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 Saturday, September 11, 1937, at 10:20 a. m.

PRESENT: Mr. Eccles, Chairman
Mr. Harrison, Vice Chairman
Mr. Broderick
Mr. Szymczak
Mr. McKee
Mr. Ransom
Mr. Davis
Mr. Sinclair
Mr. McKinney
Mr. Martin
Mr. Day

Mr. Morrill, Secretary
Mr. Wyatt, General Counsel
Mr. Goldenweiser, Economist
Mr. Williams, Associate Economist
Mr. Dreibelbis, Assistant General Counsel
Mr. Burgess, Manager of the System Open Market Account
Mr. Carpenter, Assistant Secretary of the Board of Governors of the Federal Reserve System
Mr. Thurston, Special Assistant to the Chairman of the Board of Governors of the Federal Reserve System

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 9, 1937, were approved.

Upon motion duly made and seconded, and by unanimous vote, the actions of the executive committee as set forth in the minutes of the meetings of the executive committee on June 9, June 15, July 6, August 18 and September 4, 1937, were approved, ratified and confirmed.

Mr. Burgess submitted a report prepared by the Federal Reserve Bank of New York of open market operations conducted by the New York bank for the System open market account since the meeting of the Federal Open Market Committee on June 9 and up to and including September 10, 1937.

> Upon motion duly made and seconded, and by unanimous vote, the transactions covered by the report were approved, ratified and confirmed.

Chairman Eccles then called on Messrs. Goldenweiser and Williams for a review of business and credit conditions.

Mr. Goldenweiser stated that, while the impetus of recovery had slackened temporarily, there was as yet no evidence of a general decline or recession. In the capital market, Mr. Goldenweiser said, there had been a very definite slackening of activity with less refunding than last year and a scarcity of new issues, and the stock market had gone through a pretty severe reaction recently. In the banking situation, the aggregate amount of investments had gone down and the volume of deposits had decreased but not substantially. He was of the opinion that the situation was one where, in terms of short-term developments, there was no danger of the speculative excesses or inflationary developments that were somewhat in evidence six months ago, but, where on the contrary there was a possibility that the uncertain situation, partly as an immediate result of the hesitation in the capital market, might lead to a decline in business and to a recession of indeterminable magnitude. He said that the situation was different in different industries, the textile industry showing a definite slowing down, while the automobile and the steel industries were continuing at a high rate, the latter largely on orders received previously rather than on current orders, which had fallen off. The past year, he said, had been disappointing in the construction field which had not yet recovered to anything like the extent hoped for or to the extent necessary to provide a volume of activity which would result in little unemployment and a more lasting basis of prosperity. He stated further that prices have had a mixed movement but that the situation in this respect was not unusual at this time of the year. In general, he felt that the industrial production index was not likely to go much below the 115 that had been anticipated but that it might fall below that figure for a month or two. He interpreted the industrial outlook over a somewhat longer period as being very good because of the present larger annual income than has been the case for several years and the existence of substantial shortages in many important industries such as construction, railroads, and public utilities, the expenditures of which when made will place a large amount of buying power in the hands of those who work for these concerns.

There was no reason, he said, for modifying the policy of monetary ease that was adopted by the System in 1932 and continuously maintained since that time. He believed there was less reason to deviate from that general policy now than there was last autumn or winter when prices were going up very rapidly and there was evidence of speculative developments in the securities market and in some lines of business. It appeared to him, therefore, that the System should contemplate at this time a policy of counteracting such seasonal tightening influences as are likely to develop between now and the end of the year as a result of a prospective increase in the demand for currency of approximately $400,000,000 and possibly some increase in reserve requirements owing to the growth of deposits in connection with autumn trade, which would reduce excess reserves of member banks at the peak of the currency demand to between $300,000,000 and $400,000,000, while in the New York market excess reserves might be wiped out completely.

He felt that, if it were still the System's policy to maintain a condition of monetary ease for the furtherance and completion of recovery, the System should be prepared to take action to make that policy effective, and if that point were made clear it would be easier to consider the possible courses of action that might be pursued in carrying out that policy. These alternatives in his opinion were

(1) A reduction in reserve requirements,

(2) Action by the System in the open market,

(3) Action by the Treasury to desterilize gold or to modify its policy of gold sterilization, or

(4) A combination of action by the System and the Treasury.

He was strongly of the opinion that a reduction in reserve requirements had all of the vices and none of the virtues of any other policy that could be adopted, that it would be a reversal of the position that changes in reserve requirements should not be utilized except infrequently, and that it would involve the use of an inflexible instrument instead of a flexible one, to meet a seasonal situation.

He also said that action by the Treasury to desterilize a stated amount of gold would be better than the discontinuance of further sterilization, for the reason that in the event the latter course were pursued the extent of the action could not be determined, whereas the desterilization of a given amount of gold would increase reserves of member banks by a definite amount. The objections to desterilization, he said, were that the increase in reserves could not be counteracted except by sales out of the System portfolio, and that action by the Treasury at this time also might be interpreted as violating the principle that the Federal Reserve System has primary responsibility for credit conditions and has adequate instruments for handling it. He then expressed the opinion that the most satisfactory action would be for the System to take such independent action through the medium of open market operations as, in its judgment, was necessary to meet the situation.

He pointed out that for four or five years there had been such a large volume of excess reserves that there was a tendency now to regard fluctuations in reserves as being of more importance than is justified, and that the System regards action to ease a situation more seriously than used to be the case. He suggested that the System might take counsel on the advisability of the adoption of a rule of thumb as to the volume of reserves that would be likely to produce desirable conditions in the market at different stages of business activity, and that, if such an amount could be determined upon, the System would increase its portfolio when reserves fell below that amount and let securities run off when reserves exceeded it, without feeling that it was undertaking an operation involving a matter of major policy. He called attention to the view that at one time prevailed that the New York banks should be in debt by approximately $50,000,000, that when they were in debt more than that a condition of tightness developed and that when they were in debt less than that credit conditions were considered to be unduly easy. He felt that a much more liberal rule would have to be adopted today in furtherance of the existing easy money policy, which would contemplate not only that the banks would be out of debt but also would have a volume of reserves sufficient to make them willing to undertake legitimate financing without disposing of other earning assets, and that the System could adopt a policy of maintaining approximately $250,000,000 of excess reserves for central reserve city banks and $700,000,000 or $800,000,000 for the country as a whole. He concluded by expressing the opinion that if the System would adopt such a policy it would be in a position to meet the seasonal problem without difficulty and that he would recommend that the policy be made effective.

Mr. Williams stated that the question, which was a difficult one, was whether the country was confronted at the present time with a short-term seasonal variation or whether it was something more serious than that; that he had felt that there probably would be a side-wise movement for a while during this period which would be disappointing to some and would cause some hesitancy; and that, while, on the whole, he was still inclined to that view, he was growing less confident about it and that there might be some recession.

It appeared to him that there were two influences on the situation, one of minor significance and one of greater significance. Inventories were built up last winter and early spring because of fear of rising prices, labor troubles, etc., and since that time production has been in larger volume than new orders. It had been thought, he said, that the present would be about the time when there would be some indication of when the period of hesitancy would end but that such indications were not yet in evidence. That, he added, was the kind of situation in which people become nervous and it might be that the present reaction in the stock market was a reflection of that situation. He felt that the break in the market, coming at this time, was apt to have a rather significant effect on business and might cause business men to delay activity longer than they otherwise would, resulting in a negative movement lasting longer than ordinarily would be the case.

The other question, he said, had to do with the more fundamental fact that recovery could not go forward without assistance from the heavy industries such as building, public utilities, and railroad equipment, and that although high agricultural and industrial income might result in a side-wise movement rather than a decline, there was a possibility that business would recede before going forward.

He was of the opinion that among the factors bearing on the matter were the following: It seemed clear that if the Administration went forward on the present basis there would be a reduction in this fiscal year in the income-creating expenditures of the Government of

$2,500,000,000 to $3,000,000,000, which is a substantial proportion of the national income, and which it had been expected would be replaced by private spending. While he had felt last spring that the time for such replacement had come, there was now a question in his mind whether that situation would materialize fully. The building situation, he said, was disappointing in that it now appeared that it not only had not gone forward during the recent period, but it seemed probable that it would recede owing chiefly to advances in construction costs. Notwithstanding the fact that there was evidence of rising rents and a reduction in the number of vacancies, there was a considerable statistical record behind the view that a sharp advance in construction costs was followed by a recession in building or a cessation of building expansion for a considerable period. In view of this there was a major question in his mind whether the country could count on a recovery of building to take the place of a decrease of Government income-creating expenditures.

Another question, he said, was whether an increase in public utility expenditures could be relied on, and that although there was an increase in power consumption and some evidence of pressure on facilities, it might develop that, because of all the uncertainties of the public utility situation, new expansion in that field would be slow in making its appearance. The railroad equipment industry, he felt, was made uncertain by the labor outlook for the next few months.

Mr. Williams then stated that he did not know what conclusions to draw from all of these circumstances but that they indicated a distinct possibility of a recession before further recovery. He was firmly of the opinion that sooner or later recovery would be resumed but he felt unable to say whether a recession would first occur as a means of correcting some of the existing obstacles to further recovery. The major question, he said, was whether private investment in the heavy industries during this fiscal year would take the place of a substantial contraction of public spending.

The Committee entered into a discussion of the business and credit situation as outlined by Messrs. Goldenweiser and Williams.

Mr. Harrison suggested that the problem before the Federal Open Market Committee at this time was quite different from that under consideration at the April and May meetings of the Committee and was related to the question whether the leveling off of the volume of business activity was the result of monetary or nonmonetary causes, whether the System appropriately could take any action which would tend to check a recession and to facilitate the continuation of recovery, and, if so, what form it should take. He was of the opinion that the causes of the present situation were not in the monetary field and that there had been no evidence thus far that the increases in reserve requirements of member banks had resulted in any actual restriction of credit.

During a discussion of the possible causes of the present trend Mr. Goldenweiser expressed the opinion that, while the existing situation was not due to monetary causes, it was desirable that action be taken to maintain a monetary climate favorable to economic recovery.

In this connection consideration was given to forecasts of probable demands for credit and currency between now and the end of the year which it was anticipated would result in substantial reductions in excess reserves of member banks and the possible elimination of excess reserves in the New York market with resulting increases in short-term money rates. Mr. Ransom said that action in the open market to counteract such a stiffening of rates would be consistent with the policy announced by the Federal Open Market Committee in the statement released to the press on April 5, 1937.

There was also a discussion of the relation of the current decline in security prices to the problem under consideration, and the probable effects of a continuation of that movement on the general business situation.

Mr. Ransom expressed the opinion that the anticipated year-end reduction in excess reserves was a money market problem and one in connection with which responsibility rested on the Federal Reserve System and particularly the Federal Open Market Committee to initiate whatever action was necessary to meet the situation and to continue in effect the System policy of easy money conditions. He also felt that, for this purpose, the Committee should regard the powers existing in the Federal Reserve System and the Treasury to influence credit conditions as though they resided in one place and were available for use in determining the action that should be taken. He stated that, while there was no apparent restriction of credit at the present time, the expectation by banks that less easy money conditions would exist over the year-end might result in more restrictive credit policies on the part of the banks at a time when the recovery movement had practically halted and there was some evidence that there might be a recession in business activity, and that the question before the Committee was whether action should be taken to assure the banks that there would be no shortage of reserves over the period of crop movements and increased currency requirements.

Mr. Ransom then presented, as a basis for discussion, a draft of a resolution which would instruct the executive committee of the Federal Open Market Committee to direct the purchase in the open market from time to time of sufficient amounts of Treasury bills to offset the seasonal withdrawals of currency and other seasonal influences between now and the end of the year so that the aggregate volume of excess reserves of member banks would be continuously adequate to maintain the System's policy of furthering economic recovery through monetary ease.

At 1:00 p.m. the meeting recessed for luncheon and reconvened at 2:30 p.m. with the same attendance as at the morning session.

There was a further discussion of the possible reserve position of member banks between now and the end of the year and of the prospective demands for credit in connection with the movement of crops and for currency during the holiday season. Information presented indicated that excess reserves of all member banks would probably be reduced to below $400,000,000 before Christmas, and that by the end of November excess reserves would probably have disappeared in New York and some member banks in that market might be forced to borrow or to liquidate earning assets.

Consideration was given to the question whether, in view of the present uncertain business picture and the necessity for further progress in the recovery movement, the System should take any action to create additional excess reserves in conformity with its policy of maintaining easy money conditions, and whether it should make any public statement at this time. The discussion disclosed the view on the part of a majority of the members of the Committee that the situation called for affirmative action by the Federal Open Market Committee at the present time and that some public announcement of the action taken should be made.

There ensued a discussion of the extent to which, and the form in which, action should be taken. The four alternatives presented by Mr. Goldenweiser during the morning session were analyzed, and suggestions were made that the System request the Treasury to desterilize a given amount of gold, which it was stated would have the effect of increasing member bank reserves relatively promptly and largely in the money centers where additional reserves would probably be needed, and that the executive committee be authorized to direct the purchase of a sufficient amount of short-term Government securities to provide such additional funds as might be needed to meet the expected reduction of reserves between now and the end of the year. It was the consensus of the members of the Committee that, while the System could act alone through the open market, the most desirable action would be the suggested joint action by the System and the Treasury.

At the conclusion of the discussion it was agreed that the Chairman should ascertain from the Secretary of the Treasury whether he would be willing to desterilize $200,000,000 or $300,000,000 of inactive gold as a part of a program which might be adopted along the lines of the above suggestions.

Thereupon the meeting recessed with the understanding that it would reconvene again on September 12, 1937, at 11:00 a. m.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.