

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, May 27, 1940, at 2:45 p.m.

PRESENT: Mr. Eccles, Chairman
Mr. Harrison, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Ransom
Mr. Davis
Mr. Draper
Mr. Sinclair
Mr. Parker
Mr. Schaller
Mr. Day

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

Messrs. Young, Fleming, Leach, Martin, and
Peyton, Alternate Members of the Federal
Open Market Committee

Messrs. Hamilton and Gilbert, Presidents of
the Federal Reserve Banks of Kansas City
and Dallas, respectively

Upon motion duly made and seconded
and by unanimous vote, the minutes of the
meeting of the Federal Open Market Committee
held on March 20, 1940, 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 meeting of the executive
committee on March 20, 1940, were approved,
ratified, and confirmed.

5/27/40

-2-

There were distributed to the members of the Board and the Presidents of the Federal Reserve Banks copies of a report prepared at the Federal Reserve Bank of New York of open market operations covering the period from March 20 to May 24, 1940, inclusive. Mr. Rouse reviewed and commented on the important features of the report. He also said that there were no transactions effected for System account on Saturday, May 25.

Chairman Eccles stated that following the German invasion of Holland, Belgium, and Luxembourg, the executive committee, in carrying out the instructions of the full Committee, had proceeded on the theory that during the decline from the high level which the market had reached there should be only such purchases of securities by the System as might be necessary in accordance with the policy of attempting to prevent disorderly conditions in the market, and that, apparently because of the prevalent knowledge of the experiences of investors in the market last fall when prices recovered very rapidly from a precipitous decline, the situation in the market in the recent past had been entirely different from that which existed last September when large amounts of securities were sold at rapidly declining prices. He said that as long as there were buyers in the market, as there had been during practically the entire recent period of decline, there was little need for System intervention, that the only time the System had purchased securities was when the dealers through whom System

5/27/40

-3-

operations were conducted were unable to find outside bidders and small purchases were made for System account to avoid further weaknesses, and that during the entire period of weakness only \$10,400,000 of securities were purchased. It was the feeling of the executive committee, however, Chairman Eccles added, that the System should be prepared to increase its purchases in the event the market declines further with the attendant possibility of increased selling.

There was a discussion of the question whether during the period of recovery following the decline in Government security prices last September the System should have sold more than the \$94,000,000 of securities that were disposed of. Mr. Harrison stated that probably some additional securities could have been sold without adversely affecting the market, but that the existing instructions were to buy and sell securities only for the purpose of exercising an influence toward maintaining orderly market conditions, and that even though the market might have absorbed additional amounts of securities without materially affecting market prices it had been felt that the existing instructions did not contemplate sales merely for the purpose of disposing of securities which were purchased during the September decline when such sales were not deemed necessary to prevent disorderly market conditions. He added, however, that he would favor instructions to sell securities not only for the purpose of exercising a stabilizing influence in the market but also for the purpose of disposing of securities which had been acquired in a period of market

5/27/40

-4-

weakness, whenever such sales could be made without adversely affecting the market.

During the consideration of Mr. Harrison's suggestion Mr. McKee stated that it is much more difficult for the System to dispose of any substantial amount of securities in the market than it is for any other holder for the reason that it becomes known quickly that the System is operating in the market and sales from its account have a much broader effect than sales from the portfolio of private holders.

Mr. Sinclair expressed the opinion that it was likely that the System would be called upon to buy more securities than it would have occasion to sell for the purpose of exercising a stabilizing influence and that securities should be sold whenever that could be done without an adverse effect upon market prices so that the System account would be in a better position to purchase securities in periods of market weakness. Reference was made in this connection to the present earnings of the System account and Mr. Sinclair voiced the further opinion that the question of earnings of the System should not be a consideration in determining whether securities should be sold and that the System should be prepared to use its surplus funds for a time for the payment of its expenses should that become necessary.

Chairman Eccles said that he thought that it would be a shortsighted policy to disregard the earning requirements of the System in

5/27/40

-5-

the administration of the System account, that the purchase or sale of \$200,000,000 or \$300,000,000 of securities would not have any material effect on the situation one way or another, and that as long as the present situation continued the Committee was entirely justified in holding such amounts of securities as might be deemed necessary to meet earning requirements. The opinions expressed by Messrs. Sinclair and Eccles were discussed at some length.

Mr. McKee suggested that in the future the weekly reports of open market operations prepared by the Federal Reserve Bank of New York show the par value of securities held in the System account, the unamortized premium paid on such securities, and, on an annual basis, the total interest income of the account, the net premium amortization, and the net interest earnings of the account after amortization of premium. Part of this information has been shown in these reports and Mr. Rouse stated that he would see that the additional data called for by Mr. McKee's suggestion is shown hereafter.

Mr. Ransom recommended that the special committee appointed at the last meeting of the Federal Open Market Committee (Messrs. Ransom, Harrison, and Davis) to study the question of the responsibilities of the Federal Open Market Committee with respect to the Government securities market as well as the question of the relations of the dealers to the market, be discharged. He stated that, in view of the changed conditions since the committee was appointed, together with the fact that the whole subject was under constant

5/27/40

-6-

review and discussion by the entire committee, there appeared to be little value in the study at this particular time and that, inasmuch as the members of the staff who would work on the report were fully occupied on other problems, this additional assignment should be laid aside.

Upon motion by Mr. Ransom, which was duly seconded, it was voted unanimously to discharge the special committee.

Mr. McKee renewed the suggestion made by him at the last meeting of the Committee that consideration be given to the use of profits on sales involved in shift transactions for the purpose of writing down the book value of the replacement securities purchased. Mr. Rouse stated that, in accordance with the action taken at the last meeting of the Committee, he and Mr. Smead, Chief of the Division of Bank Operations of the Board of Governors, had been studying that question and, if agreeable to the members of the Committee, a report would be prepared and sent to the members of the Committee before its next meeting, with the understanding that the report would be considered at that meeting.

The members of the Committee expressed agreement with the procedure suggested by Mr. Rouse and, at the suggestion of Mr. Fleming, it was understood that copies of the report prepared by Messrs. Smead and Rouse would also be sent to the Presidents of Federal Reserve Banks who were not members of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the transactions

5/27/40

-7-

in the System open market account for the period from March 20 to May 25, 1940, inclusive, were approved, ratified and confirmed.

Chairman Eccles called on Messrs. Goldenweiser and Williams for statements on the business and credit situation.

Mr. Goldenweiser stated that the Division of Research and Statistics of the Board of Governors had prepared a statement on recent business and credit developments which he would distribute among the members of the Committee and the Presidents. In response to a request, Mr. Goldenweiser amplified the comments contained in the statement referred to with respect to the future outlook and the possible effects of the war upon the American economy.

A statement was also made by Mr. Williams. A summary thereof and a copy of the prepared statement referred to by Mr. Goldenweiser have been placed in the files of the Federal Open Market Committee.

During Mr. Goldenweiser's statement, Mr. Wyatt, General Counsel, joined the meeting.

Following Mr. Williams' statement, Chairman Eccles referred to the expansion of the powers of the Treasury and other agencies of the Federal Government in the field of banking and credit since 1933 and to the relative diminution of the powers of the Federal Reserve System while powers of other agencies of the Government had been increased greatly. He stated also that central banks of other countries are entrusted with responsibilities which in this country

5/27/40

-8-

have been placed in other agencies. He suggested that the Presidents of the Federal Reserve Banks and the Board give thought to such developments and consider what, in their opinion, should be the functions of the Federal Reserve System. Some aspects of the matter were discussed and at the conclusion of the discussion the meeting recessed to reconvene at 10:00 a.m. tomorrow.

Robert Morrie
Secretary.

Approved:

W. S. Coolidge
Chairman.