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 Thursday, September 21, 1944, at 9:30 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. McKee
Mr. Draper
Mr. Leach

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Goldenweiser, Economist
Mr. Wyatt, General Counsel
Mr. Rouse, Manager of the System Open Market Account
Messrs. Piser and Kennedy, Chief and Assistant Chief, respectively, of the Government Securities Section, Division of Research and Statistics of the Board of Governors

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee of the Federal Open Market Committee held on July 28, 1944, were approved.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account during the period July 28 to September 20, 1944, inclusive, as reported to the members of the executive committee, were approved, ratified, and confirmed.

In accordance with the actions taken at the meeting of the executive committee on July 28, 1944, memoranda had been prepared with respect to (1) the steps to be taken to improve the situation in connection with speculative purchases and indirect purchases by banks in the next drive, and (2) the refunding of certificates maturing on September 1 and notes maturing on September 15, 1944. The memoranda, which were sent to the Treasury by Chairman Eccles on August 11 and 18, 1944, respectively, read as follows:

"MEMORANDUM FROM THE EXECUTIVE COMMITTEE OF THE FEDERAL OPEN MARKET COMMITTEE TO THE SECRETARY OF THE TREASURY

"The Executive Committee of the Federal Open Market Committee, at its meeting held on July 28, 1944, discussed the results of the Fifth War Loan Drive, giving particular attention to suggestions that might be made for further improvement in performance during the Sixth and succeeding drives. While recognizing the substantial accomplishments in increasing sales of Government securities to nonbank investors since the First War Loan Drive in December 1942, the Committee is concerned about the large expansion in bank credit, the growth in speculative purchases, and the methods of indirect purchases of securities by banks that accompanied the recent drive. It is feared that these developments, which no doubt were profitable to those who evaded the rules, will lead to further evasion in the future, unless some simple and definite yardstick is provided for limiting subscriptions that can be applied when subscriptions are initiated. Under conditions that existed during the past drive, the Reserve Banks had no basis, except in the case of dealers and brokers, by which to impose effective and uniform policing of subscriptions and had to rely primarily on the commercial banks, inasmuch as the only subscriptions subject to policing were those that involved bank loans. It is the opinion of the Committee, therefore, that additional steps should be taken to curb undesirable practices and to increase the pressure for sales to nonbank investors, to the end that the proportion of the debt going to the banking system, particularly indirectly, may be further reduced.

"At weekly reporting member banks, total loans on and investments in Government securities between June 7, the reporting date preceding the drive, and July 12, the reporting date following the drive, increased by 6.7 billion dollars. This total comprised 4.9 billion dollars of purchases of Government securities, 546 million of loans on Government securities to brokers and dealers, "and 1.3 billion of loans on Government securities to others. A substantial part of the increase in bank investments and of the loans on Government securities to brokers and dealers represented securities that were sold in the market by nonbank investors desiring to increase their subscriptions in the drive. A considerable part of the loans on Government securities to others represented subscriptions that were made for the purpose of quick resale or to carry at a profit. In addition, there is evidence that a number of banks arranged with their customers, officers, directors, or affiliated corporations to place subscriptions during the drive, with the understanding that after the drive the banks would purchase the securities thus obtained. The loans that made possible these latter transactions are in direct contravention of the Treasury's request with respect to bank loans for the purchase of securities during the drive.

"While no data are available as to the exact extent of these speculative and indirect purchases, it is evident from the figures of reporting member banks and from reports of sales in certain categories that such purchases were not only widespread but reached exaggerated proportions in certain localities. In eight States, sales of Series E bonds ranged between 83 and 121 per cent of quotas, but sales of other securities to individuals, partnerships, and personal trust accounts were disproportionately large, reaching more than three times the quota in Georgia and between two and three times the quotas in Alabama, Florida, Kentucky, Maryland, Mississippi, Oregon, and Tennessee. Such comparisons, together with knowledge of practices carried on in certain cities, created much dissatisfaction on the part of bankers and other members of the War Finance Committee organization and so impaired the usefulness of quotas.

"Bankers who respected the Treasury's request and made no speculative loans and no special subscription arrangements with their customers or with others feel that they were placed at an unfair disadvantage in relation to their competitors who engaged in such practices. They resent purchasing securities at a premium from speculators when their competitors by virtue of prior arrangements have obtained the interest on loans, obtained the use of war loan deposits, and purchased the securities at or near par. Unless the Treasury takes strong steps to eradicate such practices, it is likely that other banks will follow them "in the next drive, and sales organizations in communities that reached their quotas the hard but the sound way may be tempted to adopt the easier method. Few bankers would object to restrictive measures if they were satisfied that these measures were being applied uniformly.

"With this background in mind, the Executive Committee suggests consideration of the following measures to improve the situation:

1. That the Treasury appeal more strongly than heretofore for the whole-hearted cooperation of commercial banks in complying with Treasury wishes regarding loans on securities offered in the next drive and that the Treasury at the same time condemn the undesirable practices that developed during the Fifth War Loan Drive and indicate that in the future any subscriptions not entered in accordance with the Treasury's request will be subject to rejection.

2. That subscribers for market issues, other than brokers and dealers, be required to make a down payment of 25 per cent of their subscriptions from existing funds when entering subscriptions that involve bank loans. Policing of subscriptions from investors, other than brokers and dealers, by the Federal Reserve Banks is probably physically impossible because of their volume and timing when the drive technique is used. The only practical way to police or limit them, therefore, is at the commercial banks before they are entered and paid for. This method in any case would cause the least resentment. Since it is only those subscriptions involving bank loans that are subject to policing, it is the feeling of the Committee that the requirement of 25 per cent down payment will serve naturally to reduce speculative subscriptions and to bring about uniform action by the banks in all parts of the country. In this connection, banks should be required to certify on the subscription form that at least 25 per cent of the amount of each subscription has been paid in cash without borrowing from the certifying bank for the purpose and that they have no beneficial interest in such subscriptions.

3. That the Treasury again request the Reserve Banks to police subscriptions from brokers and dealers and that the Treasury provide a more specific yardstick, one that can be readily understood and uniformly applied.

4. That a partial-payment plan be inaugurated and the lowest denomination of marketable bonds be reduced from $500 to $100 in an attempt to increase subscriptions from

"permanent investors. These measures would also reduce the demand for securities between the drives and meet the reported demand from an increasing number of investors who would prefer to purchase marketable bonds rather than add further to their holdings or regular current purchases of Series E bonds.

5. That the number of issues offered in drives that are available for bank purchase after the drive closes be reduced. A substantial part of the speculation during the Fifth Drive arose from the fact that the basket included three issues available for bank purchase after the drive closed.

6. That the use of war loan deposits above a minimum uniform percentage be denied to all qualified depositaries who ignore the Treasury's request concerning speculative loans.

7. That consideration be given to a return to the practice of offering securities directly for commercial bank subscription. It is just as inflationary for banks to acquire securities indirectly as directly. If the indirect method serves to reduce bank purchases, it should be continued. If, however, it does not so serve, it would be preferable again to offer securities directly for commercial bank subscription. Banks might be permitted, as after the Third Drive, to purchase a limited amount of securities shortly after the close of the drive, when their excess reserves are large. Such purchases should serve to reduce the amount of speculative subscriptions from nonbank customers, since the secondary demand would be reduced. The corporate but not the individual quota should be reduced by the amount of the offering for direct bank subscription.

8. That trading in the marketable issues included in the drive be postponed until 15 days after the close of the drive.

9. That the Treasury make no increase in outstanding bills during the drive. Increases in outstanding bills are taken by the Federal Reserve, thereby adding to excess reserves, and consequently stimulate bank purchases."

"MEMORANDUM FROM THE EXECUTIVE COMMITTEE OF THE FEDERAL OPEN MARKET COMMITTEE TO THE SECRETARY OF THE TREASURY

"The Executive Committee of the Federal Open Market Committee, at its meeting held on July 28, 1944, discussed "the refunding of the certificates and notes that mature in the near future. As a result of this and subsequent discussion, the Committee suggests that the issue of September 1 certificates be refunded into a new issue of one-year certificates dated September 1 and that the two issues of September 15 notes and the issue of October 1 certificates be refunded into an issue of notes. The notes could be either an additional issue of the 1 1/4 per cent notes that were included in the Fifth War Loan, offered at a premium, or another issue with a later maturity date. The Committee would like to reserve its judgment on the terms of the note issue, however, until about the first of September.

"The reasons for these suggestions are as follows:

1. An additional supply of notes would be helpful in maintaining the pattern of rates.
2. Such a refunding would help to keep within desirable limits the outstanding amount of certificates, anticipating that a new issue of certificates will be offered in the Sixth War Loan.
3. The combination of the certificate and note refunding would reduce from three to two the number of refunding operations that the Treasury will need to undertake within the next month.
4. The number of outstanding individual Treasury issues would be reduced.
5. The September certificates are largely held by nonbank investors, principally corporations, which would prefer certificates in exchange. The October certificates are largely held by commercial banks, most of which are likely to prefer notes in exchange.
6. Although there would be some advantage in giving to holders of all four issues an option to exchange for either notes or certificates, the Committee believes that in the interest of simplicity it would be preferable not to give an option.
7. Anticipation of the 4 per cent bonds that mature on December 15 would not appear to be desirable because of the problem of interest adjustment."

Upon motion duly made and seconded, and by unanimous vote, the memoranda were approved, and their submission to the Treasury was approved, ratified, and confirmed.

In the interim following the meeting of the executive committee on July 28, 1944, there were further informal discussions with representatives of the Treasury with respect to the desirability of an increase in the weekly offering of Treasury bills. A draft of a second memorandum on this subject was prepared and submitted to the members of the executive committee, and after their suggestions had been obtained, the memorandum was revised and sent to the Treasury by Chairman Eccles on September 13, 1944, in the following form:

"MEMORANDUM FROM THE EXECUTIVE COMMITTEE OF THE FEDERAL OPEN MARKET COMMITTEE TO THE SECRETARY OF THE TREASURY

"The Executive Committee of the Federal Open Market Committee has considered further the question of increasing the weekly offering of Treasury bills, which was the subject of the memorandum of July 31. The Committee recommends that the Treasury make no increase in the weekly offering before the end of the Sixth War Loan, unless the timing of the Sixth War Loan makes necessary the building up of the Treasury balance prior to the date of payment for securities offered in the drive. In making this recommendation, the Committee has taken into account the following considerations:

1. Under present conditions, any increased amount of outstanding bills would need to be purchased by the Federal Reserve. In the opinion of the Committee, there should be no increase to raise funds when the market for notes and bonds is strong, but increases should be postponed until bills are needed to supply reserves and to maintain the pattern of rates. Otherwise, part of the reserves created by Federal Reserve purchases of bills would go to banks that already had sufficient reserves, with the result that these banks would be enabled to hold the large amount of securities that they purchased during the Fifth War Loan and would be encouraged to expand credit further by purchasing additional amounts. The existing difficulty in maintaining the pattern of rates would thereby be increased, and the continued strength in the note and bond market

"might encourage banks to purchase an even larger amount of securities during the Sixth War Loan than they purchased during the Fifth War Loan.

2. Banks hold sufficient securities to meet their needs for reserves without strain on the pattern of rates. Between September 6 and November 15, the Federal Reserve will need to supply 2.4 billion dollars of reserves, comprising 1.1 billion to meet increased reserve requirements, 1.1 billion to meet an increase in money in circulation, and about 200 million to meet a gold outflow. Weekly reporting member banks on September 6 still held 629 million dollars more of bills than they held on June 7, just before the beginning of the Fifth War Loan. Between June 7 and the peak in their holdings, reporting member banks increased their holdings of certificates by 2.3 billion dollars, their holdings of notes by about 400 million, and their holdings of bonds by 1.3 billion, a total of 4.0 billion. Since the peak, they have reduced their holdings of certificates by 134 million dollars, their holdings of notes by 97 million, and their holdings of bonds by 12 million, a total of 243 million. They still hold, therefore, 3.8 billion dollars more of certificates, notes, and bonds than they held before the beginning of the Fifth War Loan. It is apparent, therefore, that banks can readily meet their reserve needs by selling only part of these acquisitions. It is the opinion of the Committee that they should be required to do so rather than supplied with reserves by an increase in the bill offering, which as pointed out above would increase the reserves of banks that did not need them. Such a policy would reduce the demand for notes and bonds and permit them to recede in price from the advanced levels reached following the Fifth War Loan. This development is desirable if excessive speculation is to be discouraged during the Sixth War Loan. Since bank earnings are now at very high levels, there is no need from this point of view of maintaining their present holdings.

3. In maintaining the pattern of rates, Federal Reserve holdings of notes and bonds have declined by about 300 million dollars since early in July. Unless notes and bonds are restored to the Federal Reserve to replace the notes and bonds that have recently been sold, the Federal Reserve will find it increasingly difficult, if not impossible, to maintain the present pattern of rates."

Upon motion duly made and seconded, and by unanimous vote, the memorandum was approved, and its submission to the Treasury was approved, ratified, and confirmed.

On September 19, 1944, an informal meeting of the members of the executive committee was held in Washington for a discussion of the problem presented by the position taken by the Treasury that it would be necessary to raise additional funds prior to the next drive in order to maintain Treasury balances. At that time the conclusion was reached by the members of the executive committee that, in further discussions at the Treasury, Messrs. Eccles and Sproul should stand on the position previously taken that there should be no increase in the weekly offering of Treasury bills, that the need for balances as large as those contemplated by the Treasury did not exist as funds were readily available through Treasury bills or direct borrowing from the Federal Reserve Banks at any time, but that, if the Treasury insisted on maintaining a larger balance, the suggestion should be made that there be a public offering of notes, that if that were not acceptable an issue of certificates would be preferable to an increase in bills, and that if that were not acceptable the increase in the weekly bill offering should not be more than $200 million. The conclusion reached by the members of the executive committee was conveyed by Messrs. Eccles and Sproul to representatives of the Treasury at an informal conference at the Treasury on September 20, 1944.

Upon motion duly made and seconded, and by unanimous vote, the views of the members of the executive committee as set forth above were approved, and their transmission to the Treasury was approved, ratified, and confirmed.

At this point, Mr. Smead, Director of the Division of Bank Operations of the Board of Governors, joined the meeting.

In accordance with the action taken at the meeting of the executive meeting on July 28, 1944, Messrs. Smead and Rouse had prepared a memorandum covering a procedure for the allocation of securities in the System account in the event the recommendation of the executive committee were adopted that the option accounts at the individual Federal Reserve Banks be discontinued, and copies of the memorandum were sent to the Presidents of all the Federal Reserve Banks for consideration at the next meeting of the Federal Open Market Committee as a recommendation of the executive committee.

Mr. Sproul stated that the matter of discontinuing the option accounts at the Federal Reserve Banks was discussed at the Presidents' Conference which was held in Washington September 18-19, 1944, and that six of the Presidents were opposed to the discontinuance of the accounts, four favored the adoption of the allocation procedure referred to above, and two were in favor of the adoption of an arrangement which would provide for the discontinuance of the option accounts but would retain cash delivery on all bills resold to the original sellers. He had the impression that all of the Presidents would approve the arrangement last referred to if found to be practicable.

Mr. Rouse stated that he and Mr. Smead had been requested by the Presidents' Conference to study the practicability of such a procedure but that they had come to the conclusion that the arrangement was not practicable and that, if their opinion were asked, they would recommend the continuance of the option accounts and the allocation of securities in the System account in accordance with the procedure presented by them at the meeting of the executive committee on July 28, 1944. He also said that, after discussions with the operating men who handle the System accounts at the Federal Reserve Bank of New York, they had come to the conclusion that, while the procedure outlined in the memorandum prepared following the meeting of the executive committee on July 28, 1944, seemed desirable in principle, the procedure suggested at the July 28, 1944, meeting would be simpler in practice and more easily followed.

In a discussion of the matter, Messrs. Sproul and Leach indicated that several of the Presidents had taken the position at the Presidents' Conference that the present arrangement, under which it was possible to make immediate delivery on all purchases and resales of bills for the option accounts, had become well established and understood by the public, and that the arrangement should be continued and the accounting practices of the System adjusted to that arrangement. Although Messrs. Sproul and Leach previously had voted in favor of the adoption of an arrangement which would provide for the discontinuance of the option accounts, they now, in view of Mr. Rouse's statement, expressed the view that the recommendation of the executive committee should be for the continuance of the option accounts and the adoption of the procedure presented by Messrs. Smead and Rouse at the meeting of the executive committee on July 28, 1944.

Chairman Eccles again questioned whether, in view of the changed conditions since the original direction with respect to the purchase of Treasury bills was issued by the Federal Open Market Committee and the fact that banks have not been using bills to adjust their reserves as had been contemplated when the original direction was issued, the outstanding direction should be terminated. This point was discussed and the unanimous conclusion was reached that in all the circumstances such action would not be desirable at this time.

> Upon motion duly made and seconded, it was voted unanimously to recommend to the Federal Open Market Committee the continuance of the option accounts at the Federal Reserve Banks, and the adoption of the allocation procedure presented on that basis by Messrs. Smead and Rouse at the meeting of the executive committee on July 28, 1944.

Mr. Eccles stated that, while the matter did not require action at this time, he would suggest that consideration be given to whether the annual statements of condition submitted by brokers and dealers which had qualified to do business with the System open market account should be expanded to show holdings of Government securities by issues; Government securities borrowed by issues; borrowings from banks, trust companies, and other financial institutions, and from officers, directors, and others; loans to officers and directors; and net worth. The purpose, he said, would be to provide a better basis for appraisal of the condition of the individual dealers. He also said that another question that might be considered was the commissions paid the dealers in connection with transactions for the System account.

Mr. Sproul suggested that Mr. Rouse might be asked to study the matter and submit a report before the next meeting of the executive committee.

Mr. Rouse said that he would be glad to submit such a report which would also cover other related matters referred to in a letter addressed to Mr. Sproul by Chairman Eccles under date of September 11, 1944.

Chairman Eccles made the further suggestion that, while it was not urgent, consideration be given to the desirability of an arrangement under which the Presidents would report on any cases that came to their attention where representatives of the dealers in the field gave out information or in any other way undertook to induce activity in the Government security market in violation of the terms on which the New York Bank will transact business for the System account.

Thereupon the meeting recessed to reconvene following a meeting of the Federal Open Market Committee.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.