federal Reserve System, I should like to quote from the recent statement by Allan Sproul, President of the Federal Reserve Bank of New York:

"It might still be argued, I suppose, that abandoning our support of the Government security market could be encompassed within our modest program and that only moderate declines in security prices would occur, that Government securities would reach a 'natural' level, and that everything would then be much better. With markets as delicately balanced as our contacts and experience indicate the present markets to be, I cannot agree with this opinion or judgment. Without our support, under present conditions, almost any sale of Government bonds undertaken for whatever purpose (laudable or otherwise) would be likely to find an almost 'bottomless market' on the first day support was withdrawn. A rapid descent in prices going far beyond any question of the Government's credit (which is high) or relative interest rates would be most likely. Uncertainty would almost surely persist for a considerable time after such a development, the Government's necessary refunding operations would be made very difficult, and private security markets would be seriously affected. In such circumstances, there could easily be a flight of 'cash' out of both markets, and price changes so erratic as to make new financing almost impossible for some time, with what ramifications I do not like to contemplate. In the face of a Federal debt of over 250 billion dollars, in all sorts of forms held by all sorts of holders, and with a high consumption high employment economy, in which there are already severe stresses and strains, we can't treat the Government security market as we might a \$50 million issue of the XYZ corporation. I am not a believer in more and more Government controls, certainly, but this is one control which I would not want to try to let go, voluntarily, under present circumstances."

Modest use of existing powers.--The second possible line of action in the present situation is for the System authorities to exercise such modest restraints as they can with existing powers and within the limits of their responsibility for maintaining an orderly and stable

Government bond market. Policies have been directed toward this end. Interest rates on short-term Government securities have been permitted to rise and this has, for the present at any rate, effectively stopped the practice of selling short-term Government securities to the Federal Reserve and purchasing long-term securities. It may also have encouraged banks and others to invest available funds in short-term Government securities rather than seek other loans or investments. As a result the Federal Reserve System has been able to reduce some of its holdings of Treasury bills and certificates and thereby absorb available reserves.

The most effective instrument for reducing bank deposits and reserves has been the Treasury cash surplus. For several months now the Treasury has used all of its available surplus to retire securities held by the Federal Reserve Banks. In this manner not only are deposits withdrawn from commercial banks but bank reserves are eliminated through the reduction of the total amount of Reserve Bank credit. It is true that the reserves absorbed have been to a considerable extent replaced by Federal Reserve purchases of securities sold by banks needing to maintain their reserve positions, but the fact that banks have been forced to sell securities for this purpose puts them under some pressure and discourages their seeking new loans.

These pressures are particularly heavy at present. During the first quarter of this year the Treasury is obtaining a surplus of something like 5 or 6 billion dollars of cash receipts in excess of disbursements. These funds reduce bank deposits, and, since most of them go directly into the Reserve Banks, they also reduce bank reserves. The Treasury is using a large part of this surplus to retire maturing bills and certificates held by the Federal Reserve Banks, and thus the funds are not paid back into the market. Banks, in order to maintain their reserve positions, will find it necessary to liquidate a considerable amount of Government securities, which will be largely bought by the Federal Reserve System. This pressure on banks, however, is offset by many factors, including gold imports, return flow of currency, and use of excess reserves. It is also being considerably alleviated by large-scale sales of Government securities by insurance companies and other investors. In the absence of other buyers these securities are purchased by the Federal Reserve System.

Continued use of this instrument depends upon the existence of surplus in the Federal Government budget. For seasonal reasons, even when there is a surplus in the total budget, most of it comes in the first quarter of the calendar year. During the second quarter of this year the Treasury is likely to be paying out a billion and a half to 2 billion dollars more than it will be receiving. This will draw funds from the Treasury deposits with Federal Reserve Banks and return them to the reserves of commercial banks. These reserves could be absorbed if the Federal Reserve System were able to sell Government securities in the market, but its ability to do this will depend upon the willingness of banks to buy Government securities rather than to make loans with the additional funds they will have available.

During the last half of the year the Treasury will probably have little, if any, cash surplus, and should there be a reduction in tax rates there will be no surplus and perhaps some deficit. The System will, therefore, have little ammunition with which to offset a gold inflow or otherwise prevent continued inflationary credit expansion.

Increase in reserve requirements.--The third possible line of action is to obtain from Congress additional authority to increase the reserve requirements of commercial banks. The grant of authority of this nature has been recommended by the Federal Reserve Board to Congress, and the President has suggested to Congress that it give careful consideration to the Board's proposal. In requesting additional authority to increase reserve requirements, the Board endeavored to sweeten the pill somewhat for the banks by suggesting that they be permitted to hold short-term Government securities as reserves. The purpose of this particular proposal is to permit banks to retain a large part of the Government securities which they purchased during the war but to prevent them from disposing of such securities in order to obtain reserves for further expansion in bank credit.

Restraint by banks.--The fourth possible line of action is the exercise of restraint by individual banks in making loans. The bank supervisory agencies have issued a statement urging

"that banks curtail all loans either to individuals or to businesses for speculation in real estate, commodities, or securities. They should guard against the over-extension of consumer credit and should not relax the terms of instalment financing. As far as possible extension of bank credit under existing conditions should be confined to financing that will help production rather than merely increase consumer demand."

These authorities also strongly urged

"directors to see that their banks follow these policies and maintain adequate capital in relation to risk assets."

The program of the American Bankers Association to encourage self-restraint by banks is a constructive step in the right direction. To the extent that banks refrain from expanding their loans or are able to bring about some contraction, potential inflationary forces will be reduced. Under any measure of credit restraint, whether it be by limiting the supply of reserves available to banks in general or by voluntary action on the part of the banks, the individual bank will have to decide what loans are made and what are refused. The problem may be somewhat simpler for a banker when he has no funds to lend and knows he will have trouble liquidating some other asset in order to expand loans than is the case when he has a large volume of Government securities any part of which he can readily sell to acquire another asset which is more profitable or

otherwise more desirable. The latter is the position of most banks today. If they do exercise restraint they will have to set up some sort of standards to guide them in their loan policies.

These standards may be the customary ones relating to credit standing of the individual borrower. The banks may decide to exercise greater selectivity in making loans. Such a course is highly desirable from many standpoints; it would reduce somewhat the total volume of loans being made and would also leave banks in a strong position in case of an eventual business recession. If, however, the demand for good loans of high quality is great enough, there could still be over-all credit expansion under such a policy. This expansion would add to inflationary pressures.

Another set of standards which might be adopted by banks would relate to the maintenance of a high degree of liquidity. If a bank finds that in order to expand its loans it has to reduce its liquid assets below some desired level, then it may decide to restrict further loan expansion. This would be sound policy for banks which have had rapid increases in deposits and wish to be in a position to meet large withdrawals. Maintenance of a substantial amount of cash assets or short-term Government securities would also be desirable in the case of those banks with bond portfolios valued on their books at above current market prices.

A third set of standards which banks might watch would be the ratios of bank capital to assets. The ratio of capital to total assets has declined sharply in the past two decades, but this has been accompanied by an increase in cash and Government securities. To the extent that further loan expansion is offset by a decrease in Government securities, there would be little change in this particular ratio and thus it would not be a check on loan expansion. The more significant ratio is that of capital to risk assets, excluding cash and all Government securities. That ratio rose from between 15 and 20 per cent in the 1920's to around 25 per cent or more from 1934 to 1946. It has declined sharply in the past two years and is now close to 21 per cent for all member banks. Any further increase in risk assets will bring the ratio back down to the level of the 1920's. This is a situation which might give banks some concern.

In summary, it may be said that continuation of the current inflationary spiral can be facilitated by further expansion in bank loans or might be checked by restraint on bank lending. In the event of further inflation there will continue to be a growing demand for bank loans. Banks are obtaining additional funds through the gold inflow or they can readily create reserves as a basis for further credit expansion by selling some of their large holdings of Government securities to the Federal Reserve System.

All existing powers are being used by the Federal Reserve and Treasury authorities to limit the supply of available reserves, short of abandoning support of the Government bond market. Under existing powers, however, definitive limitations could be effected only by abandoning support of the Government bond market. This would probably have results far more disastrous than would be necessary if the end were reached by some other means. The Board has proposed to Congress the grant of additional powers that would permit the adoption of somewhat more restrictive policies

February 11, 1948

Principal Factors Affecting Bank Reserves and
Reserve Bank Credit
December 31, 1947 to March 31, 1948

(In Millions
of Dollars)Factors decreasing available reserves:

Treasury cash transactions--excess of receipts over expenditures (including voluntary retirement of maturing market- able securities held by others than the Federal Reserve, as well as current redemptions of non- marketable issues and market purchases by Treasury of securities for trust accounts, but excluding retirement of Federal Reserve holdings)	4,200
Calls on war loan accounts, corresponding to sales of savings bonds and notes through those accounts	<u>1,500</u>
Making a total drain from Treasury transactions of	5,700
Increase in required reserves of member banks (Increase in reserve requirements at central reserve city banks minus decrease in required reserves resulting from decline in deposits)	150
Other factors	<u>150</u>
Total	6,000

Factors making reserves available:

Increase in gold stock of about	500
Decrease in currency in circulation of	800
Decrease in excess reserves of	<u>900</u>
Total	2,200

Federal Reserve System will need to purchase in the market to maintain bank reserves a net amount of	*3,800
Of which it appears that purchases from nonbank investors may be as much as	*2,000
Leaving purchases from banks of about	*1,800
Deduct calls on war loan deposits that might not be made	<u>**800</u>
	*1,000

* From Dec. 31 to Feb. 11, Federal Reserve holdings of Government securities declined by \$1,740 million, reflecting nearly \$2,400 million of retirements and about \$650 million of purchases. Net purchases from nonbank investors have probably exceeded a billion dollars, indicating net sales to commercial banks. Thus substantial purchases from banks will need to be made in the next six weeks.

Factors Affecting Bank Reserves and Federal Reserve Credit
March 31 to June 30, 1948

(In millions
of dollars)

Factors increasing reserves

Treasury transactions (Excluding retirement of securities held by Federal Reserve but including other public debt transactions by Treasury)	2,000
Gold acquisitions	<u>500</u>
Total	2,500

Factors reducing available reserves

Required reserves--increase	500
Federal Reserve sales of Government securities needed to prevent increase in available reserves	2,000

The Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building at 10:10 A.M. on February 17, 1948.

All members of the Council were present except Messrs. Charles E. Spencer, Jr., Robert V. Fleming, John H. McCoy, and Reno Odlin. Mr. Walter S. Bucklin was present as alternate for Mr. Charles E. Spencer, Jr.

A discussion took place regarding the next meeting of the Council as the date at which the meeting would normally be held conflicts with certain bankers' meetings and would, therefore, be inconvenient for a number of members of the Council. It was decided to ask the Board to agree that the joint meeting of the Board be held either on April 27 or May 25. In the former case this would mean that the Council would actually reconvene on April 25 and in the latter case on May 23.

The meeting adjourned at 10:25 A.M.

The Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building at 10:30 a.m. for a joint meeting of the Board of Governors of the Federal Reserve System.

All members of the Council were present except Mr. Charles E. Spencer, Jr., for whom Mr. Walter S. Bucklin served as alternate. The following members of the Board of Governors were present: Chairman Eccles; Governors Szymczak, Draper, Evans, Vardaman, and Clayton; also, Mr. Carpenter, Secretary of the Board of Governors; also, Mr. Thomas B. McCabe, whose name has been submitted for confirmation to the Senate as member and Chairman of the Board of Governors of the Federal Reserve System by the President of the United States.

A DISCUSSION OF RECENT RULINGS BY THE TREASURY WITH RESPECT TO TURNING FOREIGN FUNDS OVER TO THE ALIEN PROPERTY CUSTODIAN.

E.E. BROWN read the above item of the agenda and asked the Chairman why the recommendation in question had been made by the National Advisory Council.

ECCLES replied that the Board was unanimous in its approval of the recommendation made by the National Advisory Council, but would have been glad to have had an alternate solution to the problem. The National Advisory Council invited proposals but received none. People did not like what was being proposed but no one came forth with an alternative. Accounts had been blocked during the War and the governmental authorities wished to be certain that no enemy interests were involved before funds were released. If depositors received certification from their own government, funds were released. It is estimated that at present there are still here about \$6 to \$7 hundred million (half of which is French) from countries who are to participate in the Marshall Plan. Some of this is in reality owned by citizens of enemy countries; other funds are here in order to be effectively concealed assets from the governments of the owners. Eccles feels we should not be a party to helping people conceal assets from governments to whom we are going to give funds from this country. These citizens are hiding dollar assets from their countries which need these dollars badly. The point of view of the Federal Advisory Council is one which would be in order under normal conditions but we are faced with an acute situation.

BURGESS asks whether any representatives from the banks concerned were heard.

ECCLES says Messrs. McCloy and Black appeared before the National Advisory Council but had no plan to present.

BURGESS replied that Mr. Sproul had given to the Secretary of the Treasury an alternative procedure for handling this matter in a way to insure that justice was done to the holders of foreign assets in this country.

ECCLES seems to have had no knowledge of Sproul's suggestion. It must also be remembered that there is a political angle to this as Congress is concerned that the American taxpayer should not be compelled to pay until the European funds available here have been exhausted.

SZYMCZAK said he had never heard of Sproul's suggestion.

BURGESS suggested that in this matter it would be helpful if the Board would consult with the banks concerned, and particularly with the Federal Reserve Banks, before making final decision.

SZYMCZAK states that he believes the Federal Advisory Council should take up the matter with the N.A.C.

ECCLES states that he thinks the Council might make its suggestions directly to the Senate or give it to the Board who can pass it on to Senator Vandenberg. He believes nothing would be gained now by giving it to the N.A.C. as it could not be expected that this body would reverse itself after having handed its conclusions to Senator Vandenberg. As a matter of fact, so far all the N.A.C. has done has been to ask the Vandenberg Committee whether it agrees with the proposal.

SZYMCZAK says of course there are not only the blocked funds but there are also funds belonging to citizens concerned with the European Relief Program who have free funds in this country.

BURGESS states that this is a banking matter and he thought therefore the Board might review the whole situation.

E. E. BROWN says that outside of the New York banks the main interest centers on Latin American funds which have come to this country to avoid confiscation for political reasons.

ECCLES repeats that this is a special situation as American taxpayers are being asked to contribute millions to European countries whose governments are seeking funds here while the citizens of these countries are permitted to withhold funds from their governments. He agrees that under normal conditions there would be no reason for such a plan as proposed by the N.A.C., but at present Dutch or French citizens should not be helped to evade exchange regulations promulgated by their own governments.

E. E. BROWN says this would be in order if it did not have repercussions in Latin America.

THE EFFECT THAT GOLD IMPORTS ARE HAVING ON THE FINANCIAL STRUCTURE OF THIS COUNTRY, AND STEPS WHICH MIGHT BE TAKEN TO COUNTERACT THEIR INFLATIONARY INFLUENCE.

IT IS ESTIMATED THAT AFTER THE FIRST QUARTER OF THIS CALENDAR YEAR, THE TREASURY WILL PAY INTO THE MARKET FOR CURRENT EXPENDITURES AND DEBT REDEMPTION MORE THAN IT WILL RECEIVE FROM TAXES AND SALES OF SECURITIES. THIS EXCESS OF PAYMENTS, WHICH MAY AMOUNT TO AS MUCH AS \$2 BILLION IN THE SECOND QUARTER, TOGETHER WITH A CONTINUED GOLD INFLOW, WHICH MAY EQUAL HALF A BILLION DOLLARS A QUARTER, AND PURCHASES BY THE FEDERAL RESERVE BANKS OF ADDITIONAL SECURITIES FROM NONBANK INVESTORS AND FROM BANKS NEEDING RESERVES, WILL ADD CONSIDERABLY TO BANK RESERVES.

IN THE OPINION OF THE COUNCIL, WHAT MEASURES SHOULD BE ADOPTED TO RESTRICT THE USE OF THESE ADDITIONAL RESERVES FOR FURTHER EXPANSION OF BANK CREDIT:

- A. SHOULD CONGRESS GRANT AUTHORITY TO RAISE EXISTING RESERVE REQUIREMENTS (AS DISTINGUISHED FROM THE SPECIAL RESERVE PLAN) OF MEMBER BANKS AND TO IMPOSE CORRESPONDINGLY HIGHER RESERVE REQUIREMENTS ON NONMEMBER BANKS, WITH THE UNDERSTANDING THAT THE ADDITIONAL RESERVES REQUIRED OF NONMEMBER BANKS WILL BE HELD WITH THE FEDERAL RESERVE BANKS? THE FEDERAL ADVISORY COUNCIL JOINED IN A SIMILAR RECOMMENDATION ON DECEMBER 31, 1940.
- B. SHOULD THE PRESENT POLICY WITH RESPECT TO SUPPORT OF THE GOVERNMENT SECURITIES MARKET BE MAINTAINED REGARDLESS OF FURTHER INFLATIONARY DEVELOPMENTS?
- C. OR, SHOULD THE FEDERAL OPEN MARKET COMMITTEE SELL SECURITIES IN THE MARKET IN AN AMOUNT SUFFICIENT TO ABSORB ADDITIONAL RESERVES WHICH WILL COME INTO THE MARKET AFTER THE FIRST QUARTER AND PERMIT GOVERNMENT BONDS TO DECLINE TO WHATEVER EXTENT MAY BE NECESSARY?

SHOULD DISCOUNT RATES BE INCREASED FURTHER? IF SO, HOW MUCH? WHAT SHOULD BE THE TIMING OF SUCH ACTION?

E. E. BROWN presents the Council's reply on items 2, 3, and 4 as given in the memorandum attached. He believes that the break of February 4 represents a definite change in trend but there can not be any certainty about this for another 30 to 60 days. This break may result in reduced consumer buying especially on the part of farmers. If there should be such a result, there is certainly to be a cut-back in capital expenditures. We are faced with a nervous situation in the Government bond market as many are considering the liquidation of their bond holdings. Mr. Woods is from a small city in Texas and he might be able to tell more about the repercussions in those areas and Mr. J. T. Brown has stated that people in his district have ceased buying bonds. There isn't any question but that

people generally are very cautious because of the danger of a permanent change of trend. The members of the Council feel that the break that has taken place may be a serious one and if it does not go too far will on the whole have good effects.

ECCLES agrees that it is desirable to have some recession at this time and perhaps it ought to be helped along in the interests of the country as a whole. The greater the debts structure expands under present inflated prices the greater will be the evil effects of later adjustments. It is important not to have another round of wage increases and increased costs. If this were to happen people would get deeper into debt, and later adjustments would be made more severe. A recent survey made by McGraw-Hill shows that capital expenditure in 1948 may be almost as great as they were in 1947, and this will only be possible if done in part with bank credit or in part with funds saved during the War by corporations and others. The Federal Reserve System has been buying securities to sustain the market. This is a very inflationary practice coming from the central banking system and forces an easy money situation. By that practice, debts are being converted into currency. The Treasury should use excess funds to retire Government debt held in the portfolios of the Federal Reserve Banks but not any held by private banks. He does not agree that the process should be a gradual one but such pressure as can be exerted--and it is a very mild pressure after all--should be used in the first quarter. It has been suggested to the Taft Committee that any further controls might be postponed until after the first quarter. It now appears that banks might buy for about \$1,800,000,000 if there are no withdrawals this quarter from war loan deposit accounts. The Open Market Committee has suggested to the Treasury not to reach any decision this quarter as to whether there should be a withdrawal made from war loan deposit accounts. Even if you carry over into the second quarter a reduction of war loan deposit accounts a very easy money situation will be left. The banks will have in the second quarter probably about \$2 billion of excess reserves so will be in a position to make loans or purchase Government securities. If the purchases of securities are made from the Federal Reserve System, this would help to sterilize gold imports.

PENICK feels that the shock in December was such that banks have become very cautious, and

ODLIN feels not only the banks but the public has been scared.

ECCLES believes the psychology changes very quickly and the present dose of deflation is not very great. Excess reserves are likely to be very large during the last three quarters of this year so that banks should buy bills freely.

E. E. BROWN. If you get an increase of reserve requirements banks would begin to sell long-term bonds and buy bills in their place. Corporations have now been selling long-term bonds.

ECCLES says most of the sales have been made by savings banks and insurance companies. He thinks if there should be large excess reserves, banks would begin to make 4 per cent real estate loans. If a recession takes place no harm will result from credit being withdrawn.

SZYMCZAK wants to know why bank-held debts should be retired.

BURGESS says there isn't much difference and it is merely another step in the process.

E. E. BROWN points out that the experience of the First National Bank of Chicago in savings accounts seems to indicate that people are beginning to postpone purchases.

ECCLES says a 20 per cent adjustment in building and cost of building would not be abnormal. Turning to the topic of discount rates, he does not expect there will be any increase and he hopes he can get the certificate rate to 1-1/4 per cent, but as long as banks are not under greater pressure than at present this will be impossible.

E. E. BROWN thinks the people are so jittery that it is not desirable to make any change at present.

ECCLES says the Open Market Committee had recommended to the Treasury not to make any change at present though some weeks ago it had suggested going up to 1-1/4 per cent and it may still be decided to do this for the April 1 certificates. It is regrettable that 1-1/4 on certificates and a discount rate of 1-1/2 had not been attained earlier. If excess reserves become large, banks may again go into long-term bonds and it should be pointed out that recently there were slightly less bonds on the market than there was demand.

BURGESS thinks that the recession did this, but

ECCLES says it is due to this prospect of excess reserves increasing. Banks should be kept from going into long-term bonds, and if the spread between short and long-term bonds is small enough they will buy short-term bonds.

WHAT MEASURES ARE BEING TAKEN BY BANKS TO RESTRICT CREDIT UNDER THE A.B.A. VOLUNTARY PROGRAM AND WHAT RESULTS ARE BEING OBTAINED?

E. E. BROWN. It is too early to say what the effect of the A.B.A. program has been. There is a feeling that credit should be used for productive purposes. This is due to a feeling that the inflation bubble may burst, and there are other reasons which cannot be measured.

FLEMING says most meetings so far have been "pilot" meetings and members of the Council who attended, feel they have been very successful.

It is difficult to say at this time what the ultimate effect will be. Congressmen are hearing from their constituents that they are fearing a restriction of credit.

ODLIN thinks the meetings are having an excellent effect.

PENICK attended the meeting in Kansas City which he thought went off very well and was attended by top level bankers.

SZYMCZAK asked whether the public has been informed of the results of the discussion at these meetings.

FLEMING replies that the press has been well briefed and results, except in Chicago, were good.

ECCLES wants authority to be allowed to raise reserve requirements, if necessary, to 25 per cent, 30 per cent, and 35 per cent for country banks, for banks located in reserve cities, and for banks located in central reserve cities, respectively. This would mean about \$10 billion dollars at the maximum and for at least a year even if inflation started up rates would be prevented from becoming too soft.

ARE THERE ANY AREAS IN WHICH LOANS BEING MADE BY BANKS INVOLVE GREATER CREDIT RISKS THAN HAVE BEEN THE CASE IN THE PERIOD SINCE THE WAR?

E. E. BROWN points out that the chances are banks will have greater losses than in recent years. Obviously loans are more dangerous. It is certainly more dangerous to lend on 3 dollar than on 1 dollar wheat.

IT APPEARS THAT RECENTLY THERE HAS BEEN A RESUMPTION OF THE PRACTICE BY CERTAIN LARGE DEPOSITORS OF REQUESTING THAT THE DEPOSITORY BANKS FURNISH THEM MORE DETAILED INFORMATION REGARDING THE CONDITION OF THE BANKS THAN IS GIVEN TO DEPOSITORS GENERALLY. THIS MATTER WAS DISCUSSED AT THE MEETING OF THE BOARD WITH THE COUNCIL ON MAY 14, 1945, AT WHICH TIME DIFFERING VIEWS WERE EXPRESSED BY MEMBERS OF THE COUNCIL CONCERNING THE IMPOSITION OF A PROHIBITION BY LAW OR REGULATION UPON BANKS GIVING SUCH INFORMATION. THE BOARD WOULD APPRECIATE IT IF THE COUNCIL WOULD DISCUSS THIS MATTER AGAIN AND ADVISE THE BOARD AS TO (1) THE DESIRABILITY OF THE SUPERVISORY AGENCIES JOINING IN A STATEMENT TO BANKS IN THEIR RESPECTIVE JURISDICTIONS WHICH WOULD SUGGEST THAT BANKS ADOPT A PRACTICE OF NOT MAKING AVAILABLE TO LARGE DEPOSITORS INFORMATION WHICH WAS NOT GIVEN TO THEIR DEPOSITORS GENERALLY; (2) WHAT, IF ANY, OTHER ACTION MIGHT BE TAKEN BY THE SUPERVISORY AGENCIES; AND (3) THE CONSIDERATIONS THAT SHOULD PROMPT THE SUPERVISORY AGENCIES IN ANY ACTION THAT THEY MIGHT TAKE.

E. E. BROWN says this will mean the banks will be deterred from investing freely in long-term bonds. He asked how did the whole matter originate.

ECCLES replies that the whole thing originated with the banks since they were writing in and asking what they should do. This might become serious if deflation continues and the Government no longer supports the bond market. This is one of the reasons why the basis of valuation in examinations was changed. If a large depositor is entitled to such information, then the call reports should give to the public the same information which the big depositor gets. But this would change the whole basis of the form of examination developed in '38. He points out that in some cases certain insurance companies have actually asked that the bank repeat the information given to the Comptroller of the Currency and included in his confidential report. This certainly is not permissible.

A FURTHER DISCUSSION OF CONSUMER CREDIT.

BURGESS says there ought to be some pressure applied on department stores and similar institutions. The banks have done a good job in regard to restriction of consumer credit.

THE BANK HOLDING COMPANY BILL HAS BEEN UNDER CONSIDERATION OR DISCUSSION FOR SEVERAL MONTHS. APPARENTLY A FAIRLY GENERAL AGREEMENT HAS NOW BEEN REACHED AMONG THE INTERESTED GROUPS FAVORING SUCH LEGISLATION, AND A BILL IS PRESENTLY IN THE SENATE BANKING AND CURRENCY COMMITTEE. AN OBJECTION TO ITS CONSIDERATION A FEW DAYS AGO RESULTED IN ITS BEING LEFT ON THE CALENDAR WITHOUT ACTION TO DATE. WHAT FURTHER ACTION SHOULD BE TAKEN BY THE COUNCIL AND THE BOARD IN RELATION TO THIS LEGISLATION?

E. E. BROWN. The whole matter seems to be stymied at present. The Treasury is apparently indifferent and the Marshall Plan and the tax program are blocking the road.

ECCLES. The bill is on the calendar and the committees are all in favor of the bill and this is especially true of Senators Tobey and Bricker. Lawyers from the System have briefed the assistants of Tobey and Bricker and are making an effort to have the bill called up. It all depends on Taft. It is understood that he is willing to have the bill come up but may not push it. The opposition comes from an important group on the West Coast and it has the support of Senators Downey and McCarran. A little push might do the job. Independent banks in the West and Minnesota are behind the bill. If the Council would pass a strong resolution in support of the bill it might be sent on to Senator Taft and if members then urged him to do something about the bill, the bill would pass if Taft made any real effort. Wolcott has assured him there will be no difficulty in the House.

E. E. BROWN raises the question about the date of the next meeting and it was agreed to hold the joint meeting of the Council and the Board on April 27 which means that the Council itself will meet on Sunday, April 25.

The meeting adjourned at 1:45 p.m.

The Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building on February 17, 1948, at 2:50 P.M.

All members of the Council were present except Mr. Charles E. Spencer, Jr., for whom Mr. Walter S. Bucklin served as alternate. Mr. Fleming was present at the early part of the meeting, leaving at 3:05 P.M. and before the Holding Company Bill was discussed.

E. E. BROWN brings up the matter of the changes in reserve requirements suggested by Governor Eccles. He said that before the break he would have been in favor of the Board having power to go up to 20, 30 and 35 per cent, respectively, for the three classes of banks. If the present break continues there ought to be no request made for any change. Time rates should remain as at present.

BURGESS feels that with \$20 billion of governments in the Fed there is no need to change reserve requirements.

E. E. BROWN says he feels there is no justification for a 6 per cent spread between the reserve requirements of central reserve and reserve city banks.

BURGESS says all the change would mean is transferring \$5 billion of governments from the banks to the Fed. While this might have some tendency toward having the banks restrict credit, it has the disadvantage of further increasing holdings of government by Federal Reserve Banks, which already have too many. It was moved by Mr. Williams, seconded by Mr. Penick, to refer the matter to the Executive Committee with power to act. The motion was carried unanimously.

E. E. BROWN introduced the following resolution referring to the Holding Company bill with instructions to the Secretary to hand the resolution to the Secretary of the Board for such action as had been proposed earlier by Governor Eccles. The resolution which was unanimously adopted read as follows:

"The Federal Advisory Council has approved by resolution Bank Holding Company legislation. It believes that Senate Bill No. 829 with the amendments suggested by the Council in its resolution of May 20, 1947, should be passed at this session of the Congress and that action by the Congress should not be delayed.

"The Federal Advisory Council urges the Board of Governors of the Federal Reserve System to use its best efforts to secure the passage of the bill, with the amendments suggested

by the Council and asks that this resolution be transmitted to the members of the Senate and House Banking and Currency Committees."

The meeting adjourned at 3:25 P.M.