

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

May 16, 1954

The second statutory meeting of the Federal Advisory Council for 1954 was convened in Room 1032 of the Mayflower Hotel, Washington, D.C., on May 16, 1954, at 2:10 P.M., the President, Mr. Brown, in the Chair.

Present:

William D. Ireland	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
Wallace M. Davis	District No. 6
Edward E. Brown	District No. 7
W. W. Campbell	District No. 8
Joseph F. Ringland	District No. 9
Charles J. Chandler	District No. 10
George C. Matkin	District No. 11
John M. Wallace	District No. 12
Herbert V. Prochnow	Secretary

On motion duly made and seconded, the mimeographed notes of the meeting held on February 14, 15, 16, 1954, copies of which had been sent previously to the members of the Council, were approved.

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 15 and 16.

The meeting adjourned at 6:07 P.M.

HERBERT V. PROCHNOW  
Secretary

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

May 17, 1954

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

Present: Mr. Edward E. Brown, President; Messrs. William D. Ireland, Henry C. Alexander, Geoffrey S. Smith, George Gund, Robert V. Fleming, Wallace M. Davis, W. W. Campbell, Joseph F. Ringland, Charles J. Chandler, George G. Matkin, John M. Wallace, 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 15 and 16, listing the agenda items which the conclusions reached by the Council. The *Memorandum* was delivered to the Secretary of the Board of Governors at 11:30 A.M. on May 17, 1954.

The meeting adjourned at 11:10 A.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 MAY 18, 1954

1. What is the attitude of the Board of Governors of the Federal Reserve System on the question of using Federal Reserve funds for standby credits, as indicated in the Report of the Commission on Foreign Economic Policy (Randall Commission Report)?

The members of the Council would appreciate an expression of the Board's current views on this subject, although the Council understands that the opinion of the Board at a later date might well depend upon such factors as world political and economic conditions, the amount of the standby credits requested, and the terms of the credits suggested at the time when definite proposals were under actual consideration.

All members of the Council believe that under present world conditions it would be unwise for the Federal Reserve System to participate in standby credits for amounts as large as have been suggested. A majority of the Council believes that if standby credits are sought in excess of the amount available through the International Monetary Fund, the additional credits should not be obtained from the Federal Reserve System, but from the Treasury or some other source.

2. What are the views of the Council with respect to (a) prospective business and economic conditions during the next six months and (b) probable changes in the total volume and purposes of bank loans in that period?

(a) Economic trends vary somewhat from district to district and from industry to industry. However, the members of the Council believe that the rate of business decline over the country generally has lessened, and there are indications that the decline is leveling out. The sentiment of businessmen as to future prospects has improved markedly in the period since the last meeting of the Board and the Council, and there is much more optimism.

Better moisture conditions over a wide area have materially brightened the prospects for farmers, and in turn for the many concerns from which they buy. Construction activity has been greater than was anticipated and continues to be one of the strongest single factors supporting the economy. With the increased optimism over business prospects, construction promises to continue at a high rate, offering encouragement for the future. The Council believes that business activity in the next six months will probably not change greatly from present levels, and that changes will mainly reflect seasonal trends.

(b) The volume of bank loans has been better maintained than was expected by the banks earlier in the year. Apart from seasonal trends, the Council does not anticipate any major change in the total volume of bank loans in the next six months. The Council

also does not expect any major change in the purpose of bank loans, other than an increase in the proportion of credit extended for construction.

The foregoing views on business conditions and on bank loans are necessarily predicated on the assumption that there will be no significant change in world affairs. Should a situation develop similar to that which occurred in Korea, it would probably result in another burst of feverish business activity.

3. Does the Council have any suggestions to make with respect to (a) existing System credit policies, (b) the policies that might be followed during the next several months, or (c) the manner in which these policies should be carried out?

(a) The Council believes that existing System credit policies are sound and helpful to the economy. However, the Council is of the opinion that it is desirable to so conduct open market operations that the rates on bills will not fall to as low levels as have prevailed recently.

(b) Before the end of calendar 1954 the Treasury will require a substantial amount of new funds. If the greater part of this new financing is to be done by the banks, as now seems inevitable, it will be necessary to supply the banks with considerable additional reserves. These reserves can be provided by open market operations, by a reduction in reserve requirements, or by a combination of the two methods. A reduction in the rediscount rate would not accomplish the objective, as banks generally would not borrow funds in the amounts that will be required.

To the extent that the banks will be expected to purchase the new issues, the Council believes that the additional reserves required should be provided mainly through reductions in reserve requirements appropriately timed with Treasury offerings for new money. Any small differences between the amount of the additional reserves required by the banks, and the amount made available by a reduction in reserve requirements, should be handled by open market operations. Any reduction in reserve requirements should be kept as nearly as possible to the amount of additional reserves required by the banks to enable them to absorb the new issues so as not to increase the money supply unduly.

How the suggested reduction in reserves should be made, as between central reserve city, reserve city, and country banks, is a matter for the Board to determine.

(c) The manner in which these policies should be carried out is largely covered by the Council's answer to part (b) of this item of the agenda. The Council believes that for the present at least, and unless conditions materially change, the Federal Reserve System should continue the policy it has been following of confining its open market operations to short-term Government securities.

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

May 17, 1954

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. William D. Ireland, Henry C. Alexander, Geoffrey S. Smith, George Gund, Robert V. Fleming, Wallace M. Davis, W. W. Campbell, Joseph F. Ringland, Charles J. Chandler, George G. Matkin, John M. Wallace, and Herbert V. Prochnow, Secretary.

Dr. Woodlief Thomas, Economic Adviser to the Board; Dr. Ralph A. Young, Director of the Division of Research and Statistics; and Frank R. Garfield, Advisor on Economic Research, together with members of the staff, presented a visual-audio report on the economic and business situation. Copies of the report were distributed to the members of the Council.

The meeting adjourned at 3:25 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

May 18, 1954

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

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Messrs. William D. Ireland, Henry C. Alexander, Geoffrey S. Smith, George Gund, Robert V. Fleming, Wallace M. Davis, W. W. Campbell, Joseph F. Ringland, Charles J. Chandler, George G. Matkin, John M. Wallace and Herbert V. Prochnow, Secretary.

The President of the Council read the first item of 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 15 and 16 of these minutes.

Chairman Martin stated that the Board of Governors has not taken a definite position on this matter.

Governor Szymczak added that the Board Staff has been studying the subject thoroughly.

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

A discussion followed in which members of the Board and the Council participated.

President Brown read the third item on the agenda and the conclusions of the Council as stated in the *Confidential Memorandum* previously mentioned. An extended discussion followed.

The meeting adjourned at 12:37 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.

The Secretary's notes of the meeting of the Federal Advisory Council on May 16, 1954, at 2:10 P.M. in Room 1032 of the Mayflower Hotel, Washington, D. C. All members of the Federal Advisory Council were present.

The Council approved the Secretary's notes for the meeting of the Council on February 14-16, 1954.

\* \* \* \* \*

#### ITEM I

WHAT IS THE ATTITUDE OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM ON THE QUESTION OF USING FEDERAL RESERVE FUNDS FOR STANDBY CREDITS, AS INDICATED IN THE REPORT OF THE COMMISSION ON FOREIGN ECONOMIC POLICY (RANDALL COMMISSION REPORT)?

Brown asks Fleming to comment on this item.

Fleming calls attention to the following paragraphs on pages 74 and 75 of the Report of the Commission on Foreign Economic Policy (Randall Commission Report):

After serious consideration, and after study of the testimony of highly qualified and closely interested witnesses both here and abroad, the Commission's view is that for the purposes of a gradual and controlled approach to full convertibility (except for special safeguards against capital transfers and the control of previously accumulated balances) adequate reserves could be found through a much more active utilization than heretofore of the International Monetary Fund's holdings of gold and convertible currencies which now amount to \$3.3 billion. To this end, the Commission favors also any reasonable relaxations by the Fund that might be required, such as a relaxation of the time schedule for utilization of quotas and the provision for maintaining fixed parities.

As a second means of strengthening foreign reserves and of providing foreign exchange support operations to assist in the gradual attainment of general

convertibility, the Commission recommends that the Federal Reserve System explore with foreign central banks the possibilities of standby credits or line of credit arrangements. There is ample precedent for such arrangements in the interwar period; and the Commission believes that this method is superior to any other which might be devised to provide for additional possible calls on dollars, both because it would avoid an increase in the public debt and because it could be handled more flexibly and informally, and therefore more effectively, than a formal grant of credit by our Treasury.

Fleming believes it would be desirable to ask for an expression of the Board's views regarding these sections of the Randall report. The total capital and surplus of the twelve Federal Reserve banks is a little over \$1 billion. Current discussion regarding the amount which might be needed for standby credits over and above the amount obtained from the International Monetary Fund involves figures as high as \$1 billion dollars, equal approximately to the total capital and surplus of the Federal Reserve banks.

Brown (Off-the-record comments). In discussions with various individuals, Brown understands that the amounts most frequently discussed for standby credits are \$500 million to \$1 billion and that recently the figure generally used has been \$1 billion. He also points out that this involves an amount approximately equal to the total capital and surplus of the Federal Reserve banks. He adds that some persons have maintained in the past that the capital and surplus is not a significant factor as the member banks keep the System in funds through reserve requirements. Moreover, the Federal Reserve banks might build up their surplus by retaining part of the profits of the Federal Reserve System, which now go to the Treasury. However, he is of the opinion that possible standby credits from the Federal Reserve System equal to the capital structure of the System do present some serious problems.

Fleming states that he has heard amounts for the standby credits which run even higher than \$1 billion.

Alexander. (Off-the-record comments). The Federal Reserve System could not do this without assurance that it was in line with Administration policy. There is the precedent of 1925. The British apparently feel they need at least \$2½ billion, in addition to the dollars and gold they have. Alexander believes it is probably too early for this idea to be practically considered.

Fleming thinks the best approach for the Council is to find out what the Board's views are on the subject. He is still inclined to believe it is a matter to be handled through the Treasury and not through the Federal Reserve System.

Matkin outlines developments that took place in Mexico recently following the devaluation, especially as these developments involved the shipment of American currency from Texas to Mexico.

Alexander asks whether the Federal Reserve System has the right to make such loans.

Brown states that the Randall Staff Papers make the observation that the Federal Reserve System does have the legal power to grant such standby credits.

Davis asks whether American corporations should not furnish part of the funds, as they benefit from convertibility.

Brown says that the sums involved are so large that the contributions of private corporations would not be significant.

Fleming states he is generally opposed to the idea of the Federal Reserve System granting standby credits. He believes it is a Treasury operation.

Gund is opposed to the extension of such credits by the Federal Reserve System.

Alexander believes it is too early to consider the proposal. When the right time comes, he is inclined to feel that the Federal Reserve System could extend these credits.

Wallace questions seriously the advisability of using the Federal Reserve System for such standby credits. He prefers having the Treasury handle the operation. There is too much international uncertainty. In principle, he is opposed to the theory of using standby credits of the Federal Reserve System, and even if the Federal Reserve System should extend such credits, it is too early to do it now.

Matkin. So many nations are experiencing unstable economic and political conditions that it is not now desirable to extend such credits. Matkin opposes using the Federal Reserve System for standby credits.

Campbell. The Board of the Federal Reserve Bank of St. Louis believes that convertibility is desirable but that world conditions now are not sufficiently stable. When world conditions are better, and if the amount of the standby credits requested are not too large, such credits might be extended. However, the credits should be extended through the Treasury.

Davis. The timing is bad and Federal Reserve credit should not be used for this purpose.

Ireland believes that the timing is wrong, and at the present time he does not believe the Federal Reserve System should do it.

Chandler thinks the timing is bad, but he is inclined to believe the Federal Reserve System could extend the credit, assuming the amount was not too large.

Smith. Any standby credit should be handled by the Treasury, but this is not the proper time.

Ringland. The time is wrong, and if and when it is done, the Treasury should do it.

Brown. If the amount required for such standby credits is beyond an amount which could be obtained from the International Monetary Fund, it should be handled by the Treasury. Summarizing the views of the Council, we may say that all members of the Council believe that under present world conditions, it would be unwise for the System to participate in standby credits for amounts as large as have been suggested. A majority of the Council believes that if standby credits are sought in excess of the amount available through the International Monetary Fund, the credits should not be obtained from the System but from the Treasury or some other source.

## ITEM II

WHAT ARE THE VIEWS OF THE COUNCIL WITH RESPECT TO (a) PROSPECTIVE BUSINESS AND ECONOMIC CONDITIONS DURING THE NEXT SIX MONTHS AND (b) PROBABLE CHANGES IN THE TOTAL VOLUME AND PURPOSES OF BANK LOANS IN THAT PERIOD?

Brown asks each member of the Council to comment regarding this item.

Ireland. For the first three months of 1954, business conditions in the district have generally followed conditions in the rest of the country. Business is on a reasonably even keel. Textiles have improved. The wool business is better, especially the importation of foreign wools. The shoe industry has improved. Ireland thinks the present level of business will probably be sustained. He realizes that some industries are maintaining production because they are using up backlogs. Bank loans in the first four months are up slightly since the end of the year. Payrolls are off. Department store sales are up some since the end of the year. The business decline has tended to flatten out, but Ireland does not look for a strong upturn. He expects loans to stay about where they are except for changes due to seasonal needs.

Alexander believes the business curve is flattening out. Business is holding reasonably steady. Unemployment for the district is less than for the country as a whole. Department store sales have been good. Construction has been very active and is promising for the future. Total construction awards are up over a year ago, and there are ample funds available at good rates for construction. Dairy and potato prices are off. Bank loans will show no marked up or down trends in the months ahead, but will reflect seasonal changes.

Smith. Business has levelled off. Inventories are fairly steady. Consumer spending has held up well. There is considerable emphasis on quality buying. Installment sales are down somewhat. Consumer durables are moving more slowly. Automobile sales are off slightly. Cotton and rayon textiles are up a little. Savings deposits are increasing. Consumer credit outstandings are off moderately. Any change in the volume of loans will result largely from seasonal trends.

Gund. Business is down a little. Several open hearth furnaces were put back into operation in the district. Department store sales are off slightly. Gund expects no material change in business conditions in the next few months, except that there may be a further levelling off after the middle of the year. Construction should continue heavy.

Any further business decline will probably not be substantial. His bank has gone in for more mortgage financing. Savings deposits are going up. Loans in the district will probably reflect only seasonal factors.

Fleming. Construction is strong. Employment has declined. Farm income is down. Demand deposits are off slightly, but savings deposits are up. Inventory buying is close to actual needs. The registration of automobile sales is up one per cent over a year ago. Department store sales in the district are down. Television sales are up. Bank loans are off slightly.

Davis. Someone has recently stated that we have experienced a change from boom (1953) to prosperity (1954). Department store sales are even with last year. Savings deposits are up. Consumer credit outstandings are declining. The percentage of automobiles sold for cash is increasing. Inventories in relation to sales seem high. Traffic on the Belt Line Railroad around New Orleans is up about 8 per cent over a year ago. Employment is down, Total construction is at a high level, although residential construction is down. Shipbuilding is up. Loans may stay a little above a year ago.

Fleming states that the president of the Federal Reserve Bank of Richmond visited 37 banks in North Carolina and South Carolina and found the managements in these banks generally optimistic.

Brown. The rate of decline is lessening, and business is more optimistic than it was thirty to sixty days ago. All bankers are surprised that loans have not declined more. Except for seasonal changes, Brown does not look for any sharp increase in loans. Construction has been a strong supporting influence. There will probably be no major change in the purpose of loans except that a larger proportion may be extended for construction. (Off-the-record comments).

Campbell. Department store sales are off slightly. Overall construction is strong, although residential construction is down. The volume of loans is down. Campbell does not expect any change in the volume of loans, except for seasonal trends. From the standpoint of agriculture, conditions generally look somewhat better, although the weather recently has not been too good. There is a more optimistic feeling among businessmen than prevailed two or three months ago.

Ringland. Business is relatively good, except in the range area and in mining. Department store sales are good. Inventories seem to be in better relationship to sales. Farm income is up a little. Crop conditions generally are good. The wheat acreage will be down, but the acreage taken out of wheat has gone into other crops. Total construction is up. The increase in unemployment is very slight. The total volume of loans should be about the same as last year, with no real change except for seasonal needs. Installment business is showing some improvement. The public is generally more optimistic. The inventory of farm machinery is better.

Chandler. The district in general has had good rains. There have been some bad pasture conditions in some parts of the district. Unemployment is not a serious problem. There is only one town, Albuquerque, which is listed as having surplus labor. Residential construction is at a high rate. Total loans are off only slightly. Demand deposits are up 3 per cent and savings are up eight per cent. The volume of loans in the next few months should remain about the same except for seasonal trends.

Matkin. There has been some relief from drought in some sections. Department store sales are under a year ago. Construction is strong. Unemployment is declining. Business confidence is returning. Consumers are spending freely for quality goods at attractive prices. Adjustments are continuing, but the emphasis is on the upside in business. Loans are up but they have not increased as much as they did last year. There is no reason to expect a strong upsurge in bank loans.

Wallace. The twelfth district followed the general pattern of other districts, except for some slight variation. Industrial production continues to drop but more slowly. The level of activity remains almost stable. Employment in trade and transportation has fallen slightly. The situation in copper has improved. Lead and zinc prices are somewhat better, but they are still below a general break-even point. Unemployment is less severe than for the country as a whole. With a decline in defense demand, consumer demand will have to play a larger role.

Fleming reads from the bulletin of an economic service, indicating the mildness of the present recession.

Brown. Perhaps the Council may report that there are differences in business from district to district and industry to industry but that for the country as a whole, the rate of business decline has lessened. The decline continues but it is not severe. The outlook of businessmen has improved in the period since the last meeting of the Council and the Board in February. There is more optimism than there was in February, and this may be partly responsible for the large expenditures for construction. Better moisture conditions have materially improved the farm outlook. The volume of loans has been maintained better than was anticipated. Apart from seasonal changes, the Council does not expect any material change in the volume or purpose of bank loans, except for some increase in loans for construction. The views of the Council on business conditions and on bank loans are necessarily predicated on the assumption that there will be no significant change in world affairs.

Alexander. In the absence of a deterioration in world conditions which would lead to activity such as followed Korea, it does not appear likely that there will be a marked upturn in the next few months.

### ITEM III

DOES THE COUNCIL HAVE ANY SUGGESTIONS TO MAKE WITH RESPECT TO  
(a) EXISTING SYSTEM CREDIT POLICIES, (b) THE POLICIES THAT MIGHT  
BE FOLLOWED DURING THE NEXT SEVERAL MONTHS, OR (c) THE MANNER  
IN WHICH THESE POLICIES SHOULD BE CARRIED OUT?

Fleming outlines the position of the Treasury for the balance of the calendar year. Aside from refundings, it now appears that the Treasury may need approximately \$10½ billion by the end of calendar 1954. The Treasury may need \$5 billion in the third quarter and \$5½ billion in the last quarter.

Brown states that the exact amount required by the Treasury may vary by a billion or so, depending on whether the commodity credit paper is paid off.

Fleming points out that excess reserves have been running approximately \$400 million to \$500 million each week except for last week when the amount was over \$700 million.

Brown. (Off-the-record discussion on reserves). The A.B.A. Economic Policy Commission is studying the whole question of reserves.

Ringland states that Martin discussed the question of reserves at the meeting of the officers and directors of the member banks of the ninth district at the Federal Reserve Bank of Minneapolis. Martin stated that the Board of Governors and the Staff have no reserve plan upon which everyone has agreed.

Gund. Could the Council say that money is cheap enough for anyone who can put it to good use? No reduction in reserves is advisable at present.

Brown asks how many members of the Council think that money is too cheap. A majority of the Council responded with raised hands, indicating they felt money was too cheap. Brown comments that he knows no one who is qualified to borrow, who cannot get funds.

Alexander leans slightly to the side that lending rates are a little too high. He believes that System policies generally have been satisfactory.

Brown thinks a bill rate under one per cent is too low.

Smith also believes the bill rate is too low.

Brown. Perhaps the Council may say its only criticism as to (a) existing credit policies, since the last meeting of the Council, is that open market operations could have been conducted so that the bill rate would not have fallen as low as it has recently. (All members of the Council agree). As to (b), we know that the government must engage in deficit financing, and much of the new money will have to come out of the banks. It is obvious that the banks must be supplied with considerable amounts of reserves. This can be done by open market operations, or by reducing reserves, or by a combination of both methods. A reduction in the rediscount rate would not accomplish the objective, as banks would not borrow funds in the amounts required.

Ringland. Would not a reduction in reserves adversely affect the rate structure?

Fleming. If the reduction in reserves was just sufficient to meet the needs of the Treasury financing, it would not affect the rate structure adversely.

Brown believes that a reduction in reserves of \$900 million to \$1 billion to take care of Treasury financing of \$5 billion would not adversely affect the rate structure. The Council may say, in answer to part (a) of Item III of the agenda that the existing System credit policies are helpful to the economy. However, it would have been desirable if open market operations had been conducted so that the rate on bills would not have fallen to

as low levels as recently. In answer to part (b), the Council may state that the Treasury will require a substantial amount of new funds before the end of the calendar year. If the banks are to take the major part of this new financing, they will have to be supplied with substantial additional reserves. These reserves can be provided by open market operations or by a reduction in reserve requirements, or by a combination of the two methods. Reducing the rediscount rate would not meet the problem because the banks would not borrow funds in the amounts the Treasury will need. The Council believes that the additional reserves the banks may need should be provided principally through a reduction in reserve requirements. Any small differences between the additional reserves the banks require and the amount made available by reducing reserves should be handled through open market operations. A reduction in reserve requirements should be held as closely as possible to the amount of additional reserves needed by the banks to absorb the new issues. How the reduction in reserves should be made, as between the central reserve city, reserve city and country banks, is a matter for the Board and its technicians to determine. The answer to part (c) is largely covered by the Council's answer to part (b). The Council may state it believes that at least for the present the Federal Reserve System should continue the policy it has been following of confining its operations to short-term government securities.

The meeting adjourned at 6:07 P. M.

THE FEDERAL ADVISORY COUNCIL CONVENED AT 10 A.M.  
ON MAY 17, 1954, IN ROOM 1032 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 May 18, 1954. The Memorandum was delivered to Mr. Carpenter, Secretary of the Board of Governors at 11:30 A.M. on May 17, 1954. It will be noted that each item of the Agenda is listed together with the comments of the Council.

The meeting adjourned at 11:10 A.M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS  
FROM THE  
FEDERAL ADVISORY COUNCIL  
RELATIVE TO THE AGENDA FOR THE JOINT MEETING  
ON MAY 18, 1954

1. What is the attitude of the Board of Governors of the Federal Reserve System on the question of using Federal Reserve funds for standby credits, as indicated in the Report of the Commission on Foreign Economic Policy (Randall Commission Report)?

The members of the Council would appreciate an expression of the Board's current views on this subject, although the Council understands that the opinion of the Board at a later date might well depend upon such factors as world political and economic conditions, the amount of the standby credits requested, and the terms of the credits suggested at the time when definite proposals were under actual consideration.

All members of the Council believe that under present world conditions it would be unwise for the Federal Reserve System to participate in standby credits for amounts as large as have been suggested. A majority of the Council believes that if standby credits are sought in excess of the amount available through the International Monetary Fund, the additional credits should not be obtained from the Federal Reserve System, but from the Treasury or some other source.

2. What are the views of the Council with respect to (a) prospective business and economic conditions during the next six months and (b) probable changes in the total volume and purposes of bank loans in that period?

(a) Economic trends vary somewhat from district to district and from industry to industry. However, the members of the Council believe that the rate of business decline over the country generally has lessened, and there are indications that the decline is leveling out. The sentiment of businessmen as to future prospects has improved markedly in the period since the last meeting of the Board and the Council, and there is much more optimism.

Better moisture conditions over a wide area have materially brightened the prospects for farmers, and in turn for the many concerns from which they buy. Construction activity has been greater than was anticipated and continues to be one of the strongest single factors supporting the economy. With the increased optimism over business prospects, construction promises to continue at a high rate, offering encouragement

for the future. The Council believes that business activity in the next six months will probably not change greatly from present levels, and that changes will mainly reflect seasonal trends.

(b) The volume of bank loans has been better maintained than was expected by the banks earlier in the year. Apart from seasonal trends, the Council does not anticipate any major change in the total volume of bank loans in the next six months. The Council also does not expect any major change in the purpose of bank loans, other than an increase in the proportion of credit extended for construction.

The foregoing views on business conditions and on bank loans are necessarily predicated on the assumption that there will be no significant change in world affairs. Should a situation develop similar to that which occurred in Korea, it would probably result in another burst of feverish business activity.

3. Does the Council have any suggestions to make with respect to (a) existing System credit policies, (b) the policies that might be followed during the next several months, or (c) the manner in which these policies should be carried out?

(a) The Council believes that existing System credit policies are sound and helpful to the economy. However, the Council is of the opinion that it is desirable to so conduct open market operations that the rates on bills will not fall to as low levels as have prevailed recently.

(b) Before the end of calendar 1954 the Treasury will require a substantial amount of new funds. If the greater part of this new financing is to be done by the banks, as now seems inevitable, it will be necessary to supply the banks with considerable additional reserves. These reserves can be provided by open market operations, by a reduction in reserve requirements, or by a combination of the two methods. A reduction in the rediscount rate would not accomplish the objective, as banks generally would not borrow funds in the amounts that will be required.

To the extent that the banks will be expected to purchase the new issues, the Council believes that the additional reserves required should be provided mainly through reductions in reserve requirements appropriately timed with Treasury offerings for new money. Any small differences between the amount of the additional reserves required by the banks, and the amount made available by a reduction in reserve requirements, should be handled by open market operations. Any reduction in reserve requirements should be kept as nearly as possible to the amount of additional reserves required by the banks to enable them to absorb the new issues so as not to increase the money supply unduly.

How the suggested reduction in reserves should be made, as between central reserve city, reserve city, and country banks, is a matter for the Board to determine.

(c) The manner in which these policies should be carried out is largely covered by the Council's answer to part (b) of this item of the agenda. The Council believes that for the present at least, and unless conditions materially change, the Federal Reserve System should continue the policy it has been following of confining its open market operations to short-term Government securities.



ON MAY 18, 1954, AT 10:30 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, WASHINGTON, D.C.

ALL MEMBERS OF THE COUNCIL WERE PRESENT. THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: CHAIRMAN MARTIN, GOVERNORS SZYMCZAK, EVANS, VARDAMAN, MILLS AND ROBERTSON. MR. CARPENTER, SECRETARY, AND MR. SHERMAN, ASSISTANT SECRETARY OF THE BOARD OF GOVERNORS, WERE ALSO PRESENT.

ITEM I

WHAT IS THE ATTITUDE OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM ON THE QUESTION OF USING FEDERAL RESERVE FUNDS FOR STANDBY CREDITS, AS INDICATED IN THE REPORT OF THE COMMISSION ON FOREIGN ECONOMIC POLICY (RANDALL COMMISSION REPORT)?

Brown reads Item 1 and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. Brown understands that the amount most often suggested now is \$1 billion, although \$500 million was mentioned earlier. (Off-the-record comments). Brown states that sterling is the currency for which convertibility is under consideration, but it is entirely probable that other countries would ask to be given standby credits, and this would further complicate the problem.

Martin reports that the Board of Governors has refrained from taking a definite position on this matter. Martin has not talked either with Randall or with any member of the Commission. As Chairman, Martin states he has taken a rather dim view of the matter. He asks Szymczak to comment.

Szymczak. The Staff has been studying this subject from many angles. Nothing in the Federal Reserve Act says specifically that the Board may or may not act in the capacity suggested. In 1925, the System did make a standby credit. The standby credit at that time dealt with the sale of gold on credit. Pounds sterling were also to be set up as a credit on the books of the Bank of England, and this sterling was to be used to buy prime sterling commercial bills. But the credit was never used. Other smaller standby credits were granted, but were not used. There are four methods by which the Federal Reserve System can operate in these matters: (1) deal in gold; (2) buy commercial bills abroad; (3) buy or sell government securities; and (4) open an account abroad. The first two methods were used in the 1920's. Szymczak believes that the Board would have to take the matter up with Congress. Incidentally, sterling bills are no longer available in the amounts that would be needed under one of the methods of operation. If this matter develops further, Szymczak assumes the foreign government would contact the Treasury as the head of the National Advisory Council. Then the foreign government would probably contact the International Monetary Fund. So far no foreign central bank has posed the question of standby credits, and the Board has expressed no opinion regarding such credits. Any foreign representative coming to the Board would have to state that his country wanted convertibility and would have to present a program that had been worked out. Many questions would have to be answered, such as the trade

position of the country and the exact type of convertibility desired. Convertibility might be for residents or non-residents, and for current or capital accounts. Sterling is a key currency. If additional countries wished standby credits, additional problems might be presented. (Off-the-record comments regarding some of the countries whose currencies would present real problems).

Martin. When the Randall report was made, representatives of three countries approached him. He said he would not discuss the matter with them unless the President suggested that the Board do so, and also unless the foreign countries had programs ready for discussion.

Szymczak. The President has stated publicly that this question is being discussed and explored.

Alexander states that he is not one of those who is shocked by the principle of such credits. He is certain that the Board would not make a commitment unless the commitment was sound and had been approved by the Administration as good policy. Under those conditions, the System can make standby credits of the proper amount and under the proper terms. He thinks the principle of one central bank making a loan to another central bank is sound, and it is better than dealing through the Treasuries of each country. Alexander believes that a Federal Reserve standby credit is more desirable than the so-called "Keynes loan" which was so widely discussed. Alexander is of the opinion that the idea is an acceptable one.

Fleming is certain that if Congress would not authorize the Treasury to grant a loan, it would put the System in a bad position to extend it without definite authorization from Congress. He thinks the Board has handled the matter properly.

Gund is in agreement with the views Fleming has expressed.

Brown. (Off-the-record comments).

## ITEM II

WHAT ARE THE VIEWS OF THE COUNCIL WITH RESPECT TO (a) PROSPECTIVE BUSINESS AND ECONOMIC CONDITIONS DURING THE NEXT SIX MONTHS AND (b) PROBABLE CHANGES IN THE TOTAL VOLUME AND PURPOSES OF BANK LOANS IN THAT PERIOD?

Brown reads Item II and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. The Council reviewed business conditions in each district. The business decline has not been as severe as the more pessimistic persons felt it might be. In all twelve districts construction is very active. The psychology of business men plays an important part in business trends. Business men are much more optimistic than they were sixty days ago. Better moisture conditions have materially improved the agricultural outlook. Other than seasonal trends, the members of the Council expect no major change in the volume of bank loans in the months immediately ahead.

Martin. The Board is working now on estimates of the requirements of the money markets from May 1 to December 1. The ideas of "seasonal" have changed greatly. The index of industrial production has declined

from a peak of 137 to 123. The Board is faced with many difficult questions in working out the projected requirements of the money markets.

Fleming asks whether the Board has considered the possibility of greater uncertainty in Asia.

Martin understands our defense expenditures may be at the bottom at the present time.

Chandler. In February, Martin thought a number of months would be required to liquidate inventories. Does he still feel that way?

Martin replies he still is of the same opinion. If one eliminates Indo-China and the dangers there, Martin still believes inventories are too high.

Fleming. If you think not in terms of the peaks of 1953, but of the figures of 1952, it is clear we have very good business. The columnist, Livingston, says we have gone from boom (1953) to prosperity (1954).

Martin asks if there are any areas where mortgage money is tight.

Fleming says there is plenty of mortgage money in his district.

Ireland, Smith, Ringland and Chandler all state they believe there is ample mortgage money.

Wallace thinks that mortgage money is in adequate supply.

Brown. There is no shortage of mortgage money in the seventh district. In the Council's discussion no one reported any shortage of money in any area of borrowing.

Matkin reports that there may be some shortage of money for construction loans, but not for real estate loans, and he raises the question of the limit under the law for construction loans.

Robertson says that this is a question for the Comptroller.

Davis reports that there is plenty of mortgage money in the Atlanta district. In connection with inventories, he believes some manufacturers who hear optimistic business talk are actually building up or maintaining inventories and are tending to hold up prices.

### ITEM III

DOES THE COUNCIL HAVE ANY SUGGESTIONS TO MAKE WITH RESPECT TO (a) EXISTING SYSTEM CREDIT POLICIES, (b) THE POLICIES THAT MIGHT BE FOLLOWED DURING THE NEXT SEVERAL MONTHS, OR (c) THE MANNER IN WHICH THESE POLICIES SHOULD BE CARRIED OUT?

Brown reads Item III of the agenda and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. The Council believes the System's credit policies have helped to moderate the decline. He understands the Treasury may require \$10-\$11 billion in new money, which would include taking up approximately \$1 billion of Commodity

Credit paper. If the banks are to provide the funds needed, it will be necessary to give the banks additional reserves. The amount of the reduction in reserves should be held close to the amount of money needed to finance the new issues. Any differences should be met by open market operations. The Council expects that the banks in the central reserve and reserve cities will be the ones primarily to subscribe to the new issues, although the country banks will have to be given some reduction in reserves. Unless we have another Korea in Indo-China, or some serious economic or international developments, the Council believes that open market operations, at least for the present, should be confined to short-term obligations. (Off-the-record comments regarding reserves).

Fleming. The Council is not rigid in its thinking regarding the percentage by which reserves should be reduced. (Off-the-record comments).

Wallace believes the country banks should be given some relief.

Alexander thinks the reduction in reserves should come primarily off the top, that is, the central reserve cities. However, he realizes this is not feasible. The Board worked out the reduction in reserves last year in an exceedingly able manner. Speaking for himself, he would not object to a little reduction in reserves spilling over, although the Council has expressed the desire to have the reduction in reserves fit as closely as possibly to the needs for new money by the Treasury. He does not believe there should be any mandate that the open market can never deal in longer-term issues, but at present he thinks it is desirable to confine these transactions to short-term obligations.

Martin states that he has some difficulty in determining the difference between the terms, "sloppy" and "active ease".

Alexander comments that it is difficult to foresee market requirements. However, the requirements of the Treasury are a positive. Barring unfavorable developments in Indo-China, Alexander would calculate a normal seasonal trend in the months immediately ahead. He thinks some liquidation of inventories will continue. However, world conditions are quite serious. It is possible that some manufacturers are maintaining inventories higher than they would ordinarily.

Campbell believes that the country bank purchases of the new securities which may be offered by the Treasury will equal the country banks' proportionate share of the total purchases.

Ringland states he is sympathetic with the central reserve city problem, but he believes the reserve cities deserve equal treatment on reserves.

Alexander comments that reserves are too high for both classes of cities.

Robertson states that there is no long-term mandate regarding the purchase of short-term securities by the Open Market Committee. The decision of the Open Market Committee can be changed at any time.

Fleming calls attention to the material sent by Horbett to Sherman Adams, Deputy Manager of the ABA, relative to the subject of

reserves and to correspondence on the matter. Fleming thought the matter might be brought up at this meeting.

Mills. The Council has discussed this matter in the past. The Board is merely informing the Council of its correspondence with the ABA.

Martin. The Board wishes to review the whole question of reserves.

Fleming suggests that Horbett send any studies on the matter of reserves to the Council members.

Martin says any studies will be sent to the Council.

Szymczak. The problem of reserves has changed greatly since the System was started.

Alexander states that the problem lessens as reserves are lowered and the three groups of banks--central reserve city, reserve city and country banks--are brought nearer together on the reserves required from them.

Brown. Only three members of the present Council were on the Council when the matter of reserves was discussed some time ago. He believes all members of the Council would agree that vault cash should be counted.

Robertson asks whether it would be better to try for a complete change in the reserve requirements and take years for legislation, or whether it is better to work it out piecemeal more quickly perhaps. The matter of vault cash might be dealt with as one item. This would be quicker than to wait for legislation regarding the whole subject.

Martin hopes the Board may have some program on reserves to present to the next session of Congress.

The meeting adjourned at 12:37 P. M.

\* \* \* \* \*

The next meeting of the Council will be held on September 19, 20 and 21, 1954.