

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 Thursday, June 5, 1947, at 2:45 p.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. Szymczak
Mr. Draper
Mr. Evans
Mr. Clayton
Mr. Whittemore
Mr. Gidney
Mr. Davis
Mr. Peyton

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. McCracken and Stead, Associate Economists
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Chairman of the Board of Governors
Mr. Sherman, Assistant Secretary of the Board of Governors
Mr. Musgrave, Chief, and Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Alfred H. Williams, Young, Gilbert, and Leedy, alternate members of the Federal Open Market Committee

Messrs. Leach, McLarin, and Earhart, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market

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Committee held on February 27-28 and March 1, 1947, 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 meetings of the executive committee on February 27, March 1, April 1, and May 2, 1947, were approved, ratified, and confirmed.

Upon motion duly made and seconded, and by unanimous vote, the action taken by the members of the Federal Open Market Committee on April 2, 1947, pursuant to a recommendation of the executive committee, to increase from 1-1/2 billion to 2 billion dollars the limitation on the authority of the executive committee with respect to increasing or decreasing the total amount of securities in the System account, contained in the first paragraph of the direction issued at the meeting on March 1, 1947, was approved, ratified, and confirmed.

Upon motion duly made and seconded, and by unanimous vote, the actions of the members of the Federal Open Market Committee on April 24, 1947, (a) authorizing each Federal Reserve Bank to place weekly tenders for new Treasury bills in an amount not exceeding the amount of weekly maturities in the option account and authorizing the Federal Reserve Bank of New York to place tenders for new Treasury bills in an amount not exceeding the amount of weekly maturities in the System open market account, and (b) amending the direction issued by the Committee on March 1, 1945, with respect to the purchase of Treasury bills to read as follows, were approved, ratified, and confirmed. The circumstances under which these actions were taken are set forth in the minutes of the meeting of the executive committee on May 2, 1947:

Until otherwise directed by the Federal Open Market Committee, the 12 Federal Reserve Banks are directed to purchase all

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Treasury bills that may be offered to such Banks on a discount basis at the rate of $3/8$ per cent per annum, any such purchases to be upon the condition that the Federal Reserve Bank, upon the request of the seller on or before the last business day preceding the closing day on which the Treasury will accept tenders of the bills for new Treasury bills, will sell to him Treasury bills of like amount and maturity at the same rate of discount. All bills purchased under this direction are to be held by the purchasing Federal Reserve Bank in its own account and prompt reports of all transactions in Treasury bills are to be made to the Manager of the System Open Market Account.

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the Federal Open Market Committee on May 5, 1947, in issuing the following direction to the Federal Reserve Banks was approved, ratified, and confirmed. The reasons for the direction are referred to in the minutes of the meeting of the executive committee on May 2, 1947:

On the morning of the closing day for the receipt of tenders for new Treasury bills (generally Monday), each Federal Reserve Bank will send advice to reach the Manager of the System open market account, not later than one p.m. (on Monday, May 5, not later than 2 p.m.) New York time, the amount of all maturing bills subject to the option and the amount of all maturing bills not subject to the option held in the Bank's option account, which will be transferred at par on the maturity date of the bills (generally Thursday) to the System open market account. Bills acquired on May 1 in exchange for maturing bills will, as a separate transaction, be transferred to System account at book value on Wednesday, May 7, and payment therefor will be made through interdistrict settlement fund. With respect to maturing Treasury bills sold to any Federal Reserve Bank prior to April 25, 1947, for which the seller still retains the option to repurchase at any time before maturity, the Federal Reserve Bank will honor any request by the seller to repurchase such bills and immediately advise the Manager of the System open market account the amount of bills repurchased by the seller. The amount of bills transferred by the Federal Reserve Bank to the System open market account on the maturity date will be reduced by the amount of bills repurchased by the seller. The Manager of the System open market account will provide for such contingencies from bills available by reason of partial allotment and by tendering for

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exchange a smaller amount of bills than the total holdings in the System account.

On the maturity date of the bills transferred to the System open market account, the Federal Reserve Bank of New York will credit each other Federal Reserve Bank, through the interdistrict settlement fund, the amount of maturity value of the bills transferred with immediate advice of the amount so credited and the disposition to be made of the maturing bills (which will be cancelled and shipped to the Treasury for redemption or in settlement for allotment on exchange tender in New York for the System open market account, and the Federal Reserve Bank of New York will furnish the other Federal Reserve Banks with shipment numbers).

A report of open market operations prepared by the Federal Reserve Bank of New York covering the period from March 1 to June 3, 1947, inclusive, was presented by Mr. Rouse, who read the principal portions of the report. A copy of the report has been placed in the files of the Federal Open Market Committee.

After a brief discussion, upon motion duly made and seconded, and by unanimous vote, the transactions in the System account for the period February 28 to June 3, 1947, inclusive, were approved, ratified, and confirmed.

Mr. Sproul stated that the Presidents of the Federal Reserve Banks had been advised of the recommendations made to the Treasury since the last meeting with respect to debt retirement and that the Treasury had followed substantially the program recommended by the Federal Open Market Committee and its executive committee up to the end of May. In connection with Mr. Sproul's comment, there were distributed copies of a memorandum prepared by Mr. Musgrave under date of June 6, 1947, entitled "Financing outlook".

With respect to the discontinuance of the posted rate on Treasury

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bills, Mr. Sproul stated that following the meeting of the executive committee on May 2, 1947, at which he reported on discussions with representatives of the Treasury during the period between that meeting and the meeting of the full Committee on March 1, 1947, further informal discussions had taken place and that there were certain aspects of the matter, including the possible effect on the certificate rate, that the Treasury wished to consider further. He also said that when the executive committee met with Under Secretary Wiggins at luncheon on May 2, 1947, the latter suggested possible alternatives to an announcement that the posted rate would be discontinued and expressed concern that any action, looking to an increase in the short term rate, might cause some outstanding obligations to sell at less than par. Mr. Wiggins asked, Mr. Sproul said, that the members of the executive committee consider the possibility of substituting 180-day bills (to which the posted rate would not apply) for existing 90-day bills with the thought that by this procedure any announcement of the elimination of the posted rate could be avoided. Mr. Sproul went on to say that, when Chairman Eccles and he met with Messrs. Snyder, Wiggins, and Bartelt on June 3, the opinion was expressed to the Treasury representatives that their suggestions would not be effective in solving the problems at which they would be directed, that they might confuse the market, and that they might make it more difficult to achieve the agreed objectives. They were also told, Mr. Sproul said, that the Federal Open Market Committee was still of the opinion that the posted rate should be eliminated as soon as possible, that any

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repercussions resulting from that action would be minor ones, that when the time came to change the rate on certificates the System had weapons in its hands effectively to meet any adverse reaction that might take place, and that any fear of certificates selling below par was unrealistic because certificates were considered in terms of yield and a slight dip below par would not concern anyone. Mr. Sproul added that he had the impression that the Treasury representatives agreed that the posted rate should be discontinued but still had questions as to when it should be done. While Under Secretary Wiggins indicated that a decision would be forthcoming from the Treasury this week, nothing further had been heard. Mr. Sproul made the further comment that, in addition to discussing these problems with the Treasury officials, he and Chairman Eccles had continued to advocate the issuance by the Treasury of a long-term series G-type security, and that the Treasury had also seemed receptive to this idea but thus far had been reluctant to put it into effect.

Following Mr. Sproul's report, Mr. Musgrave's memorandum on the financing outlook was read and there was a discussion of the further recommendations to be made to the Treasury with respect to debt retirement.

At the conclusion of the discussion, upon motion duly made and seconded, and by unanimous vote, the following letter to the Secretary of the Treasury was approved and it was understood that during the period before the next meeting of the full Committee and in accordance with the practice that had been followed during the

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Treasury debt retirement program, the executive committee would continue to submit monthly recommendations with respect to further debt retirement:

"At the meeting of the Federal Open Market Committee which was held yesterday, the Committee discussed the outlook for the Treasury debt retirement program with particular reference to the July 1 maturity. After examination of the estimated position of the Treasury at the end of the month and the uncertainty pertaining to such position, the Committee recommends that the Treasury offer to exchange the maturing certificates for a like amount of new 12-months 7/8 per cent certificates. If it should develop later in this month that additional funds will be available and the fiscal outlook justifies their immediate use for debt retirement, it is the Committee's view that the retirement of additional Treasury bills provide a more flexible as well as a particularly suitable means of utilizing such funds. In that case, the Executive Committee should be glad to discuss with you the further retirement of Treasury bills."

Chairman Eccles then stated that, at its meeting earlier today, the executive committee discussed briefly the suggestion that the July, August, and September certificate maturities be replaced as they matured with certificates maturing July 1, 1948, so that if in connection with the October issue of certificates it should be determined to increase the rate to, say, one per cent, the longest outstanding certificate issue would be nine months and the rate could be increased without any of the outstanding issues falling below par. Chairman Eccles added that no conclusions had been reached by the executive committee on this question, but suggested that it might be desirable for the full Committee to authorize the executive committee to make a recommendation to the Treasury along these lines if, after further study, such a procedure seemed desirable.

Mr. Evans stated that he was opposed to increasing the rate on certificates because the burden of such an increase would fall on the

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farmers, the small businessmen, and the taxpayers. He recalled the situation after World War I when the Federal Reserve System was blamed for increasing interest rates, tightening credit, and causing a fall in prices, and he said that in some places the Federal Reserve System was still held responsible. He further stated that, in his opinion, an increase in the certificate rate would have no effect on the inflationary pressures, that the lifting of controls had removed whatever brakes the Government had on inflationary pressures, that we now have inflation, and that an increase in the certificate rate would have no noticeable effect upon these pressures and would be about as effective as a slingshot against a grizzly bear. He also stated that an increase in the certificate rate would not endanger the long-term rate on E, F, and G bonds which individuals purchase. This rate is fixed and it is as low as it should go. The banks would be the only group to gain if the certificate rate were increased. He stated that this would be very unfortunate from a public relations standpoint, and that as long as the banks are getting such a large part of their revenue from interest on Government securities they could ill afford to ask for increased taxes in order to increase these earnings. He stated that there were other ways, as outlined in the Board's Annual Report, for handling the situation and that the arguments for increasing the certificate rate were not acceptable to him and he was opposed to such an increase. He favored, as in the past, eliminating the repurchase agreement for bills and also allowing the bill rate to fluctuate under the present certificate rate.

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Mr. Sproul said that the proposal referred to by Chairman Eccles would be for the purpose of "clearing the decks" in the event it was decided later to increase the short-term rate but that it did not contemplate an immediate recommendation that the rate be increased.

Chairman Eccles stated that while the steps that had been taken by the System and the Treasury had stopped temporarily the decline in yields on long-term securities resulting from "playing the pattern of rates", it could be expected that the long-term issues would continue to be under pressure, that the sale of securities from trust accounts or the issuance of a long-term restricted security would not correct the situation, that the Treasury representatives felt it would be a mistake for the long-term savings rate to decline further, and that, if there were an increase in the short-term rate to prevent further monetization of the debt, it would be possible to determine whether the pressure on the long-term rate represented an excess of savings funds over the demand for such funds or whether the pressure resulted from the difference in long- and short-term rates. He also said that, since Congress had not seen fit to give the System the additional powers suggested in the Board's Annual Report for 1945, the Committee was faced with the alternatives of allowing the long-term rate to decline further or permitting the short-term rate to rise to a point where there would be no incentive for banks to continue to "play the pattern of rates". He recognized that such an increase would not be effective in combating inflationary conditions and that any increase in rates for that purpose would have to

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be so large that it would completely upset the Government securities market.

Mr. Sproul stated that an increase in the short-term rate would not be for the purpose of combating present inflation but rather for the purpose of preventing further increases in the already excessive money supply. Action would be taken in the light of the System's responsibility for general monetary and credit conditions, and not for the advantage or disadvantage of any group or segment of the community. It is the only action available to the System which will help prevent further playing of the "pattern of rates" and further monetization of the public debt, by narrowing the spread between short and long rates and by creating some uncertainty with respect to rates.

In a discussion of the possible effects of an increase in short-term rates, Mr. Evans questioned whether it would be effective in achieving the desired results and suggested that all other possible alternatives should first be thoroughly explored. He also questioned whether there should be an increase in the short-term rate at a time when Congress was acting to cut Government expenses, decrease taxes, and discontinue other existing instruments for combating inflation such as the authority to regulate consumer credit.

In response to Mr. Evans' inquiry as to how high it was thought the short-term rate would have to go to have the desired effect, Chairman Eccles stated that the rate should be permitted to go up by steps to perhaps 1-1/4 per cent as a maximum. The reason for his opinion was that the yield on securities held by banks which would mature over the

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next five years would not average more than 1-1/4 per cent and, if they could refund these maturities into a 1-1/4 per cent obligation, the pressure on the long-term rate would cease.

Chairman Eccles also said that the Treasury was considering the problem of refunding the bonds and the notes which mature this fall, that some of the members of the Treasury staff had suggested a 1-1/2 per cent market issue, but that he would be opposed to such an issue because it would establish rights in the maturing securities and, as long as the System was supporting the market and in effect making all issues of Government securities demand obligations, there was no point in the Treasury paying 1-1/2 per cent for a 7-year obligation which would be eligible for purchase by the banks.

Mr. Evans stated that he would regard an increase in the short-term rate with greater favor if there could be an agreement by the banks and the Treasury as to what securities the banks would hold, and the interest rate they would receive. He questioned whether an increase in the short-term rate would be very effective in preventing banks from selling short-term and purchasing long-term issues.

Chairman Eccles commented that the short-term rates on Government securities tended to establish the rates on private borrowing, that these rates were so low at the present time that banks were taking risks at rates which would not give them sufficient cushion for the absorption of losses, and that as long as they were under pressure because of low rates to maintain earnings they would continue to make

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such loans and would sell short-term Governments if necessary to obtain the required funds.

Chairman Eccles also said that at hearings before committees of Congress recently he had discussed the proposal to increase the short-term rate and that there was no unfavorable reaction to the proposal. He added that, while the Treasury appeared to be in accord with such an increase, it was a question of timing and he was satisfied from his most recent discussion with Under Secretary of the Treasury Wiggins that the Treasury would not concur in the elimination of the posted rate on Treasury bills or any action looking toward an increase in the short-term rate until after the end of June.

At the conclusion of the discussion, Chairman Eccles suggested that the full Committee authorize the executive committee to make a recommendation to the Treasury with respect to the consolidation at maturity of existing Treasury certificates into four or five issues each year if, after further study, it seemed to the executive committee to be desirable that such action be taken as a preliminary step to an increase in the short-term rate.

Upon motion duly made and seconded,
Chairman Eccles' suggestion was approved,
Mr. Evans voting "no".

Reference was then made to the recommendation approved by the Committee on February 28, 1947, that a long-term restricted bond be issued by the Treasury. Chairman Eccles suggested that the Committee authorize renewal of the recommendation to the Treasury, and that the letter containing this recommendation suggest that the Treasury consult

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with the executive committee before making sales of long-term market issues of Treasury securities from Government accounts, because of the close relationship of such sales to open market operations which were the continuing concern of the Committee.

Upon motion duly made and seconded,
and by unanimous vote, the following
letter to the Treasury was approved:

"At the meeting of the Federal Open Market Committee which was held on June 5, we again considered the desirability of the Treasury issuing a G-type bond such as was recommended by the Committee in March of this year.

"The Committee writes to reaffirm its earlier recommendation. For a number of reasons, it appears highly desirable that prompt action be taken in this matter. In recent months, there has been an increasing need for meeting pressures on the long-term yield which can not and should not be met indefinitely by sales of marketable bonds for Government accounts and we think it important that a policy on the longer term issue should be formulated prior to dealing with the refunding of the large volume of fall maturities.

"Mr. Sproul and I are at your disposal for further discussion of the matter, looking to the early issuance of such securities. We should also like to have the opportunity to consult with you from time to time if and when further sales of securities from Government accounts are contemplated because of their close relationship to the Open Market operations which are the continuing concern of the Committee."

Upon motion duly made and seconded,
and by unanimous vote, it was agreed that,
pending action to discontinue the posted
rate on Treasury bills, no changes should
be made in the direction issued by the
Federal Open Market Committee to the
twelve Federal Reserve Banks on April 24,
1947, with respect to the purchase of
Treasury bills for the respective Banks'
option accounts.

There was unanimous agreement that the authority issued to the executive committee at the last meeting of the full Committee to direct the

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execution of transactions for the System account should be changed (1) to bring the direction into conformity with the procedure now in effect for transferring maturing bills held in the option accounts of the Federal Reserve Banks to the System account and the exchange of bills in the System account for new bills, and (2) to increase from 1-1/2 billion to 2 billion dollars the limitation contained in the first paragraph of the authority of the executive committee to increase or decrease the amount of securities held in the System account.

Thereupon, 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 open market account:

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 an orderly market in Treasury securities and a general level of prices and yields of Government securities which will support the Treasury issuing rates of 7/8 per cent for one-year certificates and 2-1/2 per cent for 27-year bonds restricted as to ownership; provided that the aggregate amount of securities held in the account at the close of this date /other than (1) maturing bills transferred to the System account from the option accounts of the Federal Reserve Banks pursuant to the direction issued by the Federal Open Market Committee on May 5, 1947, bills purchased outright in the market on a discount basis at the rate of 3/8 per cent per annum, bills redeemed or exchanged at maturity, and bills taken in exchange for maturing bills, 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.

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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.

There was a discussion of the time for the next meeting of the Federal Open Market Committee and it was tentatively agreed that the meeting should be held on October 2 and 3, 1947.

The meeting then recessed and reconvened at 10:00 a.m. on Friday, June 6, 1947, with the same attendance as at the earlier session except that Mr. Townsend, Assistant General Counsel, Messrs. Neal, John H. Williams, and Thompson, Associate Economists, Mr. Parry, Director of the Division of Security Loans of the Board of Governors, and Messrs. Ralph A. Young and Morse, Assistant Directors of the Division of Research and Statistics of the Board of Governors, were also present.

Chairman Eccles called for the reports of the economists and Mr. Thomas asked that Mr. Neal give the first report covering prospects for the future in industry and trade. This report was followed by a discussion of the agricultural outlook by Mr. McCracken, a report on the real estate situation by Mr. Thompson, and a statement by Mr. Stead with respect to employment, wages, and labor-management relations.

Copies of the economists' statements have been placed in the files of the Federal Open Market Committee.

Mr. Thomas stated that the picture painted by the four statements of the economists was one of inflation, the kind of condition that the

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System, in considering proper fiscal and monetary policies during the war, had sought to avoid. Because of the termination of controls, he said, inflation had developed although it was not nearly as serious as it might have been if certain policies of control had not been adopted. He added that, although there were differences of opinion as to the causes of inflation, it was important to recognize that the alleged causes, such as high prices, price support activities, demands of labor, wage policies of the Government, high profit margins in the building industry, etc., were the results as well as causes and none of them would have caused the rise in prices that had taken place if it had not been for the war and the resulting shortages of goods. He also said that the question was what should be done about the existing situation, and that while it appeared that the country was approaching or had passed the peak of inflation the downturn was not evident enough at this time to justify concern about bolstering the economy against a recession. It was his opinion that throughout the war and postwar period there had been too many fears of postwar deflation, with the result that actions which should have been taken to counteract inflation were not taken, because of the fear that they would result in contraction, and that, although any downturn should be taken care of at the proper time, the important thing at the moment was to stop abnormal pressures on the inflationary side.

Mr. John H. Williams shared Mr. Thomas' view, stating that this was a time when a "hands-off" policy might be pursued and that the country had become so fearful of deflation during the 30's that there was a tendency to adopt measures to shore up the economy whenever there was an

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indication of contraction. He referred to the suggestion that national income should not be permitted to go down too fast, as the decline might get out of hand. He felt that this situation would not occur because, for one reason, the business community was never as aware of the nature of this problem as it was at the present time, and that there was a great deal of available buying power and of unfilled demand particularly for durable goods and it would not take a very substantial correction in the situation to make that demand effective. He thought that there would and should be a mild recession which would be corrective in nature and would set the stage for a long period of balanced prosperity. He made the further comment that many people were concerned about the foreign picture and how it might affect the economy of this country, but that we were faced with a similar situation following the First World War which was largely cleared up and followed by a period of prosperity. It was his opinion that the foreign situation probably would continue to be a sustaining factor in our economy for some time to come. He was very much concerned about the British and German situation but he did not think that the foreign picture in its entirety would constitute a deflationary factor as far as the economy of this country was concerned because the United States would be called upon to supply goods and services abroad for a long time to come which would help the economy in a period of adjustment.

Mr. Rouse presented a supplementary report (a copy of which has been placed in the files) covering operations in the System open market account on June 4 and

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5, 1947, and, upon motion duly made and seconded, and by unanimous vote, these transactions were approved, ratified, and confirmed.

Thereupon the meeting adjourned.

Brester Morrie
Secretary.

Approved:

McEwen
Chairman.