MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

September 19, 1948

The third statutory meeting of the Federal Advisory Council for 1948 was convened in Room 375 of the Mayflower Hotel, Washington, D. C., on Sunday, September 19, 1948, at 2:00 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

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 28, 29, 30 and 31, of these minutes.

The meeting adjourned at 5:45 P.M.

HERBERT V. PROCHNOW
Secretary.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

September 20, 1948

At 10:30 A.M., the Federal Advisory Council reconvened in Room 375 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 28, 29, 30 and 31, listing the agenda items with the conclusions reached by the Council. The *Memorandum* was delivered to the Secretary of the Board of Governors at 12:40 P.M. on September 20, 1948.

The meeting adjourned at 12:30 P.M.

HERBERT V. PROCHNOW
Secretary.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL ADVISORY COUNCIL RELATIVE TO THE AGENDA FOR THE JOINT MEETING ON SEPTEMBER 21, 1948

1. The House Banking and Currency Committee has twice reported favorably and the House in the recent special session approved a proposal to restore the former ratio of required gold certificate reserves held by Federal Reserve Banks of 40 per cent against Federal Reserve notes and 35 per cent against Federal Reserve Bank deposits. In view of the possibility that this proposal may again be advanced in the Congress, the Board would like to know what the attitude of the Advisory Council would be toward it.

2. In the light of developments in the monetary and credit field since the Council met with the Board in April, what is the Council's judgment as to the effectiveness of policies of restraint so far adopted and what would be the Council's recommendations as to appropriate further action?

3. The use of Federal Reserve powers to raise reserve requirements.

4. The policy of supporting the government security market, especially in relation to sales by insurance companies.

Items two to four on the agenda, which are of the greatest importance, are so closely inter-related that the Council believes it best to consider them first and together.

Although there are many soft spots in the economy at present, the members of the Council feel that there is not as yet convincing evidence that the turn has been made, and that it is still the duty of the monetary authorities to take active measures to combat the inflationary trend.

On previous occasions the Council has emphasized that the primary causes of the inflation are largely outside the sphere of Federal Reserve policy, and include large government expenditures, especially for defense, foreign aid and veterans' assistance; the support of farm prices at high levels; government guarantees for housing at excessive costs; and repeated wage increases which have not been accompanied by comparable increases in production.

Specifically in relation to the questions raised by the items two to four on the agenda, the following statements represent the views of the Council at the present time:

A. The Council believes the increases which have taken place in the rediscount rate and in the certificate rate have been particularly helpful toward reducing the demand for credit by making both bankers and borrowers aware of the dangers in the present situation. Further increases in the rediscount and certificate rates should be considered if credit expansion continues.

B. It is too early to appraise the full effect of the recent increase in reserve requirements. The first effect has been to cause member banks to sell government securities to the Federal Reserve Banks. In view of the already large holdings of the Federal Reserve Banks, this action has raised the question in many peoples' minds of the future level of government bond prices and the future ability of the Federal Reserve Banks to maintain pegged prices.

Under present circumstances, of existing conservative lending policies by banks, the near absence of excess reserves, and Federal Reserve and Treasury policies of pegged prices for government securities, the Council reiterates its position that the increase of reserve requirements of banks is not a suitable instrument of credit control.

C. The Council is concerned with respect to the selling of government securities by insurance companies and other investors, in many cases to relend at higher rates. This selling is encouraged by pegged prices at a level which may offer the seller a profit as compared with the purchase price.

All the members of the Council feel that owing to the size of the debt and it-position in our whole economy, government bonds must be supported. A majority of the Council favors presently maintaining the peg at par, but not at a premium, on the long term 2½ per cent bonds. A minority of the Council favors even greater flexibility.

D. In relation to item one on the agenda, apart from the tense international situation, the Council favors in principle raising the required gold reserves from the present ratio. However, in view of the present international situation, the proper timing of an increase in required gold reserves is of the utmost importance and demands the most careful consideration. It is impossible that any legislative action will be taken before the organization of Congress in early 1949, and the Council will be glad to review this question later in the light of the situation then.

5. The gold policy of the Federal Reserve System and the Treasury, including the procedure with respect to gold exports and imports.

The Council desires to defer the discussion of this subject to a later date when it can be fully considered. In general, it believes that the movements of gold, including the transfer of gold by foreign central banks, should as far as practicable be removed from discretionary authority. The Council would be interested in knowing whether there have been occasions when licenses have been denied to foreign central banks for the transfer of gold. The Council also feels it would be desirable to examine our whole gold policy and the present legislation regarding gold, and it would welcome any data and information from the Board of Governors which would be helpful in such a study.

6. Policies of the Board of Governors in enforcing regulation of consumer credit.

Without discussing the necessity or desirability of the legislation on consumer credit, the regulations issued by the Board of Governors appear to the Council generally reasonable and fair and well received. Since the terms are similar to those already being followed by banks the effect on loans directly by banks to installment borrowers will be slight. Principal criticisms of the regulations now appear to come from dealers in furniture and used cars.

7. The Board of Governors would appreciate any further views and comments the Council may have regarding proposed Bank Holding Company legislation.

In connection with the proposed bank holding company legislation, the Council adopted the following resolution on May 20, 1947:

RESOLUTION

The Council for the past few years has at almost every meeting discussed the holding company situation, the inadequacies of existing legislation, and proposals for additional legislation in connection with it.

(1) The Council believes that holding company legislation should be enacted at this time. Experience has shown that the present legislation is inadequate and that additional legislation is urgently necessary.

(2) It approves the general approach to the holding company problem embodied in Senate Bill 829.

(3) It believes Senate Bill 829 should be amended—

(a) By adding to the declaration of policy and the standards for Federal Reserve Board, Comptroller of the Currency, and Federal Deposit Insurance Corporation action a more definite statement of objectives and standards. (A memorandum is attached which was the subject of discussion between the Board of Governors and the Federal Advisory Council which indicates the type of amendments in this regard which the Council believes necessary.) [The memorandum follows below.]

(b) By granting tax exemption to such holding companies as are required to divest themselves of non-banking assets. Simple justice requires that such tax exemption should be granted, and a precedent exists for it in the utility holding company legislation.

(c) By requiring a larger percentage than 10 per cent of the ownership of stock in two or more banks in order to create an automatic holding company relationship.

(d) By providing that incidental ownership of bank stocks in fiduciary capacities such as executor, trustee under a will, etc., should not create an automatic holding company relationship.

The Council urges the Board to submit amendments in accordance with these suggestions and to press for the enactment of the bill as so amended.

* * * * *

MEMORANDUM

SUBMITTED IN CONNECTION WITH THE FOREGOING RESOLUTION

1. To reach and regulate any banking operation which, functioning in an area or with a structure larger than that permitted to independent banks, can or does, through the medium of concentrated control, jeopardize independent competitive banking at local or regional levels or place independent banks under the particular circumstances at a competitive disadvantage;

2. To confine the size and expanse of any such banking operation, regardless of its competitive or other aspects, within limits consistent with adequate and sound banking; and

3. To control the magnitude and expanse of any such banking operation, regardless of all other considerations, to the end that, in the event of adverse general economic conditions, such an operation will not be subjected to any inordinate pressure arising from unwieldiness due solely to mere size and expanse which, in turn, may put an inordinate pressure on the nation's banking structure.

* * * * *

On February 17, 1948, the Council adopted the following resolution regarding bank holding company legislation:

RESOLUTION

"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 by 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 Council reaffirms the position it took on bank holding company legislation as expressed in the above resolutions, and favors the enactment of such legislation at the next session of the Congress.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

September 20, 1948

At 2:30 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. Woodlief Thomas, Director of the Division of Research and Statistics of the Federal Reserve System discussed the subject, "Is Inflation Approaching an End?"

The meeting adjourned at 4:00 P.M.

HERBERT V. PROCHNOW
Secretary.

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

September 21, 1948

At 10:40 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 Marriner S. Eccles, M. S. Szymczak, Ernest G. Draper, R. M. Evans, and James K. Vardaman, Jr.; also, Mr. Winfield W. Riefler, Assistant to the Chairman, and 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.

President Brown read the first four items on the agenda with the conclusions as given in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council*, as printed on pages 28, 29, 30 and 31, in these minutes.

Chairman McCabe then read the following statement relative to the various items on the agenda:

"Items 2-4, Points A, B, and C.—Concerning the economic situation, the Board's general view coincides with that of the Council, namely, that despite soft spots in the economy at the present time, the outlook is on balance inflationary and that 'it is the duty of the monetary authorities to take active measures to combat the inflationary trend.' (President Brown asked Chairman McCabe's permission to state that the Council did not make the specific comments which Chairman McCabe gave. President Brown read the following paragraph from the Council's Confidential Memorandum: 'Although there are many soft spots in the economy at present, the members of the Council feel that there is not as yet convincing evidence that the turn has been made, and that it is still the duty of the monetary authorities to take active measures to combat the inflationary trend.') The Board continues to recognize that there are special factors outside the field of banking and credit that have promoted inflation. In addition to those listed by the Council, the Board would include high corporate profits and it would like to emphasize greatly the position created by the disappearance of the Federal surplus. This surplus during the past two years has been the most powerful anti-inflationary factor in the picture, but it has been offset by other factors, notably by the expansion of bank loans. In the absence of a budget surplus, an expansion of bank credit in the coming year similar to that of the past year would have much greater inflationary effects.

"The Board has considered the suggestion of the Council that the peg on the long-term 2½ per cent bonds be maintained at par without a premium. The Board is in agreement with the majority of the Council that the long-term yield on Treasury bonds should be maintained for the foreseeable future at a 2½ per cent yield level, but believes that under present circumstances removal of the small premium would very probably have undesirable consequences. It may be that the establishment of support levels at exactly par last year would have been wiser, but removal of this small difference at the present time might undermine confidence in the whole support pattern.

"The Board notes that a minority of the Council is in favor of a more flexible policy with respect to the support program, and agrees that greater flexibility in the short-term market is a desirable objective. Increases in certificate rates and discount rates to date are beginning moves toward this objective which the System initiated.

"The Board has long recognized that the maintenance of support for the bond market has greatly limited the effectiveness of credit-control methods. It feels that recent increases in short-term rates have been helpful, particularly in inducing the banks and others to buy short-term securities to absorb excess reserves. In the presence of strong demands for credit, however, higher short-term rates cannot be relied upon as adequate in restricting credit expansion.

"The Board recognizes that increased reserve requirements with a complete peg in the Government securities market have less restraining effect than would otherwise be expected. It wishes to call to the Council's attention that one of the principal purposes of requesting Congress to give additional power to the Board to increase member bank reserve requirements was the need for absorbing additional reserves being created by the inflow of gold, by purchases of securities from non-bank holders, and by a possible return flow of currency. The current use of this authority will have the effect of increasing member bank reserve requirements by about 2 billion dollars. Since the System has purchased more than this amount of securities from non-bank holders during the past two months and will probably purchase substantial additional amounts in the immediate future, the higher requirements should not result in any net reduction in the earning assets of commercial banks. Although some banks will need to sell some Government securities in order to meet the change, the effect of the increase will be to prevent additional reserves which have become available from increasing the ability of banks to expand credit but not to reduce the lending capacity of the banks below previous levels.

"Item 1, Point D.—The Board has noted the Council's position on raising the required gold reserves from the present ratio. Its own thinking on this matter has been fully expressed in memoranda or testimony to the Banking and Currency Committees of the Congress.

"Item 5. There have been discussions between representatives of the System and of the Treasury regarding the United States gold policy, with particular reference to the possibility of relaxing or removing controls on the transfer of gold by or for foreign central banks. After extended discussions, however, it did not appear feasible for the Treasury to relinquish entirely its control over gold transactions, especially in view of the current unsettled international situation. The Board plans to review this problem from time to time and to hold further discussions with the Treasury when conditions warrant. To the extent possible, in the light of its confidential character, the Board will be glad to supply the Council with further information on the subject as a basis for future study and discussion."

* * * * *

On the question of the regulation of consumer credit, Chairman McCabe stated that the Board appreciated the views of the Council and wished to assure the members of the Council that if, at any time, they had suggestions as to policies that might be followed in regulating consumer credit, the Board would be pleased to consider them.

Chairman McCabe also stated that in connection with bank holding company legislation a series of conferences had been held by members of the Board, with representatives of bank holding companies and of the American Bankers Association, and he expected that additional conferences would be held with representatives of the Association of Reserve City Bankers and with the bank supervisors.

Mr. Williams asked whether the members of the Board had discussed with the heads of insurance companies the question of selling bonds from their portfolios, and Chairman McCabe reported that the matter had been discussed informally with individual heads of the insurance companies, but that it had not been discussed with insurance company heads as a group.

Dr. Burgess stated that in connection with the question of inflation, one of the major causes continues to be the expenditures for new capital goods.

President Brown read the conclusions of the Council relative to the gold policy of the Federal Reserve System and the Treasury, as given in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council*, as printed on pages 28, 29, 30 and 31, of these minutes.

The President of the Council then read the agenda item regarding consumer credit, together with the conclusions of the Council as given in the *Confidential Memorandum* mentioned above.

There was a brief discussion regarding Bank Holding Company legislation, the Council having expressed its opinion in the *Confidential Memorandum* previously mentioned.

The meeting adjourned at 12:55 P.M.

HERBERT V. PROCHNOW
Secretary.

NOTE: This transcript of the Secretary's notes is not to be regarded as complate 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 September 19, 1948, at 2:00 P. M. in Room 375 of the Mayflower Hotel, Washington, D. C. All members of the Federal Advisory Council were present.

THE HOUSE BANKING AND CURRENCY COMMITTEE HAS TWICE REPORTED FAVORABLY AND THE HOUSE IN THE RECENT SPECIAL SESSION APPROVED A PROPOSAL TO RESTORE THE FORMER RATIO OF REQUIRED GOLD CERTIFICATE RESERVES HELD BY FEDERAL RESERVE BANKS OF 40 PER CENT AGAINST FEDERAL RESERVE NOTES AND 35 PER CENT AGAINST FEDERAL RESERVE BANK DEPOSITS. IN VIEW OF THE POSSIBILITY THAT THIS PROPOSAL MAY AGAIN BE ADVANCED IN THE CONGRESS, THE BOARD WOULD LIKE TO KNOW WHAT THE ATTITUDE OF THE ADVISORY COUNCIL WOULD BE TOWARD IT.

E. E. Brown reviews some of the changes that have taken place in banking since the last meeting of the Council in April 1948. He mentions, particularly, the special session of Congress, the legislation regarding reserve requirements, and the recent action of the Board of Governors in increasing the reserves on demand and time deposits.

Spencer asks whether there is penalty in the proposed legislation if the gold reserves should decline below the required ratio.

E. E. Brown believes the situation would go back to what it was prior to the decrease in the reserves. He explains that because of the payment now of the earnings of Federal Reserve banks to the Treasury that the practical effect of the action would be largely psychological.

Fleming raises the question of whether this proposed gold reserve legislation may not have some relationship to the support of government bond prices.

Odlin believes that if the gold reserves fell to a point where they approached the required ratio or fell below the required ratio, legislation would be introduced to lower the ratio.

Burgess states that he testified before Congressional hearings, as the President of the American Bankers Association, when the question of changing the gold reserve ratio was up for consideration. The real argument is whether the proposed legislation would be a good influence on the operation of the banking system.

The policy of the Treasury and Federal Reserve authorities has been one of being too late with too little. The Federal Reserve System is not an ideal system, as it is operated by human beings. Consequently, he believes it would be a wholesome influence if the gold reserve requirements were raised.

Penick asks what effect the proposed legislation would have on the bond market.

Burgess. We are dealing with an inflationary situation and the brakes should be put on.

Fleming asks what the situation would be if the savings bond holders should seek to redeem their bonds in large numbers.

Odlin says he thinks there is a danger that persons who are uninformed may seek to redeem their bonds in large numbers, and therefore it is better to keep the lower ratio of gold reserves.

Spencer thinks the penalty provision is important. He would like to see the higher gold reserves.

Odlin believes that raising the gold reserves would be desirable, but actually he believes the ratio would be lowered in case of necessity.

J. T. Brown thinks it is desirable to raise the gold reserve ratio.

Woods states that psychological benefits might result by raising the gold reserve ratio, but if the ratio must be lowered again later to support the bond market, it may not be desirable now to increase the ratio. He believes that if bond prices fell below par, many savings bond customers might be concerned about their bonds.

Atwood comments that the gold reserve ratio is somewhat of a theoretical matter and would be lowered again if necessary. Consequently, he questions whether there is any real necessity for raising the ratio now.

McCoy is inclined to believe that the higher gold reserve ratio might help government bonds.

Williams favors the restoration of the former gold reserve ratio.

Penick does not favor the restoration of the former gold reserve ratio.

Kemper believes this matter is related to other economic and banking problems, and he thinks it is time to show some courage. Raising the gold reserve ratio might tend to prevent the sale of government bonds. He does not believe the inflation has tapered off. Kemper thinks it would be desirable to let the prices on long term government bonds drop. He believes the gold certificate reserve ratio should be increased, if not to the former level, then perhaps to 30 per cent and 35 per cent.

Fleming. The benefits are entirely psychological, and any drop in the gold reserve ratio later would be bad psychology.

E. E. Brown. The benefits would be psychological, but Brown prefers discussing it at a time when it would be more pertinent, perhaps some time shortly after the next session of Congress begins.

Fleming. In a shooting war with Russia, we would not think of raising the gold reserve ratio.

IN THE LIGHT OF DEVELOPMENTS IN THE MONETARY AND CREDIT FIELD SINCE THE COUNCIL MET WITH THE BOARD IN APRIL, WHAT IS THE COUNCIL'S JUDGMENT AS TO THE EFFECTIVENESS OF POLICIES OF RESTRAINT SO FAR ADOPTED AND WHAT WOULD BE THE COUNCIL'S RECOMMENDATIONS AS TO APPROPRIATE FURTHER ACTION?

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THE USE OF FEDERAL RESERVE POWERS TO RAISE RESERVE REQUIREMENTS.

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THE POLICY OF SUPPORTING THE GOVERNMENT SECURITY MARKET, ESPECIALLY IN RELATION TO SALES BY INSURANCE COMPANIES.

E. E. Brown states the three agenda items above are so closely related that it would be desirable to consider them at the same time.

Burgess. Some of us who were in Washington when these subjects were under discussion advocated a higher certificate rate and a higher discount rate. The most satisfactory arrangement that could be worked out at the time on reserves was 4 per cent on demand deposits and one and one-half per cent on time deposits. The higher certificate rate and the higher discount rate have helped banks to raise their rates on loans. Raising the reserves has resulted in banks selling government securities to the Federal Reserve banks. The whole matter has brought into focus the question of support prices. Much of the inflation today is in farm prices, real estate and capital goods projects, and much of it is financed by the sale by insurance companies of government securities. A great deal more inflation is resulting from the sales of governments and relending of the funds by insurance companies than from bank credit. There is perhaps not much advantage now in making another attack on short term rates. The real question is the support of government bond prices at these levels. It is not desirable to abandon all support. However, if bond prices fell, say to 99, the insurance companies would screen their loans more carefully.

E. E. Brown asks the members of the Council to express their opinions regarding price trends in their respective districts. He states that some agricultural prices are down and that coal and oil prices are tending downward. He also asks the members of the Council to express their opinions on the demands for credit in their districts. He states that the demands for credit in his district for various capital projects are down.

Williams says prices are tending downward for various products. He has not noticed any particular decline in the demand for credit. He is inclined to believe that various items in the federal budget, such as those relating to foreign aid, veterans' payments and defense expenditures, help to assure a continuance of the inflationary trend.

E. E. Brown. In expressing their opinions the members of the Council may wish to answer four questions: (1) Should the discount rate be further raised?; (2) Should reserve requirements be increased further?; (3) Should there be a change in the support price of bonds?; and (4) What are your observations on the demand for credit in your district?

Odlin. The demand for credit has lessened on the Pacific Coast. The gain in loans has been in consumers' paper and in real estate. Interest rates have gone up and there have been no complaints by customers. Odlin believes we may have more of the inflation digested than we may think. Some softening is being experienced in lumber prices and in plywood and doors. He asks whether the pressure of the insurance companies is not partly due to the desire to invest new funds.

Burgess. Yes, but the sale of governments is an important factor in the situation.

Odlin does not believe the rediscount rate needs to be tied so closely to the short-term rate. He thinks it might be raised. He does not believe raising the reserves had any real benefit, but thinks it merely transferred bonds from the banks to the Federal Reserve banks. He says it would probably be impossible to get an agreement to drop the peg, and he cites Senator Taft's comments in the hearings about how important the peg is considered by most people. If the peg disappears, Odlin thinks there may be heavy selling by "E" bond-holders. Any advantage in dropping the peg might be more than offset by "E" redemptions. He asks whether it would not be possible for the Open Market Committee of the Federal Reserve System to put the peg at par and charge a penalty, perhaps of one-fourth of one per cent, on purchases from institutions.

E. E. Brown. Rouse, manager of the System's Open Market Account, has indicated that he would not like to be responsible for the market if the bonds were dropped to par.

Kemper. The matter should not be considered on a par basis. It is a matter of yield.

Spencer says the situation in textiles and in shoes is spotty and there is some unemployment in his district. The tentative demand for loans is off. Raising the reserves merely transferred bonds from the banks to the Federal Reserve System. He believes that the bonds need some support and that the peg could not be pulled entirely. Further raising of the reserves would not have any important effect except possibly to keep out any speculative loans. Spencer is inclined to believe that the rediscount rate will be steadily raised.

J.T.Brown. In the sixth district there has been no appreciable increase in the demand for bank credit, except seasonal credit. The prices of cottonseed and cottonseed oil are down. There should be some method by which to stop the insurance companies or the non-bank holders from dumping their bonds on the market. After all, the Federal Reserve System is a bank organization and is set up to service the banks and not private industry. If something must be done in order to prevent the continuous dumping by non-bank holders, perhaps the peg could be kept on eligible bonds and the others be permitted to seek their own level. J. T. Brown does not favor any further increase in the reserve requirements. He does not think that the recent increase has had the effect it was felt it would have.

Woods. The compaign by banks to watch their credits was helpful and raising reserve requirements was also helpful, even though it was only psychological. The banks have placed themselves in better condition. Woods does not favor increasing reserves more at the present time. He thinks regulation "W" will be of assistance in restricting credit. He does not believe it is desirable to remove the government bond peg, but he sees no reason to pay a premium.

Atwood. There is a deflation in agricultural prices and its effects are obvious. Bumper crops have helped to decrease farm prices. The prices of older houses are also down somewhat. Atwood does not believe that higher reserves, or a higher rediscount rate, are desirable now. In connection with the pegging of bond prices, he does not think that "E" bonds would be sold in large volume if the peg were lowered. The demand for loans is not up, except seasonally, and not seasonally as much as usual.

McCoy. The shortage of all kinds of labor in his district is great. New construction in housing is heavy. There is only a small increase in bank loans. Banks are having difficulty in hiring employees. The volume of business of the shoe industry is down. The raising of bank reserves did not do any good, except that this action, together with raising the rediscount rate, helped increase the rates on bank loans. He believes the bonds should be kept at par.

Penick says there is no slackening of the inflation in his district. Heavy cotton and rice crops will create demands for loans, especially in Arkansas. He believes the question of supporting bond prices is a political question and will not necessarily be settled by bankers. The peg on bond prices might be dropped eight-thirty seconds to par, but not two points. He thinks the Board of Governors had to act in connection with raising the reserves. The Board asked for more power and it got four points on demand deposits and one and one-half points on time deposits. Having received additional power, the Board felt it had to act, and it may feel it has to act again before the election.

Fleming believes with Penick that the bond peg is somewhat of a political question now. He thinks the Board undoubtedly felt it had to raise the reserves; the Board asked for ten points and got four, and consequently had to take some action. The Board may feel impelled to act to raise the reserves again in order to meet the argument that they are not using their powers. He believes this administration will hold the bond peg and will not go below par. Fleming believes the support price around par must be kept. He thinks the insurance companies have been responsible for credit expansion with their sale of securities and their term loans. There is still heavy building in his district. Business loans are not up. There is a weakness in cotton textiles. He would like to see the Council suggest raising the rediscount rate. He favors supporting bond prices, and he believes if the bonds go below par some holders will sell because they will anticipate a further decline.

Kemper. The tenth district has the second biggest wheat crop and the largest corn crop in history. Prices may be down, but the total income will be up. He notices the prices of automobiles and farm equipment are higher. There is very little resistance to the sale of older houses. Kemper does not advocate pulling the bond peg entirely. He would not be inclined to drop it piecemeal, but he would favor a drop of perhaps five points overnight, which he believes would dry up selling. He thinks raising the reserve requirements is futile as long as the bond peg is kept. Raising the reserves and the rediscount rate helped the banks to increase their rates on loans, but brought no real benefit to the economy.

Fleming thinks that dropping the bond price below par may lead to much selling.

Kemper adds that sales of Buick, Pontiac, and Olds automobiles are down in his district, but this is due to a steel shortage.

Fleming asks whether the real crux of the situation is not in the government support of farm prices.

E. E. Brown does not favor letting the price of long term bonds go below par. He thinks that raising the reserve requirements acted as somewhat of a check on the inflationary trend. Brown summarizes the viewpoints of the Council as follows: The majority of the Council favors maintaining the peg at par, or close to par, on the longer-term two and one-half per cent bonds; a strong minority favors dropping the peg but recognizes that all support cannot be removed; all memebers of the Council believe a further rise in the reserve requirements would be undesirable now; all members of the Council agree that the recent action raising reserves was hasty and more than necessary; the increase in the rediscount rate was desirable, and a further increase in the rediscount rate may be desirable, depending on the course of events.

McCoy asks how the Board determined the amount by which to raise reserves and points out that the one and one-half per cent increase on time deposits was larger percentage-wise than the increase on demand deposits.

E. E. Brown states that it probably was due to the fact that the excess reserves have been largely in the country banks which have substantial savings deposits. The Board would probably not admit it publicly, but the substantial percentage-wise increase in reserves on time deposits may have been due to the desire of the Board to reach the excess reserves in the country banks. In connection with the question of the gold reserve ratio, Brown believes that it would be best to defer a full discussion until the new Congress organizes.

Penick points out that five or six members of the Council may go off the Council at the end of the current year.

Atwood and Odlin state that they understand the Board or some other group has recommended that membership on the Council be rotated every three or four years.

Burgess says the thing which troubles him is that the country is in one of its greatest inflations. He asks what is being done to meet it?

Spencer. To answer that question we would have to criticise the government's program.

Odlin. The question of the inflationary trend is one that relates to fiscal policy and not essentially to monetary policy. The probabilities are that the government authorities will not act.

E.E. Brown states that it is a question of fiscal policy and relates to the support of farm prices, large expenditures for defense, foreign aid and veterans assistance, as well as government guarantees for housing at excessive costs. In connection with the gold reserve ratio, Brown asks how many favor raising the ratio, not necessarily to the percentages indicated in the agenda item on this point. The vote shows that five favor raising the gold reserves, five are opposed and two are not voting.

Odlin thinks the Council might list increasing the gold reserve ratio as one of the desirable steps to take in a complete program.

E.E. Brown. Apart from the tense international situation, how many members of the Council would favor raising the gold reserve ratio? A great majority of the Council votes in favor of it. In view of the present international situation the timing would have to be carefully watched. The Council is divided on the question as to whether it would be desirable to do it now.

Burgess states that one of the advantages of raising the gold reserve ratio would be the beneficial effect on the Board. Now they tend to act from political motives. The psychological effect on the Board as the result of raising the gold reserve ratio would be good. From the standpoint of the public also, having a 40 per cent gold reserve against Federal Reserve notes would have a good psychological effect. The position of the American dollar should be protected.

E. E. Brown. No action could be taken before early 1949, and the international situation may change in the meantime. The Council may state it would be glad to review the question in the light of conditions at that time.

THE GOLD POLICY OF THE FEDERAL RESERVE SYSTEM AND THE TREASURY, INCLUDING THE PROCEDURE WITH RESPECT TO GOLD EXPORTS AND IMPORTS.

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

Burgess states that it is too early to permit American citizens to hold gold. If a foreign bank wishes to sell us gold, a license is necessary. Our authorities grant these licenses, but it should not be necessary to request permission. The Secretary of the Treasury now can buy and sell gold at any price he wishes. The buying and selling of gold should be automatic. The Gold Reserve Act of 1934 should be amended.

E. E. Brown. The discretionary powers of the authorities over gold should be amended.

Burgess. The Council may state that it desires to defer the discussion of this subject to a later date when it can be fully explored. The Council may advise the Board that it is interested in the whole gold question and would like complete data and information from the Board of Governors which would be helpful in a study of the question. There have been constant rumors by foreigners about a change in our gold price.

E. E. Brown. The Council may inform the Board that it would like to discuss the question at a later meeting. The Council may also ask the Board whether there have been occasions when licenses have been denied to foreign central banks which desired to transfer gold.

POLICIES OF THE BOARD OF GOVERNORS IN ENFORCING REGULATION OF CONSUMER CREDIT.

Burgess wishes to know whether the Board has found that the regulations have been well received and whether there seems to be a willingness to comply with them. Those handling these credits think the regulations will have little effect.

Odlin understands from conversations with people handling these credits that the regulations will probably have little effect.

E. E. Brown. Dealers in furniture and in used cars are opposed to the regulations. Manufacturers of new cars do not seem to believe the regulations will hurt their business.

Spencer asks how deliveries are being made on new cars.

E. E. Brown replies that cars selling over $3,000, except perhaps Cadillac, are being delivered almost immediately.

Burgess. On the whole, the regulations are reasonable. The Council may report to the Board that criticisms are coming from dealers in furniture and used cars, but in general those effected by the regulations believe they are reasonable.

THE BOARD OF GOVERNORS WOULD APPRECIATE ANY FURTHER VIEWS AND COMMENTS THE COUNCIL MAY HAVE REGARDING PROPOSED BANK HOLDING COMPANY LEGISLATION.

Odlin thinks the Council should reiterate its previous position.

Kemper agrees.

Odlin. We may state we do not believe there is any change in the situation that has led the Council on previous occasions to urge action on the legislation.

E. E. Brown points out that the Council adopted a resolution on May 20, 1947, and another resolution on February 17, 1948, favoring the proposed bank holding company legislation. The Council may call the attention of the Board to these resolutions and may reaffirm the position it took in its resolutions.

The meeting adjourned at 5:45 P. M.

The Council convened at 10:30 A.M. on September 20, 1948, in Room 375 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 September 21, 1948. The memorandum was delivered to the Secretary of the Board of Governors at 12:40 P.M. on September 20, 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 12:30 P.M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON SEPTEMBER 21, 1948

1. The House Banking and Currency Committee has twice reported favorably and the House in the recent special session approved a proposal to restore the former ratio of required gold certificate reserves held by Federal Reserve Banks of 40 per cent against Federal Reserve notes and 35 per cent against Federal Reserve Bank deposits. In view of the possibility that this proposal may again be advanced in the Congress, the Board would like to know what the attitude of the Advisory Council would be toward it.

2. In the light of developments in the monetary and credit field since the Council met with the Board in April, what is the Council's judgment as to the effectiveness of policies of restraint so far adopted and what would be the Council's recommendations as to appropriate further action?

3. The use of Federal Reserve powers to raise reserve requirements.

4. The policy of supporting the government security market, especially in relation to sales by insurance companies.

Items two to four on the agenda, which are of the greatest importance, are so closely inter-related that the Council believes it best to consider them first and together.

Although there are many soft spots in the economy at present, the members of the Council feel that there is not as yet convincing evidence that the turn has been made, and that it is still the duty of the monetary authorities to take active measures to combat the inflationary trend.

On previous occasions the Council has emphasized that the primary causes of the inflation are largely outside the sphere of Federal Reserve policy, and include large government expenditures, especially for defense, foreign aid and veterans' assistance; the support of farm prices at high levels; government guarantees for housing at excessive costs; and repeated wage increases which have not been accompanied by comparable increases in production.

Specifically in relation to the questions raised by the items two to four on the agenda, the following statements represent the views of the Council at the present time:

A. The Council believes the increases which have taken place in the rediscount rate and in the certificate rate have been particularly helpful toward reducing the demand for credit by making both bankers and borrowers aware of the dangers in the present situation. Further increases in the rediscount and certificate rates should be considered if credit expansion continues.

B. It is too early to appraise the full effect of the recent increase in reserve requirements. The first effect has been to cause member banks to sell government securities to the Federal Reserve Banks. In view of the already large holdings of the Federal Reserve Banks, this action has raised the question in many peoples' minds of the future level of government bond prices and the future ability of the Federal Reserve Banks to maintain pegged prices.

Under present circumstances, of existing conservative lending policies by banks, the near absence of excess reserves, and Federal Reserve and Treasury policies of pegged prices for government securities, the Council reiterates its position that the increase of reserve requirements of banks is not a suitable instrument of credit control.

C. The Council is concerned with respect to the selling of government securities by insurance companies and other investors, in many cases to relend at higher rates. This selling is encouraged by pegged prices at a level which may offer the seller a profit as compared with the purchase price.

All the members of the Council feel that owing to the size of the debt and its position in our whole economy, government bonds must be supported. A majority of the Council favors presently maintaining the peg at par, but not at a premium, on the long term 2-1/2 per cent bonds. A minority of the Council favors even greater flexibility.

D. In relation to item one on the agenda, apart from the tense international situation, the Council favors in principle raising the required gold reserves from the present ratio. However, in view of the present international situation, the proper timing of an increase in required gold reserves is of the utmost importance and demands the most careful consideration. It is impossible that any legislative action will be taken before the organization of Congress in early 1949, and the Council will be glad to review this question later in the light of the situation then.

5. The gold policy of the Federal Reserve System and the Treasury, including the procedure with respect to gold exports and imports.

The Council desires to defer the discussion of this subject to a later date when it can be fully considered. In general, it believes that the movements of gold, including the transfer of gold by foreign central banks, should as far as practicable be removed from discretionary authority. The Council would be interested in knowing whether there have been occasions when licenses have been denied to foreign central banks for the transfer of gold. The Council also feels it would be desirable to examine our whole gold policy and the present legislation regarding gold, and it would welcome any data and information from the Board of Governors which would be helpful in such a study.

6. Policies of the Board of Governors in enforcing regulation of consumer credit.

Without discussing the necessity or desirability of the legislation on consumer credit, the regulations issued by the Board of Governors appear to the Council generally reasonable and fair and well received. Since the terms are similar to those already being followed by banks the effect on loans directly by banks to installment borrowers will be slight. Principal criticisms of the regulations now appear to come from dealers in furniture and used cars.

7. The Board of Governors would appreciate any further views and comments the Council may have regarding proposed Bank Holding Company legislation.

In connection with proposed bank holding company legislation, the Council adopted the following resolution on May 20, 1947:

RESOLUTION

The Council for the past few years has at almost every meeting discussed the holding company situation, the inadequacies of existing legislation, and proposals for additional legislation in connection with it.

(1) The Council believes that holding company legislation should be enacted at this time. Experience has shown that the present legislation is inadequate and that additional legislation is urgently necessary.

(2) It approves the general approach to the holding company problem embodied in Senate Bill 829.

(3) It believes Senate Bill 829 should be amended--

(a) By adding to the declaration of policy and the standards for Federal Reserve Board, Comptroller of the Currency, and Federal Deposit Insurance Corporation action a more definite statement of objectives and standards. (A memorandum is attached which was the subject of discussion between the Board of Governors and the Federal Advisory Council which indicates the type of amendments in this regard which the Council believes necessary.) /The memorandum follows on the next page./

(b) By granting tax exemption to such holding companies as are required to divest themselves of non-banking assets. Simple justice requires that such tax exemption should be granted, and a precedent exists for it in the utility holding company legislation.

(c) By requiring a larger percentage than 10 per cent of the ownership of stock in two or more banks in order to create an automatic holding company relationship.

(d) By providing that incidental ownership of bank stocks in fiduciary capacities such as executor, trustee under a will, etc., should not create an automatic holding company relationship.

The Council urges the Board to submit amendments in accordance with these suggestions and to press for the enactment of the bill as so amended.

* * * * *

MEMORANDUM

SUBMITTED IN CONNECTION WITH THE FOREGOING RESOLUTION

1. To reach and regulate any banking operation which, functioning in an area or with a structure larger than that permitted

to independent banks, can or does, through the medium of concentrated control, jeopardize independent competitive banking at local or regional levels or place independent banks under the particular circumstances at a competitive disadvantage;

2. To confine the size and expanse of any such banking operation, regardless of its competitive or other aspects, within limits consistent with adequate and sound banking; and

3. To control the magnitude and expanse of any such banking operation, regardless of all other considerations, to the end that, in the event of adverse general economic conditions, such an operation will not be subjected to an inordinate pressure arising from unwieldiness due solely to mere size and expanse which, in turn, may put an inordinate pressure on the nation's banking structure.

* * * * *

On February 17, 1948, the Council adopted the following resolution regarding bank holding company legislation:

RESOLUTION

"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 by 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 Council reaffirms the position it took on bank holding company legislation as expressed in the above resolutions, and favors the enactment of such legislation at the next session of the Congress.

The Council convened in the Board Room of the Federal Reserve Building at 2:30 P.M. on September 20, 1948, to hear Dr. Woodlief Thomas, Director of the Division of Research and Statistics of the Federal Reserve System.

All members of the Council were present.

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E. E. Brown presents Dr. Woodlief Thomas, who speaks on the subject, "Is Inflation Approaching an End?". A copy of Dr. Thomas' remarks is attached.

The meeting adjourned at 4:00 P.M.

CONFIDENTIAL

IS INFLATION APPROACHING AN END?

After three years of conversion from a wartime economy, the economy of this country, as well as that of the world in general, is still dominated by the economic consequences of war. The vast diversion of resources into the economically wasteful activities of war and the financing of these activities resulted in a shortage of goods and a surplus of money which together have prevented the attainment of economic balance in the postwar world.

We are learning by experience what should be an economic truism; namely, in a price-controlled economy with full employment, money cannot be created for producing goods and services that are not sold on the market without either a rise in prices or the adoption of measures to keep that money inactive.

This principle was not unrecognized in adopting methods of financing the war, and perhaps all that was politically and economically possible at the time was done to prevent the undesirable consequences of war finance both during the war and in the future.

It is evident from subsequent events that not enough was done.

Not only is the vast money supply created in the war being used with increasing activity

But also individuals, business, banks, insurance companies, and others are freely converting into money the Government securities they accumulated during the war.

These uses of war accumulated liquid assets have been much smaller than they might have been -- the inflation could have been much greater. It can still be much greater.

The major question of economic policy is --

Can the necessary adjustments gradually be made so as to level out and continue a high level of income and employment?

In view of the extent to which inflation has already gone, prospects for piecemeal adjustments are not bright.

In any event removal of existing maladjustments cannot be made easier by continuing to feed inflationary forces.

Are these maladjustments already so great that the inevitable adjustment is now imminent?

Or, are the pressures for inflation still so overwhelming that more vigorous restrictive measures will be needed to prevent further creation of distortions that would make the subsequent readjustment disastrous?

In other words: Must the inflationary bubble burst?

What is the nature of factors of instability growing out of the inflation?

The test is one that looks to the future, not to the past. Merely high prices relative to prewar or relative to other goods is not a test of distortion or maladjustment. The tests are whether a given factor:

a. Contributes to or initiates a downturn in general activity, or

b. Aggravates a decline if a decline occurs.

The following factors operate toward instability in varying degrees:

1. High military expenditures.

   a. Any future reduction will have extensive economic repercussions.

   b. Even if military expenditures remain high, they will not necessarily be stabilizing. Such expenditures are dictated by considerations of national security, not by considerations of economic balance.

2. Large export balance, financed to substantial extent by Government loans and grants.

   Likely to be temporary, unless a remarkable state of balance is reached in the world economy.

3. Inventories have been built up

   No need for further large scale accumulation of business inventories

   Consumer stocks are far more adequate than earlier, particularly of durable goods purchases which are deferrable

4. Crops are large and stocks more ample. Present level of important crops is probably excessive on basis of prospective long-term foreign and domestic requirements.

   In any event, the level of prices of farm products relative to other prices is no doubt untenable

5. Urgent accumulated demands are being increasingly satisfied for:

   Consumer nondurable goods generally, and

Many consumer durable goods, except for automobiles and refrigerators

6. Postwar business expansion plans are being completed

Expenditures for expansion of manufacturing already are declining. Public utilities, railroads, and some special lines such as oil production are continuing large expenditures.

The rate of expenditures for producers' durables is exceptionally high, and, unless consumer incomes and spending are maintained or further increased, may be expected to decline

The ratio of such expenditures to GNP is currently 8.3 per cent, a rate substantially above previous peacetime periods.

7. Exceptionally high demand and prices of houses

   a. Prices and costs are high relative to income of the mass of buyers. Also high relative to prices of alternative goods.

   b. Very sharp rise in mortgage debt encouraged by:

      (1) Low down payments and interest rates
      (2) Government supports and guarantees
      (3) High current incomes and general optimism about their continuation
      (4) Turnover and refinancing of old houses

   c. People forced to buy houses because of unwillingness of owners to rent in view of rent controls and profits available from selling instead of renting.

8. Private debt is increasing. This will become particularly important after the downturn when it will be liquidated.

9. Distribution of income and liquid assets slowly becoming more concentrated. Uncertain as to whether these changes have yet gone far enough to bring about a decline in spending.

What are the continuing forces of inflationary pressure?

1. Over-all demands for goods and services are still in excess of current output.

   a. Consumer demands and buying power, notwithstanding satisfaction of some of the more urgent, are still very large.

      Large current incomes and substantial holdings of liquid assets.

b. Capital expenditures may be maintained by need to increase output, as well as by obsolescence of existing plant in terms of new demands and economical processes.

c. Governmental expenditures are likely to increase and not be balanced by additional tax receipts. Not only Federal expenditures for defense and international purposes. Situation much less restrictive than it was last year, when the Federal Government had a large surplus.

d. Substantial foreign needs for American products.

Adequate financing available to maintain exports.

2. Productive facilities are being utilized to the limit and the possibilities for further expansion are limited.

3. Absence of serious speculative excesses that may lead to widespread liquidation.

Probably accumulating in housing and commercial building, but doubtful whether yet at critical stage.

4. Relatively unimpaired debt structure.

Consumers may further expand short-term consumer debt.

Corporate debt not large relative to equity in comparison with past

Weakest phase is developing in housing.

5. Abundant credit facilities and savings available for investment

Liquid assets in banks or in low-yield investments very large

Demands for borrowing are in excess of current savings, but credit can be readily obtained from banking system

Can sell Government securities readily

Immediate prospects

Underlying forces are such as to make risk for present one of continuing inflation

Imposition of restraints is essential

Because of these underlying forces, effective restraints at this time are not likely to bring on serious depression.

Some recession in spending and perhaps in employment may develop before maladjustments are sufficiently corrected.

Could be checked by moderate action.

Continuation of inflation will necessitate later imposition of restraints or, in any event, lead to more dangerous process of adjustment -- with widespread liquidation, bankruptcy, and unemployment.

What can be done?

Basic causes are war-created money supply, deferred demands, and accumulated shortages

Fundamental remedy is either reduction or immobilization of excessive buying power. Could be accomplished by:

1. Taxation, budget surplus, and public debt retirement

2. Private debt retirement

3. Holding of savings in forms that do not add to current expenditures

Increased production would help, if accompanied by more saving or debt retirement, but increased production means also more income

If accomplished through credit expansion, it means expanded money supply

Credit is a strategic element in the situation

If inflation continues, additional credit will no doubt be demanded by businesses and consumers

If additional credit is not available, it is likely that inflation could not continue

Difficult to restrict credit because of ready availability of funds to banks and other financial institutions through sale of Government securities

Recent and prospective credit developments

Factors affecting bank reserves:

	(In billions of dollars) 3rd quarter estimate	12 months
Increased by		
Gold inflow	.3	1.9
F.R. purchases of Government securities, Restricted bonds	2.5	5.2
Other	.7	2.0
Other factors - net	--	.7
Decreased by		
Treasury cash transactions	.9	6.7
Other - net	.2	--
Increase in required reserves	2.4	3.1

Bank deposits have expanded by 2 billion in quarter and by 1.5 billion in past 12 months

Due in part to growth in bank loans of 1-1/4 billion in quarter and to 6 billion in year and to F. R. purchases of securities from nonbank investors, offset by Treasury surplus used to retire bank-held securities

Outlook is for continued demand for bank loans and other credit and for continued sales of securities to Federal Reserve, but no Treasury surplus to exert a drain.

All credit demands -- commercial loans, agricultural loans, consumer credit, mortgage loans, and new issues of corporate and State and local Government securities -- may average more than 2 billion a month during rest of this year.

Sales of securities by nonbank investors have run as high as 1 billion a month recently.

Rationale of measures adopted to restrict credit expansion

1. Voluntary measures by financial institutions

Method of rationing or selection of credit risks -- essential function of lenders.

Some, but limited, effect in reducing over-all expansion, which is the important result from general standpoint.

2. Consumer credit controls, margin requirements, and limitations on mortgage lending.

Directly restrict certain types of lending, subject to wide fluctuations.

3. Increase in short-term interest rates

Designed to encourage investors to hold these securities rather than sell to Federal Reserve or to purchase them from Federal Reserve with any available funds.

Effect is shown by sharp decline in Federal Reserve holdings and increase in bank and other holdings of short-term Government securities in past year

Bills -	Total	-3.2
	F. R.	-7.4
	Other	+3.2

May also have some restrictive effect on borrowers

4. Increase in reserve requirements

Two purposes

a. Absorb reserves created by gold inflow and purchases of securities from nonbank investors

b. Make it necessary for banks to reduce holdings of Government securities, thereby reducing liquidity and discouraging loan expansion

Key to current credit situation is in sales of Government securities to Federal Reserve, especially nonbank sales of restricted bonds.

Provides additional reserves to banks, as well as new funds to borrowers

Might not be too serious, if banks would use all of new funds to buy short-term securities from Federal Reserve

Hardly to be expected in face of active loan demand

Reduction in Federal Reserve support prices on bonds has been suggested

Of questionable effectiveness, as long as other borrowers are willing to pay more

More serious question, however, relates to possible repercussions of such action

On September 21, 1948, at 10:40 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 Eccles, Szymczak, Draper, Evans and Vardaman; also Mr. Riefler, Assistant to the Chairman and Mr. Carpenter, Secretary of the Board of Governors.

THE HOUSE BANKING AND CURRENCY COMMITTEE HAS TWICE REPORTED FAVORABLY AND THE HOUSE IN THE RECENT SPECIAL SESSION APPROVED A PROPOSAL TO RESTORE THE FORMER RATIO OF REQUIRED GOLD CERTIFICATE RESERVES HELD BY FEDERAL RESERVE BANKS OF 40 PER CENT AGAINST FEDERAL RESERVE NOTES AND 35 PER CENT AGAINST FEDERAL RESERVE BANK DEPOSITS. IN VIEW OF THE POSSIBILITY THAT THIS PROPOSAL MAY AGAIN BE ADVANCED IN THE CONGRESS, THE BOARD WOULD LIKE TO KNOW WHAT THE ATTITUDE OF THE ADVISORY COUNCIL WOULD BE TOWARD IT.

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IN THE LIGHT OF DEVELOPMENTS IN THE MONETARY AND CREDIT FIELD SINCE THE COUNCIL MET WITH THE BOARD IN APRIL, WHAT IS THE COUNCIL'S JUDGMENT AS TO THE EFFECTIVENESS OF POLICIES OF RESTRAINT SO FAR ADOPTED AND WHAT WOULD BE THE COUNCIL'S RECOMMENDATIONS AS TO APPROPRIATE FURTHER ACTION?

* * * * * *

THE USE OF FEDERAL RESERVE POWERS TO RAISE RESERVE REQUIREMENTS.

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THE POLICY OF SUPPORTING THE GOVERNMENT SECURITY MARKET, ESPECIALLY IN RELATION TO SALES BY INSURANCE COMPANIES.

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E. E. Brown reads the first four items on the agenda, as given above, and the answers which the Council had prepared and submitted in its confidential memorandum to the Board dated September 21, 1948. This confidential memorandum will be found earlier in these minutes. Brown adds that it is difficult to appraise the effect of the recent increase in reserves, as the increase has not yet become effective in all the member banks. Many banks will draw down their correspondent bank balances, and the effect may be more widespread than the increase in the reserves would indicate. With the banks holding large blocks of government securities, the dilemma of the situation is that any attempt to increase reserves results in the sale by banks of bonds at pegged prices. Consequently, banks will continue to make loans they think are sound and in the best interests of their communities. All members of the Council feel that the bond market must be supported.

A considerable majority feels that the price on the long-term bonds should be kept at par, not above par. A minority feels that a drop of a point or more would discourage selling by the insurance companies. A majority believes that if par is broken it may cause large bond sales and may, through ignorance, even lead to large redemptions of E's. In connection with the question of raising the gold reserve ratio, the Council believes that in more normal times it would be a desirable development. However, if the matter were to be voted on today under present conditions, the majority of the Council would oppose it. The Council will be glad to review this question after the organization of the new Congress early in 1949, and in the light of the international situation at that time.

McCabe. The Board is grateful for the Council's consideration of these subjects. McCabe then reads the following statement relative to the items on the agenda:

2-4. ABC Concerning the economic situation, the Board's general view coincides with that of the Council, namely, that despite soft spots in the economy at the present time, the outlook is on balance inflationary and that "it is the duty of the monetary authorities to take active measures to combat the inflationary trend." (E. E. Brown at this point asks McCabe's permission to state that the Council did not make the specific comments which McCabe has given. Brown reads the following paragraph from the Council's confidential memorandum: "Although there are many soft spots in the economy at present, the members of the Council feel that there is not as yet convincing evidence that the turn has been made, and that it is still the duty of the monetary authorities to take active measures to combat the inflationary trend." Draper says that he believes this is a very fine distinction.) The Board continues to recognize that there are special factors outside the field of banking and credit that have promoted inflation. In addition to those listed by the Council, the Board would include high corporate profits and it would like to emphasize greatly the position created by the disappearance of the Federal surplus. This surplus during the past two years has been the most powerful anti-inflationary factor in the picture, but it has been offset by other factors, notably by the expansion of bank loans. In the absence of a budget surplus, an expansion of bank credit in the coming year similar to that of the past year would have much greater inflationary effects.

The Board has considered the suggestion of the Council that the peg on the long-term 2-1/2 per cent bonds be maintained at par without a premium. The Board is in agreement with the majority of the Council that the long-term yield on Treasury bonds should be maintained for the foreseeable future at a 2-1/2 per cent yield level, but believes that under present circumstances removal of the small premium would very probably have undesirable consequences. It may be that the establishment of support levels at exactly par last year would have been wiser, but removal of this small difference at the present time might undermine confidence in the whole support pattern.

The Board notes that a minority of the Council is in favor of a more flexible policy with respect to the support program, and agrees that greater flexibility in the short-term market is a desirable objective. Increases in certificate rates and discount rates to date are beginning moves toward this objective which the System initiated.

The Board has long recognized that the maintenance of support for the bond market has greatly limited the effectiveness of credit-control methods. It feels that recent increases in short-term rates have been helpful, particularly in inducing the banks and others to buy short-term securities to absorb excess reserves. In the presence of strong demands for credit, however, higher short-term rates cannot be relied upon as adequate in restricting credit expansion.

The Board recognizes that increased reserve requirements with a complete peg in the Government securities market have less restraining effect than would otherwise be expected. It wishes to call to the Council's attention that one of the principal purposes of requesting Congress to give additional power to the Board to increase member bank reserve requirements was the need for absorbing additional reserves being created by the inflow of gold, by purchases of securities from nonbank holders, and by a possible return flow of currency. The current use of this authority will have the effect of increasing member bank reserve requirements by about 2 billion dollars. Since the System has purchased more than this amount of securities from nonbank holders during the past two months and will probably purchase substantial additional amounts in the immediate future, the higher requirements should not result in any net reduction in the earning assets of commercial banks. Although some banks will need to sell some Government securities in order to meet the change, the effect of the increase will be to prevent additional reserves which have become available from increasing the ability of banks to expand credit but not to reduce the lending capacity of the banks below previous levels.

1.D The Board has noted the Council's position on raising the required gold reserves from the present ratio. Its own thinking on this matter has been fully expressed in memoranda or testimony to the Banking and Currency Committees of the Congress.

5. There have been discussions between representatives of the System and of the Treasury regarding the United States gold policy, with particular reference to the possibility of relaxing or removing controls on the transfer of gold by or for foreign central banks. After extended discussions, however, it did not appear feasible for the Treasury to relinquish entirely its control over gold transactions especially in view of the current unsettled international situation. The Board plans to review this problem from time to time and to hold further discussions with the Treasury when conditions warrant. To the extent possible, in the light of its confidential character, the Board will be glad to supply the Council with further information on the subject as a basis for future study and discussion.

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On the question of consumer credit regulation, McCabe states it was agreed that the Board's comments should be substantially as follows: The Board appreciates the views of the Council on this matter and wishes to assure the members of the Council that if at any time they have suggestions as to the policies that might be followed in connection with the regulation of consumer instalment credit or questions with respect to the policies adopted by the Board in this field, the Board will be very glad to have the Council submit them. McCabe continues by stating that in connection with bank holding company legislation a series of conferences have been held with representatives of bank holding companies and of the American Bankers Association. The Board expects to hold more conferences with representatives of the Association of Reserve City Bankers and of the bank supervisors. The discussions with the bank holding company representatives brought forth some suggestions. McCabe further reports that he discussed the Board's reply on the pegging of bond prices with Allan Sproul, and Sproul agrees entirely with the Board's statement. The Board does not believe that the support program should be changed at present. The members of the Board believe that even a small change in price would be undesirable now.

Williams asks whether the members of the Board have discussed with the insurance company heads the question of selling bonds.

McCabe reports that they have discussed the matter with individual heads of insurance companies as they may have met them informally, but they have not discussed the matter with the insurance company heads as a group. He reports that there is a difference of opinion among insurance company executives on the subject of supporting government bonds, and that few, if any, of the insurance people like Parkinson's views.

Odlin states that Eccles will not agree with his (Odlin's) views, but that he does not like the comments regarding "high corporate profits" mentioned in the first paragraph of the Board's statement read by McCabe. Odlin believes that these profits are transitory, and he thinks it is unwise for a government agency to imply that they are one of the bad factors in the present situation.

McCabe. The Council in its memorandum did not list corporate profits as one of the causes of inflation, and the Board felt they should be included.

Eccles. A public agency like the Board could not ignore corporate profits. Corporate profits have been used by labor as a reason for demanding increased wages, and as an argument for maintaining that increased wages could be paid.

Fleming. Has the Board made any study of whether depreciation reserves are adequate, and whether profits are as large as they are said to be?

McCabe. That is the number one question at every comptrollers' convention. Most business men would agree with Fleming that the depreciation reserves are not adequate.

Eccles. The excess profits tax and wage controls should not have been repealed.

Spencer. Under the excess profits tax, expenses were often permitted to increase without carefully screening them.

E. E. Brown states that politically the excess profits tax and wage controls cannot be reinstated.

Odlin does not like the implication that corporate profits are excessively high.

Burgess. In listing the causes of inflation, and dealing with the comments of Eccles on profits, two other factors might be given: (1) business pricing policies; and (2) large programs of capital expansion. Bank term loans are not now increasing. In connection with other loans by banks, it is difficult to see where these loans could be screened further. The vulnerable place is in the capital goods expenditures. Insurance company money is going into new capital ventures. The insurance companies are using new funds from policy holders, but they are also selling government bonds to obtain funds for capital ventures. New credit is thus created for the borrowing companies and the money then finds its way into the banking system.

McCabe asks whether the insurance companies would police themselves on loans as the banks have done.

Burgess states that if the insurance companies are offered a premium, they sell more freely. If they have to take a loss in selling securities, they will be more reluctant to sell. He believes the sale of government securities by insurance companies, and the lending of the funds for new capital ventures, would be materially lessened if the insurance companies had to take a loss in selling governments. Burgess thinks the market expects that sooner or later the support price will be broken. He agrees with the increases in the rediscount and certificate rates, but not with the increase in reserves. In connection with the reserve requirements we may be milking a dry cow.

Eccles. Burgess has pointed out that the insurance companies sell governments and use the funds in new capital ventures, but it is necessary also to point out that when the money goes into the banks it is subject to multiple expansion. The reserve requirements are increased to take up this money.

Burgess. The bank credit expansion we have had is the expansion necessary to take care of an economy this size. When banks get excess funds, they buy governments.

McCabe wishes to explore further the matter of pegging bond prices. He states that the smaller banks tremble at any change downward in the support level. He asks, "What is the support level desired by those that wish to drop it?" Those that want to stop the big insurance companies from selling governments seem to favor going to a support level of 95. He says that an investment counselor of one concern recommended selling out long-term government bonds, even at a loss of 1 1/2 points, and buying short-term governments and common stock.

Fleming asks whether the Board has tried to talk over the matter with the insurance company heads.

McCabe replies that the insurance company heads are an independent lot, and he wonders whether it would be desirable.

Fleming. They are a cross section of Anerica and they certainly would not want a boom and bust situation. He believes they might recognize the real stake they have in our economy. Fleming asks what effect the dropping of the peg would have with the present foreign situation.

E. E. Brown points out that the support price of some of the shorter issues is a point or so above par.

Eccles. We have a one year 1 1/4 per cent rate and a 2 1/2 per cent long-term rate, and so we have two pegs. It would not serve the purpose of inflationary control to say that we are going to buy only 1 1/4's and 2 1/2's and let the rest go. It is not certain bonds that we are supporting, but a pattern of rates from 2 1/2 per cent on the long-term bonds to 1 1/4 per cent on the short-term securities. We believe there should be more flexibility on the short-term securities, and until that happens you cannot get away from premiums on the intermediates.

Burgess states that you cannot stop the inflation without hurting someone. The monetary authorities have this matter in their lap, and this is the place where something can be done. History may say in this inflationary situation that the Treasury and the Federal Reserve authorities adopted measures that were too late with too little.

McCabe. You also have to consider what the market might have been without support.

Szymczak. Would you let the market seek its own level?

Burgess. No.

McCabe. Exactly what does a flexible market mean?

Szymczak assumes it means dropping a little and supporting, and dropping a little and supporting.

E. E. Brown. The majority of the Council feels that the longer-term bonds cannot be allowed to go below par, and the market must be supported. He does not believe that if you have to cut off the dog's tail you should do it a half inch at a time.

THE GOLD POLICY OF THE FEDERAL RESERVE SYSTEM AND THE TREASURY, INCLUDING THE PROCEDURE WITH RESPECT TO GOLD EXPORTS AND IMPORTS.

E. E. Brown states in connection with this agenda item that the Council wishes to defer the discussion of the subject to a later date when it can be fully considered. In general, it believes that the movements of gold, including the transfer of gold by foreign central banks, should as far as practicable be removed from discretionary authority. The Council would be interested in knowing whether there have been occasions when licenses have been denied to foreign central banks for the transfer of gold. The Council also feels it would be desirable to examine our whole gold policy and the present legislation regarding gold, and it would welcome any data and information from the Board of Governors which would be helpful in such a study.

Szymczak reports that there have been no cases where foreign governments have been refused licenses, but persuasion was used in three cases: China, Argentina, and Jugoslavia. The right to refuse a license probably had something to do with the ability to persuade.

POLICIES OF THE BOARD OF GOVERNORS IN ENFORCING REGULATION OF CONSUMER CREDIT.

E. E. Brown says that without discussing the necessity or desirability of the legislation on consumer credit, the regulations issued by the Board of Governors appear to the Council generally reasonable and fair and well received. Since the terms are similar to those already being followed by banks, the effect on loans directly by banks to installment borrowers will be slight. Principal criticisms of the regulations now appear to come from dealers in furniture and used cars.

McCabe reports that Evans has done a creditable job on the regulations.

Evans says that suggestions will be welcome in connection with the regulations.

J. T. Brown asks what will be done on the policing.

Evans. We expect to see that people are kept in line. The only trouble anticipated is in the fringe areas.

E. E. Brown asks whether an amendment is to be asked which would have the effect of making unenforceable any contract which does not conform to the provisions of the regulation on down-payments or maturities. The violations are generally unintentional. To make a contract unenforceable might work much injustice.

Evans. The Board feels in this matter about as the Council does, but this is a shotgun behind the door.

Vardaman. The amendment was expected to require intent to violate.

J. T. Brown believes it would be better to leave enforcement to the Board. Otherwise, the debtors might clutter up the courts claiming the contracts are unenforceable.

Vardaman does not agree that inclusion of the illegal clause would bring any more law suits.

Evans. The Board will have representatives of each of the Federal Reserve banks here to instruct them in connection with violations. Few violations are expected, except from the fringe areas. It is hoped to stop any violations early, so that possible future violations will be discouraged. The attitude of the people is friendly.

Vardaman asks whether the friendly attitude may disappear if the terms are tightened.

E. E. Brown asks whether the Board feels it has authority to make a contract unenforceable.

Eccles, Evans and Szymczak all state the Board has the authority.

E. E. Brown understands from the comments of members of the Board that the amendment about making contracts unenforceable will only be used if absolutely necessary.

McCoy. If you have an amendment making a contract unenforceable, how many banks will refuse to buy paper from dealers. McCoy states his bank would not purchase this paper.

Eccles. Burgess has said that history may show that the Board was "too late with too little." Eccles says that the Board has been conscious of this whole situation since 1940. The Board argued in 1942 that only short-term issues should be sold and all issues should be made eligible to banks. Eccles states that the Board could have gotten away from the pattern which we have now. In financing the war we could have gone back to the traditional method of credit control by using the interest rate for control. The other alternative was a special reserve to tie the government securities to the deposits they had created. If you start to curb inflation on the traditional road, you have to let the interest rate go far enough to do it. If it had not been necessary to manage a large debt, we could have used the interest rate. Consequently, we suggested the special reserve. The Board has not been "too late with too little."

Odlin wishes the record to indicate that the Council does not approve the permanent lodgement of the powers of Regulation W with the Board.

Burgess. In the last session of Congress the American Bankers Association did not oppose the consumer credit legislation.

THE BOARD OF GOVERNORS WOULD APPRECIATE ANY FURTHER VIEWS AND COMMENTS THE COUNCIL MAY HAVE REGARDING PROPOSED BANK HOLDING COMPANY LEGISLATION.

E. E. Brown states that he assumes in connection with bank holding company legislation that the same tax exemption amendment previously discussed will be included.

McCabe and other members of the Board reply affirmatively.

E. E. Brown asks whether the Board will press for the legislation in the next session.

McCabe answers "yes".

Eccles states it is better to have preventive legislation rather than to permit situations such as that on the West Coast to develop.

Fleming believes the Board should urge the passage of the legislation in the new Congress.

McCabe reports that representatives of the FDIC and the Comptroller's office sat with the Board when the American Bankers Association representatives were in Washington, and he reports that the FDIC and the Comptroller's office will meet with them again on the proposed legislation.

Fleming asks what position the American Bankers Association members took.

McCabe replies that the ABA representatives left the impression that they would have a strong resolution drawn up endorsing the legislation.

Szymczak wonders whether the Independent Bankers are smart in introducing the matter at the ABA convention.

Odlin doubts the advisability of the Independent Bankers introducing the matter at the ABA convention.

McCabe states again that the Board is grateful for the Council's suggestions, especially on consumer credit.

E. E. Brown comments that some bankers think loans will fall off so much in the months ahead that the banks will again be buying bonds.

The meeting adjourned at 12:55 P.M.

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The next meeting of the Council will be held on November 14-16, 1948.