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 Monday, November 29, 1937, at 2:30 p.m.

PRESENT: Mr. Eccles, Chairman
Mr. Harrison, Vice Chairman
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

Chairman Eccles suggested that the Committee hear first the reports of Messrs. Goldenweiser and Williams on the business and credit situation.

Mr. Williams reviewed the circumstances which attended the development of the present business recession and stated that the decline in business activity, which was expected in the summer following the abnormal activity in the spring, did not appear until August because of the fact that production was maintained chiefly on orders for inventory accumulation and forward buying, which had been relatively larger than was realized at the time. The delay in the recession, he said, made it more severe than if it had come somewhat sooner and it was aggravated by the major decline in security prices which was quite unexpected and which caused everyone to wonder whether the country was facing another depression.

He then compared the present basic economic situation with conditions existing in 1929 and expressed the opinion that such a comparison was highly favorable to the present for the following reasons: (1) The relatively small amount of construction during the last eight years had resulted in a large accumulated demand for housing; (2) while the future needs of the utilities were uncertain because of the political situation, the demand for utility equipment would be larger and perhaps more pressing than for housing if the uncertainties in the industry could be removed; (3) much railroad equipment was obsolete and, except for the unsatisfactory economic position of the industry, there would be a substantial demand for equipment, in connection with which Mr. Williams expressed the opinion that, unless there was an increase in traffic or some specific action was taken to improve the position of the railroads, which were suffering from rising wages, tax costs, and fixed rates, it was difficult to see how the industry could make any major contribution to recovery; (4) there had been a period of approximately eight years during which, with the possible exception of the last one or two, there had been installed less than a normal amount of new general plant equipment, which, together with the rise of wages which had occurred in recent years, should create a considerable impetus toward demands for improved plant equipment when the outlook is clearer than at the present time; (5) there had been much less speculation during the current period than in 1929 either in securities or real estate; (6) the position of banking was better, with much less possibility of hoarding because of deposit insurance and with many of the weaker banks out of the picture. In the light of these conditions, he regarded the conclusion as warranted that the present trend could not go beyond a minor depression.

He referred, however, to some elements in the present situation which were different from the conditions existing in 1929 and which rendered difficult any forecast at the present time. He stated that there never had been a period of recovery during which there had existed, as in the present situation, continued monetary ease throughout the period, and that, for that reason, a policy of monetary ease could not be counted on as a major corrective. Another important thing, he said, was the Government fiscal policy, in that this was a year of transition from public spending to a balanced budget which it was anticipated would effect a reduction in the national income of from $2,500,000,000 to $3,000,000,000 and which presented the question whether the transition from a program of public spending could safely be effected with such rapidity and whether the transition should not have been begun earlier. The third question, he said, was the relation between the administration and the business community arising out of the reform and recovery program of the former, and he expressed the opinion that it would be possible to make some adjustments without abandoning the major reform objectives contemplated by the program. He felt that, if something more than a minor depression should develop, the reasons therefor would lie in the field of these three questions.

Mr. Williams then stated that the conclusion was quite clear that those in authority should not sit back and do nothing, that the program of Government spending should not be revived, but that steps should be taken to devise a means of encouraging private investment. He said that it was unwise to do nothing on the supposition that the situation would work itself out, and that the prudent thing to do would be to take affirmative action to help the situation along.

In connection with the question of the revival of Government spending, he expressed the opinion that the limits on the time and magnitude of a Government spending program had about been reached and that it would be better to continue the policy of balancing the budget than to abandon that policy. Resumption of public spending, he said, would tend to create an unstable banking and business situation and further uncertainty. He preferred to see the transition from public spending to a revival of private investment effected with as little complication by outside influence as possible, and, therefore, since the primary causes of the recession were non-monetary, he would put the emphasis on the program of private investment and first and foremost on a policy of reviving the construction industry where the most obvious gap existed. In this connection, he felt encouraged by the fact that since a diagnosis of the existing circumstances indicated that the situation did not need to get out of hand or result in anything more than a minor depression, there was a favorable atmosphere in which to work out a program of private investment.

Whether a minor monetary program should be fitted into the major program, in his opinion, was a secondary question. With reference to the question of taxes in the program, he felt that there should be a careful exploration of the undistributed profits tax, capital gains tax, and surtax, to determine whether some adjustment should be made in these fields.

Mr. Goldenweiser stated that, while no reference could be made to concrete changes, it was believed that the situation had improved somewhat over two weeks ago with some improvement in sentiment. He said that there was no previous record of a simultaneous decline in security prices and industrial production that had been as sharp and large as the present one, that this movement was accompanied by a psychological reaction which was widespread, and that it had resulted in a feeling of resentment and almost of despair as well as uncertainty as to the prospects of recovery. While this feeling was still present, he said, there had been a sufficient change in the atmosphere so that the situation could be considered a little more clearly at the present time than was the case a few weeks ago.

He then stated that the rapid rise in business activity in the spring resulted from everyone wanting to get materials before prices advanced further and plant capacity was exceeded and that after these orders had been filled new orders were not adequate and the recession, which was greater and much sharper than anyone had anticipated, was the result.

In connection with the System's position in that situation, Mr. Goldenweiser referred to the policy of monetary ease which had been followed since the early months of 1932, which had been effectuated through open market operations, devaluation of gold, large gold imports, reduction in rates on time deposits, and generally liberal policies, as well as Government spending. He stated that, when the Board of Governors in July, 1936, increased reserve requirements of member banks, the action was taken as a means of preventing future unfavorable developments and not as a reversal of the existing policy. He also said that it was, however, the first move that was not in the direction of further ease and was followed in December by sterilization of gold by the Treasury and in January, effective in March and May, by further increases in reserve requirements. He added that, while these actions had been referred to as causes of the recession, in his opinion, the recession was the result of non-monetary causes which were more fundamental. He concurred in a position which had been taken by Mr. Williams that it would have been better if the last increases in reserve requirements could have been made effective sooner, before long time interest rates had declined quite so low and before boom psychology had developed.

He then expressed the definite opinion that the action in raising reserve requirements was a correct action although somewhat late and that, if the policy adopted by the Federal Open Market Committee last spring of increasing the System portfolio had been put into effect earlier and more vigorously, regardless of whether it would have resulted in any different situation from what exists today, the System would have been in a stronger position the next time action was taken.

The question before the System, Mr. Goldenweiser said, was whether it should take any action at this time. He felt it was important that the System maintain a flexible attitude and be prepared to avoid the mistake of taking desirable action too late. He was also of the opinion that the recent purchases of securities by the System were helpful as indicating a lack of rigidity and that, if, after the Treasury financing was past, there were the slightest indication that open market action would be desirable, such action should be taken, not with the thought that it would cure the situation, but rather with the knowledge that there was practically no danger in a policy of further ease at the present time.

He stated that he was of the opinion that the present situation did not call for desterilization of gold by the Treasury on monetary grounds as there was an abundance of reserves which was likely to continue, and that if a shortage of reserves should develop it would be better for the System to act through the open market rather than for the Treasury to desterilize gold. He felt, however, that if the present business situation continued and the Treasury believed it was desirable greatly to increase its expenditures without increasing the public debt, the System reasonably could not interpose any objection to the desterilization of gold.

Mr. Goldenweiser then presented a chart showing the estimated cash income and expenditures of the Treasury for recent years and pointed out that, according to budget estimates, Treasury operations for the fiscal year 1938 on a cash basis would actually take in more money than would be paid out, whereas during the previous fiscal year approximately $2,000,000,000 was paid out in excess of the amount taken in. He expressed the opinion that, if actually carried out, this would be an unprecedented drop in Treasury expenditures and possibly more than the country's economy could sustain. He added that, if the Treasury should feel it necessary to desterilize gold in order to meet expenditures, the System later might be faced with a difficult situation for the reason that if it should be necessary to absorb a substantial amount of excess reserves through allowing maturities in the System portfolio to run off, there would result a situation where the System would be left with a small portfolio of securities with relatively long maturities which would be inadequate to meet future problems of credit control. In this connection, he said, any large addition to required reserves to enable the System to manage the situation would only accentuate the problem of how to maintain membership in the System.

He also referred to the fact that the seasonal increase in the demand for currency and credit this year had been very much less than usual and had resulted in the banks having larger excess reserves than there had been any reason to expect. This situation, he felt, was not entirely due to the smaller demands for currency and credit resulting from reduced business activity and lower prices but also to the use at this time to meet seasonal requirements of funds paid out as bonus payments last year. He did not anticipate that the further increase in currency between now and the end of the year would carry the amount of currency outstanding to a figure above that at the peak of demand last year.

He said he saw no occasion for any major monetary action at this time, but he felt that minor monetary adjustments might be made in pursuance of a liberal policy in the present situation.

In response to an inquiry with respect to the relation of prices of farm products and buying power to the recovery movement, Mr. Goldenweiser said that the farmers' buying power was an important factor in sustaining economic activity; that the prospects for prices of farm crops next year were not encouraging; and that, therefore, it was all the more necessary that something be done to encourage private financing in industry and to sustain the industrial demand for agricultural products as much as possible.

There followed a general discussion of existing conditions, during which Chairman Eccles suggested that, in order to clarify the problem before the Committee, a statement be drafted which would review the present situation and the steps that might be taken with a view to counteracting the present downward trend of business activity. The other members of the Committee concurred in the suggestion and it was understood that Messrs. Goldenweiser, Williams and Thurston would prepare a draft of statement along the lines proposed by Chairman Eccles for consideration at another session of the meeting to be held on Tuesday.

Thereupon the meeting recessed with the understanding it would reconvene on Tuesday, November 30, at 10:30 a.m.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.