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 Wednesday, September 21, 1949, at 10:40 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Gidney (Alternate for Mr. Leach)
Mr. Vardaman

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

Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors

Upon motion duly made and seconded and by unanimous vote, the minutes of the meeting of the executive committee held on August 19, 1949, were approved.

Mr. Rouse submitted reports prepared by the Federal Reserve Bank of New York on the market for United States Government securities for the period August 19 to September 19, 1949, and covering open market operations during the same period. He also presented a supplementary report covering commitments executed for the System account on September 20, 1949.

Upon motion duly made and seconded

and by unanimous vote, the transaction in the System account as reported to the members of the committee for the period August 19 to September 20, 1949, inclusive, were approved, ratified, and confirmed.

In connection with a discussion of what, if any, change should be made by the executive committee in the ranges of rates at which the Federal Reserve Bank of New York would be authorized to buy and sell bills and certificates, Mr. Rouse stated demand for the longest maturities of certificates of indebtedness had resulted in a tendency for rates on those issues to decline, while the three-months' Treasury bill rate had risen in response to a diminished demand. This preference for the longest maturity of certificates, he said, related to the existence of a general belief that market rates would be permitted to decline later this year with the continuation of the easy money policy. He also stated that the situation in the labor market and devaluation of foreign currency might be interpreted as being somewhat "bearish" and that the combination of circumstances might continue the demand for longer certificates at the expense of short certificates and bills. The question, he said, was whether this condition should continue without being allowed to reflect itself in the market price for bills or whether the rate on bills should be permitted to go higher in relation to the maintained issuing rate of 1-1/8 per cent on Treasury certificates.

In a discussion of this question, it was suggested that in the circumstances it would not be desirable to continue to supply certificates to the market while bills were being sold to the System account in volume at our ceiling rate of 1.06 per cent discount, that the market rate on certificates should not be permitted to decline further but should be held in a proper relationship to the issuing rate of 1-1/8 per cent on new certificates, and that, therefore, the best course would be to allow the bill rate to rise somewhat further. It was agreed that as long as open market policy called for the maintenance of a 1-1/8 per cent rate on certificates there was not much room for an upward adjustment in rates but that the upper limit of the range at which bills could be purchased and sold for the System account might well be moved up to 1.08. This matter was also discussed in the light of its relationship to discount rate policy and the need for a rate structure which would facilitate future refunding of maturing Treasury certificates at rates which would not require support in the market.

With respect to the range of rates at which certificates were purchased or sold for the System account, Mr. Rouse stated, in response to a question from Chairman McCabe, that the present range of 1.06 - 1.12 was satisfactory in the light of the policy to maintain the short-term rate structure at a level which would call for an issuing rate on one year certificates of 1-1/8 per cent. He also said that a range of .96 - 1.08 on bills in place of the present .94 - 1.06 would be satisfactory, and that if such a range were approved he would expect to roll-over maturing bills held in the System account, and to bring about any desired change in bill rates by day-to-day operations in the market.

In response to a question, it was stated that the executive committee had been authorized by the Federal Open Market Committee to vary the range of rates on bills without reference to the full Committee.

> At the conclusion of the discussion, upon motion duly made and seconded and by unanimous vote, it was agreed that pending further action by the executive committee, all bill transactions for the System account would be in the range of .96 - 1.08.

Chairman McCabe stated that the Board had before it for consideration action by the directors of the Federal Reserve Bank of New York reducing, subject to Board approval, the rate of discount of that Bank from 1-1/2 per cent to 1-1/4 per cent, that the Board had considered the matter at a meeting last Friday and again at meetings on Monday and Tuesday of this week, and that the advisability of a rate reduction had been discussed fully with the Federal Advisory Council which met in joint session with the Board yesterday morning. He then called upon Mr. Sproul to state the reasons for the action of the New York directors in reducing the rate.

Mr. Sproul said that it seemed to him and to the directors of the New York Bank that, beginning with the statement of policy adopted by the Federal Open Market Committee on June 28, 1949, the greater flexibility in rates since then, subsequent reductions in reserve requirements of member banks, and open market operations geared in with the foregoing, the System had brought about a decrease in interest rates, particularly in short-term rates, which was appropriate to counter a deflationary movement in which there was evidence of declining business activity and of a possible need for further future adjustments in prices and other factors.

In taking this action, he said, it was contemplated that at an appropriate time (which was considered at the meeting of the Federal Open Market Committee on August 5, 1949, to be about mid-September when Treasury financing for September and October had been decided), a reduction in discount rates would symbolize and give emphasis to this reduction in other short-term rates which the System had already brought about. Mr. Sproul went on to say that if the signs of developing business recovery which were apparent during July and August had begun to accelerate and give indication of an end of the present period of adjustment, there might be some reason for re-examining the policies adopted by the System in June, but that it had become clear that the recovery was rather precarious and that an adjustment still had to take place in the price structure. Therefore, it seemed to him that developments since the easier credit program was agreed upon had not created any reasons for changing that program. Finally, over the last weekend there had come a dramatic and world-wide development in the form of devaluation of foreign currencies which could only be interpreted as having a deflationary effect on this country, especially in the amount of its foreign trade. The additional uncertainties which that move created made it a most appropriate time to make use of the discount rate, which has largely symbolic significance, to indicate the continuance of an easy-money policy and of resistance to further declines in business activity without doing any violence to the interest rate structure that had been established and which he assumed would still be maintained. This action, Mr. Sproul felt, might have beneficial effects and he could see no possibility of harm coming from it.

Chairman McCabe reviewed the discussion of the discount rate at the meeting of the Federal Advisory Council yesterday, stating that, for reasons discussed, the members of the Council were unanimously opposed to a reduction in discount rates at this time. He then reviewed the discussions at Board meetings on September 16, 19, and 20, stating that to a considerable extent the question of action centered on whether the present was a suitable time for reducing the discount rate. Some felt that if a reduction were to be made, the sooner the better, while others felt that in view of the recent rise in business activity any action toward reducing discount rates should be deferred until evidence of a slowing down of the recovery became apparent. Chairman McCabe stated that the matter had also been discussed by telephone with the Presidents of all of the Federal Reserve Banks who were not present at this meeting and at his request, Mr. Carpenter reviewed the views expressed by the Presidents, stating that all of them indicated their directors would go along with a reduction of discount rate if it was a matter of System policy, but that some felt it would be desirable to defer taking such action at this time.

Mr. Gidney stated that the directors of his bank had discussed the matter informally and felt that a reduction in rates should not be made at this time, that a decrease in the discount rate from 1-1/2 per cent to 1-1/4 per cent would make very little difference in the business situation, and that except for threatened strikes there was a feeling of buoyancy apparent in business circles in the Cleveland Federal Reserve District. The threatened strikes, he added, were of a non-monetary character and it was his view that a reduction in discount rates would not have much effect in overcoming any depressing effects that strikes would have.

Mr. Eccles stated that he was in no way influenced by the views expressed at the meeting with the Federal Advisory Council with respect to the matter, that he had been prepared to reduce discount rates in August at the time reserve requirements of member banks were reduced, that at that time such action would have fitted in with the other actions then taken, but that in view of the recent and continuing recovery in business activity, the present did not seem to him to be an appropriate time to make the reduction. He added that he did not feel there was any immediate connection between the devaluation of foreign currencies and the discount rate, that effects of devaluation would be long-term in nature, and that the System should not now take action in anticipation of a possible depressing effect that might become apparent at a later date as a result of devaluation. With respect to present or threatened strikes in the steel, coal, automobile, and railroad industries, he emphasized that these were of a non-monetary character and that action reducing the discount rate could not be expected to overcome their depressing effects. He felt that a reduction in rates at this time in the face of the upward tendency shown recently in the economic situation would indicate that the Board held a view different from that expressed officially with respect to beneficial effects of devaluation, that the only basis for a change now would be to bring the discount rate more into line with other short-term money rates, and that for that purpose a decrease of 1/8 of 1 per cent would be adequate. Mr. Eccles also stated that sentiment with respect to business could change rapidly and if a reversal of the present upward tendency took place, an adjustment of the discount rate might then be justified from the standpoint of economic and monetary conditions.

Mr. Sproul stated, with respect to the comments by Messrs. Gidney and Eccles, that he did not feel that the System should take the position that inasmuch as strikes were non-monetary in character no action in the monetary field would be appropriate to offset their depressing effects, and that in his opinion, it was incumbent upon the System to act if it felt it could have some effect in the right direction even though the action was small and had a pshychological effect only. As to timing, Mr. Sproul felt that it was the responsibility of the System to make some judgments as to what might develop and to take action accordingly. With respect to the recent upward tendency in business, he expressed the view that the expansion in bank loans was less than seasonal and was disappointing in terms of indicating a reversal in trend, that further price adjustments were needed before the economy could be sure it could go ahead on a new basis, and that the rise in the production index during August was not one which represented a strong and full-flowing recovery. He felt that if discount rates were reduced at this time, the System could not be charged with acting because of a down-turn in business, but that such action should be looked upon as fitting in with the actions already taken. He reiterated that devaluation was a new factor of tremendous significance and that exporters already were wanting to know what effects it would have. With respect to the amount of the proposed reduction in the discount rate, Mr. Sproul said that it should be related to the reductions that had already taken place in short-term rates, that it should be an amount in keeping with the tremendous event of devaluation, and that while a reduction of

1/8 of 1 per cent might be desirable under other circumstances, it would not be appropriate at present.

Chairman McCabe stated that he had discussed the matter with Mr. Evans who was in San Francisco and that the latter had stated that while he was familiar with developments as reported in the press on the labor front and with respect to devaluation, he was not in close enough touch with the entire situation to express an opinion or cast a vote for or against a change in the discount rate.

There followed a further discussion of reasons suggested during the discussion for and against a reduction in discount rates and of the relationship of such action to open market policy, but no consensus was reached. Chairman McCabe stated that the Board of Governors would give further consideration to the action of the New York directors at a meeting of the Board to be held this afternoon.

Chairman McCabe withdrew from the meeting at this point to keep another appointment.

In a further discussion of the procedure to be followed with respect to replacing maturing bills in the System Open Market account, Mr. Sproul referred to the informal weekly consultations of the members of the committee since the meeting on August 19, 1949, and to the changed conditions which had led to the abandonment of the procedure of allowing maturing bills to run off without replacement.

The view was expressed that for the time being weekly bill maturities should be substantially replaced and any desired adjustments in the bill market should be made by day-to-day operations in the market. All of the members present concurred in this view. Mr. Rouse stated that he would place bids for new bills at rates designed to replace the total amount of maturing bills, but that it would not always be possible to judge the market exactly and, therefore, there would be times when total replacement would not be effected.

At this point Mr. Clayton withdrew from the meeting.

Reference was then made to the suggestion at the meeting of the Federal Advisory Council yesterday that more long-term restricted securities be sold from the System account and Mr. Rouse stated that this matter was commented on at the meeting of the Federal Open Market Committee on August 5, 1949, but that market conditions had not been such as to call for a change in holdings of bonds during recent weeks. Mr. Gidney suggested that it would be desirable if some change could be made in holdings of long-term bonds in the System account so as to avoid these amounts becoming more or less static.

Mr. Sproul stated that it was his understanding that Mr. Gidney was not suggesting a change in policy, but that he was emphasizing the fact that leeway had been given to the manager of the System account and that it might be used more freely than had been the case in recent weeks. Mr. Gidney agreed with this statement of his position.

Reference was then made to the direction to be issued to the Federal Reserve Bank of New York with respect to transactions in the System Open Market account. It was suggested that the executive committee authorize the Federal Reserve Bank of New York to execute transactions for the remaining authority granted by the full committee to the executive committee at its meeting on August 5, 1949. This would mean that the New York Bank would have authority to reduce holdings in the System account by approximately $1,264,000,000 below their present level.

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 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 August 5, 1949, shall not be increased or decreased by more than $3,000,000,000 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 accomodation of the Treasury; provided that the total amount of

such certificates held in the account at any one time shall not exceed $1,000,000,000.

Mr. Rouse stated that while it had been anticipated that it might be necessary for the System to purchase special short-term certificates from the Treasury to avoid a Treasury overdraft during the middle of September, such purchase was made unnecessary by the Treasury transferring $75 million from a special account to the Treasurer's general account. If the purchase had been necessary, he said, the certificates would have been taken into the System account on the first day and subsequently transferred to the Federal Reserve Bank of Richmond to be held by that Bank over the weekend when only four Federal Reserve Banks were open.

Thereupon the meeting adjourned.

S R Carpenter
Assistant Secretary.

Approved:

Thomas B. McCabe
Chairman.