



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

Z-6313 (On office
copies only)

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 6, 1966.

Dear Sir:

Supplementing our telegram of September 1, 1966, regarding the program for discount administration in the current economic environment, there are enclosed for your information and files two copies of the internal System memorandum that was quoted in our wire.

Very truly yours,

A handwritten signature in cursive script that reads "Kenneth A. Kenyon".

Kenneth A. Kenyon,
Assistant Secretary.

Enclosures

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.

FOR INTERNAL SYSTEM USE ONLY

PROGRAM FOR DISCOUNT ADMINISTRATION
IN THE CURRENT ECONOMIC ENVIRONMENT

In contrast to a somewhat reduced rate of expansion for most monetary and credit magnitudes thus far this year, bank loans to businesses have expanded at an extraordinary pace. This development needs to be taken into account, insofar as feasible, in the application of all instruments of monetary policy, including discount policy.

In the current business and financial situation, the amount of borrowing by member banks from their respective Reserve Banks may increase substantially. This is expected to result from the interaction of strong credit demands and current System policies with respect to open market operations, reserve requirements and maintenance of Regulation Q ceilings, with attendant possibilities of substantial run-offs in CD's or declines in other types of deposits, and perhaps also occasional drying up of sources of inter-bank borrowing.

In this environment, accommodation of banks at the discount window should take into account the need to curtail bank lending to the business sector of the economy. Furthermore, this accommodation should recognize that bank adjustment through such loan curtailment probably involves a longer period of time than through the orderly disposition of securities. At the same time, it is desirable that bank efforts to adjust their positions in response to pressures on the banking system do not result in a demoralization of any other financial markets where bank influence is of significant importance (e.g., the municipal market).

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It is believed that Federal Reserve Bank discount administration can help to accomplish the desired objectives, within the framework of the present Regulation A. It is likely that in those situations where there is a sharp run-off of CD's or a drying up of inter-bank sources of funds, it may be necessary, as the Regulation in fact has anticipated,^{1/} to lend to banks for somewhat longer than usual periods of time. Such longer periods of credit extension would permit the borrowing bank to make some orderly serial adjustment in the area of business loans rather than concentrating its adjustment in such other earning assets as municipal and agency securities, real estate mortgages, and other loans.

While discount officers should refrain from urging specific decisions upon member banks, they should nevertheless urge the desirability of undertaking adjustments in business loan totals. In any case, it should be made clear--again in accordance with the present Regulation^{2/}--that expansion of business loans at current rates is not in the public interest and will not be condoned while the member bank is in a position of having to borrow from the Federal Reserve Bank.

Indicated demands for industrial credit during the next few months are such that it is altogether likely that member banks will have to forego loans to some well-established prime customers. It

^{1/} ". . . Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks. . . ." Regulation A, Section 201.0, par. (d).

^{2/} Regulation A, Section 201.0, par. (e), quoted on page 3.

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is not intended that System policy shall prevent member banks from meeting legitimate and normal seasonal needs, especially where they have made some preparation to take care of this themselves; it is intended, however, that the seasonally adjusted rate of expansion of business loans shall be reduced. This should not be construed, of course, as any license to expand other types of loans unduly.

The emphasis on slowing down the rate of growth of a particular category of loan--or even achieving some reduction in individual bank cases--is a departure from recent discounting practice and tradition. It is felt to be necessary because of the Board's conclusion that the present rate of expansion of business loans is supporting an unsustainable rate of growth of business investment, with unsound consequences for economic and financial conditions. The Foreword to Regulation A has anticipated this possibility. It specifies that "each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally." It is this concern for "sound credit conditions," rooted in the Federal Reserve Act itself, which makes it currently necessary to bring to bear those aspects of discount administration which are designed to deal with unusual circumstances.

While the standards of discount accommodation outlined above can only affect directly those banks that are indebted to the Federal Reserve Banks, the Reserve Bank officials are encouraged to continue to take the initiative in communicating with any other of the larger banks

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whose general liquidity position and lending activity are such that they might soon need to borrow from the Federal Reserve. The System's policy and the reasons for it should be explained to them in an effort to encourage them to anticipate their needs and to make adjustments in their lending policies that would be appropriate to the situation.

In addition, the examination function will be asked to pay particular attention to the liquidity position of all member banks. Where appropriate, examination officials might be invited to participate jointly with discount officials in contacts with member banks whose liquidity position and lending activity are out of keeping with the program herein enunciated.

Nothing in this program is intended to modify in any way the existing procedures for extension of Federal Reserve credit to assist member banks in meeting temporary, seasonal or emergency needs under the provisions of Regulation A. Those member banks that, in an easier credit environment, may have obtained seasonal or emergency credit assistance by borrowing from their city correspondents are as eligible for accommodation at the discount window as is a member bank that previously had followed the practice of coming to the Reserve Bank for such assistance.

September 1, 1966.