

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, June 20, 1945, at 10:15 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Ransom
Mr. Draper
Mr. Evans
Mr. Alfred H. Williams
Mr. Gidney
Mr. Leedy
Mr. Gilbert

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Goldenweiser, Economist
Messrs. Hardy, Sienkiewicz, Thomas, and
John H. Williams, Associate Economists
Mr. Wyatt, General Counsel
Mr. Vest, Assistant General Counsel
Mr. Rouse, Manager of the System Open Market
Account
Mr. Thurston, Assistant to the Chairman of
the Board of Governors
Messrs. Piser and Kennedy, Chief and Assistant
Chief, respectively, of the Government
Securities Section, Division of Research
and Statistics of the Board of Governors

Messrs. Flanders, Young, McLarin, and Day, alternate members of the Federal Open Market Committee

Messrs. Leach, Davis, and Peyton, Presidents of the Federal Reserve Banks of Richmond, St. Louis, and Minneapolis, 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 28 and March 1, 1945, were approved.

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Mr. Gidney stated that Mr. K. H. Mackenzie, who was elected an associate economist of the Federal Open Market Committee at the March meeting of the Committee, had resigned as Vice President of the Federal Reserve Bank of Cleveland, and suggested that in his place Mr. L. Merle Hostetler, the financial economist at the Cleveland Bank, be elected an associate economist of the Committee.

Mr. Gilbert said that Mr. James C. Dolley, who also was elected an associate economist at the March meeting of the Federal Open Market Committee, had resigned as Director of Research at the Federal Reserve Bank of Dallas, and that it was suggested that Mr. Watrous H. Irons be elected an associate economist of the Committee, effective as of the date upon which he assumes his duties as Director of Research at the Federal Reserve Bank of Dallas which was expected to take place on July 1, 1945.

Upon motion duly made and seconded, and by unanimous vote, Messrs. Hostetler and Irons were elected associate economists of the Federal Open Market Committee to serve until the election of their successors at the first meeting of the Committee after February 28, 1946, it being understood that the election of Mr. Irons would become effective as of the date upon which he assumes his duties as Director of Research at the Federal Reserve Bank of Dallas.

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 on February 28 and March 1, 1945, were approved, ratified, and confirmed.

Mr. Rouse presented a report prepared at the Federal Reserve

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Bank of New York covering open market operations during the period from March 2 to June 16, 1945, inclusive. He also presented a supplemental report covering operations in the System account on June 18 and 19, 1945, and discussed the principal matters covered by the two reports. Following his statement copies of the principal report were distributed to the members of the Committee and others present and copies of both reports have been placed in the files of the Federal Open Market Committee.

At the conclusion of the discussion of the reports, upon motion duly made and seconded, and by unanimous vote, the transactions in the System account, during the period from February 28 to June 19, 1945, inclusive, were approved, ratified, and confirmed.

During the presentation of Mr. Rouse's report, Mr. Hostetler, Associate Economist, joined the meeting.

Chairman Eccles then called for the reports of the Economists and Mr. Goldenweiser stated that Mr. Thomas would make the principal statement.

Mr. Thomas discussed the prospects during the transition period under conditions of (1) a well balanced reconversion with a minimum of unemployment and the economy operating at near capacity without inflation, (2) rapid inflation and collapse, and (3) leading to depression and subsequent unemployment.

Mr. Thomas' statement was followed by comments by Messrs. Goldenweiser and John H. Williams.

Thereupon the meeting recessed and reconvened at 2:15 p.m. with

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the same attendance as at the morning session.

Mr. Flanders contributed some pertinent observations with respect to the situations projected by Mr. Thomas and his comments were followed by supplementary statements by Messrs. Hardy and Sienkiewicz.

Summaries of the statements made by Messrs. Thomas, Goldenweiser, Williams, Flanders, Hardy, and Sienkiewicz have been placed in the files of the Federal Open Market Committee.

There was a general discussion of possible variations in the projections referred to by Mr. Thomas, the difference in the situation existing at the end of the last war and the current conflict, and the policies that should be adopted to meet whatever situation might arise. Consideration was also given to certain of the questions raised by the statements of the Economists including the extent to which technological improvements would add to the peacetime production capacity, the necessity for profits as an incentive to private initiative, the relationship between high levels of consumption and capital formation, the possibility of individuals preferring more leisure to increased income and purchasing power, and the responsibility of the Government for full employment and whether that could be discharged effectively by deficit financing.

During the discussion, Mr. Thomas distributed copies of a preliminary draft of the Review of the Month for the July Federal Reserve Bulletin under the title of "Economic Effects of Changing War Program".

Chairman Eccles reviewed the discussions which members of the executive committee had had with representatives of the Treasury follow-

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ing the last meeting of the Federal Open Market Committee with respect to securities to be offered in the Seventh War Loan Drive and the reasons for his letter of March 9 and Mr. Sproul's telegram of March 27 to Mr. Bell, of which the Presidents of all of the Federal Reserve Banks had been informed. He also referred to the discussions with Treasury representatives in April of the Treasury's suggestion that there be a further increase of at least \$600 million in the volume of outstanding Treasury bills. He said that the members of the executive committee had taken the position that there appeared to be no need for additional offerings at the time but that if the Treasury felt that additional funds should be obtained before the next drive there would be no objection to an increase of \$600 million. He also said that the Treasury had decided to hold the increase in abeyance subject to further consideration at a later date if there were sufficient change in conditions to warrant re-consideration.

Attention was then directed to the progress of the Seventh War Loan Drive and Mr. Rouse stated that when the plans for the restriction of speculation in the drive were worked out it was felt at the Federal Reserve Bank of New York that they would be effective and easily carried out but that there had been one complication after another resulting in inequities until the Bank found itself involved in a most complicated policing job. Therefore, Mr. Rouse said, he asked Mr. Harris, Manager of the Securities Department of the Bank, to jot down his comments and that he had made the following points:

- (1) The certification procedure had not been effective and there probably would be as much speculation in this drive

as in any previous drive.

(2) The recent strength of the market gave assurance to the free rider.

(3) Many banks had not taken seriously the various requests of the Treasury nor the certification which they had to sign, which had resulted in competition between banks to the extent that many banks were very bitter about the whole arrangement.

(4) A better job could not be expected from the banks unless definite yardsticks were established for each class of investor, which was not practicable under the prevailing drive technique. As a means of holding down the volume of subscriptions most banks would prefer not to make loans to facilitate subscriptions or at rates lower than the coupon rate. Many banks had stated that the "carrying profit" was a greater inducement than the "premium profit".

(5) The difference in rates on loans between banks was a sore subject, especially in places where there were small banks and branches of large banks.

(6) The request not to sell old securities in order to buy securities offered in the current drive had not been taken seriously.

(7) If a thorough policing job were done it would greatly impair the morale of the selling organization as well as of commercial banks.

(8) Banks were reluctant to ask their customers for a financial statement if they had had no occasion to do so in their previous relationships.

Mr. Rouse concluded his statement with the comment that the situation had grown to be a serious one and that something should be done about it promptly.

It was clear from the comments of most of the Presidents that the problem of speculation and indirect buying had reached considerable proportions during the drive in their respective districts.

In response to a question as to what should be done to combat

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the speculative activities which he had outlined, Mr. Rouse referred to the decline in the yields on long-term securities which he thought would continue under present conditions to a point where the Treasury would be unable to continue the issuance of long-term 2-1/2 per cent bonds. He also pointed out that the yields on short-term securities had increased because of the efforts of the banks to maintain an average rate of earnings. To meet this situation in the long-term market he suggested that the Treasury might announce now that the Eighth War Loan Drive would take place in the fall and that a 2-1/2 per cent bond of substantially the same term as the long-term bond offered in the Seventh War Loan Drive would be included in the basket, or that the 2-1/2 per cent bond would be put on tap and taken out of the financing drives entirely, which would have the effect of creating a supply of securities and counteracting the tendency toward higher prices on long-terms. In the short-term area he did not think it would be possible at this time to discontinue the posted rate on bills, but the System might well give consideration to increasing to 3/4 per cent the differential discount rate on advances to member banks, secured by Government obligations maturing or callable in one year or less, for the purpose of taking some of the profit incentive out of borrowing for the purpose of purchasing Government securities. An essential part of any such program would be direct offerings to commercial banks.

Mr. Rouse's suggestions were discussed and Chairman Eccles stated that when the evidence of the speculation in the Seventh War Loan Drive was available and the representatives of the System were in a po-

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sition to present the picture to the Treasury, there should be an informal conference with the Treasury representatives for the purpose of meeting the speculative situation and reviewing the future program. He also suggested, as another step that might be taken to combat speculation, the requirement that collateral for war loan accounts consist of short-term securities to the extent of not less than 75 per cent.

Mr. Sproul referred to the opinion that had been expressed on numerous occasions before, that the root of the trouble was the pattern of rates and that as long as the pattern was continued no way could be devised effectively to prevent advantage being taken of it.

It was suggested that if the discount rate on short-term Government securities was to be changed, that action should be taken before the rate is frozen into the financing structure. The point was also made that when the Japanese phase of the war ends the System should be prepared with a flexible program which would permit it to act promptly to meet any situation that might develop, and that in the absence of such a program there was danger of the situation being frozen to such an extent that flexible action might not be possible.

Various possible steps that might be taken in connection with the discount rate were mentioned and it was agreed that the whole program of Treasury financing and future System policies should be considered at the proposed informal meeting with the Treasury.

Chairman Eccles stated that if the Presidents had any suggestions that they thought would be helpful in connection with such a meeting he would appreciate it if they would submit them for consideration.

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Mr. Sproul asked if there were any question on the part of the Presidents as to the desirability of raising the discount rate on short-term Government securities to $3/4$ per cent, and no objections were expressed.

At the conclusion of the discussion, Mr. Alfred H. Williams suggested that the proposed conference with the Treasury representatives should be held as promptly as possible so that the situation with respect to speculative developments in the current drive would be fresh in everyone's mind.

Turning to the action to be taken by the Committee to carry out its open market policies pending the next meeting of the Committee, there was unanimous agreement that, in view of the considerations which had been discussed at this meeting, no action should be taken at this time to change the direction issued to the Federal Reserve Banks at the meeting of the Federal Open Market Committee on March 1, 1945, with respect to the purchase of Treasury bills at a discount rate of $3/8$ per cent.

Chairman Eccles stated that at the meeting of the executive committee just prior to this meeting of the full Committee, consideration was given to the changes that might be made in the procedure for the allocation of securities in the System open market account in the light of the enactment of the reserve ratio bill, S. 510, which reduced to 25 per cent the gold certificate reserves required to be maintained by the Federal Reserve Banks against deposits and Federal Reserve notes in actual circulation. The memorandum which was presented at the meeting of the executive committee and which discussed the two points considered by that committee was read and Chairman Eccles stated that the executive

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committee had decided to recommend to the Federal Open Market Committee that it be agreed (1) that pursuant to the provisions of paragraph 2(a) of the allocation procedure now in effect and pending further action by the Federal Open Market Committee, beginning July 1, 1945, Treasury bills would not be allocated to any Federal Reserve Bank in an amount which would reduce its reserve ratio below 35 per cent and (2) that the second sentence of paragraph 2(b) of the statement of procedure be changed to read as follows:

"If, between the weekly and month-end adjustments a Bank's reserve ratio approaches the legal minimum, the Bank may sell to the Bank or Banks having the highest reserve ratio or ratios, a participation or participations in Treasury bills held in its option account for a period of days to expire on the following Wednesday or month end, whichever is earlier, except that such adjustments will be made in the System account in the event that a Bank does not hold sufficient bills in its option account."

In connection with the first point, Chairman Eccles stated that consideration had been given to the question whether the reserve ratio of an individual Federal Reserve Bank should be allowed to decline immediately to 35 per cent, as would be the case with some of the Banks if the agreed percentage were fixed at that figure, or whether it would be better if the reduction were made gradually, that while there was some feeling that the latter course might be the preferable one to follow it was agreed that the increased earnings that would accrue to the Banks with low reserve ratios if the agreed percentage were fixed at 35 per cent were more important than a higher reserve ratio and that there would be no objection from the standpoint of public reaction or otherwise to allowing the reserve ratio of the Banks to drop to that

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point immediately rather than to decline more gradually.

On the second point it was stated that the second sentence of paragraph 2(b) of the allocation procedure, in its present form and in its suggested amended form, placed no limit on the point to which the reserve ratio of a Reserve Bank might be increased between weekly statement dates, but that the executive committee felt that inasmuch as the sentence contemplated the sale of bills only for the purpose of removing the danger of a deficiency in required reserves and, since for such purpose it would not be necessary to increase the Bank's reserve ratio above 35 per cent, it would not be expected that any Bank would use the authority granted by the amended provision to increase its reserve ratio above that agreed upon by the Federal Open Market Committee pursuant to the provisions of paragraph 2(a) of the allocation procedure.

After a brief discussion of these points, upon motion duly made and seconded, the recommendations of the executive committee were approved unanimously.

In response to an inquiry as to the amount of additional funds that would have to be supplied to the market during the interim before another meeting of the Federal Open Market Committee, Mr. Rouse stated that it had been estimated at the Federal Reserve Bank of New York that funds aggregating in the neighborhood of \$2,750,000,000 would have to be supplied through open market operations and discounts before the next drive for the purpose of furnishing needed reserves, maintaining the pattern of rates and offsetting increased currency in circulation and that if the next meeting of the Federal Open Market Committee were held in October approximately \$2,000,000,000 of new funds would be needed.

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In view of that situation it was Mr. Rouse's suggestion that the Federal Open Market Committee give the executive committee a greater authority to increase the amount of securities held in the System account than was granted at the last meeting of the full Committee, with the understanding that the executive committee would grant to the Bank the usual limited authority to be increased from time to time as conditions might require.

There was no disagreement with the estimated need for funds as outlined by Mr. Rouse, and 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 purchases and sales of securities for the System account:

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, 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 practical administration of the account, or for the purpose of maintaining about the present general level of prices and yields of Government securities, or for the purpose of maintaining an adequate supply of funds in the market; provided that the aggregate amount of securities held in the account at the close of this date /other than (1) bills purchased outright in the market on a discount basis at the rate of 3/8 per cent per annum and bills redeemed at maturity and (2) 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.

That the executive committee be 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 amount of such certificates held in the account at any one time shall not exceed \$1,500,000,000.

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The suggestion was made that the next meeting of the Presidents' Conference might be held on October 1 and 2 and that the meeting of the Federal Open Market Committee might be held on the following two days. There was unanimous agreement that October 3 and 4, 1945, should be set as the tentative dates for the next meeting of the full Committee.

Thereupon the meeting adjourned.

Chester Morley
Secretary.

Approved: W. C. C. C.
Chairman.