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, October 3, 1946, at 9:30 a.m.

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

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager of the System Open Market Account
Mr. Kennedy, Special Assistant to the Chairman of the Board of Governors
Mr. Musgrave, Chief of the Government Finance Section of the 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 June 10, 1946, were approved.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account during the period from June 10 to October 2, 1946, inclusive, as reported by the Federal Reserve Bank of New York to the members of the executive committee, were approved, ratified, and confirmed.

In accordance with the procedure followed by the Treasury, informal requests were made early in July, August, and September for the recommendations of the members of the executive committee with respect

to the program for the retirement of Government debt, and on July 8 and August 7, 1946, letters were sent to the Secretary of the Treasury over the signature of Chairman Eccles setting forth the views of the committee. In response to the request in September, the Fiscal Assistant Secretary of the Treasury was advised informally that the letter of August 7, 1946, expressed the current views of the members of the committee. The two letters referred to above, copies of which were sent currently to the Presidents of all of the Federal Reserve Banks, were as follows:

Letter of July 8, 1946.

"Mr. Bartelt asked whether there has been any change in the views of the executive committee of the Federal Open Market Committee since our letter of June 6 recommending that the entire issue of August certificates be redeemed for cash.

"The committee can see no reason to change the previous recommendation. The August certificates are almost entirely held by the banking system; of the 2.5 billion dollars outstanding, commercial banks hold 1.5 billion and the Federal Reserve Banks .8 billion. The retirement of this issue for cash would be particularly desirable, therefore, in view of its restrictive effect upon bank credit at a time when inflationary pressures are very strong.

"It has been suggested that only part of the August issue be retired for cash and that the balance be exchanged. To pay off part of the issue, however, would leave only a very small issue outstanding, since the total of the August issue amounts to but 2.5 billion dollars. We feel also that an acceleration of the debt retirement program is desirable at the present time when inflationary pressures are strong, because of its restrictive influence on bank credit. In addition, it would provide an interest saving to the Treasury. A further advantage, from a market point of view, in getting the cash balance down to a working level as soon as possible through retirement of debt is that it would bring to an end earlier the large fluctuations in the market which accompany operations of this kind.

"While there has been some change in the budget picture since our letter of June 6 and legislation pending would add to expenditures late this year and early next year to cover terminal leave payments to veterans, according to our latest estimates the Treasury would have a cash balance of over 8 billion dollars at the end of August after retirement for cash of the 2.5 billion dollars of August certificates. This balance would be large enough to meet Treasury needs and permit further debt retirement in September and October. Whether it would be possible to retire any debt after October would depend, of course, on the budget situation at the time.

"We appreciate having an opportunity to express our views on this matter."

Letter of August 7, 1946.

"As requested by Mr. Bartelt, I am pleased to give you the views of the executive committee of the Federal Open Market Committee with respect to the maturing September certificates and the debt retirement program.

"A vigorous debt retirement program would result in an interest saving to the Treasury and a reduction in the earnings of banks which are at high levels. By restricting further credit expansion, it would also be helpful in combatting the current inflationary pressures. We recommend, therefore, that 2.5 billion dollars of the September certificates and 2 billion of the October and November issues be redeemed for cash. We estimate that this would still leave an ample cash balance of from 2 to 3 billion dollars at the end of November.

"It is unnecessary for the Treasury to carry a large cash balance. The Treasury can go into the market at any time and borrow at low rates by offering additional certificates. The Federal Reserve stands ready to assure the successful flotation at existing rates of any amount that might be needed by the Treasury. There is practically no limit on the amount of outstanding securities that the Federal Reserve can purchase in the market thus enabling the Treasury to successfully raise funds if needed. In addition, the Federal Reserve can lend up to 5 billion dollars directly to the Treasury under the direct buying authority. In other words, the Treasury is in a flexible position to pay off debt or borrow according to needs, thus making it unnecessary to maintain a large cash balance.

"The debt retirement program is not inflationary--on the contrary, it has been mildly deflationary. The maturing

"securities that are being paid off are held largely by the banking system. Of the 12.2 billion dollars that have been paid off since the first of March, 6.5 billion were held by commercial banks, 2 billion by the Federal Reserve Banks, and 3.7 billion by nonbank investors. Of the 12 billion dollars which will mature between now and November 1, all but 2 billion are held by the banking system. The effect of the debt retirement program by classes of holders is as follows:

"1. Retirement of securities held by commercial banks. This reduces war loan deposits and bank holdings of short-term securities. It tends to check the sale of further short-term securities to the Federal Reserve Banks which expands bank reserves--the basis for credit expansion.

"2. Retirement of securities held by Federal Reserve Banks. As war loan accounts are drawn upon to redeem in cash securities held by the Federal Reserve Banks, member bank reserve balances with Federal Reserve Banks are reduced in a like amount. As a result, the lending and investing capacity of commercial banks is effectively curtailed. Banks are placed under pressure to meet this loss of funds and they are required to sell securities to or borrow from the Federal Reserve Banks. As a result, less short-term securities are likely to be sold to the Federal Reserve Banks for the purpose of reinvesting in longer issues.

"3. Retirement of securities held by nonbank investors. The securities being redeemed are held by large corporations and not by consumers who might spend the proceeds of redeemed securities. The corporations are in a highly liquid position and will hold the funds in the form of deposits or will purchase additional securities from the banking system. When the proceeds of the securities redeemed are deposited in commercial banks reserves are required against these deposits. This increase in reserve requirements curtails the investing and lending capacity of banks."

Upon motion duly made and seconded, and by unanimous vote, the two letters were approved and their transmission to the Secretary of the Treasury was ratified and confirmed. Mr. Sproul voted to approve the letters and to ratify and confirm their

transmission to the Secretary of the Treasury, but pointed out that he had been on vacation when the letter of August 7th was prepared and sent, and that, therefore, it represented the views of his alternate on the committee and did not necessarily represent his views.

Under date of July 30, 1946, a letter was sent to Mr. Morrill by Mr. Rouse in which he referred to his statement at the meeting of the executive committee on June 10 with respect to a possible application from Blair and Company, Inc., for reinstatement as a dealer with which the Federal Reserve Bank of New York would transact business in Government securities for the System open market account. The letter stated that the application (including a signed copy of the statement of terms upon which the Federal Reserve Bank of New York would transact business with brokers and dealers for the System account) had been received, that a report had been prepared on the firm copies of which were enclosed with the letter, and that it was recommended that in accordance with the procedure adopted by the Federal Open Market Committee in February 1944, the reinstatement of the firm as a qualified dealer be approved by the executive committee. Copies of the report enclosed in Mr. Rouse's letter had been sent to the members of the executive committee and it had been suggested that the application be held for consideration at a meeting of the committee.

In a discussion of the application at this meeting, the members of the committee reviewed the information contained in Mr. Rouse's

report with respect to the reasons for the removal of the company from the list of qualified dealers, the present satisfactory management of the firm which was in no way responsible for the conditions which resulted in the earlier removal, and the change in the ownership of the company including the present relationships with Transamerica stockholders, Pacific Coast Mortgage Company, and other shareholders.

Mr. Rouse stated that the president of the firm, J. C. Andersen, was an able and honest executive on whom entirely satisfactory current reports had been received from banks in New York, and that, while he was chiefly responsible for the operation of the company, the interests represented in the ownership of the stock were in the background and were influential in the operation of the concern. He also said the company operated on a high plane, doing a substantial volume of business in Government and other securities, and that, although during the recent decline in Government security prices it suffered some losses on its holdings of Government securities, the losses represented primarily a loss of profits made earlier in the year and not a capital loss of substance.

At the conclusion of the discussion, upon motion duly made and seconded, and by unanimous vote, the reinstatement of Blair and Company, Inc., as a qualified dealer was approved with the understanding that, because of all of the circumstances connected with the past record and organization of the firm, the Federal Reserve Bank of New York would follow its operations closely and report to the executive committee any

instance in which the management violated the terms and conditions under which the Federal Reserve Bank of New York as agent for the System account will contract business with qualified dealers.

In connection with the above matter, reference was made to the fact that D. W. Rich & Co., Inc., qualified as a dealer, and Chas. E. Quincey Co., qualified as a broker, to handle business for the System account, had continued to carry what in the opinion of the Federal Reserve Bank of New York were unduly large positions in Government securities and that although the Bank had repeatedly suggested that the positions be reduced the holdings of the two concerns continued to be relatively large. Consideration was given to what action should be taken in the circumstances, and it was suggested that, inasmuch as the concerns had failed to live up to the terms on which the Federal Reserve Bank of New York would do business with qualified brokers and dealers, they should be advised that they would be disqualified for further transactions for the System account.

Mr. Rouse suggested that they first be put on notice that unless the extended positions were corrected they would be disqualified.

Mr. Vest stated that under the terms of the Administrative Procedure Act there should be notice to the companies in writing and an opportunity afforded them to make the necessary correction before action was taken to discontinue them as qualified dealers. It was understood that Mr. Rouse would follow this procedure.

> Upon motion duly made and seconded, and by unanimous vote, it was understood that in situations of this kind, where it appeared that a broker or dealer failed to comply with the terms and conditions approved by the Federal Open Market Committee, the Manager of the System Account would forward a statement of the facts in each case to the Secretary of the Federal Open Market Committee and, in the absence of receipt of advice to the contrary from the executive committee within a reasonable time, the Manager would notify the broker or dealer in writing that unless the necessary corrections were made within a stated time (which would be sufficiently long to enable the broker or dealer to comply) he would be dropped from the list of qualified dealers.

Mr. Rouse then reviewed conversations which he had had on August 28 and September 25, 1946, with representatives of Harriman, Ripley & Co., Inc., a qualified dealer, during which the question was discussed whether the firm should continue in that capacity. Mr. Rouse said that on the latter date the representatives stated that they had given a good deal of consideration to the firm's Government securities business and that, in the absence of a senior partner who thoroughly understood the business and in the light of its preoccupation with corporate financing and the difficulty of obtaining the necessary personnel, it had been concluded that it would be unwise for them to develop the business beyond its present point. In view of these circumstances, Mr. Rouse said, the representatives felt that the company should withdraw from its position as a qualified dealer and inquired whether a letter should be written advising of the withdrawal. Mr. Rouse added

that he had informed the representatives that he would have an opportunity to discuss the matter with the members of the executive committee during the next week or two and that if such a letter seemed desirable that could be arranged.

> There was unanimous agreement that in the circumstances it was desirable for Harriman, Ripley and Company, Inc. to withdraw and that, upon receipt of a written request from the company, the Federal Reserve Bank of New York should advise the firm that its position as a qualified dealer had been discontinued.

Under date of May 1, 1946, the staff group on foreign interests, consisting of representatives of the staffs of the Board of Governors and of the Federal Reserve Bank of New York and, in this instance, of the Federal Reserve Bank of Philadelphia, submitted to the informal policy group consisting of Messrs. Eccles, Szymczak, and Sproul, a memorandum of recommendations with respect to the relationships of the Federal Reserve System to the Bretton Woods institutions. Some of the recommendations involved questions of open market policy and the memorandum had been placed on the agenda for the meeting of the Federal Open Market Committee for consideration of the comments of the staff group relating to (1) direct transactions in negotiable United States Government securities with the International Monetary Fund and International Bank for Reconstruction and Development, and (2) market stabilization operations, by the Federal Reserve Banks for their own account, in securities issued or guaranteed by the International Bank.

These questions were also on the agenda for this meeting of the executive committee for preliminary discussion prior to the meeting of the full Committee.

Mr. Sproul stated that the first question had already arisen, inasmuch as the representatives of the Bank had taken up with the Federal Reserve Bank of New York the possibility of investing $125 million of the Bank's funds in United States Government securities, and that after taking the matter up informally with the members of the executive committee the Federal Reserve Bank had sold $20 million of its certificate holdings directly to the International Bank.

It was the opinion of all of the members of the committee that such direct transactions with the Bank and Fund would be more desirable than to effect purchases and sales through the market.

> Upon motion duly made and seconded, and by unanimous vote, it was agreed to recommend to the full Committee (1) that it authorize direct transactions in Government securities for the System open market account with the International Monetary Fund and International Bank for the purposes stated in the memorandum from the staff group, and (2) that the memorandum from the staff group on foreign interests be studied by the members of the full Committee and placed on the agenda for consideration at the next meeting of the Committee.

In a discussion of the question whether the Federal Reserve Banks should engage in market stabilization operations for their own account in securities issued or guaranteed by the International Bank,

Chairman Eccles stated that representatives of the International Bank were very much interested in having a ready and favorable market for the Bank's securities, that sponsorship on the part of the Federal Reserve Banks would be of considerable assistance in that direction, but that, if the matter should come up for discussion at a meeting of the International Advisory Council, of which he was a member, he would state that the matter would have to be considered by the Federal Open Market Committee, and that he, personally, would be very much opposed to the Federal Reserve Banks engaging in such operations. It was his feeling that open market operations for the System account were conducted in the Government security market for the purpose of carrying out established System credit policies and Treasury financing policies and were not for the purpose of providing a special market for any other securities, and that if such operations were undertaken in the securities of the International Bank there would be no reason why the System should not perform a similar service in connection with the securities of the Federal Home Loan Bank Administration and the Farm Credit Administration, which the System had refused to do in the past.

In response to a request for any views that the other members of the committee might have on the matter, Mr. Sproul stated that he and Mr. Szymczak favored approval of all of the recommendations contained in the memorandum of the staff group on foreign interests, but on the question of market stabilization operations by the Federal

Reserve Banks in securities of the International Bank, on which the staff group had submitted the pros and cons but had made no recommendation, he and Mr. Szymczak were of the opinion that such operations should not be undertaken. He also said that in his opinion the securities of the International Bank did not need assistance of this kind from the Federal Reserve Banks and that it would be better if they were placed on the market without such support.

Chairman Eccles stated that the International Bank might request the Federal Reserve Banks to assist in the distribution of its securities and that, in his opinion, the System should not be in a position of underwriting or sponsoring these securities, as that would also set a precedent for similar service in connection with securities of the Farm Credit Administration or any other Government agency that might be issued in the future. It was his view that the securities of the International Bank should be distributed in the same manner as other private issues.

In this connection, Mr. Sproul referred to the recommendation of the staff group that if the International Bank should arrange for a direct offering of its debentures, the Federal Reserve Banks, as fiscal agents for the Bank, should be prepared to receive subscriptions, subject to allotment, from banks, dealers, and the general public. He said that it would be desirable for the Federal Reserve Banks to render this service if it were made clear that they were not acting in any way as underwriters or sponsors of the securities.

Chairman Eccles stated that another aspect of this matter was the question whether the securities of the International Bank should be considered as being eligible for purchase by national banks as investment securities. It was the consensus of the members of the committee that the Comptroller of the Currency should rule that the securities were eligible for bank investment, but that banks should not be encouraged by those in supervisory positions to purchase them.

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

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.