

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, May 27, 1940, at 2:45 p.m.

PRESENT: Mr. Eccles, Chairman
Mr. Harrison, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Ransom
Mr. Davis
Mr. Draper
Mr. Sinclair
Mr. Parker
Mr. Schaller
Mr. Day

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Goldenweiser, Economist
Mr. Williams, Associate Economist
Mr. Dreibelbis, Assistant General Counsel
Mr. Rouse, Manager of the System Open
Market Account
Mr. Thurston, Special Assistant to the
Chairman of the Board of Governors

Messrs. Young, Fleming, Leach, Martin, and
Peyton, Alternate Members of the Federal
Open Market Committee

Messrs. Hamilton and Gilbert, Presidents of
the Federal Reserve Banks of Kansas City
and Dallas, respectively

Upon motion duly made and seconded
and by unanimous vote, the minutes of the
meeting of the Federal Open Market Committee
held on March 20, 1940, 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 meeting of the executive
committee on March 20, 1940, were approved,
ratified, and confirmed.

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There were distributed to the members of the Board and the Presidents of the Federal Reserve Banks copies of a report prepared at the Federal Reserve Bank of New York of open market operations covering the period from March 20 to May 24, 1940, inclusive. Mr. Rouse reviewed and commented on the important features of the report. He also said that there were no transactions effected for System account on Saturday, May 25.

Chairman Eccles stated that following the German invasion of Holland, Belgium, and Luxembourg, the executive committee, in carrying out the instructions of the full Committee, had proceeded on the theory that during the decline from the high level which the market had reached there should be only such purchases of securities by the System as might be necessary in accordance with the policy of attempting to prevent disorderly conditions in the market, and that, apparently because of the prevalent knowledge of the experiences of investors in the market last fall when prices recovered very rapidly from a precipitous decline, the situation in the market in the recent past had been entirely different from that which existed last September when large amounts of securities were sold at rapidly declining prices. He said that as long as there were buyers in the market, as there had been during practically the entire recent period of decline, there was little need for System intervention, that the only time the System had purchased securities was when the dealers through whom System

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operations were conducted were unable to find outside bidders and small purchases were made for System account to avoid further weaknesses, and that during the entire period of weakness only \$10,400,000 of securities were purchased. It was the feeling of the executive committee, however, Chairman Eccles added, that the System should be prepared to increase its purchases in the event the market declines further with the attendant possibility of increased selling.

There was a discussion of the question whether during the period of recovery following the decline in Government security prices last September the System should have sold more than the \$94,000,000 of securities that were disposed of. Mr. Harrison stated that probably some additional securities could have been sold without adversely affecting the market, but that the existing instructions were to buy and sell securities only for the purpose of exercising an influence toward maintaining orderly market conditions, and that even though the market might have absorbed additional amounts of securities without materially affecting market prices it had been felt that the existing instructions did not contemplate sales merely for the purpose of disposing of securities which were purchased during the September decline when such sales were not deemed necessary to prevent disorderly market conditions. He added, however, that he would favor instructions to sell securities not only for the purpose of exercising a stabilizing influence in the market but also for the purpose of disposing of securities which had been acquired in a period of market

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weakness, whenever such sales could be made without adversely affecting the market.

During the consideration of Mr. Harrison's suggestion Mr. McKee stated that it is much more difficult for the System to dispose of any substantial amount of securities in the market than it is for any other holder for the reason that it becomes known quickly that the System is operating in the market and sales from its account have a much broader effect than sales from the portfolio of private holders.

Mr. Sinclair expressed the opinion that it was likely that the System would be called upon to buy more securities than it would have occasion to sell for the purpose of exercising a stabilizing influence and that securities should be sold whenever that could be done without an adverse effect upon market prices so that the System account would be in a better position to purchase securities in periods of market weakness. Reference was made in this connection to the present earnings of the System account and Mr. Sinclair voiced the further opinion that the question of earnings of the System should not be a consideration in determining whether securities should be sold and that the System should be prepared to use its surplus funds for a time for the payment of its expenses should that become necessary.

Chairman Eccles said that he thought that it would be a shortsighted policy to disregard the earning requirements of the System in

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the administration of the System account, that the purchase or sale of \$200,000,000 or \$300,000,000 of securities would not have any material effect on the situation one way or another, and that as long as the present situation continued the Committee was entirely justified in holding such amounts of securities as might be deemed necessary to meet earning requirements. The opinions expressed by Messrs. Sinclair and Eccles were discussed at some length.

Mr. McKee suggested that in the future the weekly reports of open market operations prepared by the Federal Reserve Bank of New York show the par value of securities held in the System account, the unamortized premium paid on such securities, and, on an annual basis, the total interest income of the account, the net premium amortization, and the net interest earnings of the account after amortization of premium. Part of this information has been shown in these reports and Mr. Rouse stated that he would see that the additional data called for by Mr. McKee's suggestion is shown hereafter.

Mr. Ransom recommended that the special committee appointed at the last meeting of the Federal Open Market Committee (Messrs. Ransom, Harrison, and Davis) to study the question of the responsibilities of the Federal Open Market Committee with respect to the Government securities market as well as the question of the relations of the dealers to the market, be discharged. He stated that, in view of the changed conditions since the committee was appointed, together with the fact that the whole subject was under constant

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review and discussion by the entire committee, there appeared to be little value in the study at this particular time and that, inasmuch as the members of the staff who would work on the report were fully occupied on other problems, this additional assignment should be laid aside.

Upon motion by Mr. Ransom, which was duly seconded, it was voted unanimously to discharge the special committee.

Mr. McKee renewed the suggestion made by him at the last meeting of the Committee that consideration be given to the use of profits on sales involved in shift transactions for the purpose of writing down the book value of the replacement securities purchased. Mr. Rouse stated that, in accordance with the action taken at the last meeting of the Committee, he and Mr. Smead, Chief of the Division of Bank Operations of the Board of Governors, had been studying that question and, if agreeable to the members of the Committee, a report would be prepared and sent to the members of the Committee before its next meeting, with the understanding that the report would be considered at that meeting.

The members of the Committee expressed agreement with the procedure suggested by Mr. Rouse and, at the suggestion of Mr. Fleming, it was understood that copies of the report prepared by Messrs. Smead and Rouse would also be sent to the Presidents of Federal Reserve Banks who were not members of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the transactions

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in the System open market account for the period from March 20 to May 25, 1940, inclusive, were approved, ratified and confirmed.

Chairman Eccles called on Messrs. Goldenweiser and Williams for statements on the business and credit situation.

Mr. Goldenweiser stated that the Division of Research and Statistics of the Board of Governors had prepared a statement on recent business and credit developments which he would distribute among the members of the Committee and the Presidents. In response to a request, Mr. Goldenweiser amplified the comments contained in the statement referred to with respect to the future outlook and the possible effects of the war upon the American economy.

A statement was also made by Mr. Williams. A summary thereof and a copy of the prepared statement referred to by Mr. Goldenweiser have been placed in the files of the Federal Open Market Committee.

During Mr. Goldenweiser's statement, Mr. Wyatt, General Counsel, joined the meeting.

Following Mr. Williams' statement, Chairman Eccles referred to the expansion of the powers of the Treasury and other agencies of the Federal Government in the field of banking and credit since 1933 and to the relative diminution of the powers of the Federal Reserve System while powers of other agencies of the Government had been increased greatly. He stated also that central banks of other countries are entrusted with responsibilities which in this country

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have been placed in other agencies. He suggested that the Presidents of the Federal Reserve Banks and the Board give thought to such developments and consider what, in their opinion, should be the functions of the Federal Reserve System. Some aspects of the matter were discussed and at the conclusion of the discussion the meeting recessed to reconvene at 10:00 a.m. tomorrow.

Robert Morrie
Secretary.

Approved:

W. S. Coolidge
Chairman.

The meeting of the Federal Open Market Committee was reconvened in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, May 28, 1940, at 10:25 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Harrison, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Ransom
Mr. Davis
Mr. Draper
Mr. Sinclair
Mr. Schaller
Mr. Day
Mr. Leach (alternate for Mr. Parker)

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Wyatt, General Counsel
Mr. Williams, Associate Economist
Mr. Dreibelbis, Assistant General Counsel
Mr. Rouse, Manager of the System Open
Market Account
Mr. Thurston, Special Assistant to the
Chairman of the Board of Governors

Messrs. Fleming, Martin, and Peyton, Alternate
Members of the Federal Open Market Committee

Messrs. Hamilton and Gilbert, Presidents of
the Federal Reserve Banks of Kansas City
and Dallas, respectively.

Consideration was given to the question whether events since the last meeting of the Committee called for any change in the existing System policy.

Mr. Harrison referred to the suggestion made by him at the meeting yesterday that the executive committee be authorized to sell securities, within limits to be fixed by the full Committee, not only for the purpose of exercising an influence toward orderly conditions

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in the market but also for the purpose of disposing of securities which had been acquired in a period of market weakness whenever such sales could be made without adversely affecting the market. He said the reason for this suggestion was that as the New York Bank interpreted the existing instructions of the executive committee such sales had not been authorized. He believed it would be good policy in the administration of the System account to reduce the account when possible during a stable or rising market after a substantial amount of securities had been purchased during a decline for the purpose of exercising a stabilizing influence. In this connection he pointed out that under the authority granted to the New York Bank by the executive committee the Bank could make such shifts in the System account as may be necessary for the practical administration of the account or for the purpose of exercising an influence toward orderly market conditions and he suggested that there be added the authority to make sales of securities when desirable or advisable in the practical administration of the account, it being understood that the New York Bank would consult with the members of the executive committee as had been done in the recent periods. While he did not anticipate that an opportunity for such action would present itself in the near future he felt it would be well to permit such an operation should an occasion therefor arise.

In the discussion which followed members of the Committee present concurred in the belief that the existing instructions to

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the executive committee were broad enough to permit sales under the conditions indicated by Mr. Harrison when in the judgment of the executive committee sales were desirable or advisable. Mr. Harrison said that if it were understood that the existing instructions were sufficiently broad to authorize the New York Bank to sell securities, which had been purchased in a period of market weakness for the purpose of exercising a stabilizing influence, whenever there was a strong buying market and there were not sufficient offerings, he felt the resolution of the full Committee would be satisfactory in its present form. All of the members of the Federal Open Market Committee present indicated agreement that the resolution should be so interpreted.

Thereupon, Mr. Harrison moved that the following resolution, which is in the same form as the resolution adopted at the meeting of the Federal Open Market Committee on March 20, 1940, be adopted.

"That the executive committee be directed until otherwise directed by the Federal Open Market Committee to arrange for such transactions for the System Open Market Account (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement) as in its judgment from time to time may be necessary for the purpose of exercising an influence toward maintaining orderly market conditions; provided that the aggregate amount of securities held in the Account at the close of this date shall not be increased nor decreased by more than \$500,000,000."

Mr. Harrison's motion, having been duly seconded, was put by the chair and carried unanimously.

Mr. Harrison referred to the question recently submitted by

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the Board of Governors to the Federal Advisory Council and to the boards of directors of the Federal Reserve Banks on the subject of easy money and stated that at the meeting of the Presidents of the Federal Reserve Banks yesterday the statement prepared by the Federal Advisory Council was read for the confidential information of all of the Presidents, and that since any comments in that or other statements of the Council relating to open market policy would apply to the Federal Open Market Committee to the extent that it had played a part in the easy money policy of the System, he would like to get the reaction of the Board to the replies that had been made.

At Chairman Eccles' suggestion it was agreed that a meeting of the Board of Governors with the Presidents of the Federal Reserve Banks should be held following this meeting for the purpose of discussing that matter as well as the question raised by Chairman Eccles at the meeting of the Federal Open Market Committee yesterday afternoon with respect to the place of the Federal Reserve System in the banking and monetary problems of the country.

Mr. Harrison said that one of the questions assigned to the committee which was appointed at the last meeting of the Federal Open Market Committee (Messrs. Ransom, Harrison and Davis) and which was discharged at the meeting yesterday, was the relation of the dealers to the Government securities market and that, as he had stated at a previous meeting of the Federal Open Market Committee, the Federal Reserve Bank of New York had made a study of that problem and had prepared a memorandum regarding it, copies of which had been handed to

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Messrs. Ransom and Davis. Copies of the memorandum were distributed during this meeting to the other members of the Committee and to the Presidents of the Federal Reserve Banks who were not members of the Committee, except Messrs. Young and Parker who were absent, and it was understood that Mr. Rouse would send copies to them.

Mr. Ransom referred to the banking studies which were prepared by the staff of the Board of Governors and sent to the Presidents of all Federal Reserve Banks for their comments. He stated that the studies were in the process of being edited and it would be helpful if the Board could have any further suggestions that the Presidents may have to make as promptly as possible.

Mr. Harrison stated that at the meeting of the Presidents yesterday the legislative committee appointed by the Presidents' Conference handed to the Presidents several memoranda which had been prepared by the committee on questions which it had had under consideration prior to receipt by the Federal Reserve Banks of the questionnaire prepared by the Senate Committee on Banking and Currency in connection with the Wagner Resolution and that copies had not been submitted to the Board for the reason that it was felt that before that was done the memoranda should be reviewed by all of the Presidents.

In a discussion of the Wagner questionnaire, Mr. Ransom stated that no one on the Board or its staff had anything to do with the preparation of the questionnaire and that the best information available

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to the Board was that it was prepared by parties outside the service of the Government.

The suggestion was made by Chairman Eccles that in view of the developments which have taken place since the questionnaire was prepared it was possible that the studies contemplated by the Wagner Resolution would be postponed indefinitely and that it was possible that an emergency might arise which would make it necessary for Congress to pass banking legislation without prolonged study of the subject.

Thereupon the meeting adjourned.


Secretary.

Approved:


Chairman.