A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Friday, February 27, 1948, at 10:15 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. Clayton
Mr. Davis
Mr. Draper
Mr. Evans
Mr. Gidney
Mr. Peyton
Mr. Szymczak
Mr. Whittemore

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Neal, Stead, Thompson, and John H. Williams, Associate Economists
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Arthur Willis, Special Assistant, Securities Department, Federal Reserve Bank of New York

Messrs. Alfred H. Williams, Young, Gilbert, and Leedy, alternate members of the Federal Open Market Committee

Messrs. Leach, McLarin, and Earhart, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Messrs. Bopp and Irons, Vice Presidents of the Federal Reserve Banks of Philadelphia and Dallas, respectively, Messrs. McCracken and Robb, Directors of Research of the Federal Reserve Banks of Minneapolis and Kansas City, respectively, and Mr. Ralph A. Young, Associate Director of the Division of Research and Statistics, Board of Governors

Mr. McCabe, Chairman designate, Board of Governors

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 9, 1947, were approved.

Upon motion duly made and seconded, and by unanimous vote, the actions of the executive committee of the Federal Open Market Committee as set forth in the minutes of the meetings of the executive committee held on December 9, 1947, and January 20, 1948, were approved, ratified, and confirmed.

Chairman Eccles stated that at the meeting of the executive committee on January 20, 1948, there had been distributed copies of a report prepared by Messrs. Rouse and Smead pursuant to the action taken at the last meeting of the Federal Open Market Committee with respect to the allocation of securities in the System open market account, and that the procedure was approved unanimously by the executive committee at that meeting with the understanding that it would be submitted with a favorable recommendation for its ratification at the next meeting of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the procedure for the allocation of securities in the System open market account, as set forth in the minutes of the meeting of the executive committee on January 20, 1948, was approved, ratified, and confirmed.

Mr. Rouse presented and discussed a report of open market operations covering the period from December 9, 1947, to February 20, 1948, inclusive, together with a supplemental report covering commitments made on February 24, 25, and 26, 1948, and there followed a brief discussion of the transactions that had taken place and the conditions that had prevailed in the market during the period covered by the reports. Copies of the report first mentioned were distributed during the meeting and copies of both reports have been placed in the files of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account for the period December 9, 1947, to February 26, 1948, inclusive, were approved, ratified, and confirmed.

Mr. Thomas then presented a report on economic prospects and their financial implications, stating that inflationary forces continued to be the dominant economic factor in the United States and throughout most of the world, that the recent sharp decline in prices of several commodities had weakened somewhat, for the time being at least, upward pressures on the general price level, but that in view of special circumstances bearing upon these selective price declines it should not be concluded that the underlying inflationary spiral of costs, prices, and incomes which characterized 1947 had ceased to operate. He also said that an analysis of economic prospects led to the conclusion that there would continue to be a demand for bank loans in 1948 that might result in a credit expansion exceeding that of 1947, that such a development would mean a continued large volume of expenditures at high and perhaps advancing prices supported by expanding bank credit, that if such developments occurred the economic situation would become increasingly vulnerable, that continuing inflationary developments along these lines would heighten the risk of a serious deflationary setback at some stage, and that the policy determining authorities of the Federal Reserve System would need to face the question whether the resources of the System should continue to be used to support such a course of developments. A copy of Mr. Thomas' statement has been placed in the files of the Federal Open Market Committee.

Mr. Bopp then reported the results of a survey of business sentiment as measured by a meeting of Philadelphia business leaders held at the Federal Reserve Bank of Philadelphia on February 18, 1948, stating that the outstanding impression gained from the meeting was that there was no tendency to view the early future with alarm although a note of caution had been introduced into the outlook by the recent sharp declines in commodity markets, that there was general agreement that some price adjustments would have to be made over the relatively near future in view of the better balance between supply and demand, and that none of those at the meeting looked forward to any serious recession of economic activities as a near-term prospect. Mr. Bopp also said that the problems of meeting greatly increased capital requirements and the difficulty of attracting venture capital were brought up repeatedly, and that the discussion indicated that business expected to go to banks to an increasing degree during 1948 for new capital funds. He added, however, that it was the general view that postwar investment plans were running out and, except in special instances such as in the utilities and oil industries, the rate of investment in later years would be substantially lower than during the immediate postwar years.

Following Mr. Bopp's remarks, Mr. John H. Williams made a statement, a copy of which has been placed in the files of the Federal Open Market Committee, with respect to the foreign situation in which he commented that economic recovery in Europe had proceeded more rapidly than was generally realized and had reached a point where output in several countries was larger than in the prewar period, that despite this recovery Western European countries were confronted with inflationary forces postponed from the war, and that they faced a difficult problem in meeting their balances of payments over the next several years. He also said that the impact of European conditions had been a major influence upon the United States economy throughout the postwar period and especially in 1947, during the second half of which the need for furnishing food to Europe had been a major spearhead of our inflation. He felt that there was need for continued help by the United States to Europe along the lines of the European Recovery Program, that an important question was the means by which the Program should be financed in view of the domestic anti-inflationary policy, that the recent drop in domestic food and farm commodity prices introduced uncertainty as to whether the inflationary pressures might have run their course, and that if this proved to be the case he felt that funds to finance the European Recovery Program should be obtained in part by borrowing from nonbank sources. As to the future impact of the European Recovery Program on the domestic economy, Mr. Williams felt that the effects probably would be more helpful than harmful, since our general objective must be to maintain a large volume of production and employment in the United States while doing everything possible to stabilize or reduce prices. In this connection he stated that, while monetary measures were important and should be used in dealing with the inflation problem, the chief danger in the present uncertain circumstances might be in pursuing a too severe rather than a too mild policy.

Copies of a memorandum prepared in the Board's Division of Research and Statistics with respect to Treasury financing and bank credit were then distributed. The memorandum, a copy of which has been placed in the Federal Open Market Committee files, stated that during the remaining six weeks of the first quarter of 1948 an excess of Treasury tax and other receipts over current expenditures would enable the Treasury to build up large deposits with Federal Reserve Banks and thus withdraw funds from commercial banks, that such a drain would make it necessary for commercial banks to liquidate some of their assets, that such liquidation presumably would take the form of sales of Government securities most of which would be purchased by the Federal Reserve System, that this need for liquidation should put some pressure on banks and discourage them from making loans, and that it appeared that banks might need to sell almost $2 billion of securities to the Federal Reserve during this period if reserves were to remain substantially at their present level.

The memorandum also discussed probable developments during the period March 31 to June 30, 1948, stating that tentative estimates indicated the Federal Reserve might find it necessary to sell as much as $1 billion of Government securities during that period to prevent an increase in reserves available to banks for credit expansion, and it presented the outline of a possible program of debt retirement and new financing during the rest of the first quarter of the year and the period from March 31 to June 30. With respect to the estimate of the growth in reserves of banks during the second quarter of the year, Mr. Thomas said that at the meeting of the executive committee yesterday it was pointed out estimates made by the Federal Reserve Bank of New York arrived at a conclusion that the easing of pressure on banks would be much less (perhaps as much as $2 billion) than was indicated by the estimates prepared at the Board.

Chairman Eccles stated that it seemed clear that the situation for the rest of this quarter would be one of substantial pressure on bank reserves as a result of which he felt it would be desirable to permit war loan deposits to accumulate in commercial banks. He also said he felt no change should be made in the present policy of retiring a portion of weekly issues of maturing Treasury bills. With respect to the second quarter, Chairman Eccles said that if the expected easing in the reserve position of banks took place, there would probably be a tendency for banks to seek additional investments either by expanding loans or by purchasing additional securities, that if these investments were in the form of short-term securities there would be less argument for increasing the short-term rate, and that to keep banks from resuming the purchase of longer term Government securities it might be desirable to narrow the spread between yields on short-term and long-term Government securities, which indicated a recommendation to the Treasury that certificates maturing April 1, 1948, be refunded with an 11-month issue of 1-1/8 per cent certificates. He went on to say that such an issue would indicate to the market a probable rise to 1-1/4 per cent in the rate to be paid on certificates maturing June 1, but that it would not necessarily commit the Treasury at this time to the adoption of such a rate if the entire outlook changed substantially in the meantime. He also said that if the Treasury was not now willing to consider the possibility of advancing the rate on certificates to 1-1/4 per cent on June 1, it would be undesirable to issue an 11-month 1-1/8 per cent certificate on April 1.

Mr. Sproul stated that the Committee was faced with the need for making important decisions when the available statistical information on which to base those decisions was not as helpful as the members of the Committee would like, that the unknown factors in the situation were very important and many important factors involved a large element of psychology, and that the difference of $2 billion in the estimates of the staff of the Federal Reserve Bank of New York and the estimates made by the Board's staff was of extreme importance because it might mean that if the latter estimates were correct the Treasury would be putting about $1 billion into the market and if the New York figures were correct the Treasury would take $1 billion out of the market in the second quarter. In these circumstances, he said, the Committee had to make its decisions at this meeting more largely on the basis of judgment than had been the case at times in the past.

Mr. Sproul felt that the most important question now was whether the recent break in commodity markets (a) was the beginning of a major readjustment of the distortions and strains in our economy which might involve a business recession of serious proportions; (b) was a correction of an unbalanced situation which would contribute to the maintenance of a generally strong position, although leaving us with some inflationary pressures still at work; (c) was a minor interlude in a continuing postwar inflationary boom. He added that, if it was the first, monetary and debt policies should be reversed so as to avoid contribution to what might become a drastic deflation; if it was the second, existing policies should be continued about as at present until the outlook was more clearly defined; and if it was the third, the System should intensify pressure if it had the means to do so. He expressed the view that policies should be conducted according to the second possibility, and that no further calls should be made on war loan accounts during this quarter. He also discussed the conditions which would influence debt management decisions in the second quarter and would form the basis for a recommendation that the April 1 maturity of Treasury certificates be refunded with an 11-month 1-1/8 per cent certificate as suggested by Chairman Eccles. He felt that such an issue would be a threat of higher rates to come without definitely and finally committing the Treasury to an increase in the certificate rate in connection with the June 1 refunding, that for the present no further increase of reserve requirements of central reserve city banks should be made, and that the suggested program should be subject to reversal within the rest of the current half-year if conditions changed to warrant such a reversal.

Mr. Sproul suggested that the immediate recommendations to the Treasury should be (1) that no further calls be made on war loan accounts during the first quarter, (2) that withheld taxes be channeled through war loan accounts as soon as that change in procedure can be made effective, and (3) that an 11-month 1-1/8 per cent certificate be offered in exchange for the April 1 maturity, which would be an indication that a 1-1/4 per cent rate would be established in connection with the June refunding if conditions at that time made such action desirable and that the action might be followed by an increase in the discount rate.

It was his view that these recommendations would meet the immediate situation and that early in the second quarter, when trends could be more clearly defined, recommendations could be made with respect to further actions that might be taken.

There was a general discussion of the current monetary and credit situation and the possible effects of actions available to the System and the Treasury under existing conditions, as well as of the possible effect of a grant to the System of additional authority to regulate the expansion of bank credit while at the same time carrying out its policy of supporting the Government securities market.

Toward the end of the discussion Mr. Sproul again suggested that the three actions previously mentioned by him be recommended to the Treasury with the understanding that the retirement of System bill holdings would be continued at the rate of at least $100 million a week through April and perhaps beyond that time.

Mr. Evans repeated his view that the short-term rate should not be increased further, that an increase in the rate to 1-1/4 per cent would not be effective as an anti-inflationary measure, that the existing short-term rates were too high with the result that in 1947 banks had net current earnings before income taxes of about 11 per cent on their invested capital, and that this might have very undesirable effects upon the attitude of the public towards commercial banks. He added that the most effective, efficient, and economical method for channeling short-term Government securities into the banks would be by the special reserve plan. This method would enable the Government to finance its short-term securities at a rate of interest fair to the banks and the tax payers. The alternative plan of constantly increasing the short-term rate is a weak, inefficient, and costly process for accomplishing the desired result.

Chairman Eccles stated that an increase in the rate to 1-1/4 per cent would not be for the purpose of increasing bank earnings but to narrow the spread between short- and long-term rates so that when banks had excess reserves after the first quarter of the year there would be less likelihood of their buying long-term securities because of the higher yield, thereby putting pressure on the long-term rate as was done last year.

Chairman Eccles then suggested that the full Committee authorize the executive committee to submit to the Treasury recommendations on the four points proposed by Mr. Sproul.

> Upon motion duly made and seconded, Mr. Sproul's proposal was approved with the understanding that the executive committee would also make such further recommendations with respect to Treasury financing and debt management as appeared to be desirable pending another meeting

of the full Committee. Mr. Evans voted "no" on the portion of the above action that contemplated a further increase in the short-term rate.

In connection with the foregoing discussion, Chairman Eccles said that one of the most inflationary factors in the expansion of bank credit for some time had been the growth in mortgage credit, that the Board was on record with Congress as feeling that Government insurance and guarantee provisions with respect to housing credit should be tightened, that the program contained in the President's special message to Congress last week went beyond what was already being done, and that if such a program was enacted it would have seriously adverse effects on the problem of inflation and credit control. Chairman Eccles also said that the Board would send a summary of this bill to the Presidents of all the Federal Reserve Banks so that they would have available an analysis of the proposed legislation.

There was then distributed copies of a memorandum prepared in the Board's Division of Research and Statistics under date of February 25, 1948, to which were attached schedules prepared at the Federal Reserve Bank of New York of yields on a proposed new series of Treasury savings notes intended to meet the conditions of a 1-1/8 per cent and a 1-1/4 per cent certificate rate. Reference was made to the conclusion reached at the meeting of the executive committee on January 20, 1948, that no recommendation should be made to the Treasury with respect to a new series of savings notes until a decision had been made on an increase in the short-term rate to 1-1/4 per cent. The matter was discussed and the members of the Committee indicated that they continued to be of that opinion.

> After a brief discussion of possible terms of the new series of savings notes, upon motion duly made and seconded, and by unanimous vote, the executive committee was authorized, after a decision had been reached by the Treasury whether the short-term rate would be increased, to formulate and submit a recommendation to the Treasury with respect to the issuance of a new series of savings notes, if in the judgment of the executive committee such action was desirable.

Reference was made to recent statements by the Secretary of the Treasury at a press conference which appeared to commit the Treasury and the Federal Reserve System to the support of all issues of securities at par. Mr. Sproul stated that he felt that, inasmuch as the President of the United States had avoided such a commitment in his Economic Report to Congress, and as the Federal Open Market Committee's present policy provided for the maintenance of only the long-term 2-1/2 per cent rate, the Secretary of the Treasury should avoid making such statements.

The matter was discussed and Chairman Eccles suggested that, at the appropriate time, when other matters were being considered with the Secretary of the Treasury, the statement be made to him that the question of the nature of the commitment of the System with respect to support of the Government security market had been raised with the members of the Committee as it undoubtedly had been with representatives of the Treasury, that the only commitment that the System had made was, under existing and prospective conditions, to maintain the 2-1/2 per cent long-term rate and not that it would support all issues of Government securities at par, and that it was the feeling of the Committee that care should be taken to avoid any statement which might give the impression that any other commitments had been made.

Upon motion duly made and seconded, and by unanimous vote, Chairman Eccles' suggestion was approved.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.