MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

November 15, 1953

The fourth statutory meeting of the Federal Advisory Council for 1953 was convened in Room 1032 of the Mayflower Hotel, Washington, D.C., on November 15, 1953, at 2:20 P.M., the President, Mr. Brown, in the Chair.

Present:

Ernest Clayton	District No. 1
Henry C. Alexander	District No. 2
Geoffrey S. Smith	District No. 3
George Gund	District No. 4
Robert V. Fleming	District No. 5
Paul M. Davis	District No. 6
Edward E. Brown	District No. 7
V. J. Alexander	District No. 8
Joseph F. Ringland	District No. 9
Charles J. Chandler	District No. 10
De Witt Ray	District No. 11
John M. Wallace	District No. 12
Herbert V. Prochnow	Secretary

Mr. George G. Matkin, who will represent District No. 11 in 1954, also was present.

On motion duly made and seconded, the mimeographed notes of the meeting of the Council held on September 13, 14 and 15, 1953, copies of which had been sent previously to the members of the Council, were approved.

A complete list of the items on the agenda 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 and 29.

The meeting adjourned at 5:20 P.M.

HERBERT V. PROCHNOW
Secretary

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

November 16, 1953

At 10:00 A.M., the Federal Advisory Council reconvened in Room 1032 at the Mayflower Hotel, Washington, D.C.

Present: Mr. Edward E. Brown, President; Messrs. Ernest Clayton, Henry C. Alexander, Geoffrey S. Smith, George Gund, Robert V. Fleming, Paul M. Davis, V. J. Alexander, Joseph F. Ringland, Charles J. Chandler, De Witt Ray, John M. Wallace, and Herbert V. Prochnow, Secretary.

Mr. George G. Matkin, who will represent District No. 11 in 1954, also was present.

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 and 29, listing the agenda items with conclusions reached by the Council. The *Memorandum* was delivered to the Secretary of the Board of Governors at 12:10 P.M. on November 16, 1953.

The meeting adjourned at 11:50 A.M.

HERBERT V. PROCHNOW
Secretary

MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL ADVISORY COUNCIL RELATIVE TO THE AGENDA FOR THE JOINT MEETING ON NOVEMBER 17, 1953

1. The Board would be glad to have the views of the Council on the prospective business and economic situation during the rest of the year and into the first half of 1954. The Board is particularly interested in the comments of the members of the Council on the probable demands for bank credit during the remainder of the year and the liquidation of loans after the turn of the year.

Although business continues moderately downward over the country, from the peak levels established earlier this year, the volume of business has not declined as much as had been generally anticipated last summer, or at the time of the Council's meeting in September. Economic conditions vary from district to district, but over-all business activity has held up exceptionally well. Steel mill operations, construction, and automobile production have been among the important influences which have helped up to now to moderate the business decline and to offset downward trends in certain other segments of the economy.

No serious downturn in business seems probable in the months immediately ahead, but further downward adjustments such as we have had in recent months in particular industries seem highly probable. The outlook for the rest of the year and into the first half of 1954 is for an additional moderate decline in the gross national product as these adjustments take place and until the over-all economy becomes stabilized. Any reduction in the gross national product, even a reduction as relatively small as five or six per cent, will result in a considerably larger percentage decrease in the net income of business before taxes and in the volume of bank credit.

Lower commodity prices, a slackening in inventory accumulation, and the financing of an unusually large amount of agricultural production by the Commodity Credit Corporation have been among the factors which lessened the demand for bank credit this fall, and resulted in less than the normal seasonal increase in loans. The belief is general that Christmas business will be good, and the Council believes some further moderate increase in bank credit will take place during the balance of the calendar year.

In the first half of 1954 business will be confronted with large tax payments under the Mills Plan, and it is expected these cash payments will require some borrowing from banks. However, with the probable continuance in the next few months of the economic factors which have curtailed the demand for bank credit this fall, plus the reduction of excessive inventories which exist in many cases, the Council believes that there will be a fairly sharp liquidation of loans after the first of the year.

2. The Board would also appreciate having the comments of the Council as to what if any changes should be made in System credit policies to meet changes in the business and economic situation in the foreseeable future.

As stated in its answer to the first item of the agenda, the Council believes that the decline in business activity has been less than was expected at the time of its last meeting in September. Also, the seasonal increase in the demand for bank credit has been less than was then anticipated. The money market is in an easier position than it has been for many months, as evidenced by the sharp decline in the cost of Government borrowing and by the downward tendency of interest rates generally. The danger of disturbing the economy by making money unduly and artificially cheap is at present fully as great as the danger of restricting business by too high interest rates, and a consequent reduction in the use of credit. The Council believes the Board in its Open Market operations should be as ready to sell short term securities if bank loans are repaid in volume and money rates are disorderly on the downward side, as to purchase securities if the level of interest rates and any difficulty of obtaining credit should threaten to accelerate a business decline.

3. Does the Council have any comments with respect to the recent action of the New York State Banking Board removing the limitation on the payment of interest on savings accounts or with respect to whether any action should be taken by the Federal bank supervisory authorities to raise the existing limitations on the payment of interest on time and savings deposits by member and insured nonmember banks?

The Council believes that special considerations not applicable to banks generally were responsible for the action of the New York State Banking Board removing the limitation on the payment of interest on savings accounts by Mutual Savings Banks. The Council can see no advantage to be obtained by raising the existing limitations on the payment of interest on time and savings deposits by member and insured nonmember banks, and it would have the effect of encouraging unsound banking. Few banks are paying rates as high as those already permitted. It would encourage some banks, with inexperienced or speculative management, to pay interest rates higher than would be consistent with such banks' safety.

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

November 16, 1953

At 2:15 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. Ernest Clayton, Henry C. Alexander, Geoffrey S. Smith, George Gund, Robert V. Fleming, Paul M. Davis, V. J. Alexander, Joseph F. Ringland, Charles J. Chandler, De Witt Ray, John M. Wallace, and Herbert V. Prochnow, Secretary.

Mr. George G. Matkin, who will represent District No. 11 in 1954, also was present.

Dr. Woodlief Thomas, Economic Adviser to the Board of Governors, discussed the subject, "The Changing Course of Credit".

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

November 17, 1953

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

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

Chairman William McC. Martin, Jr.; Governors M. S. Szymczak, R. M. Evans, James K. Vardaman, Jr., and J. L. Robertson; also Mr. S. R. Carpenter, Secretary, and Mr. Merritt Sherman, Assistant Secretary, Board of Governors.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Messrs. Ernest Clayton, Henry C. Alexander, Geoffrey S. Smith, George Gund, Robert V. Fleming, Paul M. Davis, V. J. Alexander, Joseph F. Ringland, Charles J. Chandler, De Witt Ray, John M. Wallace, and Herbert V. Prochnow, Secretary.

Mr. George G. Matkin, who will represent the District No. 11 in 1954, also was present.

President Brown 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 28 and 29 of these minutes. A brief discussion of this item followed, in which members of the Council and the Board participated.

President Brown then read the second agenda item and the conclusions of the Council as given in the *Confidential Memorandum* mentioned above.

Chairman Martin replied that he was glad to hear the Council's comment as he believe it represented an approval of the idea of flexibility. The problem, however, was one of delicate balance.

President Brown stated that he felt the responsibility of managing the market was one of the most important that the Board would have in the months ahead.

President Brown read the third item on the agenda and the conclusions of the Council as expressed in the *Confidential Memorandum* cited above.

A discussion, most of it off-the-record, followed, in which members of the Council and the Board participated.

The meeting adjourned at 12:20 P.M.

HERBERT V. PROCHNOW
Secretary

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. The concise official minutes for the entire year are printed and distributed later.

H. V. P.

The Secretary's notes on the meeting of the Federal Advisory Council on November 15, 1953 at 2:20 P. M. in Room 1032 of the Mayflower Hotel, Washington, D. C. All members of the Federal Advisory Council were present. Mr. George G. Matkin, President, The State National Bank of El Paso, El Paso, Texas, who will represent the Eleventh District in 1954, was also present.

The Council approved the Secretary's notes for the meeting of September 13-15, 1953.

* * * *

ITEM I

THE BOARD WOULD BE GLAD TO HAVE THE VIEWS OF THE COUNCIL ON THE PROSPECTIVE BUSINESS AND ECONOMIC SITUATION DURING THE REST OF THE YEAR AND INTO THE FIRST HALF OF 1954. THE BOARD IS PARTICULARLY INTERESTED IN THE COMMENTS OF THE MEMBERS OF THE COUNCIL ON THE PROBABLE DEMANDS FOR BANK CREDIT DURING THE REMAINDER OF THE YEAR AND THE LIQUIDATION OF LOANS AFTER THE TURN OF THE YEAR.

Brown reads the three items on the agenda and asks Clayton, representing District No. 1 to comment on Item I on the agenda.

Clayton. The general level of business in the First District is off about 5 per cent from where it was during the first half of the year, but it is still as high as it was last year at this time. Opinion is divided as to whether it will go lower, or move sideways from this point. There is no expectancy of a serious drop, and present thinking is that 1954 will be a good year but not as good as 1953. While the optimists are saying that the much advertised recession has not occured and that the end of the excess profits tax will help profits in 1954, there are many others who continue to feel that production may outstrip consumption and that some further downward movement is to be expected. They point out that plant capacity is about twice as great as it was pre-war, that taxes are still high, that there is a disparity of purchasing power among various groups and that future income is heavily mortgaged.

Total loans in the District are about 7 per cent higher than a year ago. Business loans have declined since March, but this decline has been offset by gains in real estate and consumer loans. Looking ahead, business loans are expected to be reduced in January, possibly quite substantially, with a pickup to meet March tax payments.

Consumer and real estate loans are expected to continue their slow upward movement, but increasing caution by lenders in these fields may stop the increase or even turn the direction downward. There is no pressure for higher interest rates and the prime rate will probably decline before too long.

H. Alexander. Business continues at a high level but it is off from the peaks established earlier this year. Employment is down slightly from June. Retail trade is a little above a year ago, but the increase has been largely in automobiles and appliances. Building has declined. Farm income is down. Business in the district has been generally representative of conditions over the country. The volume of business is good, but it is down slightly; and there is a feeling that business has passed the peak. A recent survey of estimated capital expenditures for 1954 showed an 8 per cent decline. Alexander had expected a little larger decline in business than has actually taken place. He believes adjustments will continue but that they will not be serious. Some persons believe that we may now have an improvement in business, but Alexander is not inclined to share this view. He thinks the seasonal demand for credit in the weeks ahead will not be sufficient to offset the amount by which the demand for credit has been below normal this fall. He believes loans will turn down after January and the 3-1/4 per cent prime rate may then be difficult to hold.

Brown. (Off-the-record comments on interest rates).

Smith presents the views of several of the major banks in his district and of the Federal Reserve Bank of Philadelphia. He states that, on balance, most bankers are moderately pessimistic at present. Housing in the medium price ranges is moving satisfactorily. Textiles are in relatively good condition. Retail trade has been hit by the warm weather. Christmas business looks good. Business has not declined as much as had been anticipated but the present moderate decline may continue after January. Smith believes interest rates will soften.

Gund believes that business in the first half of 1954 will show some decline, especially in automobiles and durable goods. Industrial production will be lower. Construction by state and local governments will probably be good, but residential construction may be off somewhat. (Off-the-record comments on interest rates and money policies). There is a definite possibility of declining interest rates in the months immediately ahead.

Fleming. Loans have not increased in volume this fall as they did last year. After January there may be a further liquidation of loans. There is some unemployment in his district. Despite the unemployment in the city of Washington especially, department store sales have held up well and for the year may equal 1952. The coal industry is in somewhat better condition. Residential construction is down, but industrial construction is up. Fleming estimates that the gross national product in the first half of next year may show a decline (at an annual rate) of approximately 4 per cent to 8 per cent. (Off-the-record comments). The agricultural industry is having real problems. Interest rates will probably soften by spring.

Davis. Department store sales in his district are ahead of last year although furniture and appliance sales are down. Bank deposits are up. There has been considerable new plant expansion, especially of utilities. The rayon industry is running about 75 per cent of capacity and nylon at about 100 per cent. Davis expects loans to decline. Inventories are high, partly because of unseasonal weather. No serious business decline in the months immediately ahead is anticipated.

V. Alexander. With higher expenses and salaries, reducing interest rates presents a difficulty. Business is better than expected. Deposits and loans are up in his district. Retail sales are good. A large part of the cost of cotton production is going to the pickers instead of to the farmers, and this money will be spent. Alexander estimates that less than 50 per cent of the cotton is machine picked. Unless there is pressure from outside the district, banks in the district would be inclined to hold their local rates.

Ringland. Business is generally good. The drought still prevails in some sections. Farm income is almost as good as it was last year. Deposits are up from 1952. Retail sales are about as good as they were last year, except that October was bad. The farm machinery people believe they have about hit bottom. No large decline in loans is expected after the first of the year. Some soft spots are beginning to appear in connection with installment loans. Rates in the district will be determined by the rate situation nationally.

Chandler. Rains in the agriculture sections have helped the district considerably. Loans are down this year, whereas they were up substantially last year. Bank deposits are down. Employment generally is good, but aircraft employment is down. There is too much crude oil and oil supplies are at a peak. Residential construction is down perhaps as much as 25 per cent. Commercial construction is up, especially in Denver. Department store sales are off. Inventories are about 12 per cent ahead of last year. Cotton production is approximately 20 per cent ahead of a year ago. Chandler believes the district has had more loan liquidation than most of the districts, and he does not believe there will be further substantial liquidation. The rate situation in his district is not under pressure.

Ray. During July, August, and September it was hot and business was on the decline. Since that time rain has broken the peak of the drought. Retail sales are about 8 per cent higher in October than they were in September, but they are 6 per cent below last year. One can buy any car, except a Cadillac, at any price above the cost to the dealer. The dealers are experiencing what might be called profitless prosperity. Residential construction is down. Industrial and commercial construction is up. There is no unemployment. The district has an overproduction of oil. There is also an exceptionally large cotton crop. More problems of bankruptcy (not large ones) are appearing than the district has had in recent years. As a whole, the economy is in good condition. No softening of interest rates is expected in the district, unless there are pressures from outside the district. There is some tendency to increase the savings rates.

Ringland. (Off-the-record comments on savings interest rates)

Ray. There is a certain amount of instability in the rates on savings and time deposits.

Wallace. Every city in the Twelfth District has experienced a decrease in federal employment. The mining industry is weak because of adverse price developments. Lumber and plywood are also weak. Activity in the shipyards has decreased. Volume in the furniture industry is down. Over-all employment was at an all-time high in September 1953. Employment in the first half of 1954 will probably compare favorably with the first half of 1953. The adjustment in the agriculture industry is largely completed in the Twelfth District. A slight increase is expected in bank loans from now on into 1954 but the increase will probably be at a lower rate than it was a year ago. Interest rates, so far as this district is concerned, should hold quite steady.

Brown. The general situation in the Seventh District is a composite of the other districts. Business has slackened but not as much as expected in September. Loans have not increased to the extent that they did late in 1952. The agricultural implement business is down considerably, although it may be near the bottom with the present production of implements at a low level. Consumer hard goods is off. Employment generally is good. Retail stores are over-inventoried. Carloadings on the Western railroads are down about 8 per cent. Automobile production in 1954 is not expected to be as large as it was in 1953. A few weeks ago, the steel industry expected production might go as low as 80 per cent before the end of 1953. Steel production recently has been around 95 per cent and is expected to continue at a high level in the weeks immediately ahead. Gross national product for the first six months of 1954 may decline 6 per cent to 8 per cent on an annual basis, but it is not expected to decrease as much as 10 per cent. Business is good but there will probably be a further moderate decline into 1954. A decline of 6 per cent in gross national product might mean as much as a 15 per cent decline in corporate profits. Loans have not increased as much as expected, and bankers expect considerable loan reduction after the first of the year. Residential construction in Chicago is holding up well. Business conditions are more favorable now than had been anticipated in September, but the economy is still on a downward trend. With an increase in deposits and the probability of a decline in loans, the prime rate will probably break by January.

In its report to the Board, the Council may say that business continues moderately downward over the country but the volume of business has not declined as much as had been anticipated last summer, or early in the fall. Business conditions vary from district to district, but over-all business activity has held up exceptionally well. Some further decline in the gross national product is anticipated before the economy becomes stabilized. The increase in loans this fall has been substantially less than normal. Some increase will take place during the last of the year. After the first of the year, it is anticipated there will be a fairly sharp liquidation of loans. Any reduction in the gross national product will result in a much larger decrease in net income before taxes, and in the volume of bank credit. The members of the Council do not expect a serious decline in the whole level of the economy.

ITEM II

THE BOARD WOULD ALSO APPRECIATE HAVING THE COMMENTS OF THE COUNCIL AS TO WHAT IF ANY CHANGES SHOULD BE MADE IN SYSTEM CREDIT POLICIES TO MEET CHANGES IN THE BUSINESS AND ECONOMIC SITUATION IN THE FORESEEABLE FUTURE.

Brown. The business decline has not gone as far as had been anticipated at the time of the Council meeting in September. The demand for credit has been less than was expected, and the money market is in an easier position than it has been for a number of months. There are some indications that the money market is getting too easy. The dangers of demoralization on the side of easy money at this time are probably as great as the dangers on the side of tight money. It is important that the money market be watched carefully now and that the Open Market Committee be as ready to sell short term securities as to purchase them.

H. Alexander states that from May 6 to November 4, member bank excess reserves increased from $378 million to $1 billion. (Off-the-record comments).

Brown. The Council expected last September that the business decline this fall would be more rapid. The Board may have put more money into the market than was needed. (Off-the-record comments). If there is any error in judgment now, it should be on the side of not easing the money market too much. Money should not be made too easy, and the Board should be ready to sell short term obligations, if necessary. On the other hand, if business should experience a more serious decline than now appears probable, the Board can further ease the market through Open Market operations.

ITEM III

DOES THE COUNCIL HAVE ANY COMMENTS WITH RESPECT TO THE RECENT ACTION OF THE NEW YORK STATE BANKING BOARD REMOVING THE LIMITATION ON THE PAYMENT OF INTEREST ON SAVINGS ACCOUNTS OR WITH RESPECT TO WHETHER ANY ACTION SHOULD BE TAKEN BY THE FEDERAL BANK SUPERVISORY AUTHORITIES TO RAISE THE EXISTING LIMITATIONS ON THE PAYMENT OF INTEREST ON TIME AND SAVINGS DEPOSITS BY MEMBER AND INSURED NONMEMBER BANKS.

Brown reads Item 3 and asks for comments. (A number of members of the Council indicate that they do not favor raising the existing limitations on the payment of interest on time and savings deposits by member and insured nonmember banks).

H. Alexander understands that the mutual savings banks in New York were in favor of removing the limitation on the payment of interest on savings accounts because some of the banks had reached a point where the addition of earnings to their capital funds would have subjected them to additional taxes. They felt it was better to pay the depositors a higher rate.

Fleming states that the banks in Washington have raised to 2 per cent. Some banks have had the experience of demand deposits being converted into savings deposits. (Off-the-record comments)

Brown. There would be no practical advantage in taking off the ceiling as most banks are not paying the maximum permissible rates now. The Council may say it sees no advantage in raising the existing limitations and that there are some disadvantages. The Council believes the present limitations are sufficiently high. Raising the limitations would encourge some banks, with inexperienced management, to pay higher interest than would be consistent with the safety of the banks.

Fleming. The Council might mention the possibility that the trend in interest rates at the present time is downward.

* * * *

Fleming. (Off-the-record discussion on bad debt reserves).

* * * *

The meeting adjourned at 5:20 P. M.

THE COUNCIL CONVENED AT 10 A.M. ON NOVEMBER 16, 1953, IN ROOM 1032 OF THE MAYFLOWER HOTEL, WASHINGTON, D. C. ALL MEMBERS OF THE FEDERAL ADVISORY COUNCIL WERE PRESENT. MR. GEORGE MATKIN, WHO WILL REPRESENT DISTRICT ELEVEN IN 1954, WAS ALSO 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 November 17, 1953. The memorandum was delivered to the Secretary of the Board of Governors at 12:10 P.M. on November 16, 1953. It will be noted that each item of the agenda is listed together with the comments of the Council.

The meeting adjourned at 11:50 A.M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON NOVEMBER 17, 1953

1. The Board would be glad to have the views of the Council on the prospective business and economic situation during the rest of the year and into the first half of 1954. The Board is particularly interested in the comments of the members of the Council on the probable demands for bank credit during the remainder of the year and the liquidation of loans after the turn of the year.

Although business continues moderately downward over the country, from the peak levels established earlier this year, the volume of business has not declined as much as had been generally anticipated last summer, or at the time of the Council's meeting in September. Economic conditions vary from district to district, but over-all business activity has held up exceptionally well. Steel mill operations, construction, and automobile production have been among the important influences which have helped up to now to moderate the business decline and to offset downward trends in certain other segments of the economy.

No serious downturn in business seems probable in the months immediately ahead, but further downward adjustments such as we have had in recent months in particular industries seem highly probable. The outlook for the rest of the year and into the first half of 1954 is for an additional moderate decline in the gross national product as these adjustments take place and until the over-all economy becomes stabilized. Any reduction in the gross national product, even a reduction as relatively small as five or six per cent, will result in a considerably larger percentage decrease in the net income of business before taxes and in the volume of bank credit.

Lower commodity prices, a slackening in inventory accumulation, and the financing of an unusually large amount of agricultural production by the Commodity Credit Corporation have been among the factors which lessened the demand for bank credit this fall, and resulted in less than the normal seasonal increase in loans. The belief is general that Christmas business will be good, and the Council believes some further moderate increase in bank credit will take place during the balance of the calendar year.

In the first half of 1954 business will be confronted with large tax payments under the Mills Plan, and it is expected these cash payments will require some borrowing from banks. However, with the probable continuance in the next few months of the economic factors which have curtailed the demand for bank credit this fall, plus the reduction of excessive inventories which exist in many cases, the Council believes that there will be a fairly sharp liquidation of loans after the first of the year.

2. The Board would also appreciate having the comments of the Council as to what if any changes should be made in System credit policies to meet changes in the business and economic situation in the foreseeable future.

As stated in its answer to the first item of the agenda, the Council believes that the decline in business activity has been less than was expected at the time of its last meeting in September. Also, the seasonal increase in the demand for bank credit has been less than was then anticipated. The money market is in an easier position than it has been for many months, as evidenced by the sharp decline in the cost of Government borrowing and by the downward tendency of interest rates generally. The danger of disturbing the economy by making money unduly and artificially cheap is at present fully as great as the danger of restricting business by too high interest rates, and a consequent reduction in the use of credit. The Council believes the Board in its Open Market operations should be as ready to sell short term securities if bank loans are repaid in volume and money rates are disorderly on the downward side, as to purchase securities if the level of interest rates and any difficulty of obtaining credit should threaten to accelerate a business decline.

3. Does the Council have any comments with respect to the recent action of the New York State Banking Board removing the limitation on the payment of interest on savings accounts or with respect to whether any action should be taken by the Federal bank supervisory authorities to raise the existing limitations on the payment of interest on time and savings deposits by member and insured nonmember banks?

The Council believes that special considerations not applicable to banks generally were responsible for the action of the New York State Banking Board removing the limitation on the payment of interest on savings accounts by Mutual Savings Banks. The Council can see no advantage to be obtained by raising the existing limitations on the payment of interest on time and savings deposits by member and insured nonmember banks, and it would have the effect of encouraging unsound banking. Few banks are paying rates as high as those already permitted. It would encourage some banks, with inexperienced or speculative management, to pay interest rates higher than would be consistent with such banks' safety.

THE COUNCIL CONVENED IN THE BOARD ROOM
OF THE FEDERAL RESERVE BUILDING AT 2:15 P.M.
ON NOVEMBER 16, 1953. ALL MEMBERS OF THE
FEDERAL ADVISORY COUNCIL WERE PRESENT.
MR. GEORGE MATKIN, WHO WILL REPRESENT
DISTRICT ELEVEN IN 1954, WAS ALSO PRESENT.

Dr. Woodlief Thomas, Economic Adviser to the Board, discussed the subject, "The Changing Course of Credit." Dr. Thomas furnished the attached outline of his remarks.

The meeting adjourned at 4 P.M.

THE CHANGING COURSE OF CREDIT

by

DR. WOODLIEF THOMAS

ECONOMIC ADVISER TO THE BOARD OF GOVERNORS

FEDERAL RESERVE SYSTEM

In the 2-1/2 years since Treasury-Federal Reserve accord, credit developments and credit policies have passed through 3 stages -

1. Adjustment to new policies - to about April 1952
2. Restraint on expanding credit - May 1952 to May 1953
3. Slackening of credit expansion - since May 1953

These experiences have given opportunity for use of credit policy and for development of instruments and guides best suited to broad objective of contributing to maintenance of stable economic growth.

<u>Period of adjustment</u> - to Spring of 1952

Most rapid increase in defense expenditures - actual decrease in private expenditures.

Changes, Second Quarter 1951 to Second Quarter 1953

G. N. P. - total	+15	- 4-1/2%
Federal Government	+16	
Construction, equipment, & other	+ 3	
Change in inventories	-16	
Personal consumption expenditures	+12	

Decline in wholesale prices, rising wages, and moderate increase in consumer prices - due to lagging prices.

Substantial private credit expansion - though at a slower rate than in preceding year.

Withdrawal of support of Government bonds reduced liquidity of lenders - and changed their attitude.

Decrease in expansion of mortgages, consumer credit, and bank loans to business.

Corporate security issues increased.

Treasury reduced indebtedness, but bank holdings of Government securities increased slightly - attracted by higher rates and greater liquidity needs.

Other investors continued to reduce holdings, but at slower pace.

Period of adjustment (continued)

Total bank credit expansion fully as large as in previous year.

Increased monetary demands with expanding economic activity and growth in liquidity requirements because of reduced liquidity of Government securities.

Demand deposits and currency increased by 7% - more rapid than growth in G.N.P.

Time deposits, which had decreased in previous year, also increased considerably.

Reserves needed for monetary expansion supplied largely by gold inflow ($2 billion); some by increase in Federal Reserve advances ($1/2 billion).

Need of member banks to borrow occasionally exerted some restraint on credit expansion - also restrained by Regulations W and X and by voluntary program.

Federal Reserve decreased holdings of Government securities.

But at times during period, especially during Treasury refunding, bought securities; sold early in 1952.

Money rates and bond yields showed only moderate fluctuations around levels reached shortly after the accord.

Period of restraint on expansion - Spring 1952 to Spring 1953

In the following year, although increase in defense program slackened, private activities increased sharply, accompanied by accelerated expansion in private credit demands.

Changes, Second Quarter 1952 to Second Quarter 1953

G. N. P. - total	+27 - 8%
Federal Government	+ 4
Construction, equipment, & other	+ 2
Change in inventories	+ 8
Personal consumption expenditures	+13

Further declines in wholesale prices and increase in wages; stable consumer prices.

Striking acceleration of credit expansion.

All types of credit increased about 31 billion vs. 20 billion previous year.

Biggest change in consumer credit - 5 vs. ½

U. S. Government - 2½ vs. -1

Mortgage loans, security issues, and short-term bank loans to business also moderately larger.

Significant change in source of funds.

Period of restraint on expansion (continued)

Savings institutions & other nonbank - 24 vs. 13

Commercial & Federal Reserve Banks - 7 vs. 6

Much of commercial banking funds represented savings.

Time deposits increased by 3 billion or 7 per cent.

Active elements in money supply - private demand deposits and currency - up only about 3 per cent in year, compared with 7 per cent in previous year.

Less than expansion in G.N.P., which was 8 per cent.

Turnover increased and liquidity lessened.

Basis for monetary growth and for gold outflow.

Supplied by increase in Federal Reserve credit

In 12 months reserve needs up over 2 billion, due to

Currency	+1.3
Gold	- .7
Required reserves	+ .2

Required reserves increased only slightly because private money supply increase was partly offset by decline in U. S. Government deposits.

Reserve Bank Credit at times supplied by outright purchase of securities, temporary repurchases, or advances to member banks.

Adjust restraining influence by choice of methods.

U. S. security holdings up by 1-1/2 billion

Member bank borrowing restraining

Exceeded 1.5 billion at times and continued to average above 1 billion until May.

Objective to supply funds needed for moderate growth in economy and seasonal purposes, avoiding inflation or deflation. Required supplying credit demands more from savings with minimum recourse to bank credit.

Some rise in interest rates indicated pressures of demand were in excess of available supply.

Period ended in May with severe pressures on money and capital markets.

Recognition of heavy Treasury financing needs forthcoming.

Government deficit and large private credit demands - exceptional for peace time.

Issuance of 3-1/4 per cent bonds.

Period of restraint om expansion (continued)

Basis for monetary growth and for gold outflow (continued)

Not so much cause of rise in rates as a result.

Aim was to borrow without resort to bank credit and Federal Reserve assistance.

Short-term borrowing under circumstances would also have caused rise in rates.

Treasury had to compete for available funds.

Many private borrowers endeavored to anticipate needs - over $4 billion of security issues for new capital in second quarter.

Increase in ceiling on V.A. and F.H.A. insured mortgages brought large volume of mortgages on market.

If all demands had been met, might have had a "bubble on top of a boom" and subsequent collapse.

Economy was operating at capacity - overtime.

Effect of restraint began to be evident.

Possibly was more severe than necessary or desirable - due to growing demand not to curtail supply of credit.

Period of slackening credit demand

Since May, money markets have eased dramatically - due in part to

Slackened credit demands

Federal Reserve actions to supply reserves.

General economic activity has been relatively stable - no further overall growth; decrease in rate of inventory expansion.

Weaknesses appearing in various sectors.

Credit demands -

Treasury the heaviest borrower - over 8 billion net in last half of year, compared with 6 billion in same period of 1952.

Mortgage loans probably slightly larger than a year ago - despite complaints of shortage of mortgage money.

Very real in F.H.A. and V.A.

Issues of State and local Government securities larger than last year.

Corporate security issues slightly smaller than last year.

Period of slackening credit demand (continued)

Credit demands (continued)

Short-term bank loans to business much less than a year ago

Business expenditures for capital equipment and inventory expansion has been above last year.

But retained earnings and depreciation allowances have been larger.

Consumer credit showed much smaller increase in recent months than a year ago.

With bank loan expansion less than last year, banks have shown a much larger increase in holdings of Government securities.

In both years banks bought Government securities at times of new offerings, especially in July, and later sold them to others, as Treasury drew upon funds and banks expanded loans.

Total bank credit expansion in recent months has been somewhat less than a year ago.

Bank deposit increase has accordingly been smaller than last year and so has currency demand.

Growth in demand deposits since April has been approximately usual seasonal amount.

No element of longer - trend growth.

Savings have continued large and a large portion of credit demand has continued to be met by nonbank lenders.

Reserves to meet slackened monetary expansion have been supplied in part by Federal Reserve open market operations and in part by reduction in reserve requirements.

Additional required reserves to meet deposit growth less than in same six months last year - 500 million vs. 800 million

Currency growth also less	-	600 million	vs.	1,100 million
More gold outflow	-	500 "	vs.	100 "

Means of supplying reserves different from last year.

Open market purchases began early in May and totalled about 1.6 billion to date, compared with 1-1/4 billion in same period last year.

$1.1 billion supplied this year through decrease in reserve requirements.

Last year banks borrowed additional 3/4 billion; this year have reduced borrowings by about 3/4 billion.

Timing of reserve actions, this year as last, aided bank underwriting of Treasury financing, but total reserves supplied were based on overall economic needs - not Treasury plus all other.

Period of slackening credit demand (continued)

Money rates and bond yields declined sharply from high levels reached in May.

Bill rates at below 1-1/2 per cent - as low as at any time since accord.

U. S. Government bond yields back to level at beginning of year - still above 1952.

Corporate and minicipal bonds have declined less and are still well above peaks of previous years.

Change in policy?

Principal change has been to supply needed reserves without forcing member banks to borrow.

Partly because borrowings were already large and were having restraining effect.

Also because of change in economic climate - little or no further restraint needed.

Total amount supplied determined by seasonal and normal growth needs - about same as last year.

Usual seasonal demand deposit growth about 6 billion in last half of year-require 1 billion of reserves.

Seasonal currency demand about 3/4 billion.

Allow another 1/2 billion of reserves for normal growth and some 500 million for a gold outflow.

Close to 3 billion of Federal Reserve credit needed to cover these demands in half year.

So far about 2.6 supplied through open market operations and reduction in reserve requirements but 800 million used to reduce member bank borrowings.

Actual needs have been less than projections so far.

Credit and monetary expansion has been less than last year, despite greater availability of funds this year.

Last year banks willing to borrow to obtain funds, this year used available funds to pay off borrowings.

Will need nearly 1 billion more of Federal Reserve credit in next six weeks.

Purely seasonal and temporary

Banks might be willing to borrow for purpose

Some can be supplied through repurchase contracts.

Need for outright purchases will depend on market behavior.

Was difference from last year due to -

Decrease in demand by borrowers?

More restrictive lending policies by banks?

Apparently more of former, but probably some of latter.

In a sense Federal Reserve policy not changed.

Objective the same - supply reserve funds needed for stable economic growth.

Not hard money or easy money policies - but a "balanced" money policy.

Aim is for credit demands to be met as much as possible from savings, with such bank credit growth (other than investment of savings deposits) as is needed to meet demand for transactions, money and current liquidity.

Monetary growth not excessive; may have been too little.

Experiences provide basis for assessing policy measures.

Given the broad objective stated, several questions remain to be answered -

What guides to policy?

What techniques?

What have been effects?

What lessons have been learned?

Guides have changed.

Shift from rather rigid support of U. S. security prices first to orderly market then to adequacy of reserves.

Level of interest rates not a guide, but considered as an indicator, especially for day-to-day operations - principally short-term.

Seasonal variations in monetary needs - one of chief guides - variation of over $2 billion during year in demand for Federal Reserve credit.

Allowance for growth - first approximation may amount to between $1 and $1-1/2 billion a year.

Other quantitative factors affecting reserves - gold, Treasury balances, etc., must be offset.

Qualitative credit tests - kept in mind.

Course of production, employment, and prices - ultimate guides and tests of effects.

Techniques have been developing

In a sense a return to traditional procedures used in 1920s.

Orderly market in Government securities - used especially in refundings.

Involves judgment as to correctness of prices, interfered with market judgments.

Gradually abandoned.

Necessitated some change in Treasury procedures.

New offerings had to be priced to assure favorable reception.

Purchases later confined to Treasury bills.

Nearest approach to money.

Discount obligations - price not important in evaluating asset holdings.

Federal Reserve avoids influencing relationships between different securities.

Permits market arbitrage.

Development of repurchase agreements with dealers

Means of providing purely temporary funds

Banks needing funds sell to dealers, who carry by borrowing from other banks or sell bills to others.

When reserves are scarce and money market tight, dealers sell to Federal Reserve.

Similar to Bank of England.

Rate sometimes above market - sometimes below.

System will buy only when and in such amounts as seems necessary to ease a tight market.

Should these operations be entirely controlled by rate changes?

Member bank borrowing

Another means of providing temporary funds - not only to borrowing bank but to market in general.

More restrictive than open market purchases or repurchase contracts, because banks generally do not like to be in debt.

Problem of how to limit banks that don't mind borrowing - privilege not a right.

Penalty rate - would have to be very high.

Techniques have been developing (continued)

Refusal to lend - not always feasible.

Discouragement to continuous or frequent borrowing - difficult but essential

Task of administration by Reserve Banks

Willingness to lend freely in emergency.

Effects of policies

Difficult to measure effects of monetary policies

If desired results not obtained, may be because of overwhelming power of nonmonetary factors or because monetary measures were not applied with adequate vigor.

If desired results are obtained, might be attributed to other factors.

In general, since accord, credit developments seem to have been properly influenced by measures of monetary policy.

Post-Korea inflationary boom came to an end when credit restraints became more vigorous.

Economy continued to operate at capacity - with neither inflation or deflation.

Apparently no serious unsound credit developments - although test may still be in future.

Restraint on credit expansion exerted first half of 1953 seems to have had considerable restrictive effect - especially in mortgage market and perhaps also in other forms of bank lending.

If all demands had been met, then there might have developed a serious inflationary bubble.

Consequences of current easier money availability yet to be seen.

What significant conclusions might be drawn or questions raised on basis of this experience?

The Federal Reserve can follow a flexible monetary policy, even with a large public debt or even with a Government deficit.

Does not mean ignoring Government securities market or Treasury's needs - now most important sector of money market.

Means these needs should be met in manner consistent with maintenance of economic stability.

The Treasury can compete with other borrowers and raise needed funds without

What significant conclusions (continued)

creation of excessive amounts of new money. Must be willing to pay rates required and adjust to market conditions.

Bank credit can be expanded to facilitate Treasury financing without undue permanent monetary expansion, if Federal Reserve policy is adequately restrictive in following period.

Desirable to offer securities attractive to nonbank investors, but not necessary to restrict bank purchases, if supply of reserves is properly limited.

There has been a free market in Government securities.

Money rates and bond yields have been determined by market forces.

Variations in demand for credit and the available supply of savings have been the dominant factors.

Federal Reserve operations have been for monetary purposes - and the supply of reserves has been relatively stable with adjustments for seasonal variations and growth.

Not determined, except temporarily, by Treasury needs.

Self-reliant and resilient Government securities market requires a minimum of intervention by the Federal Reserve in influencing relationships between prices of various issues.

Yet further changes in market procedures may be needed to promote a flexible market that can operate on its own and provide reasonable liquidity and marketability without creation of new money.

Reinforcement is given to the view that flexible use of general monetary policies (i.e., those concerned with the volume of money) is an indispensable element for the maintenance of stable economic growth.

Should not be concluded, however, that monetary measures alone can determine the course of events.

In conclusion -

Understanding of recent developments and of policies adopted will give the public--particularly the financial community-- a better basis for knowing what to expect and for adapting their operations accordingly.

ON NOVEMBER 17, 1953, 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, WASHINGTON, D. C.

ALL MEMBERS OF THE COUNCIL WERE PRESENT. MR. GEORGE MATKIN, WHO WILL REPRESENT DISTRICT ELEVEN IN 1954, WAS ALSO PRESENT. THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: CHAIRMAN MARTIN, GOVERNORS SZYMCZAK, EVANS, VARDAMAN AND ROBERTSON. ABSENT: GOVERNOR MILLS. MR. CARPENTER, SECRETARY, AND MR. SHERMAN, ASSISTANT SECRETARY OF THE BOARD OF GOVERNORS, WERE ALSO PRESENT.

ITEM I

THE BOARD WOULD BE GLAD TO HAVE THE VIEWS OF THE COUNCIL ON THE PROSPECTIVE BUSINESS AND ECONOMIC SITUATION DURING THE REST OF THE YEAR AND INTO THE FIRST HALF OF 1954. THE BOARD IS PARTICULARLY INTERESTED IN THE COMMENTS OF THE MEMBERS OF THE COUNCIL ON THE PROBABLE DEMANDS FOR BANK CREDIT DURING THE REMAINDER OF THE YEAR AND THE LIQUIDATION OF LOANS AFTER THE TURN OF THE YEAR.

Brown reads Item 1 of the agenda and the conclusions of the Council, as expressed in the Confidential Memorandum to the Board attached. All members of the Council have been surprised that business has held up as well as it has this Fall. Steel production has continued at an exceptionally high level. Any drop in the gross national product will be reflected in a larger percentage decline in net profits before taxes. In the event a company is now paying excess profits tax, the removal of this tax may leave such companies with higher earnings.

Martin. Are there any areas more pessimistic than other areas?

Chandler reports that his district is probably more pessimistic than most districts, because of the lack of rain until recently.

Martin. Is the Middle West generally more pessimistic?

Chandler. The agricultural areas, as a whole, are probably more pessimistic.

Ray states his district is one in which there is considerable pessimism.

Vance Alexander. The farmers are always pessimistic, and at present they are pessimistic about next year. However, Alexander reports that business in his district is generally good.

Vardaman asks how steel production has been able to keep at its present high level. If steel production has held at a high level because of automobile production, will not a decline in automobile production be more serious, as it will affect both the automobile industry and steel.

Davis states that there is a great deal of steel being used for structural purposes.

H. Alexander. The automobile companies are producing a large number of cars. Profits of the companies may not be so good. There are some estimates for a fifteen per cent cut in automobile production in 1954.

Brown. Large amounts of commodities are going to the Commodity Credit Corporation. Loans to the flour mills and the cash grain houses are down considerably. Meat processors have shown an improvement in their business. Since 1939 we have had prosperity, and some maladjustments are evident in the economy. We have had overproduction in some lines, and readjustments will have to be made until the economy becomes stabilized.

Gund. Readjustments are taking place and one can see the change in viewpoint even in persons who seek work.

Smith. There is a considerable volume of new plant and office construction in his district.

Wallace. The overall situation in the twelfth district is probably a little better than it is for the United States as a whole. Every state in the twelfth district has experienced a decline in federal employment, but employment as a whole is good. There will probably be a rather heavy building and loan program on the coast in the year ahead.

ITEM II

THE BOARD WOULD ALSO APPRECIATE HAVING THE COMMENTS OF THE COUNCIL AS TO WHAT IF ANY CHANGES SHOULD BE MADE IN SYSTEM CREDIT POLICIES TO MEET CHANGES IN THE BUSINESS AND ECONOMIC SITUATION IN THE FORESEEABLE FUTURE.

Brown reads Item 2 of the agenda and the conclusions of the Council, as expressed in the Confidential Memorandum to the Board attached. In May the Council felt that the System's credit policies were too restrictive. Later the System placed funds in the market which helped to correct the tight money situation. Since September the business decline has not been as great as had been anticipated. The money market is easier than it has been for months. The Council does not believe that lower rates, or more funds in the market at present, would be helpful to the business situation. It is as necessary to be careful not to ease credit too much as it is to be certain that credit is not tightened too much. All members of the Council believe that the prime rate will decline, and that it is only a question of whether it occurs by the first of the year or a month or two later.

H. Alexander. In May the Council thought the money market was too tight. In September the Council thought the market had been handled well by the Board. In September the Council felt that it would be advisable to lean to a somewhat easier money market. Business has not declined this Fall as much as the Council anticipated. There has been a more than seasonal decline in loans. Fed. funds have varied from as low as 1/8 per cent on one day to 1 15/16 per cent the next day. Credit is available to borrowers and the interest rate structure is not a deterrent to business. There is no case at present for a further easing of the money market.

Brown states that he believes these comments represent an approval of the idea of flexibility, and he is glad to hear them. He thinks the problem is one of a delicate adjustment. For example, the projections they had made called for an increase in loans of over twice the volume that actually resulted. Unfortunately, the feeling developed that the Federal Reserve System had reversed its policy and was ready to supply money freely. In view of Treasury activities and year-end requirements, the System cannot tighten the market so much that everyone will say the Board is really going to tighten up the market now.

Gund states that he was fearful that lip service might be given to free markets and the play of the markets, but that the real policy might be cheap money.

(Off-the-record comments)

Fleming comments that he is certain the Treasury has not changed its objectives. The Treasury cannot afford to have too much attrition at this time.

Brown feels that the responsibility of managing the market is one of the most important responsibilities that the Board has in the months ahead.

Szymczak. It is a difficult problem to determine the exact amount which the market needs at the exact time.

Fleming. It is a very delicate operation.

Evans states he thinks the Council's answer to Item 2 of the agenda is a very good answer, but the Board cannot shift its policies up and down too fast. The Board cannot bob up and down too often in too short a time. The Board expected a considerably heavier demand for funds than occurred. In September the Council also talked of possible reserve reductions, but the Board did not go that far. The Board values these opinions of the Council, as the Council's views help the Board to form better judgments.

Ringland states that the installment volume in his district has declined since May, and they have seen some troublesome situations. He believes the installment business may be a business barometer, as well as steel.

Evans asks who is carrying the implement dealers with their heavy stocks.

Ringland. Sometimes the banks and sometimes the companies carry the paper, but the companies probably carry more of it. The dealers also have their own funds invested in these inventories.

Vance Alexander. His bank is not carrying the implement dealers.

Davis. The companies are carrying a great deal of this paper.

Brown does not believe the country banks are carrying too much of this paper. He states the companies are carrying much of it.

Robertson asks whether the rate of growth in consumer credit is healthier now than it was a year ago.

Ringland. Yes.

H. Alexander states that he was one of those who said in September that a situation might develop where it would be necessary to reduce reserves. However, the need for a reduction in reserves did not develop. With a growing economy, it is necessary to increase the amount of credit available to the economy by perhaps an average of three per cent annually. One way to provide this credit is to reduce reserves instead of having the System constantly buying securities. It is unfortunate to have the idea prevail that a reduction in reserves means the economy is having real difficulty. Alexander would like a little smoother operation in the money market, with changes that are not so sharp. He realizes this is a difficult objective to attain.

Evans believes that reserves are too high. He favors lower reserves. He asks whether the banks would relieve the System of part of its holdings of governments if reserves were reduced. (A number of members of the Council stated that their banks would buy bonds).

H. Alexander believes that spreading funds over the country through a reduction in reserves would result in the 7,000 member banks doing fully as good a job as a bond trader in New York. He believes it would help revitalize the economy.

ITEM III

DOES THE COUNCIL HAVE ANY COMMENTS WITH RESPECT TO THE RECENT ACTION OF THE NEW YORK STATE BANKING BOARD REMOVING THE LIMITATION ON THE PAYMENT OF INTEREST ON SAVINGS ACCOUNTS OR WITH RESPECT TO WHETHER ANY ACTION SHOULD BE TAKEN BY THE FEDERAL BANK SUPERVISORY AUTHORITIES TO RAISE THE EXISTING LIMITATIONS ON THE PAYMENT OF INTEREST ON TIME AND SAVINGS DEPOSITS BY MEMBER AND INSURED NONMEMBER BANKS.

Brown reads Item 3 of the agenda and the conclusions of the Council, as expressed in the Confidential Memorandum to the Board attached. Brown then explains why he believes action was taken in New York to remove the limitation on the payment of interest on savings accounts. Some outlying banks in large cities, and some country banks, are paying 2-$\frac{1}{2}$ per cent, but the amount of deposits involved in relation to total savings deposits is very small. Brown believes that the small additional amount which savers might get in some banks would be offset by the encouragement given to unsound banking.

Chandler asks whether there is an appreciable demand by member banks for an increase in rates.

Martin and Robertson reply, "No".

(There was some off-the-record discussion as to why this question was included in the Agenda).

Vance Alexander. The removal of these limitations, or raising the maximum interest rates, would be bad for country banks.

(Off-the-record comments).

Fleming states that there are evidences that interest rates are tending downward at the present time. The time for any change is wrong now. He believes unsound banking would result if the limitations were removed or the possible maximum rates were raised at present.

(Off-the-record comments).

The meeting adjourned at 12:20 P.M.

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The next meeting of the Council will be held February 14, 15 and 16, 1954.