FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7459
September 17, 1974]

Statement by the Federal Advisory Council on Bank Lending Policies

To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:

Following is the text of a statement issued September 16 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today released the attached statement on bank lending policies that was received from the Federal Advisory Council, a statutory body established under the Federal Reserve Act. The statement suggests how banks can effectively adapt lending policies in the current period of credit restraint.

The Board believes the Council's statement can be helpful to commercial banks in formulating their lending policies under current circumstances.

The Board regards restraint in lending policies as essential to the national effort to control inflation. Restraint best serves the public interest when limited credit resources are used in ways that encourage expansion of productive capacity, sustain key sectors of national and local economies, provide liquidity for sound businesses in temporary difficulty, and take account of the legitimate needs of individuals and of small as well as large borrowers.

The Board noted particularly that the Council in its statement recognized "the special vulnerability of the home-building industry." An active home-building industry is vital to the well-being of local communities as well as of the Nation as a whole, and it is to the interest of banks and other financial institutions to give reasonable support to the financial needs of that industry.

The Federal Advisory Council is composed of twelve leading bankers, one from each Federal Reserve District. It was created by the Federal Reserve Act and under law is required to meet with the Board of Governors at least four times a year. The attached statement stems from a discussion of bank lending policies during a recent FAC meeting with the Board.

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STATEMENT OF THE FEDERAL ADVISORY COUNCIL ON COMMERCIAL BANK LENDING POLICIES

The members of the Federal Advisory Council firmly believe that inflation remains our most acute domestic problem and that the effort to reduce it deserves the full dedication of all Americans. We have been pleased recently to observe the renewed efforts of the Administration and other segments of our National Government, in consultation with a broad representation of interested groups in the private sector, to identify appropriate and effective policies to deal with this problem.

As bankers we are acutely aware of the disproportionate role which a restrictive monetary policy has had to bear thus far in the fight against inflation. We are particularly hopeful that fiscal and other measures will be adopted which will soon alleviate this excessive reliance on monetary restraint and high interest rates, because government spending and budget deficits are a major cause of inflation.

We recognize, however, that regardless of the measures adopted, money and credit will necessarily remain limited in supply as long as inflationary pressures persist. We are confident that sufficient money will be made available to assure orderly operation of credit markets and to provide for the resumption of real growth in the economy. However, we foresee a period of considerable duration when the supply of lendable funds will be limited, and when, therefore, it will be necessary for banks to restrict the growth in their loan portfolios by selecting carefully and responsibly the uses to which they put their loanable funds.

It is also clear that this process contributes to the very desirable objective of reducing interest rates, a development banks welcome. Relief from the present unprecedentedly high rates would be particularly beneficial to those segments of the economy that are by their nature heavily dependent on borrowed money, such as housing and public utilities.

In view, therefore, of the extreme importance of

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bank lending policies in today's environment, we should like to describe those policies which we believe are appropriate in present circumstances and which, we feel, are already being followed by many banks.

The basic credit needs for normal operations of all established business customers should, of course, be met to assure the production and distribution of goods and services.

Loans to finance capital investment by business are also appropriate, where access to capital markets is not available and where the investment is reasonable in size and necessary to maintain or improve productivity, or to increase capacity to meet existing or clearly anticipated demand. In considering such loans, banks should weigh the relative importance of the particular business with respect to such factors as the nature of its product or service and its significance as an employer in the local area. Particular consideration should be given to the needs of established businesses which are basically sound but which suffer a temporary lack of liquidity because of present conditions.

Loans for purely financial activities, such as acquisitions or the purchase of a company's own shares, would normally not be appropriate uses of limited bank funds.

Loans for speculative purposes, such as purchasing securities or commodities other than in the ordinary course of business, excessive inventory accumulation, or investing in land without well-defined plans for its useful development, are not generally suitable.

A regrettable aspect of restrictive monetary policy is that it tends to produce an uneven impact, bearing more heavily on some sectors of the economy than others. Therefore, banks should make an effort to utilize their limited funds equitably, giving consideration, for instance, to the special vulnerability of the home-building industry.

Similarly, consumer credit should receive its share of bank funds. The basic requirements of individuals for household needs and automobiles should be accommodated, but discretionary spending which might be deferred should not be encouraged.

Loans to foreigners which are funded from domestic sources should also be weighed against the above criteria. In addition, banks should give careful consideration to the diversion of loan funds from United States customers through such loans.

Implicit in these policies is a need for close communication and counseling between bankers and their customers to agree on ways to reduce or defer borrowing needs or to identify alternate sources of financing.

The Council recognizes that it is impossible to prescribe a precise and particular list of priorities for proper bank lending. We do feel, however, that the policies outlined describe a responsible posture that is appropriate to present circumstances. We believe that Government credit allocations are not needed and that they would be counter-productive.

We are confident that the Nation's banks will continue to cooperate with our Government and all sectors of the economic community in implementing sound and necessary national policy.

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Additional copies of this circular will be furnished upon request.

ALFRED HAYES,

President.