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 Monday, October 4, 1948, at 11:00 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. 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. Ralph A. Young, Associate Director, Division of Research and Statistics, 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. Gidney, Leach, McLarin, and Earhart, alternate members of the Federal Open Market Committee

Messrs. Davis and Peyton, Presidents of the Federal Reserve Banks of St. Louis and Minneapolis, respectively, and Mr. Willett, First Vice President of the Federal Reserve Bank of Boston

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 20, 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 May 20, June 23, August 11, and September 8, 1948, were approved, ratified, and confirmed.

Upon motion duly made and seconded, and by unanimous vote, the actions of the members of the Federal Open Market Committee on August 11, 1948, and September 24, 1948, increasing from $1,500,000,000 to $3,000,000,000, and from $3,000,000,000 to $4,000,000,000, respectively, the limitation, contained in the first paragraph of the direction issued on May 20, 1948, on the authority of the executive committee to direct transactions in the System account were approved, ratified, and confirmed.

A report of open market operations prepared by the Federal Reserve Bank of New York covering the period from May 20, 1948, to September 29, 1948, inclusive, was then read and discussed by Mr. Rouse. He also presented a supplementary report covering commitments on September 30 and October 1, 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 May 20, 1948, to October 4, 1948, inclusive, were approved, ratified, and confirmed.

In connection with the report of transactions in the System open market account Mr. Sproul called attention to the substantial increase that had taken place in the System holdings of Government securities maturing in more than 10 years and suggested that a study be made of the advisability of the Treasury refunding some of the long-term securities held in the System account with special short-term issues bearing a lower interest rate.

Mr. Sproul's suggestion was discussed and, upon motion duly made and seconded, Chairman McCabe was authorized unanimously to appoint a committee to study the matter and report to the Federal Open Market Committee.

Secretary's note: Following the meeting Chairman McCabe appointed Messrs. Thomas, Rouse, and Riefler as the members of this committee.

Chairman McCabe then called upon Mr. Thomas for the reports of the economists.

Mr. Irons said that, despite a strong degree of inflation-consciousness and moderately restrictive credit measures, the demand for bank credit had continued strong and the banks had been able and apparently willing to meet at least a considerable part of that demand, that both inflationary and deflationary forces were at work in the economy, and that if natural forces were allowed to exert their influences the economy might find itself past the peak of the inflationary boom and faced with a readjustment. He added, however, that in view of the international situation and the possibility that the country would enter upon a program of large defense and military preparedness expenditures the outlook was for more inflation and more additions to bank loans, and that he doubted whether drastic credit restriction would be either adequate to do the job of restraining inflation or compatible with the sort of defense program contemplated.

Mr. Thomas said that in his view further inflationary business expansion was to be expected at least through the first half of 1949, that there was some possibility of a sharp further inflationary development if the international situation worsened, and that in the longer run the question was whether the economy could make piecemeal adjustments from this situation or whether the unstabilizing factors were such that a collapse was inevitable. He also stated that he felt it more than likely that additional measures of credit restraint would be needed in order to keep the inflation from getting out of hand, that if present demands for credit were not met the inflation might be broken at this stage, and that the Federal Reserve System should use such restraints as it had to avoid a worse collapse later on.

Mr. John H. Williams expressed the opinion that inflation was in the process of wearing itself out, that the prospect was for moving sidewise or even downward, that a serious downturn was unlikely, and that the present Federal Reserve policy directed toward the raising of short-term interest rates should be continued as vigorously as possible but that this was not an appropriate time to unpeg the long-term rate.

Copies of the statements of Messrs. Irons and Williams and of the paper on The Business Outlook from which Mr. Thomas talked have been placed in the files of the Federal Open Market Committee.

At Chairman McCabe's request Mr. Sproul reviewed developments since the meeting of the Federal Open Market Committee on May 20, 1948, following which the meeting recessed and reconvened at 2:10 p.m. with the same attendance as at the morning session.

Mr. Sproul referred to a memorandum prepared under date of October 1, 1948, pursuant to the request of the executive committee at its meeting on August 11, 1948, on "Federal Reserve Policy with Respect to Treasury Bill Rates". Copies of the memorandum were distributed to all members of the Committee before this meeting and a copy has been placed in the files of the Federal Open Market Committee. Mr. Sproul reviewed briefly the contents of the memorandum and the discussion at the meeting of the executive committee this morning, stating that there was general agreement by the executive committee that (a) the System's weekly bids for Treasury bills should be designed to effect some redemption of System holdings of bills each week so as to absorb reserves and thereby put more pressure on bank reserves, (b) that the New York Bank should experiment in its operations in bills so as to make the penalty for selling bills as heavy as it could within the general program for support of the bill and certificate rates, and (c) that the bill rate should be allowed to rise as close to the present 1-1/4 per cent certificate rate as possible without affecting that rate and when the certificate rate moved up from 1-1/4 per cent the bill rate should be allowed to move up as close to the certificate rate as possible.

He also said that it was the view of the executive committee that the Federal Open Market Committee should move promptly to increase the market rate on one-year Treasury certificates, and that to this end there should be a meeting with the Secretary of the Treasury as soon as possible to discuss the action to be taken in the market to bring about a rise in short-term rates in anticipation of the January Treasury financing. He added that, if the Committee approved this procedure and if the Secretary of the Treasury did not object to the proposed action, market operations should bring about a rise in the short-term rate to perhaps 1-1/2 per cent prior to the January financing and that, as the certificate rate moved up, the support prices of other shorter-term issues would be adjusted accordingly. If the Treasury disagreed with the program, Mr. Sproul said, the Committee would then have to consider whether to proceed despite Treasury objections.

In response to an inquiry from Mr. Clayton as to whether the executive committee had given consideration to increasing the short-term rate to 1-3/8 per cent instead of 1-1/2 per cent, Mr. Sproul said that the thought was to get banks interested in buying short-term securities rather than long, that the executive committee felt that the increase could go to 1-1/2 per cent, but that no definite rate was proposed and that, if the situation seemed to call for it, the rate might not go beyond 1-3/8 per cent.

Mr. Sproul made the further comment that the program outlined above would be presented to the Treasury as a matter which the Open Market Committee wished to discuss; not as something the Treasury would be expected to approve or disapprove, but to which it could object if it chose to do so. If, he said, there were delay, as was the case this summer, and the Treasury did not express agreement or objection, the Committee should press the matter.

Mr. Evans stated that it seemed to him that the course of events had clearly demonstrated the need for additional authority over bank reserves in the form of the special reserve plan previously proposed by the Board or the plan under which reserve requirements would be based on the type of deposit rather than the location of the bank, and that before Congress convened the Board of Governors and the Presidents should undertake to reach an agreement so that the over-all credit policies of the System would have full System support. There was a discussion of Mr. Evans' suggestion but no conclusions were reached.

Before this meeting there were distributed to those present copies of a memorandum prepared in the Board's Division of Research and Statistics on the outlook for bank reserves and Treasury financing. Mr. Thomas referred to the recommendations that might be made to the Treasury with respect to the use of Treasury balances as a means of affecting member bank reserves during the remainder of the year. This matter was discussed, together with the possibility of further debt retirement by the Treasury and action to increase the discount rates at the Federal Reserve Banks.

Chairman McCabe called on the members of the Federal Open Market Committee and the Presidents who were not members of the Committee for their views on the program proposed by the executive committee and discussed at this meeting, and it was the consensus that the program should be carried out. During their individual comments the Presidents expressed a variety of views on the question raised by Mr. Evans with respect to increased authority over bank reserve requirements.

At the conclusion of the individual statements, upon motion duly made and seconded, and by unanimous vote, the program as recommended by the executive committee and discussed at this meeting was approved, with the understanding that Messrs. McCabe and Sproul would present the program to the Secretary of the Treasury at the earliest possible date.

Secretary's note: Following the meeting, Chairman McCabe called the office of Secretary Snyder for an appointment for the afternoon of Wednesday, October 6, but learned that the Secretary was out of the city. An appointment was made for Messrs. McCabe and Sproul to see the Secretary on Wednesday, October 13, 1948, at which time the following letter, which had been approved by the members of the executive committee of the Federal Open Market Committee, was handed to the Secretary as a statement of the views of the Federal Open Market Committee:

"In my letter of September 13, 1948, I stated that sometime in the near future Mr. Sproul and I, in behalf of the Federal Open Market Committee, would like to discuss with you the two matters referred to in the letter and other matters relating to the credit and monetary situation. This letter has been prepared as a basis for a discussion of policies to be followed during the remainder of the current year.

"It is believed that the period will be characterized by additional sales of bonds by nonbank holders which will have to be purchased by the Federal Reserve Banks in accordance with the present policy of supporting the 2-1/2 per cent long-term rate. It is possible that such purchases by the System will be in substantial amounts. These transactions, together with a further gold inflow, will add to bank reserves at a time when there is a strong demand for bank loans. In order to curb the inflationary effects of this expansion, it is important that substantial pressure be kept on the reserve position of banks. To accomplish this the Federal Open Market Committee proposes that substantially the following program be undertaken promptly.

"1. Short-term rates.

a. Treasury bill policies. The rates on the System's weekly bids for exchanges of maturing bills will be "adjusted so as to bring about reduction in the System's portfolio at the time of the exchange. This will absorb bank reserves and put the banks under some restraint. The policy with respect to bills will be designed to achieve, as suggested in my letter of August 11, 1948, a greater degree of flexibility in the bill rate and, it is expected, will result in higher rates on Treasury bills in relation to the current rate on certificates.

"b. Certificates. The Federal Open Market Committee will also allow the market yields on certificates to increase. This increase will encourage banks to purchase Government securities or to maintain their holdings and thereby discourage further loan expansion during the remainder of the period. Furthermore, it will permit the investment in short-term securities of corporate and other balances which would not be attracted by existing rates. This increased demand will enable the System to sell some of its holdings and thereby absorb bank reserves. Depending on market conditions, the rate might be permitted to go as high as 1-1/2 per cent.

"c. Other short-term securities. The rates at which the System supports other short-term securities will be adjusted to conform to the higher certificate rate and the 2-1/2 per cent long-term rate.

"2. Debt retirement and Treasury refunding.

Because of its restrictive effect, it is desirable that the Treasury continue to draw upon its war loan balances to retire securities held by the Federal Reserve as rapidly as the Treasury's cash position permits. It appears at the present time that bills could be retired at the rate of $100 million a week for a number of weeks and at the same time available trust funds could be used to purchase marketable securities. Such purchases would reduce the amount the System would have to purchase in support of the long-term 2-1/2 per cent rate. If it should develop during the period that System support was not necessary for that purpose, the Treasury could purchase the issues needed for trust account investment directly from the System account.

"As suggested in my letter of September 13, it is recommended that the $571 million dollar issue of bonds to be redeemed on December 15 be refunded. This issue is held entirely outside the Federal Reserve and retirement in cash would put funds into the market unnecessarily. The terms of the refunding as well as of the certificates "maturing on January 1, 1949, would be considered later in the light of developments with respect to the short-term rate.

"3. Treasury balances.

Also as proposed in my letter of September 13, 1948, it would be desirable for the Treasury to time calls on war loan deposit accounts so as to exert some drain on bank reserves. In carrying out the transactions referred to above the Treasury could reduce its war loan balances as low as $500 million (they now amount to about $2.1 billion) and could also reduce its balances with the Federal Reserve below the present level of $1.7 billion. Large tax receipts in the first quarter of 1949 and current income in the second quarter will provide adequate means for meeting all needs during the remainder of the fiscal year.

"4. Other System actions.

It is believed that as soon as the market rate on certificates has risen above the 1-1/4 per cent rate, the discount rate of the Federal Reserve Banks should be increased to 1-3/4 per cent. Such action would be an indication to the public of the System's views with respect to the need for restraint. Also the Board of Governors will continue to study the situation for the purpose of determining the action that should be taken during the period further to increase member bank reserve requirements."

With respect to the authority to be granted to the executive committee to effect transactions in the System open market account, Mr. Rouse said that, on the assumption there would be a meeting of the full Committee in December, an authority of $2 billion would be adequate.

Thereupon, upon motion duly made and seconded, 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 $2,000,000,000.

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 unanimously that the Presidents would discuss informally the date for the next meeting of the Presidents' Conference and that during the joint meeting of the Board of Governors and the Presidents tomorrow a tentative date would be fixed for the next meeting of the Federal Open Market Committee.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

Thomas B. McCabe
Chairman.