

A meeting of the executive committee of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, October 14, 1947, at 10 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. Draper
Mr. Szymczak (alternate for Mr. Vardaman)

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Smith, Economist, Government Finance
Section, Division of Research and
Statistics, Board of Governors

In accordance with the understanding reached at the meeting of the executive committee on October 7, 1947, drafts of a letter to the Secretary of the Treasury, with respect to the program of credit policy and debt management discussed at the meeting of the Federal Open Market Committee on that date, were prepared at the Federal Reserve Bank of New York and in the Board's offices, and before this meeting a copy of a draft of letter prepared by Mr. Thomas in the light of the earlier drafts was submitted to each of the members of the executive committee.

When Mr. Davis was in attendance at the meeting of the executive committee on October 7 he stated that it would not be possible for him to attend a meeting of the committee today and it was understood that a copy of the draft of statement prepared

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for consideration at this meeting would be sent to him for his comment. Accordingly, a copy of Mr. Thomas' draft of letter was sent to him by air mail last night with the statement that it would be helpful if his comments could be received by noon today.

The draft of letter was read and discussed and a number of changes, principally in manner of presentation, were agreed upon. It was understood that the statement would be revised and given further consideration during the afternoon.

Chairman Eccles referred to the suggestion that had been made previously that the Board of Governors submit to the Congress a report by the Federal Open Market Committee with respect to the monetary and credit problems with which the Committee had to deal. He suggested that, instead of the Federal Reserve Bank of New York and the Board of Governors covering this matter separately as parts of their regular annual reports, a statement could be prepared in the form of a special report by the Federal Open Market Committee and submitted to the Congress by the Board. In a consideration of this suggestion it was agreed that the preparation of such a statement would be desirable with a view to submitting it sometime around the end of January of next year after the President's annual and budget messages had been submitted and the effects of these messages could be observed.

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At the conclusion of the discussion, upon motion duly made and seconded and by unanimous vote, Mr. Thomas and Mr. Roelse, Vice President of the Federal Reserve Bank of New York, were requested to prepare a preliminary draft of such a report.

The meeting then recessed and reconvened at 2:20 p.m. with the same attendance as at the morning session.

The draft of letter to the Secretary of the Treasury, revised in accordance with the discussion at the meeting this morning, was read and approved unanimously as follows, with the understanding that it would be presented when Messrs. Eccles and Sproul met with Under Secretary of the Treasury Wiggins at 3:30 o'clock and with Secretary of the Treasury Snyder at 4:00 o'clock this afternoon:

"The Federal Open Market Committee, at its meeting on October 7, which was attended by the Presidents of all of the Federal Reserve Banks, discussed at length the present economic situation of the country, in its domestic and international aspects, and the relation of monetary and credit factors, and of debt management, to what presents itself to us as a clearly developing accentuation of inflationary tendencies. In the light of this discussion it was the opinion of the group that a constructive recommendation to you, with respect to the November 1st financing, could be made only as part of a broader program of bringing to bear on this situation all of the weapons of control which are now available to us in the field of monetary policy and debt management.

"Inflationary pressures have been strong in our economy during the past few months, and there is ample indication that these pressures will continue strong, and perhaps be accentuated, in the months immediately ahead. The basic causes of this situation are well known. A vast supply of money and other liquid assets was created during the war and there have been additions to this accumulation of purchasing power since the end of the war. There has also been an inadequate supply of goods and services, both domestic and foreign,

"growing out of the destruction of war and the deferment of civilian demands when a large part of output was destined for military use. The obvious consequence has been that, at current prices, the supply of purchasing power in the hands of active spenders is far in excess of the value of even present high levels of output.

"The existing situation, therefore, spells continuing pressure toward higher prices. In addition we must take cognizance of the fact that conditions are highly favorable to further credit expansion. Continued heavy demands for bank loans are likely from business, from mortgage borrowers, and from consumers. The means of such additional credit expansion are readily at hand in the form of gold imports and too easy access to Federal Reserve credit, both of which provide the banking system with the reserves on which a not less than six-fold expansion of credit can be based. In view of the decline in earnings, banks are under considerable pressure to increase their assets or to shift from low-yielding to higher-yielding assets. In such circumstances, it is too much to expect that further increases in bank credit will be confined to productive loans; the more likely outcome, in the absence of repressive measures, will be an increase in speculative credit.

"The Committee recognizes that the strongest forces working toward inflation lie outside of the field of current monetary policy and debt management, and that the means of control which are at our joint disposal can be of only limited effectiveness. The Committee feels, however, that further credit expansion would augment the existing forces of inflation. The situation is now so critical as to warrant our taking every action, within the power of the Treasury and the Federal Reserve System, to eliminate or moderate excessive credit expansion. The vigorous action which in former times could have been relied upon to check the progress of inflation is now denied to us because of the necessity of maintaining the stability of the market for Government securities, and all that depends on such stability, but this should not deter us from taking whatever action lies within the area of practical discharge of our responsibilities.

"In the light of this background and this forecast the Committee wishes to place its recommendations with respect to the November 1st financing within the framework of a broader program of credit policy and debt

"management. The group is strongly in favor of a program which would comprise the following:

"1. It is of prime immediate importance that measures be adopted to offset the expansionary effect of gold inflow on bank reserves and also to put some pressure on banks by requiring them to sell securities to maintain their reserve positions. This can best be accomplished by a reduction in Federal Reserve holdings of Government securities. Since it would be difficult for the Federal Reserve to reduce its portfolio by selling securities in the market, the best procedure would be for the Treasury to use its cash balances to retire Federal Reserve holdings of maturing bills and certificates. It is estimated that the Treasury will have in November and December about 2.5 billion dollars available for retirement of marketable debt, and another billion dollars in January. The Federal Reserve portfolio holds a little over one billion dollars of the next three issues of maturing certificates. Depending upon the needs of the situation, the Federal Reserve could present these certificates for retirement and funds would still be available for the retirement of bills to the extent found to be desirable.

"2. The policy of raising short-term rates of interest should be continued so as to lessen the urge on the part of banks either to reach out for longer-term Government securities, or to make undesirable loans and investments, in order to maintain earnings. This would mean moving up issuing rates on certificates, and permitting the current rate on Treasury bills and market yields on outstanding certificates to rise in accordance with market demands and the coupon rates adopted on newly issued certificates. In view of large maturities of high-coupon issues, during the next few years, a large part of which are held by banks, the Treasury is in a position to reduce its interest burden by refunding into lower-rate short-term issues. If, however, the rates are too low commercial banks will seek other assets and shift more of their Government securities to the Reserve System. Moderately higher short-term rates will diminish this tendency and at the same time not raise the Treasury's interest costs.

"The policy of grouping all certificates into four quarterly issues and of gradually raising rates should be continued as follows:

"(a) Certificates maturing November 1 should be refunded with either a one per-cent 11-month

"certificate or a 1-1/8 per cent 14-month note.

"(b) Certificates maturing December 1 should be exchanged for a 1-1/8 per cent 13-month note and those maturing January 1 for a 12-month certificate at the same rate.

"(c) Holders of bonds maturing December 15 should be offered the privilege of exchange into the 1-1/8 per cent notes issued on December 1.

"3. It is recommended that the Treasury adopt measures to encourage holders of maturing savings bonds to reinvest the proceeds into additional issues for the purpose of keeping these funds out of the spending stream. This may be accomplished by giving the holders of maturing savings bonds the option to use the funds obtained to purchase either (a) series E bonds above the limit of \$3,750 for total purchases in any one year; or (b) a special nonmarketable 10-year bond, with an annual interest coupon of 2-1/2 per cent and the option of redemption at par after six months on 60 days' notice.

"4. Increase the Federal Reserve Bank discount rates to 1-1/4 or 1-1/2 per cent in line with market conditions after a further increase in the rate on certificates is indicated.

"5. Increase reserve requirements for central reserve city banks (New York and Chicago) from 20 to 26 per cent in three 2-per cent steps. These increases, which would put considerable pressure on banks in these cities and make it necessary for them to shift Government securities to the Reserve System in order to maintain reserves, should be timed in accordance with the need for pressures on the central money markets so as to obtain the full benefit of the psychological as well as the actual effect of the increases.

"6. In view of the pressures for consumer credit growth from buyers, sellers, and lending agencies and at the end of Regulation W on November 1, the Board of Governors will prepare a strong statement stressing the dangers inherent in an excessive expansion of such credit and urging the adoption of self-imposed restraints. The Board will give this statement a national release and will send copies to the various national credit organizations. Each Federal Reserve Bank will send copies of the statement over the signature of the President to Regulation W registrants in its district and will give the statement wide local publicity. Wherever

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"practicable the matter will be discussed with representatives of the various credit organizations.

"7. An agreement is being sought among Federal and State bank supervisory agencies to direct bank examinations toward discouraging expansion of bank loans, especially consumer loans, real estate loans, and what may appear to be speculative business loans. They should also urge the maintenance of a high degree of liquidity and, where banks reduce liquidity and increase risk assets, the building up of their capital positions.

"This program would, of course, require constant consultation between representatives of the Federal Open Market Committee and of the Treasury, and Mr. Sproul and I would expect to hold ourselves at your disposal so that we may be able to time the various steps of the program in relation to the demands of the situation as it develops."

Secretary's Note: Mr. Davis advised the Assistant Secretary by telephone that with the exception of two questions with respect to the savings bond refunding as contained in draft of letter sent to him by air mail, the program outlined was satisfactory to him. He was informed that the final draft of letter had been changed to conform to his views on the two points and he asked to be recorded as approving the letter in its final form.

Thereupon the meeting adjourned.

Chester Norrie
Secretary.

Approved:

W. H. C. [Signature]
Chairman.