MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

April 25, 1948

The second statutory meeting of the Federal Advisory Council for 1948 was convened in Room 932 of the Mayflower Hotel, Washington, D. C., on Sunday, April 25, 1948, at 2:10 P.M., the President, Mr. Brown, in the Chair.

Present:

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
Herbert V. Prochnow	Secretary

The Council accepted with regret the resignation of Mr. Walter Lichtenstein as Secretary, and on motion duly made and seconded elected Mr. Herbert V. Prochnow as Secretary.

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 18 and 19.

A brief discussion also took place regarding the Bank Holding Company Bill.

The meeting adjourned at 5:50 P.M.

HERBERT V. PROCHNOW
Secretary.

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MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

April 26, 1948

At 10:00 A.M., the Federal Advisory Council reconvened in Room 932 of the Mayflower Hotel, Washington, D. C.

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

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 18 and 19, listing the agenda items with the conclusions reached by the Council. The *Memorandum* was delivered to the Secretary of the Board of Governors at 12:23 P.M. on April 26, 1948.

The meeting adjourned at 12:10 P.M.

HERBERT V. PROCHNOW
Secretary.

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CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL ADVISORY COUNCIL RELATIVE TO THE AGENDA FOR THE JOINT MEETING ON APRIL 27, 1948

1. It is understood that the Federal Reserve System is now considering a program of allowing, first, immediate credit on all sendings to the Federal Reserve System of transit items, regardless of the number of days it may take to collect either by air mail or train, and second, the possible elimination of sorting transit items by reserve districts and direct sendings to the Federal Reserve banks and their branches. These procedures, if contemplated, involve important changes in the functioning of the banking system, and it would be most desirable for the Board of Governors and the Council to discuss them.

   In relation to the first part of this question, the Council wishes to restate its position as expressed on page five of its memorandum to the Board of Governors on November 18, 1947, as follows: "No changes in the check collection processes should result in making items available sooner, on the average, than the period required for their collection. For example, for the Federal Reserve banks to make all items immediately available would be unsound, as it would make funds available when they were not actually collected. It would be the equivalent of granting a loan without interest and of paying a cash subsidy for deposits in the Federal Reserve banks."

   Also, adding the amount of float to bank reserves would be inflationary. Such an unrealistic banking practice invites abuses.

2. In view of the change in the Government's budgetary prospect which will considerably reduce further retirement of marketable debt and which may mean a cash deficit, what should be the System's recommendation as to types of securities (maturities, yields, eligibility) that should be offered by the Treasury for refunding or for new money?

   The Council does not believe it can be assumed that the budget will show a cash deficit. There is as yet no conclusive evidence indicating the direction of the economic trend in the coming months. As to new issues, the following comments are made:

   A. The basic principle to follow is that as much as possible of the short term debt should be funded into securities which will be purchased and retained by non-bank investors.

   B. The markets will not now absorb large amounts of non-eligible securities. However, the Federal Reserve System should sell bonds out of its portfolio, at or near present prices, whenever there is a demand in the market for them.

   C. Emphasis should continue to be placed upon the sale of E, F, and G bonds, and the amount of F's and G's which an investor may acquire should be increased.

   D. Bills and certificates should be sold at slightly higher rates than now prevail as a means of selling to non-bank investors, reducing the incentive for banks to lengthen maturities and as a means also of keeping some pressure on credit.

3. What should be done in the monetary and credit field to counteract the inflationary pressures that may be created by the new defense proposals and the world aid program?

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The balance between deflationary forces and inflationary forces is not yet clear. As recently as thirty days ago, the deflationary factors were in the ascendancy. It is too early to determine whether the new defense proposals and the increase in the program for world aid will lead to a resumption of inflationary forces. Until the trend is clearer, it would not appear necessary or wise to give the Federal Reserve System added powers to increase banks' reserve requirements. The very granting of such powers might in itself have injurious deflationary effects. If the armament program is expanded beyond present estimates, it may require added amounts of bank credit rather than less.

In the meantime the powers which the System and the Treasury already possess, without new legislation, are large. The Board has the power to raise the discount rate, which is an effective method of calling public attention to the desirability of checking credit expansion. The Reserve System has recently demonstrated that through relatively slight changes in open market policy it can greatly influence bank operations, the security markets, and business. Although the Board has raised the reserve requirements of the central reserve city banks from 20 to 22 per cent, the Board still has the power to increase these particular reserve requirements to 26 per cent.

Many foreign nations have given up large amounts of their gold reserves in the past year or two, so that our gold imports in the immediate future are unlikely to be as large as they have been. Moreover, the Open Market Committee may sterilize gold imports by selling United States securities or letting them run off without replacement.

The recent trend in bank loans has demonstrated that the banks generally are following a cautious and conservative loaning policy.

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MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

April 26, 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; Messrs Charles E. Spencer, Jr., W. Randolph Burgess, David E. Williams, John H. McCoy, Robert V. Fleming, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, J. E. Woods, Reno Odlin, and Herbert V. Prochnow, Secretary.

Dr. Ralph A. Young, Associate Director, Division of Research and Statistics of the Federal Reserve System, spoke on the subject, "The Economic Situation and Outlook".

The meeting adjourned at 3:45 P.M.

HERBERT V. PROCHNOW
Secretary.

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

April 27, 1948

At 10:35 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 Thomas B. McCabe; Governors M. S. Szymczak, Ernest G. Draper, R. M. Evans, and Lawrence Clayton; also Mr. S. R. Carpenter, Secretary of the Board of Governors.

Present: Members of the Federal Advisory Council:

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

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 18 and 19 of these minutes. President Brown then stated that the Council believed it would be helpful on matters of this kind if the Federal Reserve staff would discuss them with the proper committees of the American Bankers Association, the Association of Reserve City Bankers, and experienced operating officials of banks.

Chairman McCabe stated that the whole matter was discussed with a committee of the Association of Reserve City Bankers in January; the committee was assured that the matter would be given careful consideration and would be taken up with the Federal Advisory Council before anything would be done. Chairman McCabe further stated, assuming anything is finally done, a year or two would be needed in order to consider the matter properly.

President Brown then read the second 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 found in these minutes on pages 18 and 19.

Mr. Szymczak asked whether point A in the Council's conclusions on the second item on the agenda meant that as short-term securities mature, the Treasury should go into long-terms.

Dr. Burgess replied that the Council's comment referred to savings bonds especially, and that point A of the Council's memorandum was a long-term objective to be kept in mind.

President Brown and Chairman McCabe agreed that there was probably no fundamental difference between the Council and the Board on this item of the agenda.

The President of the Council read the third item on the agenda and the conclusions of the Council as given in the *Confidential Memorandum,* mentioned above. Various members of the Council emphasized that it would be undesirable at present to introduce any proposals to increase bank reserves. Several members of the Council suggested that a study should be made of the whole question of reserves.

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Chairman McCabe asked whether banks would prefer a special reserve requirement or an increase in regular reserves. In the discussion, a number of the members of the Council indicated that neither an increase in the regular reserves nor special reserves were advisable.

Chairman McCabe reported that he was sending a letter to the Federal Reserve banks asking for their opinions on the matter of reserve requirements. Chairman McCabe asked whether the Executive Committee of the Council would be ready to meet on short notice with the Board. President Brown assured him that the Executive Committee could meet with the Board any time upon a few days' notice.

During the discussion, the program of the American Bankers Association urging restraint in the extension of credit was commended. Dr. Burgess pointed out that the weak argument of the Board was the argument that the Board has no powers to restrict credit expansion, whereas the Board has ample powers.

The meeting adjourned at 12:50 P.M.

HERBERT V. PROCHNOW
Secretary.

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MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

April 27, 1948

At 3:00 P.M., the Federal Advisory Council convened in Room 654 of the Mayflower Hotel, Washington, D. C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Messrs. Charles E. Spencer, Jr., W. Randolph Burgess, David E. Williams, John H. McCoy, Robert V. Fleming, J. T. Brown, Henry E. Atwood, James M. Kemper, J. E. Woods, Reno Odlin, and Herbert V. Prochnow, Secretary.

Absent: Mr. James H. Penick.

There was a discussion on the advisability of giving the Board of Governors a written statement of the Council's viewpoint on the present situation in the financing of housing and real estate. The Board of Governors had indicated that a statement from the Council would be appreciated, and might be sent to the proper Committees of Congress by the Board in support of the Board's position on these matters.

After some discussion, the Council adopted the following resolution, which was sent with the letter below to the Secretary of the Board of Governors:

Resolution Adopted by the Federal Advisory Council on April 27, 1948.

The Board of Governors has asked the judgment of the Council on the housing situation and on the position taken by the Board on the financing of housing programs.

The Council is in general agreement with the analysis of the problem stated by Mr. Eccles before the Joint Committee on the Economic Report on November 25, 1947.

The desired objective is to build as rapidly as possible the housing veterans and others so urgently need of sound quality, and at prices they can afford to pay and retain ownership. The capacity of the building industry is limited. Attempts to force building beyond that capacity by excessive loans or unsound subsidies lead to shortages of labor and materials, higher prices, and poor quality construction by speculative and unqualified builders. We approve the specific suggestions on housing legislation now before Congress in the Board's letter of April 5, to Senator Tobey.

Washington, D. C

* * * * *

April 30, 1948

Mr. R. S. Carpenter, Secretary
Board of Governors of the Federal Reserve System
Washington 25, D. C.

Dear Mr. Carpenter:

You will please find enclosed a Resolution of the Federal Advisory Council with reference to the financing of housing.

The Board of Governors may feel free to use this Resolution in connection with the hearings of any Congressional Committee on this subject.

Very sincerely yours,

(Signed) HERBERT V. PROCHNOW
Secretary.

The meeting adjourned at 4:00 P.M.

HERBERT V. PROCHNOW
Secretary.

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ACTION OF THE EXECUTIVE COMMITTEE OF THE FEDERAL ADVISORY COUNCIL ON H.R. 2799.

The following letter, which is self-explanatory, was received by President Brown

THE RIGGS NATIONAL BANK
OF
WASHINGTON, D. C.
Postal Zone 13

May 12, 1948

AIR MAIL

Mr. Edward E. Brown, President
Federal Advisory Council
c/o First National Bank
Chicago, Ill.

Dear Ned:

Late yesterday afternoon, Governor Clayton called me on the telephone and stated that they were anxious to have some support if it was obtainable from the Executive Committee of the Federal Advisory Council in connection with a proposed amendment to the Federal Home Loan Bank Act.

Governor Clayton stated that, while the Board had originally been consulted on this matter, they had not been consulted on the draft of the amendment which had been cleared by Mr. Foley, Administrator of the Housing and Home Finance Agency and the Bureau of the Budget, and there were certain features of the legislation which they felt were undesirable. I told Governor Clayton that the only thing we could do was to take a mail vote and if our minds could meet, possibly a resolution could be adopted by the Executive Committee of the Council which would be helpful.

I requested Governor Clayton to forward me sufficient copies of the proposed amendment and the Board of Governors' objections in order that I may transmit them to you as President of the Council, so that if you felt it was desirable you could have Mr. Prochnow, Secretary of the Council, forward them to the various members of the Executive Committee for their information and comments, or possibly a proposed resolution if you concur with the viewpoint of the Board of Governors. It is not necessary for Mr. Prochnow to send one to me and in order to expedite the matter, I am enclosing five copies of the proposed amendment and the features of the Bill to which the Board of Governors object.

I have not had an opportunity yet to read the proposed amendment and the Board's comments but I will do so promptly and will be in a position shortly to give you my viewpoint on this matter.

Yours very sincerely

(Signed) ROBERT V. FLEMING
Second Vice President
Federal Advisory Council

Enclosures

As a result of the above letter, the members of the Executive Committee approved by mail the following resolution:

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RESOLUTION ADOPTED BY THE EXECUTIVE COMMITTEE OF THE FEDERAL ADVISORY COUNCIL ON MAY 17, 1948

In connection with the proposed amendment to H.R. 2799, the Executive Committee of the Federal Advisory Council is in agreement with the Board of Governors of the Federal Reserve System that the following three features of the proposed amendment are undesirable:

1. Section 3 of the amendment would authorize the Secretary of the Treasury to purchase up to $1 billion of the obligations issued by the Home Loan Banks. If such authorization is provided at all, it should be limited to well defined emergency situations.

2. Section 6 of the amendment would direct the Secretary of the Treasury to loan to the Federal Savings and Loan Insurance Corporation up to $750 million, as determined by the Home Loan Bank Board. It is appropriate that the Federal Savings and Loan Insurance Corporation, as a Government Corporation, should obtain its funds from the Treasury; but it should first be required to build up adequate reserves to avoid an unnecessary burden on the Treasury.

3. Section 8 of the amendment would make insured share accounts of savings and loan associations lawful investments for fiduciary and public funds. Such shares are not appropriate investments for such funds, but the fact that they were approved as such would convey a misleading sense of liquidity to other investors.

* * * * *

The resolution above was sent to the Secretary of the Board of Governors with the letter which follows:

May 18, 1948

Mr. S. R. Carpenter, Secretary,
Board of Governors of the Federal Reserve System,
Washington 25, D. C.

Dear Mr. Carpenter:

You will please find enclosed a Resolution of the Executive Committee of the Federal Advisory Council, with reference to the proposed amendment to H.R. 2799. The Board of Governors may feel free to give this Resolution to the appropriate Committees of Congress, or to the confreres if the bill goes to conference.

Very sincerely yours,

(Signed) HERBERT V. PROCHNOW
Secretary.

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

H. V. P.

The Secretary's notes on the meeting of the Federal Advisory Council on April 25, 1948, at 2:10 P.M. in Room 932 of the Mayflower Hotel, Washington, D. C. All members of the Federal Advisory Council were present.

The Council accepted with regret the resignation of Walter Lichtenstein as Secretary, and on motion duly made and seconded, elected Herbert V. Prochnow as Secretary.

* * * * *

IT IS UNDERSTOOD THAT THE FEDERAL RESERVE SYSTEM IS NOW CONSIDERING A PROGRAM OF ALLOWING, FIRST, IMMEDIATE CREDIT ON ALL SENDINGS TO THE FEDERAL RESERVE SYSTEM OF TRANSIT ITEMS, REGARDLESS OF THE NUMBER OF DAYS IT MAY TAKE TO COLLECT EITHER BY AIR MAIL OR TRAIN, AND SECOND, THE POSSIBLE ELIMINATION OF SORTING TRANSIT ITEMS BY RESERVE DISTRICTS AND DIRECT SENDINGS TO THE FEDERAL RESERVE BANKS AND THEIR BRANCHES. THESE PROCEDURES, IF CONTEMPLATED, INVOLVE IMPORTANT CHANGES IN THE FUNCTIONING OF THE BANKING SYSTEM, AND IT WOULD BE MOST DESIRABLE FOR THE BOARD OF GOVERNORS AND THE COUNCIL TO DISCUSS THEM.

E. E. Brown asks Fleming to comment on this item.

Fleming states that the addition of the float to bank reserves would be distinctly inflationary, and that it is definitely unsound banking practice to make funds available before they are actually collected. He points out that treasurers of corporations would soon learn that the Federal Reserve banks were making items immediately available to banks. Corporations would then demand immediate availability and the practice would spread to banks.

E. E. Brown reads the following statement from the memorandum of the Council to the Board of Governors on November 18, 1947: "No changes in the check collection processes should result in making items available sooner, on the average, than the period required for their collection. For example, for the Federal Reserve banks to make all items immediately available would be unsound, as it would make funds available when they were not actually collected. It would be the equivalent of granting a loan

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without interest and of paying a cash subsidy for deposits in the Federal Reserve banks." Brown states that at the time the Council discussed this matter with the Board in November 1947, Eccles said he was not interested in what effect a Federal Reserve policy of making items immediately available would have upon the correspondent banking system. Eccles also stated that when the economic situation was such that immediate availability would not add to the inflationary trend he would take steps to place it in operation. Brown believes the Council should reiterate its former position in this matter. It is clearly obvious that adding the amount of float to the reserves would be distinctly inflationary.

Fleming thinks the language used in the previous memorandum of the Council on this question was good, but believes it might be amplified.

E. E. Brown states that the matter of making items immediately available is one of principle and not of mechanics. It is an unsound banking principle.

Kemper. It makes funds available without interest and without security.

Penick. If banks receive immediate availability, they will pass it on to industry, and eventually it will be a subsidy to customers.

Kemper. It makes kiting possible.

E. E. Brown states that it could be said it promotes kiting.

Odlin. The banks have built up a system for collecting checks, and it is a dangerous practice to overthrow an established and smoothly operating process for a practice that is clearly unsound.

Fleming believes it would tend to break down correspondent bank relationships.

Penick asks whether it might be advisable for the Council to submit an item for the agenda at the next meeting indicating various practices that the Federal Reserve System has adopted, such as the absorption of postage and other steps, all of which have tended to break down correspondent bank relations.

McCoy is inclined to believe it might not be best to submit such an agenda item, as he thinks the Federal Reserve staff is not concerned about any injury it may do correspondent bank relationships.

E. E. Brown asks in connection with the second part of this agenda item whether it might not be advisable for the Council to stay away from any discussion of it.

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McCoy thinks the Federal Reserve System could save banks their costs on sorting. It would be beneficial if the Federal Reserve banks took items just as they come.

Kemper states that if his bank dumped items on the Federal Reserve bank, his bank would lose one of its best talking points with correspondent banks. He believes that what the Federal Reserve System is aiming at is to get all items directed to the Federal Reserve banks and then obtain the bank balances. In connection with availability, his bank charges customers exactly the time required to make an item available.

Spencer comments that the availability schedule in his bank was disrupted last winter because of the weather.

E. E. Brown states that the correspondents of his bank receive quicker availability than if they send their items through the Federal Reserve bank. He does not believe that the second part of this agenda item, dealing with sorting, is as important as the first part.

Fleming thinks the Federal Reserve System will use sorting as a means of getting correspondent bank balances.

Burgess. The question of sorting is one of working out the best procedure gradually,and not making sweeping changes.

Woods states that his bank sends its items directly to its correspondent in Dallas which sorts the items.

Atwood. The Federal Reserve Bank of Minneapolis does not require sorting for most banks now. There are not over a dozen banks in the district which are required to sort.

Fleming thinks the Federal Reserve System should make any changes in the handling of items gradually and after conferences with the proper committees of the American Bankers Association, the Association of Reserve City Banks, and experienced operating officials of banks.

E. E. Brown suggests that the memorandum to be given to the Board of Governors should include the paragraph which he had quoted earlier from the memorandum to the Board of Governors on November 18, 1947.

> IN VIEW OF THE CHANGE IN THE GOVERNMENT'S BUDGETARY PROSPECT WHICH WILL CONSIDERABLY REDUCE FURTHER RETIREMENT OF MARKETABLE DEBT AND WHICH MAY MEAN A CASH DEFICIT, WHAT SHOULD BE THE SYSTEM'S RECOMMENDATION AS TO TYPES OF SECURITIES (MATURITIES, YIELDS, ELIGIBILITY) THAT SHOULD BE OFFERED BY THE TREASURY FOR REFUNDING OR FOR NEW MONEY?

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Burgess states (1) that it cannot be assumed the budget will show a cash deficit; (2) as to general business, no one knows whether the inflationary trend will be resumed in the near future; and (3) if the inflationary trend is resumed, the Board still has ample powers to deal with the situation as indicated in the open market on December 24. If the inflationary trend is resumed, then as many securities as possible should be sold outside the banks. Not enough has been done to make the savings bonds attractive.

E. E. Brown asks whether there would be a market for a long-term 2½ per cent bond, non-eligible to banks.

Burgess does not believe so. Moreover, the FederalReserve banks have several billions of dollars of long term bonds in their portfolios which they should sell whenever there is a demand in the market for them. The sale of these bonds, which are held in the portfolios of the Federal Reserve banks, and the increased sale of saving bonds are ways of meeting the problem. The Federal Reserve banks have plenty of long-term obligations in their portfolios that could be sold.

E. E. Brown. The Federal Reserve banks bought a considerable amount of long-term, non-eligible securities. Brown does not understand why they have not sold them.

Fleming states that Senator Taft has remarked that he questions some of the estimates which are presented on the economic trend, in view of the inaccuracy of some previous estimates.

E. E. Brown believes that the Council should include in its answer to this agenda item a recommendation (a) that bills and certificates should be sold at somewhat higher rates than now prevail; (b) that emphasis should be placed on the sales of E, F and G bonds with the limit on the F's and G's raised; and (c) that bonds should be sold out of the portfolio of the Federal Reserve System whenever there is a demand for them. In view of the holdings of the Federal Reserve System, there is no need now for issuing long-term ineligibles.

Burgess agrees with this statement. He adds that over a period a refunding job should be done. As of today, there is no real market for long-term bonds.

E. E. Brown repeats that the Federal Reserve System ought to sell some of its bonds.

Burgess states that the principle to follow is that refunding should take place whenever there is an opportunity. There are the savings bonds and the securities held in the Federal Reserve System portfolio to meet the present problem.

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E. E. Brown. The current bond campaign does not look very hopeful. The principle which should be followed is that as much as possible of the short-term debt, whether in or out of the banking system, should be refunded into non-eligible securities. The market now will not take a large amount of non-eligibles. Bills and certificates should be sold at slightly higher rates than now prevail. Emphasis should be placed on the sale of E, F and G bonds and the amount of F's and G's which an investor may acquire should be increased. The Federal Reserve System should sell out of its portfolio, at or about present levels, whenever there is a demand in the market for non-eligible securities.

Burgess. The increased bill rate has led to a wider distribution outside of the banks.

WHAT SHOULD BE DONE IN THE MONETARY AND CREDIT FIELD TO COUNTERACT THE INFLATIONARY PRESSURES THAT MAY BE CREATED BY THE NEW DEFENSE PROPOSALS AND THE WORLD AID PROGRAM?

Fleming asks whether the amount to be spent for world aid will be larger than it was last year.

Burgess states that the actual expenditure for world aid may be little or no more than last year. Defense expenditures are larger. Last year many foreign nations gave up large amounts of their gold reserves so that our gold imports in the near future are not likely to be as large as they have been. Consequently, some foreign nations will not be able to spend as much here this year as they have in the past year. Burgess estimates that perhaps $600 million or $700 million in new gold will come from South Africa. The Open Market Committee has the power to sterilize gold imports by selling United States securities or letting them run off.

Spencer states that his associates do not believe gold imports this year will be as high as $3 billion.

Fleming. A competent banker will adjust his reserve position to meet any higher reserves the Board may have the power to require. He mentions that Eccles testified just before McCabe took the office of Chairman.

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(At this point there was an off-the-record discussion on reserve requirements and related subjects).

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Fleming reads from Eccles' most recent testimony indicating Eccles' belief that an increase in reserve requirements can be made to apply to all banks.

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E. E. Brown believes that reserve requirements can be made to apply to all banks, probably under the power to regulate the issuance of currency.

Burgess. McCabe could very properly say that he has not had an opportunity to study the whole complex problem of reserves, and, therefore, would not wish now to make any recommendation on reserves. If McCabe should propose an increase in reserves to Congress, it will probably be defeated, and it will alienate state banks.

Atwood asks how the Republicans, who have just voted to reduce taxes, could now vote to increase reserves. He believes McCabe would find it impossible to get higher reserves at present.

E. E. Brown. If the defense expenditures are for atomic bombs, guided missiles and similar projects, then the inflationary pressures may not be serious. However, if there are expenditures for large military ground forces, trucks, tanks and the shipment of military equipment abroad, there may be a further upward pressure on the economy. E. E. Brown states that if he were convinced we were going to have more inflation, he would be inclined to be for an increase in reserves. If and when the economic trend becomes clearer, it is time enough to consider an increase in reserve requirements. He is inclined to believe that the differences in reserve requirements are perhaps too great between the country, reserve city and central reserve city banks. He thinks any possible increase in reserve requirements in the future should probably not be a flat percentage for each group. E. E. Brown mentions merely as tentative figures to illustrate his point, 20 per cent for country banks, 24 per cent for reserve city banks and 28 per cent for central reserve city banks. A large increase in reserve requirements, such as Eccles proposes, would mean that some banks would have difficulty making adequate earnings, and the whole private banking system might be endangered.

Atwood. Is there any logical reason for present reserve requirements, or does the whole matter of reserve requirements represent an accidental and haphazard development.

Burgess states that it is largely the latter.

E. E. Brown says the reserve requirements grew out of the national banking system, but they are not logical now. Sproul has argued for uniform reserve requirements on demand deposits with a higher rate on interbank deposits.

Atwood asks whether Eccles did not say that the whole reserve requirements were set up on an illogical basis.

J. T. Brown. Considering the previous arguments of Eccles, how can he now justify a blanket proposal?

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Woods understands a study is now under way in the Federal Reserve System on the whole subject of reserves.

Atwood believes McCabe could state that he wishes to study the question more fully.

Burgess. If a war psychology should develop in the country, the banks will have to carry a heavier loan load.

E. E. Brown. In 1940 and 1941 the banks were not particularly heavy lenders.

Burgess comments that at that time we had large excess reserves of around $6 billion.

E. E. Brown. If the maximum requirements are raised, the minimum requirements should not be raised, because a deflationary period might require that reserves be reduced. Any well-managed bank will keep itself in a position to meet possible increased reserve requirements, if these powers are given to the Board.

Fleming does not think there is anything in the next thirty days or so to justify increased reserve requirements.

Odlin believes McCabe would make a mistake to align himself with the present Board on an increase in reserves.

Fleming states that any gold imports can be offset by selling government securities. The increase in loans since January is not very large and much of it is in real estate loans.

E. E. Brown reports that retail store loans are up because their credit sales are up. Finance companies are also using credit, but some commodity loans are down.

Burgess states that mortgage debt is up, but this is a matter of national policy. The government budget and consumer spending are inflationary forces.

Odlin asks how the Council can do anything contrary to its November statement when everything the Council said then has been borne out by the facts since that time.

Kemper. The Board will state that conditions have changed since November because of the new defense proposals and the world aid program.

E. E. Brown reports that he talked with Sewell Avery who believed that thirty days ago deflationary factors were in the ascendancy.

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However, Avery now believes there is a changing attitude on the part of buyers. Brown states that those in favor of higher reserves may argue that unless something is done now a crisis may arise and be on us before new legislation can be enacted.

Burgess believes the Board has the necessary weapons now and does not need new legislation. He mentions the power to raise the rediscount rate, the large holdings of government securities in the portfolio of the Federal Reserve System, the possibility of increasing reserves to 26 per cent in the central reserve cities and the building up of balances in the treasury account in the Federal Reserve System.

Williams does not believe that reserve requirements should be increased now, but thinks the Council might help McCabe to obtain a better picture of the situation before he accepts the idea of higher reserve requirements.

E. E. Brown mentions that the press states Winfield W. Riefler, economics professor at the Institute for Advanced Study at Princeton, will become assistant to McCabe, May 1. Brown has known Riefler for some time. He wonders what Riefler's position will be on increasing reserve requirements.

Burgess thinks that Riefler believes somewhat in the managed money idea, but he states Riefler has done some good work in various capacities and was connected with the National Bureau of Economic Research.

Fleming asks whether a few members of the Council should talk with Secretary of the Treasury Snyder in the morning on this whole matter.

E. E. Brown suggests that Fleming see Snyder.

Fleming requests that Burgess accompany him. (It is agreed by the Council that Fleming and Burgess should see Snyder in the morning.)

E. E. Brown. The balance between the inflationary and deflationary forces is extremely narrow. The armament program has introduced a new factor, but he believes the Board has powers to meet the situation. Any increase in reserves, such as proposed by Eccles, would so reduce the earnings of some banks that they would be forced into risks carrying higher rates, all of which would defeat the very objectives of the proposal. He does not believe any legislation should be passed at this time.

Burgess. It is necessary to analyze carefully what an increase in reserves would do. It would encourage some banks to take riskier loans.

Fleming. Many bank stocks are selling below book value now. If their earnings fall further, it would make it more difficult to increase their capital.

McCoy. Many banks have as much on deposit with their correspondents as with their respective Federal Reserve banks. If reserve requirements are raised, the banker will sell securities.

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Odlin says that reserve requirements have followed a certain pattern for a considerable time, and he does not think it would be desirable to increase country banks say from 14 per cent to 20 per cent, which would be almost a fifty per cent increase.

E. E. Brown states that his previous figures of 20 per cent, 24 per cent and 28 per cent for the three classes of banks were not meant to be fixed and he was only speaking to illustrate a principle of a closer relationship between the three classifications of banks.

Odlin. The proposal of the Board of Governors for increased reserves is but a small part of the whole program, the major phase of which is the Federal Budget. The confidential memorandum of the Council to the Board of Governors on November 18, 1947, listed other matters which were far more important than the expansion of bank credit in the present economic situation.

E. E. Brown. If banks are forced to raise interest rates as a result of tighter reserves, government lending agencies will then be asked to make loans at lower rates to veterans, small business concerns and other groups, all of which will result in the futher injection of government into the banking system.

BANK HOLDING COMPANY BILL

E. E. Brown asks Odlin whether he has any comment to make on this legislation.

Odlin indicates his displeasure with the recent A. B. A. statement.

E. E. Brown thinks the A. B. A. statement on the bank holding company legislation may have put "the nails in the coffin" regarding this legislation for this session of Congress.

Kemper states that he has heard there may be a new school of thought on bank holding company legislation.

The meeting adjourned at 5:50 P.M.

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The Council convened at 10:00 a.m. on April 26, 1948, in Room 932 of the Mayflower Hotel, Washington, D. C.
All members of the Council were present.

The Council prepared and approved the attached confidential memorandum to be sent to the Board of Governors relative to the agenda for the joint meeting of the Council and the Board on April 27, 1948. The memorandum was delivered to the Secretary of the Board of Governors at 12:23 p.m. on April 26, 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 12:10 p.m.

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MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON APRIL 26, 1948

1. It is understood that the Federal Reserve System is now considering a program of allowing, first, immediate credit on all sendings to the Federal Reserve System of transit items, regardless of the number of days it may take to collect either by air mail or train, and second, the possible elimination of sorting transit items by reserve districts and direct sendings to the Federal Reserve banks and their branches. These procedures, if contemplated, involve important changes in the functioning of the banking system, and it would be most desirable for the Board of Governors and the Council to discuss them.

In relation to the first part of this question, the Council wishes to restate its position as expressed on page five of its memorandum to the Board of Governors on November 18, 1947, as follows: "No changes in the check collection processes should result in making items available sooner, on the average, than the period required for their collection. For example, for the Federal Reserve banks to make all items immediately available would be unsound, as it would make funds available when they were not actually collected. It would be the equivalent of granting a loan without interest and of paying a cash subsidy for deposits in the Federal Reserve banks."

Also, adding the amount of float to bank reserves would be inflationary. Such an unrealistic banking practice invites abuses.

2. In view of the change in the Government's budgetary prospect which will considerably reduce further retirement of marketable debt and which may mean a cash deficit, what should be the System's recommendation as to types of securities (maturities, yields, eligibility) that should be offered by the Treasury for refunding or for new money?

The Council does not believe it can be assumed that the budget will show a cash deficit. There is as yet no conclusive evidence indicating the direction of the economic trend in the coming months. As to new issues, the following comments are made:

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A. The basic principle to follow is that as much as possible of the short term debt should be funded into securities which will be purchased and retained by non-bank investors.

B. The markets will not now absorb large amounts of non-eligible securities. However, the Federal Reserve System should sell bonds out of its portfolio, at or near present prices, whenever there is a demand in the market for them.

C. Emphasis should continue to be placed upon the sale of E, F, and G bonds, and the amount of F's and G's which an investor may acquire should be increased.

D. Bills and certificates should be sold at slightly higher rates than now prevail as a means of selling to non-bank investors, reducing the incentive for banks to lengthen maturities and as a means also of keeping some pressure on credit.

3. What should be done in the monetary and credit field to counteract the inflationary pressures that may be created by the new defense proposals and the world aid program?

The balance between deflationary forces and inflationary forces is not yet clear. As recently as thirty days ago, the deflationary factors were in the ascendancy. It is too early to determine whether the new defense proposals and the increase in the program for world aid will lead to a resumption of inflationary forces. Until the trend is clearer, it would not appear necessary or wise to give the Federal Reserve System added powers to increase banks' reserve requirements. The very granting of such powers might in itself have injurious deflationary effects. If the armament program is expanded beyond present estimates, it may require added amounts of bank credit rather than less.

In the meantime, the powers which the System and the Treasury already possess, without new legislation, are large. The Board has the power to raise the discount rate, which is an effective method of calling public attention to the desirability of checking credit expansion. The Reserve System has recently demonstrated that through relatively slight changes in open market policy it can greatly influence bank operations, the security markets, and business. Although the Board has raised the reserve requirements of the central reserve city banks from 20 to 22 per cent, the Board still has the power to increase these particular reserve requirements to 26 per cent.

Many foreign nations have given up large amounts of their gold reserves in the past year or two, so that our gold imports in the immediate future are unlikely to be as large as they have been. Moreover, the Open Market Committee may sterilize gold imports by selling United States securities or letting them run off without replacement.

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The recent trend in bank loans has demonstrated that the banks generally are following a cautious and conservative loaning policy.

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The Council convened in the Board Room of the Federal Reserve Building at 2:00 p.m. on April 26, 1948, to hear Dr. Ralph A. Young, Associate Director, Division of Research and Statistics of the Federal Reserve System.

All members of the Council were present.

* * * * * * * *

E. E. Brown presents Dr. Ralph A. Young, who speaks on the subject of "The Economic Situation and Outlook". A copy of Dr. Young's remarks are attached.

The meeting adjourned at 3:45 P.M.

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THE ECONOMIC SITUATION AND OUTLOOK

Remarks by Ralph A. Young, Associate Director
Division of Research and Statistics
Board of Governors of the Federal Reserve System
before the
Federal Advisory Council—April 26, 1948

The economy has now absorbed the largest deflationary fiscal and monetary operation in its history for so short a period of time. Over the past four-month period, December through March, Federal Reserve credit has been reduced by 1.6 billion dollars, and the total money supply has been contracted by nearly 4 billion.

The deflationary threat of this large fiscal and monetary operation has proved to be a complete illusion. In retrospect, the accompanying readjustments in primary commodity and financial markets were no more than tremors, expressing temporary business fears and uncertainty. After all, up to the beginning of the operation we had had the longest period of sustained business activity on record—its beginning dates back roughly to May 1938. Furthermore, we have all been schooled in the doctrine, fostered by business cycle theory, that an expansion period at some point will be succeeded by a period of contraction. Accordingly, many were prepared to believe that, with the main strength of inflationary expansion forces possibly spent, and with many factors of unbalance in the economic situation, the strains of deflationary fiscal and monetary operations could well signal commencement of some, perhaps relatively severe, business recession.

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Factors of Underlying Strength.--In our own estimates of the outlook, prepared earlier in the year, we were inclined to discount any serious business recession at this time and to anticipate, at least through 1948, sustained high levels of production and employment with renewed, but modest advance in the wholesale and consumer prices. In making this estimate, we were impressed especially by the following factors of underlying strength.

(1) The sheer size of the public's stock of liquid assets available for spending; the maximum temporary reduction in this stock resulting from first quarter fiscal and monetary operation could hardly exceed two per cent.

(2) Personal incomes and holdings of liquid assets continued to be widely distributed; wages were still advancing; and prospective tax reduction would add to spending power.

(3) Backlog demands were still strong in many areas and business expenditures on plant and equipment had the promise of being well maintained.

(4) Business inventories were not high in relation to sales and farm inventories were comparatively low.

(5) Foreign purchases of American goods would be sustained in fairly large volume as a result of the Economic Cooperation Program.

(6) Fiscal operations, although temporarily deflationary, would be inflationary on balance after the first quarter of the year. With fairly active business, real estate, and consumer requirements for credit, financing demands could easily exceed the current savings available for such financing, with the result that a sizeable portion of the demand

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would have to be satisfied through the banks. This would mean resumption of bank credit and monetary expansion. The useable instruments of monetary policy would probably not suffice, considering the potentialities for additional bank reserves, to restrain such bank credit expansion.

These fundamental factors of strength continue to influence our estimates of possible economic developments for the near-term future. There are now, of course, still other strategic factors to be taken into account. The most important of these is the certainty that defense expenditures, because of the threatening international situation, will be considerably larger than originally provided for in the budget for fiscal '49. Another important factor, however, is the rapidly changing psychology of the business and financial community, as well as the public, with respect to the business and inflationary outlook.

While a substantial increase in our national defense expenditures is a certainty, the final amount of such expenditures is highly uncertain. On the basis of programs under consideration or seriously mentioned, we are inclined to estimate a figure of about 2 billion dollars as the likely addition to Federal expenditures from this source for the next fiscal year. This is, of course, on top of other expenditure increases, particularly stemming from the program of Economic Cooperation, so that total expenditures of the Government for the next fiscal year promise to be approximately 5 billions higher than in fiscal '48.

Effects of Increased Federal Expenditures.--A substantial increase in Federal expenditures over the next year will tend to have a considerable lifting effect, direct and indirect, on total national product.

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Other important lifting factors will be larger expenditures by State and local governments, a further substantial increase in domestic private investment, and some additional expansion in consumer expenditures. The combined effect of these lifting factors may be a rise in total product of from 6 to 8 per cent over the annual product rate of 245 billion dollars experienced in the first quarter of this year. This would mean an annual product rate of somewhat over 260 billion dollars during the first half of next year.

An accompanying rise in business profits and personal incomes would provide increased Federal revenues, so that, despite the recent tax reduction bill, the Government's budget deficit might turn out to be relatively small, perhaps in the neighborhood of one billion dollars. With funds available from continued sales of savings bonds and other public debt receipts, it should still be possible for the Treasury to cover from available cash funds voluntary redemptions by holders of maturing issues. On the other hand, probably there will be no Treasury funds available for retirement of Federal reserve-held debt, and some resort to borrowing in the market is at least within the range of possibilities.

The prospective increase in Federal expenditures will have another important effect on the general economic situation. The additional expenditures are capable of absorbing, directly or indirectly, more than the probable net addition to the nation's labor supply. Since, with a rising national product, other new demands for labor are likely, a further decline in unemployment and tightening of the labor market seems a reasonable expectation. This will mean that pressures for advancing wages will be sustained.

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General Economic Outlook.--On the whole, the economic outlook is for a continuing expansion of aggregate demand for goods and services. While further expansion in industrial production is to be expected, it seems scarcely possible that such expansion, on the basis of existing capacity, could exceed no more than 5 per cent. There should also be some expansion of output in service industries, but agricultural output, while uncertain, is unlikely to surpass greatly the average of the past three years. The outlook, then, sums up into a prospect for continuing inflationary pressures and some further rise in prices.

It is extremely difficult to appraise the changing psychological attitudes of business and consumers towards this renewed inflationary outlook. Our general feeling is that, while international uncertainties and the domestic threat of the reimposition of economic controls could activate a rush to buy available supplies of durable and semi-durable goods, the most reasonable expectation is for those in strong financial positions to desire to retain those positions. If businesses and consumers conduct their expenditure programs with reasonable restraint, the performance record of the economy over the next twelve months should be one of gradually advancing levels of production and employment, with some, but probably not alarming, further inflation of wholesale and consumer prices.

There are a number of considerations that may be adduced in support of a pattern along these lines. Among the more important of these are the following:

(1) Industry is only now completing its first postwar program of retooling and expansion. The initiation of second program may be

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approached with greater conservatism than characterized the undertaking of the first.

(2) Consumers, as well as businesses, have satisfied many of their deferred demands for semi-durables and durables, except in the case of automobiles, and housing demand is tapering off because of very high prices on residential real estate.

(3) An increasing number of consumer units are operating with no liquid assets or with deficits, and with the high levels of consumer prices many more consumer units are experiencing reduced flexibility in current expenditures and a reduced margin for savings.

(4) It now seems that the third round of wage increases will be smaller than those of earlier rounds.

(5) The banks, under continuing encouragement from the bank supervisory authorities and more aware of the need for loan restraint as a result of the recent nation-wide educational program of the American Bankers Association, may be less responsive than last year to the strong credit demands that will likely confront them.

Voluntary Restraint on Credit Expansion.--This raises a very pertinent question, namely, the extent to which voluntary restraint on the part of bankers can be relied upon to hold down bank credit expansion in a new situation of gradually mounting inflationary pressures. It is fairly clear, I think, that the program of voluntary credit restraint has had no proper test since its initiation near the end of last year.

The slackening in bank loan expansion since that time has reflected primarily a small decline in the volume of business loans, and

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this decline was heavily concentrated with New York and Chicago banks. Reports indicate that the decline, at least in New York, was largely in loans to food processing industries, to sales finance companies, and to public utilities. Special factors were operative with each of these borrower groups. On the other hand, for banks as a whole, loans to consumers and real estate owners have continued to expand at about the same rate as last year. In addition, banks have added moderately to their holdings of State and local government and corporate securities.

Banks have been going through a period of readjustment as a result of fiscal and monetary pressures and of general economic uncertainty, and reappraisal of lending policies would be a natural concomitant of such a period. Furthermore, the period has been one of seasonal slack in business credit demand, with slackness accentuated by uncertainty as to the economic outlook. If banking developments over the near term are consistent with the pattern that we are inclined to expect, then the first real test of voluntary credit restraint as a weapon of monetary control will come in the second half of the year, when pressures upon the banks from additional borrowing demand will probably reach their full strength. There will be little restraint upon the banks from fiscal operations during this period, and monetary policy has little left in the way of useable restrictive ammunition.

Prospective Bank Credit Demands.--Business borrowing demands will probably be the most active element in the market for credit and especially bank credit during the next twelve months. Even before the recent developments in the tax, world aid, and rearmament fields, business

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in the aggregate anticipated spending substantially more this year--about 15 per cent more--on plant and equipment than it spent in 1947. From all indications, such expenditures in 1948 will amount to about twice the amounts spent in 1929 and 1941, the two preceding high years. These expenditure estimates for plant and equipment represent additional expansion programs of a wide variety of industries, with large dollar increases over last year shown by trade, service, finance, communications, and transportation other than railroads. They also include the extension of sizeable expenditure programs in the railroad, electric utility, petroleum, food, and chemical industries.

Another element in business borrowing demands will be increases in business inventory and receivable holdings, and these will be further influenced by any price advances that occur. Business inventories are still low relative to current sales by any prewar standards and in such industries as iron and steel, nonferrous metals and petroleum they are low by any standards.

Business profits both before and after taxes should reach another all-time high this year, and the volume of undistributed profits should also attain a new high record. While business will have a large volume of funds available from retained earnings and other internal sources, the amount is not likely to meet all needs for financing asset expansion, so that considerable financing will have to be done through the market, the insurance companies, and the banks. In this connection, it should be pointed out that business liquid asset holdings over-all can no longer be regarded as a possible source of funds for financing the acquisition of other assets. For all nonfinancial businesses as a group, such holdings

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are no longer high relative to operating requirements, as compared to prewar relationships. Moreover, since March of last year, business liquid asset holdings have been increasing in about the same dollar volume as the increase in accrued income taxes.

Real estate loans will be another area of substantial credit demand. Some tightening of the mortgage market has occurred and there are reports of a few banks which regard themselves as loaned up in the real estate field. On the other hand, a large volume of new mortages continues and will continue to be generated as a result of the current heavy construction activity. Of the new mortgages placed with lenders so far this year, banks have taken their fair share. It should be recognized that the new housing program, now under consideration by Congress, will, if enacted, greatly strengthen financing demands in the residential mortgage field.

In recent months, consumer loan outstandings at banks, despite some seasonal reduction in aggregate consumer installment credit volume, have been rising at about the same rate as last year. While a tapering-off of backlog demand for consumers durable goods has been occurring—for some items, demand has slackened markedly, current buying of consumer durables as a group continues in substantial volume and likewise credit demand for their financing. There is nothing in the prospective situation to suggest any abatement of expansion in consumer instalment credit volume; on the contrary, the indications are for sustained strength of credit demand in this area.

Credit demands of farmers may be a somewhat more important factor in totalbank credit demand this year thanin the past two years.

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Farmers as a group are in exceptionally strong financial position and have large liquid asset holdings. However, farm operating costs have been rising in relation to farm income, and many more farmers than in the past two years may be obliged to seek bank accommodation.

The point was made earlier that expenditures of State and local governments are expected to rise this year. A substantial part of this increase will be financed by borrowing. Although interest rates to municipal borrowers have risen noticeably from a year ago, these governmental units are under pressure to make up urgent deficiencies in public facilities and, in some cases, to provide special veterans benefits. The prospect is, therefore, that a sizeable volume of new State and municipal issues will be seeking lodgment with the banks. The likelihood of the availability of a large volume of corporate securities has already been mentioned. This will further add to pressures for additions to bank holdings of other securities.

Taking all of these considerations into account, voluntary credit restraint has a very large responsibility to carry over the next twelve months. There should be no relaxation of efforts to impress upon the banks the continuing need for vigilance in adhering to conservative credit standards and to anti-inflationary loan policies.

Prospects for Bank Profits.--In closing, I should like to comment briefly on bank earnings prospects. Generally speaking, net profit levels will probably compare with those for 1947, but, because of some further increase in capital accounts, will decline moderately when expressed as a percentage of these accounts. The following factors

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will probably make for an increase in aggregate bank earnings during the year: (1) some shift from low-yield Governments to higher-yielding loans and other securities; (2) an absolute increase in the volume of loans and other securities; (3) a higher average yield from both Governments and loans, reflecting interest rate increases; and (4) a small increase in earnings from service charges and miscellaneous sources. These factors of increase will likely be offset, however, by increases in practically all expense items, especially wages and salaries, and by some increases in the volume of losses and charge-offs in excess of recoveries and profits on loans and securities. Thus, net current earnings will be up, but net profits, in all likelihood, will be about the same as for 1947.

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On April 27, 1948, at 10:35 a.m., the Federal Advisory Council held a joint meeting with the Board of Governors of the Federal Reserve System in the Board Room of the Federal Reserve Building.

All members of the Council were present.

The following members of the Board of Governors were present: Chairman McCabe; Governors Szymczak, Draper, Evans and Clayton; also, Mr. Carpenter, Secretary of the Board of Governors.

IT IS UNDERSTOOD THAT THE FEDERAL RESERVE SYSTEM IS NOW CONSIDERING A PROGRAM OF ALLOWING, FIRST, IMMEDIATE CREDIT ON ALL SENDINGS TO THE FEDERAL RESERVE SYSTEM OF TRANSIT ITEMS, REGARDLESS OF THE NUMBER OF DAYS IT MAY TAKE TO COLLECT EITHER BY AIR MAIL OR TRAIN, AND SECOND, THE POSSIBLE ELIMINATION OF SORTING TRANSIT ITEMS BY RESERVE DISTRICTS AND DIRECT SENDINGS TO THE FEDERAL RESERVE BANKS AND THEIR BRANCHES. THESE PROCEDURES, IF CONTEMPLATED, INVOLVE IMPORTANT CHANGES IN THE FUNCTIONING OF THE BANKING SYSTEM, AND IT WOULD BE MOST DESIRABLE FOR THE BOARD OF GOVERNORS AND THE COUNCIL TO DISCUSS THEM.

E. E. Brown reads the first item on the agenda and the answer which the Council had prepared and submitted in its confidential memorandum to the Board on April 26, 1948. The Council also thinks making items available immediately might encourage some chains or groups of banks to engage in kiting and so actually carry a fictitious reserve. In connection with the second part of this question, the Council believes it is largely a matter of banking mechanics, and it is not now necessary to discuss it with the Board. However, it is suggested that in the interests of harmony, matters of this kind should be discussed by the Federal Reserve staff with the proper committees of the American Bankers Association, the Association of Reserve City Bankers, and experienced operating officials of banks.

McCabe states that this whole matter was discussed with a committee of the Association of Reserve City Bankers in January; the committee was assured that the matter would be given careful consideration, and also would be taken up with the Federal Advisory Council before anything would be done. Even assuming anything is finally done, a year or two will be necessary for consideration of the matter.

IN VIEW OF THE CHANGE IN THE GOVERNMENT'S BUDGETARY PROSPECT WHICH WILL CONSIDERABLY REDUCE FURTHER RETIREMENT OF MARKETABLE DEBT AND WHICH MAY MEAN A CASH DEFICIT, WHAT SHOULD BE THE SYSTEM'S RECOMMENDATION AS TO TYPES OF SECURITIES (MATURITIES, YIELDS, ELIGIBILITY) THAT SHOULD BE OFFERED BY THE TREASURY FOR REFUNDING OR FOR NEW MONEY?

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E. E. Brown reads the second item on the agenda and the answer which the Council had prepared and submitted in its confidential memorandum to the Board on April 26, 1948. He also states that the Council is in agreement with the general policy and attitude of the Board in the last four or five months on the types of securities to be issued. The Council believes the amount of F's and G's which an investor may acquire should be increased.

McCabe asks how large an amount of F's and G's the Council believes an investor should be permitted to acquire.

E. E. Brown believes the amount might be $200,000 to $250,000. He also states that an increase in the certificate rate to 1-1/4 per cent would encourage corporations to buy certificates. Every small increase in yield encourages buyers.

McCabe understands several members of the Council will discuss this subject with Secretary of the Treasury Snyder today.

Fleming replies that he anticipates this subject will be discussed with Secretary of the Treasury Snyder at noon.

McCabe asks whether increasing the limit on F's and G's would depress the market on the long term 2-1/2's.

E. E. Brown does not think so. He believes that most investors would prefer marketable securities.

McCabe reports that a committee of industrialists favored increasing the amount of F's and G's which an investor might purchase.

Burgess comments that the bond drive has recently started, and that it is difficult to show good results. He believes that liberalizing the terms on the F's and G's would be helpful.

McCabe thinks there is a real opportunity to sell E's on the pay roll deduction plan. He believes 25 per cent to 35 per cent of the employees in plants could be induced to take E's on a pay roll plan.

Williams states that raising the limits on the F's and G's would be helpful.

Szymczak asks what is meant by point A in the Council's answer to the second item on the agenda as given in the confidential memorandum of the Council to the Board on April 26, 1948. He asks whether it means that as short terms mature now we should go into long terms.

Burgess replies that the Council's comment now refers to savings bonds especially. Part A of the Council's memorandum is a long term objective to be kept in mind.

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E. E. Brown does not believe there is any fundamental difference between the Council and the Board on this second item of the agenda.

McCabe states that he believes they are in agreement.

WHAT SHOULD BE DONE IN THE MONETARY AND CREDIT FIELD TO COUNTERACT THE INFLATIONARY PRESSURES THAT MAY BE CREATED BY THE NEW DEFENSE PROPOSALS AND THE WORLD AID PROGRAM?

E. E. Brown reads the third item on the agenda and the answer which the Council had prepared and submitted in its confidential memorandum to the Board on April 26, 1948. Brown states that this is the $64 question, and the Council has given most of its consideration to this item. The Council is in unanimous agreement that additional powers should not be granted to the Board now. In February the Council felt that although its members did not know what the economic trend would be in the following months, they were inclined to believe, on the evidence available, that the deflationary forces were in the ascendancy. At the same time, Eccles and Woodlief Thomas indicated that although they did not know what direction the economic trend might take, they were inclined to believe that on the evidence available, the inflationary forces were in the ascendancy. Actually, as it developed, deflationary forces were set in motion and bankers were considerably concerned whether they could prevent a depression. Then came the President's program. New economic forces may now be set in motion. No one can state with assurance what direction the economy will take. The Council believes that to ask Congress to raise the reserves or permit special reserves would have a very injurious effect at a time when it is not apparent which way "the cat will jump". Should legislation be passed permitting the Board to require higher reserves, most banks will increase their reserves so that they are ready for the maximum which may be required. The Council understands that V or VT procedures may be used to finance defense. Large amounts of bank credit may be needed. It may be considered not important that larger reserve requirements would reduce bank earnings. However, reduced bank earnings would lessen the ability of banks to build their capital structures. Increased reserves and reduced bank earnings would also lead some banks to take loans involving greater risks with higher rates in order to get more earnings. If interest rates to veterans and small business concerns increase, the pressure would be on to have government lending agencies make the loans at lower rates. The result would be that government obligations would have to be sold to obtain funds. Every time there is a convention of builders or real estate dealers now, there is a demand for government financing. For the various reasons which we have indicated, the Council thinks higher reserve requirements are unwise now. If the inflationary spiral should move up sharply in the next few months, the Council might be inclined to reopen the discussion.

Burgess. At the time (December 31, 1940) when the Special Report to the Congress was made by the Board of Governors of the Federal Reserve System, the Presidents of the Federal Reserve Banks, and the Federal Advisory Council, it was thought that higher reserve requirements were desirable. But

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the situation was entirely different then from what it is now. At that time there were excess reserves of approximately $6 billion whereas now there are practically no excess reserves. The level of required reserves was also lower then than it is now. The Federal Reserve banks had smaller holdings of government securities than they have today. The Council believes that the Board has adequate powers for the present situation. The action on Christmas Eve on the open market had a tremendous effect. The amount of what might be termed immobile bank money actually runs now to a considerable percentage of the funds of banks. Today the only source for capital in banks is what the banks earn.

Fleming comments that the amount of gold imports this year may not amount to more than half the total gold imports for last year.

Burgess states that Ralph Young, in his remarks to the Council yesterday, estimated that gold imports in 1948 would be about $1.5 billion.

Woods. The action in the open market on Christmas Eve was very effective. Banks of the size he represents believe that higher reserves would be damaging, and they would be against it unless it is imperative. He states that for Congress to give the Board the power to raise reserves would be tantamount to raising the reserves, as it would lead banks to take steps to prepare themselves in advance.

J. T. Brown believes that this item on the agenda clearlyrelates to the suggestions already made to Congress on the matter. It would be a very difficult problem to make an increase in reserves effective with both member and non-member banks. If an increase in the reserves were not made applicable to non-members, the difference in reserve requirements would be very great. He mentions that about one bank in nine in his state is a member of the Federal Reserve System, and states that he believes everything should be done to induce banks to join the System. If, under an act of Congress, the non-member banks were told that they would be compelled practically to double their reserves, it would definitely antagonize these banks. It might start a serious argument in Congress. Moreover, increasing reserves may drive many banks to seek earnings through loans of a character it would be undesirable for them to make. No one seems to favor price controls and other types of controls over our economy. Attention seems to be centered on bank reserves. He believes that this represents an effort to shoot a snow bird with a cannon. No one has any assurance of the direction our economy will take in the months immediately ahead.

Szymczak calls attention to the Special Report to the Congress in 1940 in which non-members were included.

J. T. Brown believes this is a time for harmony in the economy.

Fleming reads from the recent testimony of Eccles, in which Eccles asked for an increase of 10 per cent in reserves on aggregate demand

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deposits and 4 per cent on time deposits in addition to present requirements. Eccles mentioned that this increase would give the Board power to increase bank reserves in the aggregate by a maximum of about $12 billion. Fleming points out that Eccles also suggested in his testimony adding the special reserve plan to the proposed increase in cash reserves. In other words, Eccles requested power to increase the regular reserves and power to require special reserves as well.

E. E. Brown states that in February, Eccles said he would like authority to raise reserve requirements if necessary to 25 per cent, 30 per cent, and 35 per cent, respectively, for country banks, reserve city banks and central reserve city banks.

McCoy says that his bank has as much due from banks as it has in reserves, or about 40 per cent. If the reserves are increased, his bank will sell bonds.

Szymczak asks why McCoy's bank should have deposits scattered over the country.

McCoy replies that the bank's customers expect different kinds of service in various parts of the country.

McCabe asks which would hurt more—a special reserve requirement, or an increase in orthodox reserves.

Odlin suggests that the Board might find it helpful to quit looking so closely at charts and examine the real problems of extending credit in banks. He states that asking which plan the banks prefer is like asking whether a person would prefer to lose his right leg or his left leg. Odlin does not believe any increase in reserves is necessary, and he does not believe that banks are making speculative loans.

Kemper states that he does not know which direction our economy will take. Dr. Young's talk yesterday did not indicate a very great economic upswing this year. He believes that any consideration of reserves should be confined to cash reserves and not special reserves, and he also thinks consideration of the whole question of reserves may well be postponed. Kemper does not like control of securities that a bank may buy, or control of rates.

Szymczak says that on the matter of rates we are already so deep in controls that it is hard to get out.

Williams thinks a thorough study of reserves—their historical development and all aspects of the subject—would be enlightening. He would suggest a postponement of consideration of higher reserves.

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Penick believes the program of the A. B. A. of urging restraint in credit has been quite effective. He also believes that to give the Board power to increase reserves is essentially the same as using the power.

Atwood believes a study of the whole question of reserves should be made. He thinks the development of reserve requirements has been a haphazard one. The whole development of reserves and the percentages required do not make sense.

Szymczak is inclined to agree and says a Federal Reserve study is now being made.

Atwood. Why should we add 10 per cent to something that does not make sense?

E. E. Brown states that there is a wide difference of opinion on the whole question of reserves. He asks why there should be an increase in reserves on time deposits from 6 per cent to 10 per cent. There is the problem of competition with the mutual savings banks.

Szymczak. The simplicity of increasing the time deposit requirement was the cause for the suggested increase.

McCabe. The president of a large bank has said that the supervisory authorities are not on the job in watching loans more critically.

Fleming thinks the examiners have been more critical in their examinations.

Szymczak. It is probably not possible to have an examiner consider a loan with inflation in mind. Just what is an inflationary loan?

McCabe says that he is much concerned over this discussion and the wide difference of opinion between the Council and the Board on the matter. He has only been a member of the Board of Governors about twelve days. The Board has made a recommendation to Congress, and the Council thinks the recommendation is wrong. McCabe states that he will be called to testify in Congress, and they will ask him, knowing the viewpoints of the Council and the Board, "What is your (McCabe's) viewpoint?" If we assume the inflationary spiral is up 4 per cent or 5 per cent, what position should he take before Congress? McCabe asks the Council's advice. He states that the Administration is asking for controls, and another group opposes controls. What should he (McCabe) suggest? He believes Ralph Young's estimate shows deposits will increase $8 billion to $10 billion during the balance of the year from the low point this year.

E. E. Brown states that the question of the direction of our economic trend will depend considerably on agricultural prices. The question of the direction of our economy is a delicate one, but it is

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possible that the peak of the inflation may be over. However, if we have tremendous expenditures for guns, movements of ground troops, and similar items, we may have a strong inflationary development. E. E. Brown does not accept McCabe's assumptions.

Fleming states that he agrees with Senator Taft that the economic trend is often not as bad as the estimates had indicated it might be. He states that the effect of an inflow of gold of perhaps $1.5 billion in 1948 can be offset.

Burgess states that the Open Market Committee may offset gold imports by selling United States securities or letting them run off without replacement.

Fleming. Even with increased expenditures, the budget may be balanced. The deposit increase this year may not be over 3 per cent. His bank has large swings, as all banks have, and they must take care of these swings. He mentions that the estimate of Woodlief Thomas on the possible increase in loans for the first quarter was considerably larger than the increase which actually took place. Fleming says that if he saw anything in the situation that would seriously affect the economy, he would favor higher reserves. However, he does not see any need for these powers now.

Szymczak. The Council has given the Board nothing in writing which the Board can send to Congress in connection with mortgage credit.

E. E. Brown reports that he testified regarding mortgage credit before the Tobey Committee and the Joint Committee on the Economic Report.

Fleming reports that he gave similar testimony.

Szymczak also wishes the Council might speak on consumer credit.

Fleming says the trouble with consumer credit is not with the banks. He believes it was wrong to have the testimony by the Board before the Joint Committee on the Economic Report on April 13, 1948, in connection with higher reserves, as the testimony was given just before the new Chairman was confirmed, and placed him in an unfortunate position.

Szymczak mentions that the Board had prepared a statement for Congress last November, and the new Chairman would have been in the same position regardless of the statement before the Joint Committee on the Economic Report on April 13, 1948.

Odlin believes that too much emphasis is being placed on the need for higher reserves when other factors are the basic cause of our trouble.

Atwood asks whether McCabe would find it desirable to have a study made of the over-all question of reserves.

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McCabe reports that he is sending a letter to the Federal Reserve banks, asking for their opinions on the matter of reserve requirements, just as he asked the Council today.

Szymczak. There was no desire on the part of the Board of Governors to appear before the Joint Committee on the Economic Report, but the Board was asked to make a statement.

Fleming says that he has sympathy with McCabe on his problem.

Burgess states that he appreciates the position in which McCabe has been placed, and suggests that there are three problems: (1) an economic problem; (2) a political problem in Congress; and (3) a political problem with banks. The Chairman of the Board of Governors is really the titular head of the banking system of this country. If all of us work together, the problem that confronts us can be met. The last time it was considered, we went with a joint recommendation. Burgess believes that the weak argument of the Board is their argument that they have no powers. He thinks that the argument may arise because of the feeling during the war that the government bond market was untouchable. The open market action in December was powerful medicine, and it did not hurt the government bond market. From the point of view of the economic problem, nothing would be lost by postponing action. From the standpoint of the political problem in Congress, a proposal to increase reserves would almost certainly lead to much argument. In connection with the third problem, the political problem with banks, the Chairman of the Board might jeopardize his leadership. It is desirable for the Board to support Eccles on short term rates and also to support him in his views on mortgage credit. However, in connection with the proposals Eccles made on reserve requirements, McCabe may say that it is a highly controversial subject among bankers and economists, and he would like to defer action on it until he has given the subject thorough consideration.

E. E. Brown comments that in Mexico where banks are subject to a 50 per cent cash reserve, they have had inflation and they have a severe recession now. A decline, even to 99½ in the government bond market, would have a tremendous effect, and a drop to 90 might seriously injure the banking system. A small change in government bond prices would have an important effect. E. E. Brown believes McCabe can state that he thinks sufficient powers are in the hands of the Board now, and that he desires to give more study to the particular question of reserves.

Odlin. Credit arises out of the demand of the people for the credit. If banks do not extend credit, the prospective borrowers will obtain it from the government, and it will be more inflationary than bank credit.

Clayton asks, in relation to Odlin's comment, whether it is hopeless ever to ask for a control of credit. He says someone has stated that we should not have higher reserves if we have no expansion, and

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someone else has said if we do expand, we should not have higher rese... Is one to judge from these comments that either way, no higher reserves are advisable?

E. E. Brown. If there are very large military expenditures for large numbers of ground troops, then it may be necessary to prohibit the manufacture of goods of various kinds in order to maintain an orderly economy. A control of credit might be advocated if there were a large speculative expansion of credit in banks.

McCabe expressed the appreciation of the Board for the Council's viewpoint on the various questions on the agenda. He hopes that the Executive Committee of the Council will be ready to meet on short notice, if necessary, with the Board.

E. E. Brown replies that the Executive Committee can meet with the Board upon a few days' notice.

The meeting adjourned at 12:50 p.m.

(It was agreeable both to the members of the Council and the Board to have the next meeting on September 19-21, 1948.)

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The Council reconvened in Room 654 of the Mayflower Hotel at 3:00 p.m. on April 27, 1948. All members of the Council were present, except Mr. Penick, who had plane reservations requiring his departure.

There was a discussion on the advisability of giving the Board of Governors a written statement of the Council's viewpoint on the present situation in the financing of housing and real estate. The Board of Governors had indicated that a statement from the Council would be appreciated, and might be sent to the proper Committees of Congress by the Board in support of the Board's position on these matters.

After some discussion, votes were taken on the following questions:

(1) Does the Council wish to make any statement at this time?
All members of the Council but one were in favor of making a statement.

(2) If the Council desires to make a statement, should the Council associate itself with the Board's viewpoint?
All members of the Council were in favor of associating the Council with the statement of Chairman Eccles on housing finance before the Joint Committee on the Economic Report on November 25, 1947.

(3) Does the Council favor making a statement independent of the Board?
In view of the Council's vote on question (2), this question proved unnecessary.

The Council asked Burgess to draw up a statement which the Board might present to Congress as the Council's viewpoint.

The Council then adopted the following resolution which was sent with the letter below to the Secretary of the Board of Governors:

Resolution Adopted by the Federal Advisory Council
on
April 27, 1948

The Board of Governors has asked the judgment of the Council on the housing situation and on the position taken by the Board on the financing of housing programs.

The Council is in general agreement with the analysis of the problem stated by Mr. Eccles before the Joint Committee on the Economic Report on November 25, 1947.

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The desired objective is to build as rapidly as possible the housing veterans and others so urgently need of sound quality, and at prices they can afford to pay and retain ownership. The capacity of the building industry is limited. Attempts to force building beyond that capacity by excessive loans or unsound subsidies lead to shortages of labor and materials, higher prices, and poor quality construction by speculative and unqualified builders. We approve the specific suggestions on housing legislation now before Congress in the Board's letter of April 5, to Senator Tobey.

Washington, D. C.

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April 30, 1948

Mr. S. R. Carpenter, Secretary
Board of Governors of the Federal Reserve System
Washington 25, D. C.

Dear Mr. Carpenter:

You will please find enclosed a Resolution of the Federal Advisory Council with reference to the financing of housing.

The Board of Governors may feel free to use this Resolution in connection with the hearings of any Congressional Committee on this subject.

Very sincerely yours,

Herbert V. Prochnow
Secretary

The meeting adjourned at 4:00 p.m.

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