

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 Monday, July 10, 1950, at 10:35 a.m.

PRESENT: Mr. McCabe, Chairman  
Mr. Sproul, Vice Chairman  
Mr. Eccles  
Mr. C. S. Young  
Mr. Szymczak (alternate for Mr. Evans)

Mr. Morrill, Secretary  
Mr. Carpenter, Assistant Secretary  
Mr. Thomas, Economist  
Mr. Vest, General Counsel  
Mr. Rouse, Manager of the System Open Market Account  
Mr. Thurston, Assistant to the Board of Governors  
Mr. Riefler, Assistant to the Chairman, Board of Governors  
Mr. Ralph A. Young, Director of the Division of Research and Statistics, Board of Governors  
Mr. Kenyon, Assistant Secretary, Board of Governors  
Mr. Youngdahl, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors  
Mr. Arthur Willis, Special Assistant, Securities Department, Federal Reserve Bank of New York

At the beginning of this meeting copies were distributed of (1) a memorandum dated July 7, 1950, from Mr. Thomas on the subject of current considerations relative to open market policy and (2) a memorandum of comments on the current business and credit situation.

Upon motion duly made and seconded and by unanimous vote, the minutes of the meeting of the executive committee held on June 14, 1950, were approved.

7/10/50

-2-

Upon motion duly made and seconded and by unanimous vote, the action of the members of the executive committee on June 30, 1950, increasing from \$1 billion to \$1.5 billion the limitation on the authority of the Federal Reserve Bank of New York to increase the total securities held in the System account, as contained in the first paragraph of the direction issued by the committee at its meeting on June 14, 1950, was approved, ratified, and confirmed.

During the meeting Mr. Rouse distributed copies of a report prepared at the Federal Reserve Bank of New York of open market operations during the period June 12 to July 6, 1950. He also distributed copies of a supplementary report covering commitments executed for the account on July 7, 1950. Copies of the reports, the principal sections of which were commented on by Mr. Rouse during the meeting, 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 open market account for the period June 13 to July 7, 1950, inclusive, were approved, ratified, and confirmed.

In connection with the review of developments since the last meeting of the committee, Mr. Sproul stated that, following the meeting of the Federal Open Market Committee on June 14, 1950, he and Chairman McCabe called on Secretary of the Treasury Snyder and, with Mr. Haas, Director of the Technical Staff of the Treasury, and Mr. Bartelt, Fiscal Assistant Secretary of the Treasury, present,

7/10/50

-3-

informed the Secretary of the decisions reached by the Federal Open Market Committee with respect to open market policies to be carried out after July 1, 1950, when the July financing was out of the way. The response of the Secretary, Mr. Sproul said, was that the Treasury and the committee were considering the same problems, and that the Treasury would continue to study the matter and would keep in touch with representatives of the committee.

Chairman McCabe stated that, when he saw Secretary Snyder about two weeks ago, the latter was concerned about the comments which were appearing in the press with respect to differences between the Treasury and the Federal Reserve System on monetary and fiscal policies, that the Secretary thought that these stories were contributing to the heavy sales of short-term securities to the System account, and that he wanted to explore whether there was any way in which that kind of reporting could be curtailed. The Secretary suggested, Chairman McCabe said, that the Open Market Committee caution its staff about talking to reporters on matters of this kind and stated that he would caution the Treasury's staff. Chairman McCabe added that he had reported his conversation with the Secretary of the Treasury to the Board, at which time it was pointed out that the situation created by the June and July refunding operations of the Treasury were such that anyone familiar with market conditions could write the stories which had been appearing in the

7/10/50

-4-

press and the weekly news letters without talking to members of the staff of the Federal Open Market Committee or the Treasury.

Chairman McCabe suggested that, in the light of the mounting inflationary pressures which were evident in the economy and the developments in Korea which intensified these pressures, there should be a review by the Federal Reserve System of the various powers available to it to combat inflation and a decision should be made as to what action should be taken and the timing of such action. In that connection he referred to the dangers inherent in the greatly accelerated expansion of housing credit and consumer instalment credit and there was a discussion of what if anything further might be done by the System or what suggestions might be made in the direction of counteracting such expansion. Particular attention was given in this connection to the high level of mortgage credit at the present time as compared with 1945, 1939, and 1929 and to the different conditions existing in those periods compared with the present. It was the unanimous opinion of the members of the committee that it would be desirable if action could be taken by responsible authorities in Government to slow down the very rapid expansion of credit for housing. In this connection, Chairman McCabe read a letter which he addressed on July 7, 1950, to the Chairman of the Council of Economic Advisers making certain suggestions with respect to the midyear economic report of the President.

7/10/50

-5-

Mr. Szymczak suggested that the first problem for consideration by the committee today was what should be done under the authority granted by the Federal Open Market Committee at its last meeting with respect to short-term rates, and that one of the most important considerations from the standpoint of the System's relation to the market was the securities that the Treasury might offer in the future for the purpose of meeting the Government needs for new money which, if the Korean incident lasted for some time, would be substantially larger than would otherwise be the case.

Mr. Sproul suggested that there was no question that the forces which had been set in motion by the developments in Korea would accentuate the inflationary situation which the Federal Open Market Committee had in mind on June 14, 1950, when it was decided that short-term rates should be increased as a means of credit restraint. The question for decision, he said, was whether in the current situation, which was a relatively delicate one, action to increase the short-term rate would have the effect which would have been expected in peacetime. It was possible, he said, that the action might create the very type of uncertainty which would express itself in further consumer buying as well as purchases by business to build up inventories in anticipation of controls and rationing, so that the action would result in the very conditions which the Committee was trying to avoid.

7/10/50

-6-

Looking at the longer range picture, Mr. Sproul expressed the opinion that in the event of major military commitments a more nearly horizontal structure of rates than existed during the last war was highly desirable. Other members of the committee concurred in Mr. Sproul's comments and consideration was given to what might be a desirable range of rates in the event of a major military conflict.

Mr. Eccles suggested that the System might propose a range of rates from 1-1/2 per cent to 2-1/2 per cent with the understanding that all bank financing would be done at the lower rate, and that securities offered at higher rates should be ineligible for bank investment.

During a discussion of the most effective way to cope with existing money market conditions in the face of the uncertain military situation, it was suggested that existing pressure on long-term rates, and the need for System purchases of short-term securities to replace reserves absorbed by the sale of long-term securities from the System account, would be greatly relieved if the Treasury would announce immediately its intention to offer a long-term nonmarketable tap issue of the kind previously recommended by the Federal Open Market Committee. It was also suggested that, if such a program were agreed upon, the committee should continue to watch the situation and take such further action as might be called for when the outlook with

7/10/50

-7-

respect to inflationary pressures and the fiscal and budgetary picture was somewhat clearer.

Mr. Sproul proposed that, in addition, the System urge the proper authorities of Government to impose restrictions on further expansion of housing credit, and that it suggest the reimposition of consumer instalment credit controls (which could be done without legislation if the President should declare the existence of a national emergency). He also expressed the hope that if this were done it would be possible within a short period of time to determine whether further action with respect to short-term rates, as contemplated at the last meeting of the full Committee, would be justified.

With respect to the suggestion that consumer instalment regulation be restored, the thought was expressed that unless it could be done without new legislation the proposal might result in a rush of buying before the controls could be reimposed. It was also suggested, while there was considerable evidence of buying in anticipation of shortages in both consumer and industrial materials, that situation could very quickly ease in the event of a settlement of the war in Korea.

All of the members of the committee indicated unanimous agreement with the proposal that the Treasury be urged to issue the non-marketable security previously recommended by the Federal Open Market

7/10/50

-8-

Committee. After discussion as to how the proposal should be submitted to the Treasury and the action the executive committee should take with respect to short-term rates in the event the Treasury agreed to the proposal, it was suggested that a letter to the Secretary of the Treasury be prepared which, after informal approval by the members of the executive committee, could be presented or sent to the Secretary and amplified in a conference which Chairman McCabe and Mr. Sproul might have with Secretary Snyder.

This suggestion was approved by unanimous vote.

Secretary's note: The letter was informally approved by the individual members of the committee and sent to the Secretary of the Treasury by messenger on July 13, 1950, in accordance with this action, in the following form:

"The Executive Committee of the Federal Open Market Committee at a meeting in Washington on July 10, 1950, gave consideration to the open market operations of the Federal Reserve System, and to related instruments of credit policy, particularly as they have been and may be affected by the Korean situation.

"It seemed clear to the Committee that with our economy operating close to capacity, in terms of aggregate production and employment, there is little slack with which to meet the added requirements of our military operations. The impact of this new pressure is already beginning to be apparent. Expansion in both consumer and business expenditures, previously evident, has been accelerated. Commodity prices have risen further, reflecting in part speculative buying. A new round of demands for wage increases is reported in the making. As a consequence, a further demand for bank credit is likely, and bank credit has already shown a substantial expansion this year. In these circumstances, and in the light of probable increases

7/10/50

-9-

"in the Treasury's needs for new money during the remainder of the year, it seems more important than ever that Government borrowing be done outside the banking system to the fullest extent possible. In the light of our previous conversations, we believe that you are in general agreement with this view, although you have had reservations as to the sufficiency of non-banking funds to warrant such an offering. Under present circumstances, we are convinced that vigorous efforts should be made to obtain such funds as are available.

"Conditions in the Government security market, as well as the developing economic situation, now make a prompt implementation of a program along the lines which we last discussed more important than ever. The Government security market in recent weeks has been characterized principally (1) by a strong investment demand for long-term bonds, with a resulting tendency for long-term interest rates to fall; and (2) by market sales of short-term securities with a resulting tendency for short-term rates to rise. These two tendencies have been checked only by Federal Reserve sales of bonds and purchases of notes and certificates in substantial amounts. System purchases have not only supplied banks with reserves needed to offset those absorbed by System sales of long-term securities but also have provided reserves for a substantial volume of overall monetary expansion.

"We could now either let short-term rates rise or long-term rates fall, but one thing we cannot do for very long with our present portfolio is to prevent both movements and, at the same time, adequately to discharge our responsibilities for credit restraint in the light of prospective inflationary pressures. In view of the Korean situation, we have been holding in abeyance our previous decision to discontinue purchasing large amounts of short-term securities at a rigidly pegged rate structure and to buy such securities only at rising rates after the completion of the Treasury's July first financing. We would be prepared to continue to hold this decision in abeyance at least until we have a clearer view of our likely involvement in war production and expenditures and of the expansion of bank credit which may face us, provided the Treasury would announce at an early date the offering of a long-term bond for purchase by nonbank investors.

"We believe that a tap offering of bonds to nonbank

7/10/50

-10-

"investors of the sort recommended in my letter to you of May 25, 1950, and discussed in the conference which Mr. Sproul and I had with you on June 15, is now essential, rather than merely desirable, both on broad economic grounds and in order to relieve the situation that exists in the Government security market. We strongly urge that the Treasury make an early announcement of such an offering. Sales of such bonds by the Treasury would:

1. Absorb a portion of the nonbank funds available for investment and help to restrain an excessive expansion of private economic activity;
2. Help prevent a rise in long-term bond prices--public and private--an undesirable development under existing conditions.
3. Relieve the Federal Reserve System of the necessity of selling bonds, at least in present volume, and thus remove or reduce one factor which has been causing banks to sell short-term securities to the Federal Reserve Banks.

"In view of the developing economic situation, the expansion of bank credit which is under way and in prospect, and the likelihood of continuing pressures (in opposite directions) on both the long-term and short-term security market under existing conditions, we believe that an immediate announcement that the Treasury intends to issue such a bond, and its issuance as soon as possible thereafter, would be in the public interest. The announcement would promptly remove some of the existing pressures in the long-term market, and the early issuance of the bonds would complete this relief.

"We recognize, of course, that there are other powerful factors in the credit situation, such as the accelerating expansion of mortgage and consumer debt, and we would want to join with you in urging that steps be taken wherever possible to curb this expansion. Within the range of the existing powers of the Treasury and Federal Reserve System, however, we believe that a most effective immediate step which could be taken would be to adopt the program which we have suggested for financing the Treasury's cash needs during the remainder of the year. I will be glad to discuss any phases of this problem with you at your earliest convenience."

7/10/50

-11-

There was agreement that the general direction issued at the last meeting of the executive committee of the Federal Open Market Committee to the Federal Reserve Bank of New York to effect transactions for the System account should be renewed but that, since the authority of the Federal Reserve Banks to purchase securities directly from the Treasury had been renewed by the Congress, the last sentence of the existing direction should be eliminated.

Thereupon, upon motion duly made and seconded, the executive committee voted unanimously to direct the Federal Reserve Bank of New York, until otherwise directed by the executive committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities and allowing maturities to run off without replacement) for the System account, either in the open market or directly from, to, or with the Treasury, as may be necessary, in the light of changing economic conditions and the general credit situation of the country, for the practical administration of the account, for the maintenance of 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 total amount of securities in the account at the close of this date shall not be increased or decreased by more than \$1 billion exclusive of special short-term certificates of indebtedness purchased for the temporary accommodation of the Treasury pursuant to paragraph (2) of this direction;

(2) To purchase direct from the Treasury for the System open market account 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 \$750 million.

7/10/50

-12-

In taking this action it was understood that the limitations contained in the direction include commitments for purchases and sales of securities for the System account.

It was also agreed that the existing understanding with respect to the replacement of maturing Treasury bills held in the System account should continue unchanged.

Upon motion duly made and seconded and by unanimous vote, the Federal Reserve Bank of New York, operating under the general direction issued earlier during this meeting, was authorized to continue to purchase and sell Treasury bills and certificates within a range of 1.12-1.24 per cent until such time as a decision was made by the members of the committee, in order to carry out the policy agreed upon at the last meeting of the Federal Open Market Committee, that short-term rates should be increased, at which time the Bank would be authorized to make such purchases and sales within a range of 1.12-1.36 per cent.

In connection with the above matter, Chairman McCabe suggested the desirability of experimenting with a slight increase in the rates at which bills and certificates were being purchased for the System account. Mr. Rouse questioned whether such action should be taken because of the possibility of its being misunderstood and stated that in the easy money market which was expected during the period immediately ahead there would be little opportunity for such a step. Mr. Sproul suggested that the next time the market tightened the System could move its buying rates on bills and certifi-

7/10/50

-13-

cates up a point.

It was agreed unanimously that, operating under the general direction issued by the executive committee, the Federal Reserve Bank of New York would be authorized to continue to sell long-term Government securities from the System account unless and until there was a change in the business and credit situation or the Treasury issued new securities to finance the deficit which would make it undesirable to pursue the policy further; it being understood that should the price on the longest restricted issue decline to 100-3/4 another meeting of the executive committee would be called to consider what further instructions should be issued to the Federal Reserve Bank of New York in accordance with the action taken at the meeting of the full Committee on June 14, 1950.

It was agreed that the next meeting of the executive committee would be subject to call by the Chairman.

Thereupon the meeting adjourned.

Orvester Morrill  
Secretary.

Thomas B. Luce  
Chairman.