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, March 22, 1937, at 10:35 a.m.

PRESENT: Mr. Broderick
Mr. McKee
Mr. Ransom (alternate for Chairman Eccles)
Mr. Harrison
Mr. Sinclair

Messrs. Szymczak and Davis, Members of the Federal Open Market Committee.

Mr. Morrill, Secretary
Mr. Goldenweiser, Economist
Mr. Williams, Associate Economist
Mr. Dreibelbis, Assistant General Counsel
Mr. Carpenter, Assistant Secretary of the Board of Governors
Mr. Thurston, Special Assistant to the Chairman of the Board of Governors
Mr. Piser, Senior Economist in the Division of Research and Statistics of the Board of Governors

Upon motion by Mr. Ransom, which was duly seconded, Mr. Harrison was elected to serve as chairman of the meeting in the absence of Chairman Eccles.

For the information of the members of the Federal Open Market Committee who were not present at the meeting of the executive committee on March 13 or the meeting of the full Committee on March 15, Messrs. Harrison and Ransom reviewed the circumstances which had attended the calling of the two meetings, as well as telephone conversations with Secretary Morgenthau in Georgia and Chairman Eccles in Florida and discussions by members of the executive committee since the meeting on March 15. Mr. Harrison also reported informally on the transactions of the New York bank for the Treasury and the System open market account since March 9 which resulted in the purchase of a total of $121,000,000 of Government bonds for the account of trust funds administered by the Treasury and of $68,000,000 for the System open market account in replacement of shorter term securities held in the account.

It had been felt, Mr. Harrison said, because of the continued weakness of the Government securities market, that it would be desirable to hold a meeting of the executive committee today in order to review the entire situation and to consider any suggestions with respect to the steps to be taken by the committee with a view to preventing a disorderly market. He also said that it appeared from a telephone conversation which Mr. Burgess had on Saturday with the Secretary of the Treasury that he was entirely satisfied with the manner in which the Federal Reserve System was handling the situation.

Mr. Ransom stated that on March 17 the Secretary of the Treasury advised over the telephone that the Treasury Department had only approximately $14,000,000 additional funds available for investment and inquired whether the System would be willing to take over the entire amount of bonds that it was found necessary to purchase to prevent a disorderly market. Mr. Ransom said that, after consulting with Messrs. Harrison and Sinclair by telephone and personally with the members of the executive committee in Washington, he called the Secretary on the morning of March 18 and advised him that the committee was ready to direct the purchase for the System open market account, in replacement of shorter term securities held in the account, of all Government bonds acquired in accordance with the policy of preventing a disorderly market, whenever the Treasury felt that it had no further funds to invest. Mr. Ransom inquired during the conversation on the 17th whether some of the Secretary's remarks indicated that he felt that the System should purchase securities for the purpose of increasing the System portfolio as distinguished from purchases of bonds in replacement of shorter term securities held in the account and the Secretary replied that he felt that the decision on that matter was one for the System to make. Mr. Ransom added that the Secretary conveyed the impression that he was interested only in keeping the market orderly and had stated that he wanted to inform the System that, since he had only $14,000,000 available at that time for investment, if the Treasury were called upon to make additional purchases in order to prevent a disorderly market such purchases would have to be accomplished with funds derived from the transfer of gold certificates to the Federal reserve banks or in some other manner.

Mr. Harrison expressed the opinion that the present condition of the Government bond market reflected an understandable adjustment, after a prolonged rise, to various conditions which bear directly upon the value of long-time fixed income investments. It might well be felt, he stated, that the bond market was undergoing a somewhat belated readjustment after almost two years of steady rise; that this readjustment was probably made more drastic by recent rises in commodity prices and consequent talk of inflation which tended to keep other investors out of the market at a time when banks were selling; and that it was likely that the readjustment was more severe than it would have been if action to check the long and steady downward trend in interest rates had been taken sooner. In fact, he said, if there were any criticism to be made of the System in the matter of increasing reserve requirements, it would be, he thought, that it had waited too long. He added that he felt that one of the lessons that might be learned from recent experience was that open market operations to avoid a disorderly market should not follow the market too closely, and that it probably was a mistake to attempt to offset minor day-to-day adjustments in the market.

In response to an inquiry from Mr. McKee as to where the selling was coming from, Mr. Harrison said that it was difficult definitely to ascertain who the sellers were although it was likely that some of it was due to liquidation by dealers of their position following the March 15 financing and more generally due to sales by banks and others throughout the country. He pointed out that the present weakness in the market was not so much caused by heavy offerings as by the fact that corporations, trusts, and other investors were keeping out of the market because of talk of the possibility of price inflation, supplemented by labor troubles and world-wide armament programs, which resulted in a lack of bidders for the securities being offered.

Mr. Harrison said that the Treasury had not yet entirely exhausted the funds available to it for investment and that, therefore, all bonds acquired since March 12 had been equally divided between the Treasury and the System open market account.

Mr. Harrison referred to the fact that the action taken by the

Federal Open Market Committee at the meeting on March 15 in authorizing the executive committee to increase or decrease the total amount of securities held in the System open market account was with the distinct understanding that the account would not be increased unless an emergency arose which, in the judgment of the executive committee, would justify such an increase. He expressed the opinion that existing conditions did not constitute such an emergency as the Committee had in mind.

There followed a discussion of the effect of the recent decline of prices of Government securities on the yield of such securities, the question when buyers might be expected to come into the market, reasons for the tendency of some banks to sell securities rather than to reduce their balances with correspondent banks to meet the increase in reserve requirements, and changes in the Government security holdings of reporting member banks.

Mr. Goldenweiser referred to the failure of income tax receipts to reach Treasury estimates as a further unsettling factor in the monetary situation. He also expressed the opinion that there was considerable room for expansion of commercial loans of member banks, that, generally speaking, there was no necessity for the liquidation by member banks of their Government security holdings in order to meet increased reserve requirements or customers' borrowings for business purposes, and that, while there had been some stiffening of rates since last November, a substantial strengthening of long term rates was not to be expected for some time to come, although short term rates, which had been very much lower than the long term rates, might go up considerably in comparison to the rates recently in effect.

Mr. Williams referred to the elements in the present situation which point toward the development of inflationary trends before a full recovery has been attained and raised the question whether, if an inflationary situation develops, it will not be necessary to permit rates to increase in order to meet that situation and whether in such a case excess reserves or even easy money would be justified. In this connection he referred to certain phases of the economic situation which have inflationary tendencies notwithstanding the fact that full recovery has not been achieved and he suggested that in this situation the System should resist all suggestions that action be taken which would increase excess reserves and that it should look in the direction of restrictive measures in order to check the inflationary trends.

There was also a discussion, in the light of the situation existing since the latter part of 1935, of the relative merits of an increase in reserve requirements and the absorption of excess reserves through open market operations. Mr. Sinclair suggested a discussion of the question whether the Board of Governors would be justified in any circumstances in rescinding its action with respect to the increase in reserve requirements which will take effect on May 1.

When this question was raised Mr. Harrison was absent from the room discussing the existing market situation with Mr. Burgess, Manager of the System open market account, who was in New York. Upon his return and after reviewing Mr. Burgess' report, Mr. Harrison said that he was still of the opinion that there was no reason why the System should change its present policy of preventing a disorderly market through shifts in the System open market account and that there was no justification for taking action at this time to increase the System portfolio. The other members of the Federal Open Market Committee present indicated agreement with Mr. Harrison's position.

In connection with the question raised by Mr. Sinclair, the question was raised whether the Board of Governors might obtain up to date information with respect to the distribution of excess reserves of member banks. However, it was felt that, as the inquiry which would have to be made of the Federal reserve banks in order to obtain such information might create the impression that the Board would take action to rescind the May 1 increase in reserve requirements, such an inquiry should not be made. In this connection Mr. Goldenweiser said that he thought that Mr. Smead and he might be able to develop some information that would be useful without sending out an inquiry.

It was stated that as the authority granted to the New York bank at the meeting of the executive committee on March 15 to effect transactions in the System open market account continued only until the next meeting of the committee, it was necessary that such authority be renewed at this meeting.

> Upon motion duly made and seconded, and by unanimous vote, the executive committee directed the Federal Reserve Bank of New York, until the next meeting of the executive committee, superseding all previous authorizations, (1) to replace maturing securities in the System open market account by purchases of like amounts of bills or of notes maturing within two

years, (2) to make such shifts of securities in the account as may be necessary in the proper administration of the account, up to an aggregate of $50,000,000, into other Government securities having maturities within a range of one year from those of the securities sold, (3) to make such other shifts (which may be accomplished when desirable through replacement of maturing securities) of securities in the account as may be necessary in the proper administration of the account, up to an aggregate of $100,000,000, into other Government securities having maturities which are not within a range of one year from those of the securities sold, (4) upon approval by a majority of the members of the executive committee, which might be obtained by telephone, telegraph or mail, to make such other shifts as might be found to be desirable and advisable within the limits of the authority granted to the executive committee by the Federal Open Market Committee, and (5) to permit such fluctuations, up to a limit at any one time of $25,000,000, in the amount of holdings of Government securities in the System open market account between weekly statement dates as may be desirable for the practical administration of the account in making shifts between and replacement of securities pursuant to the authority granted by the executive committee.

The meeting recessed at 1:15 p.m. and reconvened at 3:10 p.m. with the same attendance as at the morning session, with the exception of Mr. Piser.

There was a general discussion of the question whether, in the case of an emergency, the Board of Governors would be justified in rescinding the increase in reserve requirements which will become effective on May 1 and it was the opinion of a majority of the members of the Federal Open Market Committee present that such action would be undesirable for the reason that it would amount to a reversal of the policy which formed the basis for the increase and would be an action taken because of weakness in the Government bond market rather than because of a fundamental condition in the business or credit situation calling for such action. It was pointed out that many banks throughout the country had already adjusted their reserve position to meet the increase and to rescind the action now unless absolutely necessary, would result in discrimination against such banks.

At the conclusion of this discussion it was also expressed as the opinion of a majority of the members present that the action of the Board in increasing reserve requirements was entirely proper both in the light of the circumstances which existed at the time action was taken and in the light of existing conditions, that in the present situation there was no justification for a reversal of the policy of the Board with respect to reserve requirements of member banks, that the System portfolio should not be increased in the absence of an emergency which was not now foreseen, and that the present policy of operation through shifts in the System open market account for the purpose of preventing a disorderly market should be continued.

Mr. Harrison referred to the action taken by the Federal Open Market Committee at its meeting on January 28, 1937, in authorizing the executive committee to direct the readjustment of participations of the Federal reserve banks in the System open market account as of April 1, 1937, and called attention to the possibility that some Federal reserve bank might object to a transfer of securities at book value, rather than the present lower market values. This matter was discussed briefly.

The suggestion was made and agreed to that it would be desirable for the executive committee to meet again tomorrow for discussion of developments in the market for Government securities. Accordingly, the meeting recessed at 4:50 p.m. with the understanding that it would convene again at 10:30 a.m. tomorrow.

Chester Morrill
Secretary.

Approved: George L. Harrison
Chairman pro tem.