

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 Wednesday, December 18, 1940, at 11:10 a.m.

PRESENT: Mr. Eccles, Chairman  
Mr. Harrison, Vice Chairman  
Mr. Szymczak  
Mr. McKee  
Mr. Ransom  
Mr. Davis (latter part of meeting)  
Mr. Draper  
Mr. Sinclair  
Mr. Parker  
Mr. Schaller  
Mr. Day

Mr. Carpenter, Assistant Secretary  
Mr. Wyatt, General Counsel  
Mr. Rouse, Manager of the System Open  
Market Account

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

Mr. Kimball, Secretary of the Conference of  
Presidents

Mr. Clayton, Assistant to the Chairman of the  
Board of Governors  
Mr. Bethea, Assistant Secretary of the Board  
of Governors

Upon motion duly made and seconded,  
and by unanimous vote, the minutes of the  
meeting of the Federal Open Market Com-  
mittee held on September 27, 1940, were  
approved.

Upon motion duly made and seconded,  
and by unanimous vote, the actions of the

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executive committee of the Federal Open Market Committee as set forth in the minutes of the meetings of the executive committee on September 27 and November 1, 1940, were approved, ratified, and confirmed.

Prior to this meeting the members of the Federal Open Market Committee had been furnished with copies of a report prepared at the Federal Reserve Bank of New York of open market operations during the period from September 27 to December 14, 1940, inclusive, and copies of the report were furnished to other Presidents of Federal Reserve Banks at this meeting. Mr. Rouse commented upon the important features of the report and, at Mr. McKee's request, discussed briefly the factors underlying the recent increase in prices of Government securities. Mr. Rouse's statement was followed by a discussion of factors influencing the Government securities market.

At this point Mr. Bethea withdrew from the meeting.

Chairman Eccles reviewed briefly the suggestions which had been considered by the members of the executive committee in connection with December Treasury financing when that matter was under consideration recently, the discussions which they had had with the Secretary of the Treasury and members of his staff, and the reasons for the decision of the Treasury to do the financing in the form finally decided upon. Prior to this meeting copies of the memoranda on the subject of Treasury financing, which had been prepared under dates of December 6 and 7, 1940, and sent to the Secretary of the Treasury, had been placed in the hands of the regular members of the Federal Open Market Committee and during

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the afternoon session of this meeting copies of the memoranda were handed to the Presidents of the Federal Reserve Banks who are not regular members of the Committee.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account for the period from September 27 to December 17, 1940, inclusive, were approved, ratified, and confirmed.

Before this meeting the Secretary of the Federal Open Market Committee had sent to each member of the Committee a copy of the report of examination of the System open market account made as at the close of business on September 7, 1940, by the examiners for the Board of Governors of the Federal Reserve System as a part of the regular examination of the Federal Reserve Bank of New York.

It was stated that there was nothing in the report that required action by the Federal Open Market Committee at this time and, upon motion duly made and seconded, and by unanimous vote, the report was ordered to be filed.

Mr. Smead, Chief of the Division of Bank Operations of the Board of Governors, was called into the meeting in connection with the discussion of the report prepared by him and Mr. Rouse on the basis for the allocation of securities in the System open market account and the various accounting procedures that might be adopted for the account. Copies of this report were distributed to the members of the Board of Governors and the Presidents of Federal Reserve Banks at the meeting of the Federal Open Market Committee on September 27,

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1940, when it was agreed that the report should be placed on the agenda for consideration at this meeting.

Reference was made to the comments in the report relating to the basis for the allocation among the Federal Reserve Banks of the securities held in the System open market account and inquiry was made by members of the Board as to the consideration given by the Presidents in their meeting yesterday to this phase of the report.

Mr. Schaller replied that the Presidents had voted to request Messrs. Smead and Rouse to submit a recommendation as to any changes that they felt should be made in the procedure now being followed with respect to the allocation of securities in the account.

Mr. Smead stated that it would be his recommendation that a procedure for the quarterly allocation of securities be adopted, as outlined in the memorandum, which would (1) allocate sufficient securities to each Federal Reserve Bank to cover expenses not covered by accrued earnings on Government securities and estimated earnings from other sources, (2) allocate a sufficient amount of additional securities to each bank to cover dividend requirements, and (3) allocate any remaining securities among the banks on the basis of average daily participations in the System account since June 30, 1936, which is the basis on which profits on sales of securities in the System account are distributed among Federal Reserve Banks at the present time. Mr. Rouse joined in this recommendation.

Upon inquiry from President Sinclair, Messrs. Smead and Rouse

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stated that they were of the opinion that, if adopted, the proposed basis of allocation could be put into effect in connection with the January 1 reallocation of securities in the account.

Inquiry was made whether the Presidents were willing to approve the recommended procedure and all of the Presidents voted to approve.

Thereupon, upon motion duly made and seconded, the proposed procedure was approved unanimously by the members of the Federal Open Market Committee with the understanding that if possible the new procedure would be followed in connection with the January 1, 1941, reallocation.

Reference was then made to the comments in the report submitted by Messrs. Smead and Rouse with respect to the manner in which Government securities should be shown in the weekly statement of condition of Federal Reserve Banks and with respect to the disposition to be made of profits on sales of securities from the account. Upon inquiry as to the action taken by the Presidents' Conference on these matters, Mr. Kimball stated that the Presidents had expressed the opinion (1) that there should be no change in the manner in which Government securities are now shown in the weekly statement of condition of Federal Reserve Banks, and (2) that it should be the uniform policy of the Reserve Banks to transfer profits on sales of securities from the System account to reserves for contingencies to the extent that such profits are available after the payment of ordinary expenses,

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dividends, and any special charge-offs.

Mr. Peyton stated that there was the feeling on the part of some of the Presidents that the latter question was worthy of further consideration but that for the current year the policy should be as stated by Mr. Kimball.

At this point Mr. Davis, Mr. Goldenweiser, Economist, and Mr. Williams, Associate Economist, entered the room.

Mr. McKee stated that he would prefer to apply profits on securities sold against the premium on securities held in the account.

The decisions of the Presidents' Conference were discussed in the light of Mr. McKee's comment and it was the consensus of those present that the procedure to be followed in the treatment of profits should be uniform at all Federal Reserve Banks.

There followed a discussion of the possible reasons for the establishment by the Federal Reserve Banks of contingent reserves or reserves for other purposes, at the conclusion of which, upon motion duly made and seconded, it was voted unanimously to recommend to the Board of Governors that no change be made in the manner in which Government securities held in the System open market account are shown in the weekly statements of condition of Federal Reserve Banks.

Upon motion duly made and seconded, it was also voted unanimously that for the current year profits on securities sold from the System open market account should be transferred to reserves for contingencies.

Messrs. Goldenweiser and Williams were then called upon for comments with respect to the problems before the Committee. A copy of the

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statement made by Mr. Goldenweiser and a copy of a paper delivered by Mr. Williams at the annual meeting of the American Economic Association in New Orleans on December 28, 1940, which he subsequently submitted as covering a broader field than his statement at this meeting, have been placed in the files of the Federal Open Market Committee.

During Mr. Williams' statement Mr. Morrill, Secretary, joined the meeting.

At 1:00 p.m. the meeting recessed and reconvened at 3:00 p.m. with the same attendance as at the conclusion of the morning session; and, in addition, Mr. Piser, Senior Economist in the Division of Research and Statistics of the Board of Governors.

There was a discussion of the policy to be adopted by the Committee with respect to the transactions to be effected in the System open market account and reference was made in this connection to the proposed submission to Congress of a joint statement by the Board of Governors, the Presidents of the Federal Reserve Banks, and the Federal Advisory Council, in regard to the present and potential excess reserve problem. Reference was also made to the substantial sales that had been made from the account since the last meeting of the full Committee (which had reduced the total securities in the account to \$2,184,100,000) and to the many uncertainties in the present situation which have a bearing on the Government securities market including proposals that income from future issues of Government securities be taxable, the question of the extension of the debt limit, the form

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that defense financing will take, the extent to which defense expenditures will be met by taxation, and the problems growing out of the large and increasing volume of excess reserves. Consideration was given to whether the changes in the situation since the last meeting of the Committee were such as to require any change from the existing policy of making sales of securities from the account when such sales could be made without adversely affecting the market, whether the policy adopted should contemplate transactions only for the purpose of exercising an influence toward maintaining orderly market conditions, or whether the authority of the executive committee should be limited to purchases of securities and to making shifts of securities in the account.

The question was raised as to whether it would be wise to permit the account to be reduced to or below an amount, the income from which would be sufficient to meet the expense and dividend requirements of the System. It was stated that the amount that would be necessary for the purpose would depend upon the maturities of securities held and that, if it should become necessary materially to shorten the maturities in the account, earnings on an amount of securities equal to the present total holdings might be inadequate to meet the expenses of the System.

Several of the members of the Committee were of the opinion that under present conditions there was no occasion for further sales

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from the account at this time for the purpose of reducing the account but that the authority to make purchases and sales for the purpose of exercising an influence toward maintaining orderly market conditions should be continued, with the understanding that the whole question of policy would be reviewed sometime after the first of the year.

Mr. Harrison inquired whether any consideration was being given by the Board of Governors to the exercise of its remaining authority to increase reserve requirements. Mr. Eccles replied that the Board had not recently discussed that question.

There was also discussion of the conditions under which further sales from the account might be called for and of the possible effects on the market of the statement proposed to be submitted to Congress by the Board, the Presidents, and the Federal Advisory Council.

As a result of the various discussions the suggestion was made that there were many uncertainties in the situation at the present time which could not be appraised satisfactorily and that therefore the executive committee should be in position to act in accordance with its best judgment in the light of developments from time to time, especially when it might be deemed desirable to exercise an influence toward preventing disorderly conditions in the market during the interval before another meeting of the full Committee, but that, in view of the large reduction in the portfolio that had been accomplished during the past several months, there was no need for making further sales for the sole purpose of reducing the account, and that, therefore, the

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resolution adopted at the last meeting might be renewed, with a limitation of \$200,000,000 upon the extent to which the holdings in the System account might be increased or decreased.

There was general concurrence in this suggestion and, after a reading by Mr. Morrill of the resolution adopted at the meeting on September 27, Mr. Harrison offered a motion, which was duly seconded, that the following resolution 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 advisable in the light of existing conditions; provided that the aggregate amount of securities held in the account at the close of this date shall not be increased or decreased by more than \$200,000,000.

Mr. Harrison's motion was put by the chair and carried, Mr. Draper voting "no".

Mr. Draper stated that he voted "no" on the above resolution for the following reasons which were broader in scope than those outlined by him when voting in the negative on a similar resolution adopted at the meeting of the Federal Open Market Committee on September 27, 1940:

"I do not believe that in the present circumstances sales from the portfolio are necessary in order to maintain orderly market conditions. I have seen no recent evidence of the market being disorderly. In my judgment, also, sales from the portfolio for the purpose of maintaining an orderly market should be resorted to much less frequently and less vigorously than purchases at a time when the market is declining rapidly. Rapid declines are apt to result in a selling wave amounting to panic, which I

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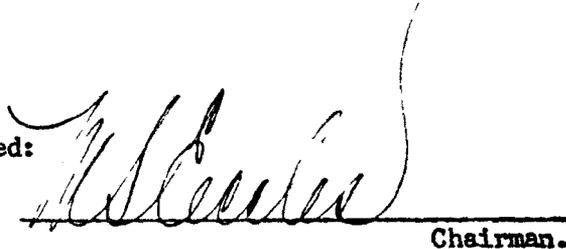
"believe should be prevented when possible. On the other hand, there is little danger of a panic when the market advances, and it makes little difference whether a rise is rapid or slow, so long as the level it reaches is appropriate to existing conditions and is not the result of purely speculative purchases.

"A still more important reason for my belief that there is no occasion to sell is that our portfolio has been reduced very substantially and that we shall need all the ammunition we can muster when reserve requirements will have been increased and the time comes to adopt a policy of credit restriction in order to prevent inflation."

Thereupon the meeting adjourned.

  
Assistant Secretary.

Approved:

  
Chairman.