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 27, 1950, at 10:05 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Evans
Mr. C. S. Young

Messrs. Szymczak and Vardaman, members of the Federal Open Market Committee

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

Upon motion duly made and seconded and by unanimous vote, the minutes of the meeting of the executive committee held on August 18, 1950, were approved.

Upon motion duly made and seconded and by unanimous vote, the action of the members of the committee on August 21, 1950, increasing from $1 billion to $2 billion the limitation contained in the first paragraph of the direction issued to the Federal Reserve Bank of New York on August 18, 1950, authorizing transactions for the System Open market account was approved, ratified, and confirmed.

Upon motion duly made and seconded and by unanimous vote, the transactions in the System open market account reported to the members of the executive committee for the period August 16 to September 26, 1950, inclusive, were approved, ratified, and confirmed.

Chairman McCabe stated that, in considering recommendations to be made by the executive committee to the full Committee at its meeting tomorrow, the two principal questions seemed to be whether to let the short-term interest rate increase further at this time and whether the Board of Governors of the Federal Reserve System should increase reserve requirements of member banks. In this connection, he referred to a memorandum prepared in the Board's offices under date of September 21, 1950, with respect to an increase in reserve requirements, copies of which had been furnished to the members of the committee before this meeting and a copy of which has been placed in the files of the Federal Open Market Committee.

Mr. C. S. Young stated that he would favor a further gradual firming of the short-term interest rate. With respect to reserve requirements, he said that in the Chicago district there would be a further seasonal increase in total loans during the next few weeks, that seasonal liquidation of agricultural loans would be less than usual during that period because of crop conditions and that he would anticipate considerable liquidation of such loans in December. The time for an increase in reserve requirements, he felt, would be in December or perhaps after the first of next year, but it would not be desirable to increase requirements now. Mr. Young added that the threat of an increase in reserve requirements was having as great an effect in restraining new commitments by banks as would an actual increase in requirements at this time.

Mr. Sproul then made a statement substantially as follows:

The information is still overwhelming that inflationary pressures are strong and that accelerated expansion of bank credit is contributing to that pressure. The action we have been able to take, complicated as it was by Treasury action with respect to its refunding of the September and October issues, has not yet had much effect. However, I do not think there was any reason for us to believe it would have an effect immediately in checking bank credit expansion, particularly after the terms of the Treasury refunding were announced. It is a question of bringing pressure to bear steadily over a period of time to check this expansion and to bring support to whatever factors there may be which would lead to restraint on the part of bankers.

Having started on this program, having taken the first and most important step, and encountered all the difficulties which went with that very important step, there is no other course but for us to proceed with that program so long as the economic and credit situation is as it is. When yields on short-term Government securities go up and prices go down it becomes less attractive and more painful for banks to sell us Government securities to get reserve funds. At the same time it is necessary for us to offset these purchases so far as possible by sales to banks which are not in need of reserve funds or to nonbank investors. The more attractive the rate the more readily we will be able to make those sales. I would think, therefore, we ought to proceed immediately with open market operations which would permit the short-term rate to rise. I think there might be some advantage in widening the range between bills and one-year certificates. I think we might proceed with that operation until the one-year certificate rate has come close to or equals the discount rate, so that whether the banks come to us to sell Government securities or to discount, both windows to Federal Reserve credit would be costing approximately the same and the discount rate so far as borrowing was concerned would be effective.

Whether we should combine with this an increase in reserve requirements is a question, but until we have gotten the rate structure in a more flexible position I see little to be gained and something to be lost by increasing reserve requirements. I think we would have fired off another round of ammunition which would not have had its maximum effect. We would also have complicated the situation for increasing the rate structure. We would have to purchase a considerable amount of Government securities to enable banks to meet the increase in reserve requirements and there is a danger that we would become frozen into the existing pattern of rates. We would have a much more difficult job of maintaining an orderly market, which must continue to be one of our objectives, while an increase in reserve requirements is going into effect. As to the future use of an increase in reserve requirements, I think my recommendation to the Board would have to depend on the effectiveness of what we have already done in the open market and the increase in interest rates. If those proved ineffective and it was felt that we had no other way to go, then I think you would want to consider an increase in reserve requirements, not so much in terms of its effectiveness but in terms of what we said in our statement of August 18 and in terms of what our relations with Congress would be when we seek additional powers. As you know, I have not had much use for increases in reserve requirements as a means of credit control except on a long-term basis to meet a fundamental change in the reserve situation, so I would consider that more in the nature of a tactical move until we have tested out to the fullest extent the operations in the open market.

There has been some search for something dramatic that might be done. I think the most dramatic thing we could do is the thing we ought to do: to proceed with our program of increasing the short-term rate. I think the market wonders whether we will be allowed to go ahead. I think the market is also looking to see if we try to get out of the situation by seeming to do something without really doing anything. The threat of an increase in reserve requirements, I think, is as effective as its use. We ought to proceed with the program of making reserve funds less readily available and improving our opportunity of offsetting by sales of securities the increased amount of reserve funds we will have to provide in future months. Our ultimate objective is to get in to position where we are not supporting either the long or the short end of the market. But we cannot afford while carrying on this experiment on the short end to engage the enemies we would attract if we also abandoned the long end. I would support the long end at present on a temporary basis. If housing is damped down in the next two or three months we will begin to see some decline in demand for long-term funds. Meantime I would support the long-term bond if necessary at par and a quarter.

In response to a question from Chairman McCabe, Mr. John H. Williams said that the System would not get anywhere until it had freedom over the whole range of rates, that it would be necessary to remove support of the long-term bonds. He felt that the committee should proceed with the program started in August and that the present offered an opportunity for going ahead in view of the fact that it would be some time before the Treasury would have to undertake another refunding operation.

Mr. Thomas said that he felt that the first job for the System to finish was the one that had been started in August, that is, to have a structure of rates under which the System would be functioning; that the System's policy adopted August 18 had been largely frustrated by the Treasury refunding operation which had forced the System to buy securities at low rates and to mop up the reserves thus created by selling other issues. At present the System was in a position of being unable to sell securities without having to buy other securities at a pegged rate. With respect to reserve requirements, Mr. Thomas stated that he did not agree with the views previously expressed that an increase in reserve requirements would not be effective, that he felt the evidence to support that view was in reality to the contrary, and that such an increase would have a restraining effect. However, he felt that it would not be desirable to increase reserve requirements until after the short-term rate had been permitted to rise since an increase in reserve requirements would result in the necessity for the System to purchase securities to provide the additional reserves and such action would be very upsetting to the Government securities market unless the System purchased at a pegged rate. A far preferable course, he felt, would be to allow an increase in the short-term rate to where banks would have to suffer losses if they did sell present security holdings, after which there would be an opportunity to increase reserve requirements. The first step would be to get the one-year rate to a point which would give a wider spread between the bill rate and the one-year certificate rate.

Mr. Ralph A. Young stated that there were two problems to be considered: the current inflationary pressures, and the fact that it appeared that over a longer period of time the economy was to be subjected to a continuing inflationary situation. If the economy is moving into a garrison economy, he thought the basic situation would continue inflationary and strong continuing demands for bank credit could be expected. Mr. Young felt the issue whether to increase reserve requirements was not clear cut, but that there would be a question whether increasing the short-term rate alone would be sufficient.

Mr. Riefler commented that he felt the short-term rate should be permitted to increase further, that the whole endeavor on which the Committee embarked on August 18 was certainly not worth while if the increase in short-term rates was to be limited to what had already taken place. The economic situation called for a higher rate, the Committee had started out to bring about such a program, and the program ought to be completed. Mr. Riefler felt that an increase in reserve requirements would have as its objective an increase in rates and he could not see how the System could escape a pegged rate structure if an increase in reserve requirements was announced before the short-term rate had been permitted to rise further.

Mr. Szymczak stated that he felt there was no question but what there should be a further increase in the short-term rate, but he also felt there should be an increase in reserve requirements almost simultaneously. He felt that the increase in reserve requirements by the Board was necessary in the light of the policy expressed in the statement issued on August 18 and as a step prior to asking Congress for additional authority which he felt was necessary. He also said that a realistic approach made it necessary to recognize that no substantial increase in the long-term rate would be permitted and that an increase in the one year rate could not go much beyond 1 1/2 per cent without affecting the long-term ineligible bond. Purchases of these bonds by the Open Market Committee would add to bank reserves. In connection with presenting a program to Congress, Mr. Szymczak felt it was necessary to look to the time when substantial additional authority would be needed on the assumption that it would be necessary to peg the long-term 2 1/2 per cent rate and if this were to be done it would be essential that the System have some means of absorbing reserves which might be put into the market in that operation. This would be even more so—to the extent the Treasury had to sell its securities to the banks. To this end, he expressed the view that a program presented to Congress shortly after November 27 should include a concrete recommendation for the special reserve plan or something similar to it.

Mr. Evans was of the opinion that the System should announce a policy of supporting long-term bonds at par, that the Board should increase reserve requirements promptly by the full amount of the authority which it now has, and that there would be no objection to acting to increase the short-term rate further although he doubted that such an increase would have much effect in restraining credit expansion. He also expressed the view that the System should prepare a program to present to Congress covering the problem of restraining the inflationary pressures in the current situation and that such a program should include a request for the special reserve plan or some other plan which would require banks to hold short-term securities issued at a low rate of interest to offset deposits acquired after a certain point.

Mr. Vardaman stated that he felt reserve requirements should be increased, perhaps in two steps, as promptly as possible after the short-term rate had been permitted to increase, and that it was necessary to have used up the remaining authority of the Board to increase reserve requirements before Congress reconvened on November 27. He added that he would also eliminate from the public mind any uncertainty as to whether Government bonds would be maintained at par.

Mr. Eccles did not believe that an increase in the short-term rate would restrain lending or borrowing, that it was not the raising of the rate itself which would have that effect, and that in any event no substantial increase in the rate could be anticipated, unless the short-term rate was permitted to go up and the long-term rate to rise with it, which would involve letting Government bonds go below par. If the long-term rate were pegged, he said, there was a limit to the rise that could take place in the short-term rate without supporting the long rate, which would offset the action in increasing the short-term rate. He also said it would be necessary to present the matter to Congress with a clear explanation of the problems and the alternatives available before the System could permit long-term Government bonds to go below par. This did not mean, however, that he was opposed to letting the short-term rate rise to the point where it would go without causing continuing heavy sales of long-term bonds to the System. With respect to reserve requirements, Mr. Eccles felt such action would be effective in restraining bank credit expansion and that it would be desirable to increase requirements as promptly as possible after the short-term rate had been permitted to increase.

There was a general discussion of the varying views of the members of the committee as set forth above. There was also discussion of the possible effects on the money market, and the effectiveness from the standpoint of System policy, of a further increase in short-term rates and an increase in reserve requirements. Consideration was given to (1) the extent to which the short-term rate might increase before it would result in continuing pressure on the long-term rate, and (2) the policy to be followed in connection with further declines in prices of long-term Government securities.

It appeared from the discussion that there was agreement that the short-term rate could be allowed to increase somewhat further, that this action was desirable, and that the differences of opinion related primarily to whether there should be an increase in reserve requirements and, if so, the timing of such an increase.

At the conclusion of the discussion, Chairman McCabe stated that, because of the differing views that had been expressed he would suggest that no attempt be made to formulate recommendations for submission to the Federal Open Market Committee at its meeting tomorrow but, rather, that the discussion of the executive committee be summarized for the information of the members of the full Committee. He also stated that if he and Mr. Sproul could get an appointment with Secretary of the Treasury Snyder before the meeting of the full Committee tomorrow it would be possible to give the Committee the benefit of any further views that Mr. Snyder might have.

It was agreed unanimously that the procedure suggested by Chairman McCabe should be followed.

Thereupon the meeting recessed to reconvene following the meeting of the Federal Open Market Committee on September 28, 1950.

Chester Morrill
Secretary.

Thomas B. McCabe
Chairman.