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, January 23, 1946, at 10:00 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. Szymczak
Mr. Evans
Mr. Alfred H. Williams

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Wyatt, General Counsel
Mr. Vest, Assistant General Counsel
Mr. Thomas, Associate Economist
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
Mr. Connell, General Assistant, Office of the Secretary, Board of Governors
Mr. Goldenweiser, Consultant to the Board of Governors of the Federal Reserve System

Mr. Eccles stated that Mr. Vinson, Secretary of the Treasury, had advised by telephone last evening that, because of a call from the President and an engagement to leave Washington tonight to make a speech on the British loan, it would not be possible for him to give the desired time to a meeting with representatives of the Reserve System as had been arranged for this afternoon for a discussion of System credit policies and policies to be followed by the Treasury in the administration of the public debt. While Mr. Vinson might have been able to give an hour to such a discussion today, he preferred to arrange for a meeting some day next week that would be convenient when there would be ample time for full consideration of the whole matter. Chairman Eccles also said that he told Mr. Vinson that our plans had been made for the conference and we regretted that the meeting could not be held as scheduled, but that he did not think it wise to urge that Mr. Vinson see the System representatives today when his time was so limited. Mr. Vinson told him, Chairman Eccles added, that he had seen representatives of the insurance companies on January 21, 1946, but that he had made no commitments, and that he was entirely open minded on the policies that should be adopted.

Chairman Eccles made the further comment that he had asked Mr. Goldenweiser, Consultant to the Board, who was in Washington yesterday, to stay over to attend this meeting of the executive committee as well as the meeting which it had been expected would be held with Treasury representatives this afternoon.

It was agreed that the time to be suggested for the conference next week with the Treasury representatives could be determined at the end of this meeting.

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 December 5, 1945, were approved.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account during the period December 5, 1945, to January 22, 1946, inclusive, as reported to the members of the executive committee, were approved, ratified, and confirmed.

In a discussion of the authority to be given to the Federal Reserve Bank of New York to execute transactions for the System open market account, it was agreed that the direction issued at the last meeting of the committee should be renewed so that the authority of the Bank to sell securities for System account, which was almost exhausted, would be restored.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the executive committee directed the Federal Reserve Bank of New York, until otherwise directed by the executive 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 practical administration of the account, or for the purpose of maintaining about the present general level of prices and yields of Government securities, or of maintaining an adequate supply of funds in the market; provided (a) that the total amount of securities in the account at the close of this date shall not be increased or decreased by more than $500,000,000 [exclusive of bills purchased outright in the market on a discount basis at the rate of 3/8 per cent per annum and bills redeemed at maturity, and special short-term certificates of indebtedness purchased for the temporary accommodation of the Treasury pursuant to paragraph (2) of this direction], and (b) that this paragraph shall not limit the amount of Treasury bills purchased pursuant to the direction of the Federal Open Market Committee issued under date of March 1, 1945, or the redemption of such bills;

(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 accommodation of the Treasury; provided that the total amount of such certificates held in the account at any one time shall not exceed $750,000,000; and

(3) Upon approval by a majority of the members of the executive committee, which may be obtained by telephone, telegraph, or mail, to make such other purchases, sales or exchanges for the account as may be found to be desirable within the limits of the authority granted to the executive committee by the Federal Open Market Committee.

> In taking this action it was understood that the limitations contained in the direction included commitments for purchases or sales of securities for the System account.

Mr. Rouse stated that there were $1,351,600,000 of certificates in the System account which mature February 1, and that on Monday, January 21, 1946, he issued instructions to enter $1,000,000,000 of this amount for exchange for new certificates, but that he had held up instructions on the balance of $351,600,000 pending discussion by the executive committee whether the remainder should be allowed to mature or should be exchanged for the new issue. It was his feeling that, in view of present market conditions, it might be well for the System to allow some of its maturing certificates to run off. However, he realized that this would not be a desirable procedure until after there had been an opportunity to discuss the matter with the Secretary of the Treasury, and since it would not be possible to see Secretary Vinson today as had been contemplated, he felt the entire amount should be exchanged for the new issue.

There was agreement by the members of the executive committee with the suggestion that the Treasury should redeem maturing securities as a means of reducing the present large Treasury cash balance, and that, when the conference with the Treasury representatives was held, the action to be taken in connection with maturing certificates in the System account should be discussed, but that pending such a meeting the System's holdings of maturing certificates should be exchanged for new securities.

Chairman Eccles referred to the letter which he addressed to Secretary of the Treasury Vinson under date of December 13, 1945, in which he again raised the question of the desirability of discontinuing the preferential discount rate, and to Mr. Vinson's reply dated December 29, 1945, requesting, for the reasons stated therein, that the rate be retained. These letters are in the files of the Board of Governors and copies were sent to the Presidents of all of the Federal Reserve Banks.

The Chairman also stated that the question of the elimination of the preferential discount rate was only a small part of the larger problem of what the future credit policies of the System and the policies of the Treasury with respect to the management of the public debt were to be. In this connection, reference was made to a memorandum prepared by Mr. Sproul under date of January 12, 1946, setting forth a possible basis for the forthcoming discussions with the Treasury, and the position set forth in the memorandum was discussed.

While this discussion was under way Messrs. Ransom and Draper came into the room.

During the meeting copies of a memorandum prepared under date of January 22, 1946, at the request of Chairman Eccles, were distributed and at this point the memorandum, which contained the following proposals, was read:

1. The Federal Reserve would discontinue the preferential discount rate. This would not increase interest rates as the Federal Reserve would continue to support certificates at 7/8 per cent by purchasing whatever amounts of certificates might be necessary for this purpose.

2. The Treasury would reduce the weekly offering of Treasury bills from 1.3 billion dollars to 500 million (approximately the amount needed by the banking system to meet day-to-day fluctuations in reserve funds), and each week would refund the remaining 800 million of bills which are held by the Federal Reserve Banks into special certificates with a rate of 1/8 per cent. The Federal Reserve would discontinue the bill buying rate and repurchase option and would permit the rate on bills to increase to the point where it would be in line with the rate on certificates at which rate the Federal Reserve would buy and sell bills freely for the purpose of assisting banks in making day-to-day adjustments in reserve positions.

3. The Treasury would reduce its large cash balances by redeeming in cash the 10.7 billion dollars of certificates and notes that mature, and bonds that have been called for redemption, in March and April.

4. The Treasury and the Federal Reserve jointly would ask the Congress for legislation to permit the establishment of a requirement that all commercial banks in the country maintain their holdings of Treasury bills and certificates at or above a specified percentage of their net demand deposits. The requirement would be placed sufficiently high so that commercial banks as a whole would need to buy bills and certificates on balance.

Mr. Evans raised the question of the desirability of action to increase reserve requirements of central reserve city banks from 20 to 26 per cent. This possibility was discussed but without definite expressions of opinion, because it would have to be considered in relation to the broader aspects of the general policy as to reserve requirements.

Chairman Eccles outlined his reasons for the above proposals, particularly the fourth proposal which was designed to enable the System to stabilize bank holdings of Government securities without increasing bank earnings. He thought that an increase in interest rates would not be accepted by the country or agreeable to the Treasury, and that there would be continued political pressure to reduce bank earnings from Government securities. Reference was made to the present trend toward increased holdings by banks of medium and long-term securities, and there was a discussion of how the above proposals would affect that situation.

Mr. Sproul questioned whether the Federal Reserve should propose a program which could not be made effective until the adoption by Congress of legislation, because that might mean that the present tendencies toward lower yields on securities and an increased volume of bank credit would continue indefinitely, and even though the economic situation seemed to demand action we would be committed to inaction. While he felt that it would be necessary eventually to adopt something along the lines of Chairman Eccles' fourth proposal, he questioned whether the mere suggestion and consideration by Congress of such legislation would be as effective as Chairman Eccles indicated in influencing banks to discontinue purchasing medium and longer-term bonds. He thought that the System should be taking action to prevent any further decline in interest rates and any further increase in the volume of bank credit and that if such action did result in a moderate rise in short-term rates and increased cost of Treasury borrowing, the cost would be negligible when compared to the results that would flow from inaction.

Mr. Sproul preferred to eliminate the preferential rate, with the necessary temporary support to the short-term rate following that action, and then, if the economic situation continued to warrant it, to allow short-term rates to rise very moderately. This, he thought, would have the effect of arresting any further decline in long-term rates and support could be provided to prevent an increase in long-term rates above 2-1/2 per cent. Meanwhile there could be a determination of action looking toward a more permanent solution of our fiscal-monetary problems through some security reserve plan such as recommended in the fourth of Chairman Eccles' proposals.

Chairman Eccles stated that he did not expect the program as he had outlined it to be dependent upon the enactment of legislation but rather that the problem would be presented in discussions with Treasury representatives as one that had to be met and that the Federal Reserve proposed to meet it by eliminating the preferential discount rate and the buying rate on bills with the assurance that the action would not result in an increase in the interest cost to the Treasury, and that at the same time legislation would be proposed to Congress for meeting the long-term situation.

All of the points raised by Chairman Eccles and Mr. Sproul were discussed at considerable length, together with the manner in which the problem facing the System would be presented in discussions with Treasury representatives.

In response to a request for his views, Mr. Goldenweiser suggested that the System should emphasize (1) that further expansion of bank credit should be stopped, and (2) that, in order to stop such expansion which arises from the open-door to the Federal Reserve Banks, the System proposes to eliminate the preferential rate and the buying rate on bills and to get into a position where it could act to restrict credit as required by the needs of the situation. He was of the opinion that in presenting the matter to the Treasury the Federal Reserve representatives should take the position that the System was opposed to increasing the cost of the public debt, was concerned about the earnings of banks, and felt that something should be done to keep them from being unreasonably large. With these premises clearly stated, he thought that the System might express willingness to support the 7/8 per cent rate on certificates pending an indication as to the likelihood of legislation such as that proposed by Chairman Eccles.

As he saw the matter there was only one point on which there was a substantial difference of opinion in this meeting and that was with respect to support of the rate on certificates. He did not think that was a question of economics but of strategy, on which he would say to the Treasury that if the expansion of bank credit could be stopped as a result of the first three steps proposed by Chairman Eccles, together with the proposal of legislation, it would not be necessary to support the rate as that would be done by the banks. If, however, the expansion of credit continued the question might arise whether, after the matter had been brought to the attention of Congress, it might not be better gradually to withdraw support and see what happened. He believed that the problem could be met step by step provided the System did not propose to the Treasury that the short-term rate be increased. He pointed out that an increase in the rate would not have its usual economic significance, because it would not be contemplated at this time that the System would use rates as a means of restricting credit, and, therefore, the System would not have the interest in a higher rate that it otherwise might have in an inflationary period. The steps which the Federal Reserve would propose would be for the purpose of preventing a further expansion of bank credit and, if they did not have that result, then would be the time to give consideration to an increase in the rate. If the problem were approached in that way, Mr. Goldenweiser did not believe the Treasury could have any objection. He did not think the Treasury should consider the problem primarily from the standpoint of the interest cost to the Treasury but from the standpoint of maintaining the long-term rate which was much more important in the public interest than the additional cost to the Treasury of some increase in short-term rates.

In this connection, Mr. Goldenweiser referred to the suggestion which he had made previously that as a means of turning back to the Treasury the surplus earnings of the Federal Reserve Banks the Board of Governors, under the provisions of the fourth paragraph of Section 16 of the Federal Reserve Act, prescribe a rate of interest to be paid by the Federal Reserve Banks on the amount of Federal Reserve notes outstanding less the amount of gold certificates held by the Federal Reserve agent as collateral for such notes.

Chairman Eccles questioned the desirability of this step for the reason that the funds received by the Treasury under this arrangement would not be applied as a reduction in the cost of the public debt but would be received into the general revenues of the Treasury and the Treasury would be more interested in a direct reduction in the interest cost of the public debt.

Mr. Sproul indicated a preference for the arrangement proposed by Mr. Goldenweiser rather than an issue of special certificates to the Federal Reserve Banks at a 1/8 per cent rate, and there was a discussion as to which of these suggestions would be the more desirable procedure.

Chairman Eccles expressed the opinion that the Federal Reserve should not commit itself to support the 7/8 per cent certificate rate, but that it should support that rate until it could be ascertained whether there was a better alternative, and that the Treasury should be told that the four proposals referred to above were one way of meeting the problem. He realized that the Treasury might not wish to take either course and that if Congress did not give additional authority with which to meet the situation there would be no other alternative except to raise rates.

Mr. Sproul thought we might be faced with that alternative before the outcome of the proposed legislation was known, and that, therefore, there should be no commitment that would tie the System's hands while the legislation was being considered.

Chairman Eccles stated that he would support the market until there was an opportunity to see what the attitude of Congress was with respect to the legislation but that if the time required for its enactment was too long the System would have to take action to increase short-term rates.

The meeting then recessed and reconvened at 2:30 p.m. with the same attendance as at the end of the morning session.

Mr. Thomas distributed copies of three memoranda entitled (1) Monetary and Fiscal Policies Toward Economic Stability, (2) Reserve in Treasury Bills and Certificates, and (3) Prospects for Bank Earnings (preliminary). These memoranda were discussed, particular consideration being given to the problem of bank earnings.

Chairman Eccles then stated that at his request Mr. Vest had prepared a resume of the statutory responsibilities of the Federal Reserve System in the credit field which it was thought would be of interest to the members of the executive committee. The memorandum, prepared under date of January 23, 1946, was read and Chairman Eccles stated that it served to emphasize that the System had a statutory responsibility in the field of credit, that that responsibility rested solely on the System in the exercise of its best judgment in the public interest, that the System would hot be relieved of responsibility because the Treasury did not want the System to take action which it believed in the exercise of its responsibility should be taken, and that, therefore, he felt that the System had a duty to present its position to the Secretary of the Treasury and say to him that as long as any action by the System did not increase the cost of the public debt the Treasury should not object and that the System should take such action.

Mr. Sproul said that the question of raising the short-term rate was the only point on which there might be a difference of opinion at this meeting, that it was possible that in the next few months the question whether interest rates should be increased would be the overriding consideration, and that to lay too much stress on the fact that there would be no change now or in the short-term or long-term future might compromise the System's position.

Mr. Williams renewed a suggestion made early in this meeting that, inasmuch as Secretary Vinson would not reach a decision on the problems involved without discussion with his own staff, it would be desirable for the Federal Reserve to initiate preliminary discussions between staff representatives of the Treasury and the System.

This suggestion was discussed and it was agreed that Chairman Eccles should call Secretary Vinson and suggest that he and Mr. Sproul meet with the Secretary at 2:30 o'clock on the afternoon of Wednesday, January 30; that if agreeable to Secretary Vinson arrangement would be made for staff meetings before that time; and that if the meeting with Mr. Vinson was arranged for the afternoon of January 30 the members of the executive committee would meet on the morning of that day for a preliminary informal discussion.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.