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 Thursday, May 20, 1948, at 10:30 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Clayton
Mr. Draper
Mr. Eccles
Mr. Evans
Mr. Gilbert
Mr. Leedy
Mr. Szymczak
Mr. Williams
Mr. Young

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Townsend, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Bopp, Irons, Langum, Robb, and John H. Williams, Associate Economists
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman of 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. Leach, Gidney, McLarin, and Earhart, alternate members of the Federal Open Market Committee

Messrs. Whittemore, Davis, and Peyton, Presidents of the Federal Reserve Banks of Boston, St. Louis, and Minneapolis, respectively.

Messrs. Thompson and Johns, Vice Presidents of the Federal Reserve Banks of Cleveland and Kansas City, respectively.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on February 27 and March 1, 1948, 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 February 26, March 1, and April 21, 1948, were approved, ratified, and confirmed.

A report of open market operations covering the period from March 1, 1948 to May 17, 1948, inclusive, was then read and discussed by Mr. Rouse. He also presented a supplemental report covering commitments made on May 18 and 19, 1948. 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 February 27, 1948 to May 19, 1948, inclusive, were approved, ratified, and confirmed.

A report of examination of the System open market account as of February 20, 1948, made in connection with the regular examination of the Federal Reserve Bank of New York and submitted by the examiner in charge for the Board of Governors, had been brought to the attention of each member of the Committee before this meeting. The report noted three exceptions to the policy of restricting transactions in United States Government securities for the System open market account to brokers and dealers who, in the opinion of the Federal Reserve Bank of New York, met the qualifications outlined by the executive committee of the Federal Open Market Committee. These exceptions consisted of:

1. The purchase of Treasury bills in the amount of $3,300,000 from an unqualified dealer;
2. The direct sale of $4,040,000 Treasury Bills to a member bank; and
3. The purchase of $300,000 Treasury Bonds from an unqualified dealer.

The examiner's report also noted that the exceptions were reported by the Federal Reserve Bank of New York to the executive committee of the Federal Open Market Committee in the reports of System open market account transactions with qualified dealers for the months of August, October, and December 1947, respectively.

In commenting on the exceptions, Mr. Rouse stated in connection with the first that the Federal Reserve Bank of New York had previously purchased bills awarded to the unqualified dealer on tenders at the "pegged" 3/8 per cent rate, and that the firm did not realize that the reversion to a market rate changed the situation. Under the circumstances it appeared to the Reserve Bank, Mr. Rouse said, that the transaction was justified and that it could be used as the occasion for advising the dealer that the

Federal Reserve Bank could not deal with the dealer in this respect unless he should become qualified. Mr. Rouse also said that the second transaction was for the purpose of completing a $5 million order received from a member bank under market conditions and for reasons which appeared to make the transaction a proper one, but that no further purchases or sales would be arranged with the System account on member bank orders. The third transaction, Mr. Rouse added, was simply an oversight under pressure of work.

Following Mr. Rouse's comments, upon motion duly made and seconded, and by unanimous vote, the report was received and ordered filed.

Reference was then made to the recommendation made by the executive committee of the Federal Open Market Committee as recorded in the minutes of its meeting on April 21, 1948, that no change be made at the present time in the statement of terms established by the Federal Open Market Committee in 1944 upon which the Federal Reserve Bank of New York, as agent for the System account, transacts business with brokers and dealers in United States Government securities.

Mr. Carpenter stated that a report had been prepared by the Federal Reserve Bank of New York pursuant to the action at the meeting of the Federal Open Market Committee on March 1, 1948, that it had been considered at the meeting of the executive committee on April 21, 1948, and that the executive committee voted unanimously to concur in the conclusion reached in the report made by the Federal Reserve Bank of New York and to recommend to the full Committee that no change be made at this time in the statement of terms or their interpretation.

Mr. Rouse stated that there had been very little complaint by unqualified dealers that they were at a disadvantage in effecting transactions in Government securities during the past few months and that there appeared to be no problem such as might have existed at the time the question was raised by some of the smaller dealers around the end of 1947.

> Upon motion duly made and seconded, and by unanimous vote, it was agreed that no change should be made in the form or interpretation of the statement of terms upon which the Federal Reserve Bank of New York, as agent for the System account, transacts business with brokers and dealers in United States Government securities.

Chairman McCabe then called for the reports of the economists.

In accordance with a procedure suggested by Mr. Thomas, Mr. Langum made a statement outlining the factors which had contributed to changes in the "active money supply" and in bank reserves in the period since the end of February 1946 when the public debt was at its highest point.

Following Mr. Langum's remarks, Mr. Thomas gave a report on the economic outlook in which he cited, among other factors, the continuing inflationary pressures and the need for additional authority to limit credit growth in future months as a means of avoiding still further additions to the money supply. In connection with his remarks, Mr. Thomas referred to a memorandum prepared in the Division of Research and Statistics under date of May 19, 1948, on the Outlook for Treasury Cash Position, and copies of the memorandum were distributed.

Mr. John H. Williams then discussed the economic outlook, concluding that, while there was still an inflation potential in the money supply especially if velocity increased, a considerable part of the inflationary pressures had already been soaked up by the increases in prices that had occurred and that the economy might be well on the road toward an adjustment.

Copies of the statements of the three economists and of the Outlook for Treasury Cash Position have been placed in the files of the Federal Open Market Committee.

During a discussion of the situation, Mr. John H. Williams stated that it seemed clear to him that the present situation called for continuing the monetary policies that had been in effect unless it should develop that these policies would have positive deflationary effects. He went on to say that present interest rate levels, not only short-term but long-term, were abnormally low, that rates such as these had never before existed, that short-term rates had always been important instruments of monetary control, and that he thought it was important to increase such rates and he would be willing to see longer term rates go up in order to be able to exercise a greater influence in the money market.

Mr. Alfred H. Williams asked for the views of the other economists.

Mr. Bopp stated that he felt inflationary pressures in the economy were still great and that, in fact, they were getting stronger.

Mr. Thompson said that he felt that the most significant recent development in that connection was the survey of consumer finances which showed that demand was outrunning the supply, that more consumers expected to buy heavy durable goods in 1948 than in 1947, and that as long as there was little prospect of reducing demand inflationary pressures would continue severe.

Mr. Irons felt that there were continuing inflationary pressures, but he agreed with the statement Mr. John H. Williams had made, and stated that a continuation of monetary policies that have been followed recently would be adequate for dealing with the situation.

Mr. Robb expressed the opinion that, on balance, the inflationary pressures were increasing, that the public generally had come to the conclusion that present prices were more or less permanent, and that individuals therefore were resuming buying more aggressively.

Mr. Langum felt that the country was in for a continuing period of inflationary pressures and that a further increase in bank loans would be very inflationary in effect.

Mr. Thomas stated that at a meeting in Atlanta earlier this month, prior to the recent increase in stock market activity, it was the consensus of the Current Business Developments Committee, composed of economists from the twelve Federal Reserve Banks, that the hesitation and uncertainty which slowed or interrupted the upward movement of the principal dollar measures of business activity in the first quarter did not signal a downturn in production and employment, that the underlying sustaining forces now appeared to be strong enough to absorb the shocks likely to be generated either by foreign or domestic developments in the period under review, and that the basic sustaining factors would be reinforced by some expansionary influences, the most notable of which were the disappearance of the Treasury cash surplus, increasing Government expenditures, and some further expansion of credit. He went on to say that the Committee concluded that businessmen and consumers alike since the end of the war had weathered a succession of shocks and signals pointing toward a downturn, each of which had been followed by the resumption of inflationary developments, that they were now likely to be strongly impressed by the inflationary implications of current events like the evaporation of the cash surplus, the tax cut, defense spending, and the limited power of the monetary authorities to restrain credit expansion, and that in consequence the Committee expected that through the end of October 1948 production and employment would continue at high levels and that wholesale prices and living costs would advance beyond previous peaks.

At Chairman McCabe's request, Mr. Sproul reported on developments since the last meeting of the Committee, stating that, in the conversation which Chairman McCabe and he had with Secretary of the Treasury Snyder and Under Secretary Wiggins on April 28, the views of the Committee were presented as set forth in the letter sent to Secretary Snyder under date of April 26, transmitting the recommendations with respect to debt management as agreed upon at the meeting of the executive committee on April 21. He said that they presented the proposals in that letter in as strong a manner as possible and found the Treasury representatives questioning but indicating some degree of receptiveness of the ideas advanced. Treasury representatives, Mr. Sproul said, raised questions concerning the recommendations, however, including inquiries as to why, when the situation was quiet as it was at present and war loan accounts could be drawn on further to maintain pressure on the market, any further steps should be taken; what would happen next fall (when the situation might be more difficult) if all our ammunition were used now; why increase the short-term rate; and what would be the objection to having some downward pressure on long-term rates. (Mr. Sproul thought the latter was an exploratory question and that the Treasury representatives were not interested in permitting such pressure to develop.) There was the further question what effect changes in the short-term rate would have as an anti-inflation instrument, and Mr. Sproul said that he and Chairman McCabe agreed that an increase in the short-term interest rate was a minor anti-inflationary measure, but that the Committee felt it would work in the right direction and that it was worthwhile to use it.

Mr. Sproul went on to say that subsequent to the April 28 meeting he wrote a letter to Secretary Snyder under date of May 3, a copy of which has been placed in the files of the Federal Open Market Committee, and which summarized the situation as follows:

> "To sum up, it appears to me that the additional need for credit to finance defense contracts during this calendar year will be relatively small and can be satisfactorily and readily met, in most cases, out of available sources of bank credit; that there is nothing in the situation yet to warrant a relaxation of general pressure, now or in the remaining months of 1948, in order to make certain that these few specialized needs are adequately met. In fact, unless we wish to contemplate a situation in which 'nonessential' demands for credit will compete with the requirements of national defense and our foreign aid program, we must act now to hold the gains we have made thus far this year — to prevent a renewed expansion of the volume of credit and of the money supply. That is the reason and purpose, as I see it, of the program of the executive committee of the Federal Open Market Committee which we have discussed with you. And, as we said at our meeting, the market situation is such that the sooner we act the better."

Mr. Sproul said that he and Chairman McCabe met again with Secretary Snyder last Wednesday (May 12), prior to the announcement of the June financing on May 13, 1948. He added that they went over much the same ground as in the earlier discussion, but that the new element in the picture was that Secretary Snyder during the intervening period had talked with a number of bankers from various parts of the country, in whose opinion he had confidence, and that a majority of them had told him the best thing to do was to make no change in the short-term interest rate at this time. They felt that the situation was not serious and would not likely get out of hand and that an increase in the rate might be delayed at least until next autumn. Mr. Sproul added that, although the Federal Advisory Council had advised the Board of Governors that the Council was in agreement that the short-term rate should be increased, two members of the Council, who were also members of the American Bankers Association Committee on Government Borrowing, advised the Secretary that the rate should not be increased and that it was probable that such advice from the bankers had swung the decision away from the recommendation of the Federal Open Market Committee. Although he and Chairman McCabe again strongly presented the views of the Committee as set forth in the letter of April 26, Mr. Sproul said, they found resistance to the recommendations and left the meeting with little feeling that an increase in short-term rates would be announced. Mr. Sproul also reported that on the following day Secretary Snyder called Chairman McCabe on the telephone and said that he had come to a decision to refund the June and July maturities of Treasury securities with one year 1-1/8 per cent certificates, adding that it was the most difficult decision he had had to make as Secretary of the Treasury because of the strong recommendations of the Federal Open Market Committee for an increase in the rate.

Chairman McCabe said that, although the decision of the Treasury was a grave disappointment, he felt the Committee should follow up with further policy recommendations in an effort to secure agreement of the Treasury along the lines previously recommended.

Thereupon the meeting recessed and reconvened at 2:15 p.m. with the same attendance as at the morning session except that Mr. John H. Williams was not present.

Turning to the question of policy with respect to support of the Government securities market, Mr. Rouse said that the effect of the Treasury announcement of the 1-1/8 per cent certificate last Thursday was instantaneous in the market and that prices of Government bonds advanced sharply. He expressed the opinion that prices had risen to a point where there was an opportunity for the System to reduce its holdings of bonds acquired since November. He felt that the System should take advantage of that opportunity, not with a view to stopping any advance in prices but rather to temper the rise by partially meeting the demand. He thought that the demand would not be large but that there would be a relatively limited supply which would have an effect on prices unless the System supplied bonds from the System account. He added the comment that the immediate problem was one of giving full support to the Treasury's June and July refunding program. After that, he said, the next maturity would be on September 15, and whatever policy was proposed by the Committee should be gotten under way sometime between June 25 and August 1, 1948.

In a discussion of policy with respect to selling bonds from the System account, Mr. Clayton suggested that it would be logical to sell as many bonds as we could without upsetting the market.

Chairman McCabe suggested that the present policy with respect to bills and certificates would have to be continued until the July financing was completed, that there should be a decision on the question of sales of bonds from the System account, and that the policy with respect to bills and certificates after July 1 should also be considered. He felt that the second question was the one before the Committee at the moment.

In response to a question from Chairman McCabe, Mr. Rouse said that, as proposed by Mr. Clayton, he would suggest a policy of selling securities whenever the System could do so to withdraw reserves from the market and to partially meet the demand without "topping off" the market and bringing about a price decline. If a situation should arise, after the July refunding operation was over, in which the bond market dropped back to existing support levels Mr. Rouse would favor lowering these prices and not buying the five- to seven-year maturities as freely as had been done in the recent past. On the long maturities, he said, he could conceive of a situation in which the System could go along for possibly six months without having substantial amounts of long-terms offered to the System but that if bank loans increased materially the situation might be different.

Mr. Sproul expressed the opinion that the policy should be to tip the balance toward taking funds out of the market rather than supporting the market at any particular level. That would mean, he said, that the System could sell securities from the System account during the period immediately ahead without interfering with the June and July financing.

Mr. Eccles stated that he might be a somewhat more reluctant seller than had been indicated by Messrs. Rouse and Sproul and that perhaps his point was a question of emphasis rather than difference of approach. He said the System had favored an increase in the short-term rate in order to protect the long-term 2-1/2 per cent rate, that the long-term rate could be maintained by narrowing the spread between the long and short rate or by selling securities from the System account and Treasury trust accounts, but that if the latter were done it would tend to keep a wide spread between the long and short rate, would take the pressure off the short rate, and would make it appear less necessary that the short-term rate be raised.

Therefore, he was inclined to let the market for the long bonds reflect the demand, based on the continuation of the short-term rate, until such time as agreement could be reached to raise the short-term rate.

During the ensuing discussion Mr. Rouse outlined what had been done during the last few days with respect to offering for sale securities from the System account and Treasury trust accounts.

The discussion resulted in an agreement that, if the bond market continued to be strong, the Federal Reserve Bank of New York, acting under the direction to be issued by the executive committee of the Federal Open Market Committee following this meeting, would sell bonds from the System account in such amounts as to resist a rise in prices, it being understood that selling would be accelerated as prices went up without at any time stopping the rise and that if the movement were reversed and the rise were later resumed, selling would be resumed at the lower point and would again follow the rise upward.

With respect to the policy to be followed after July 1, 1948, Mr. Szymczak suggested that the full Committee determine what its position would be so that the executive committee would be able to discuss the matter with the Treasury. It was his view that the full Committee should take the position that, if inflationary pressures continued, the short-term rate should be permitted to rise in the market so that when the September refunding was undertaken it would be at a 1-1/4 per cent rate.

In a discussion of Mr. Szymczak's suggestion, it was made clear that the question of an increase in the market rate would be discussed with representatives of the Treasury, and that, if the Treasury raised objection, and the inflationary situation continued to justify an increase in the short-term rate, another meeting of the full Committee would be called to consider what the Committee's responsibilities were and what action should be taken in the circumstances.

> At the conclusion of the discussion, upon motion duly made and seconded, it was agreed unanimously that the procedure outlined by Mr. Szymczak and during the ensuing discussion should be followed.

In response to an inquiry from Mr. Szymczak as to what further action should be taken by the Committee with respect to a new issue of savings notes, Chairman McCabe suggested that the Committee continue to urge such an offering.

> Upon motion duly made and seconded the staff was requested to prepare a draft of letter to the Treasury, to be sent with the approval of the members of the executive committee, renewing the suggestion that a new issue of savings notes be offered and that the annual limit of F and G savings bonds for pension fund investment be increased from $100,000 to $200,000 or $250,000.

In connection with the instructions to be issued to the executive committee it was suggested that, in view of financing operations and other factors that would affect the market during the next few months, the existing limitation on the authority to make changes in holdings of the System account was larger than would be needed and that the amount could be reduced to $1.5 billion.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the following direction to the executive committee was approved, with the understanding that the limitations contained in the direction would include commitments for the System open market account:

The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), as may be necessary, in the light of the general credit situation of the country, for the practical administration of the account, for the maintenance of stable and orderly conditions in the Government security market, and for the purpose of relating the supply of funds in the market to the needs of commerce and business; provided that the aggregate amount of securities held in the account at the close of this date other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury shall not be increased or decreased by more than $1,500,000,000.

The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase for the System open market account direct from the Treasury of such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held in the account at any one time shall not exceed $1,500,000,000.

It was agreed that the next meeting of the Federal Open Market Committee should be set tentatively for the week of October 4, 1948.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

Thomas B. McCabe
Chairman.