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 Tuesday, December 9, 1947, at 10:00 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. Szymczak
Mr. Draper
Mr. Evans
Mr. Vardaman
Mr. Clayton
Mr. Whittemore
Mr. Gidney
Mr. Peyton
Mr. Gilbert (alternate for Mr. Davis)

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Neal, Thompson, Stead, and John H. Williams, Associate Economists
Mr. Rouse, Manager of the System Open Market Account
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Arthur Willis, Special Assistant, Securities Department, Federal Reserve Bank of New York

Messrs. Alfred H. Williams, Young, and Leedy, alternate members of the Federal Open Market Committee

Messrs. Leach and Earhart, Presidents of the Federal Reserve Banks of Richmond and San Francisco, respectively

Messrs. Clark and Hitt, First Vice Presidents of the Federal Reserve Banks of Atlanta and St. Louis, respectively

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on October 6-7, 1947, 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 meetings of the executive committee held on October 6-7 and 14, 1947, were approved, ratified, and confirmed.

A report of open market operations during the period October 7, 1947, to December 3, 1947, was read and commented upon by Mr. Rouse. He also presented a supplementary report covering transactions executed on December 4, 5, and 8, 1947. Copies of these reports have been placed in the file of the Federal Open Market Committee.

Mr. Rouse stated in connection with his report that the recent period had been a very difficult one from the standpoint of handling open market operations, that on two or three occasions, because of psychological factors, the market was dangerously close to an avalanche of selling, but that it was to be expected that there would be a considerable amount of selling while the present unsettling influences, including discussions of possible anti-inflation measures, continued.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account for the period October 4 to December 8, 1947, inclusive, were approved, ratified, and confirmed.

Chairman Eccles stated that he felt there should be no concern about the substantial amount of selling of Treasury bonds that had taken place, that the Committee had been anticipating for a long time that yields on long-term bonds should increase, and that to whatever extent action in raising short-term rates had contributed to this development it represented a step toward the objectives of open market policy during recent months. He felt, however, that the increase in short-term rates was a negligible factor and that because of increased opportunities for investment and great demands for capital funds there would have been pressure on the long-term market if nothing had been done to increase the short rate.

He also referred to retirement of securities held by the Federal Reserve Banks as a further cause of pressure on the banks to sell Government securities to the Reserve Banks to provide needed reserves. He stated that the commercial banks apparently were selling long-term and buying short-term issues, and that the fact that there had been a net decrease in the System's holdings of securities was evidence of the fact that on balance the commercial banks were not "running away" from Government securities but rather that the policy of the System of keeping the banks under pressure was having the desired effect of causing them to reverse the practice that they had been following for a considerable period of selling short-term and buying long-term issues.

Chairman Eccles questioned whether the System, through the purchase of unrestricted issues and the Treasury by the purchase of restricted issues, should continue to maintain existing prices of Treasury bonds, thereby providing an opportunity to holders to sell securities at a substantial premium, and outlined reasons why it would be better to permit the prices of such securities to decline to a level nearer par.

Mr. Sproul agreed that selling of Governments would continue as long as there was a gap between savings and the demand for funds. He felt that if, by a combined program of debt management and Federal Reserve action the purchase by the System of long-term issues could continue to be offset by the sale of short-terms, it would be a very successful operation in terms of the situation that the System has been facing. He was of the opinion that the level of market prices of securities was not a question of how much profit might accrue to banks and other holders but of how the System could continue to exercise its influence so that this selling of long and buying of short Governments might continue without accelerating the fears of holders to a point at which there would be selling of Government securities at a rate which would force the System to put an excessive amount of funds into the market. He stated that, while he favored bringing the prices of bonds down, it should not be done at the risk of bringing about a fear psychology that would affect adversely Treasury financing operations, the System's credit program, and the confidence in Government securities of a wide variety of holders.

In the course of a discussion of the considerations entering into a determination of the level at which prices of Treasury obligations should be supported and the timing of changes in existing support levels, it was suggested that, as was to be expected, the present discussions in Congress and in committee hearings of various proposed methods for combating inflation were resulting in a sensitive and unsettled Government securities market, and that for that reason it might be better to defer any change in the present support program until the latter part of December, when prices could again be lowered.

During this discussion Messrs. Vardaman and Vest left the meeting to attend the argument before the Supreme Court of the Bank of Lakewood Village case in which the Board of Governors is involved.

Mr. Thomas presented briefly the possible effects on the market of debt retirement through the first quarter of 1948 and commented on a chart showing the yields on various restricted and unrestricted issues of Government securities on December 30, 1944, April 6, 1946, August 29, 1947, and December 1, 1947, and on the possible effects of a further increase in the short-term rate and what if any spread there should be between restricted and unrestricted and between other individual issues of Government securities.

Chairman Eccles renewed his suggestion that the market should be permitted to decline nearer to par on the long-term issues even if it did result in increased selling to the Federal Reserve Banks. He felt that System purchases would be less if that procedure were followed than would otherwise be the case. In this connection he expressed the view that the System should not purchase any additional amounts of partially tax exempt issues but that they should be permitted to find their natural level in relation to other issues.

Mr. Rouse commented that these issues had been acquired only when they had declined to a level when they were clearly out of line with prices of other issues.

Mr. Sproul stated that the problem was whether Government security prices should be permitted to decline further while the market was subject to the disturbing influences of current discussions of measures to combat inflation or whether the present program should be continued until the market had steadied to a point where a resumption of a downward movement could be undertaken without encouraging selling throughout the list in addition to selling for the purpose of meeting demands for reserve funds.

Chairman Eccles said he agreed that action to allow market prices to decline should not be taken immediately but that the Committee should recognize that, because of the retirement of debt out of Treasury cash balances and other factors which would put pressure on the market, there would be continuous selling of securities over the next several months and the System should not be disturbed by a situation it had intentionally helped to bring about.

Mr. Sproul responded that the Committee need not be disturbed by that situation but by the temporary situation that might encourage unnecessary liquidation in addition to the selling referred to by Chairman Eccles. There was not a difference in approach, he said, but a question when the downward movement should again be resumed.

Mr. Rouse expressed the view that it was a question whether the Committee should run the risk of panicky conditions in the Government securities market for the benefit of a 3/8 or 1/2 per cent decline on the restricted 2-1/2's and he questioned whether such a move was worth that risk. He agreed that the market should be placed on a lower level at the first opportunity without incurring such a risk.

Chairman Eccles stated he had discussed the matter with Under Secretary Wiggins, who also questioned the desirability of maintaining existing premiums on bank eligible securities.

Mr. Thomas suggested that, if action to reduce the level of prices were not taken now, there might not be another opportunity over the next four months because of pressures resulting from retirement of Government debt.

Mr. Rouse stated that if prices were to be reduced the decline should take place quickly.

After some further discussion of the timing of action and of the undesirability of permitting banks and other holders to realize substantial premiums on their holdings of securities, Chairman Eccles questioned whether, since it was recognized that insurance companies, savings banks, and other investors would be forced to sell bank eligibles to meet more favorable investment demands, the System should make it possible for them to sell at substantial premiums rather than to make a downward adjustment quickly and put real support under the market at the lower prices agreed upon. He recognized that the argument would be made that, while anti-inflation measures were being debated in the present special session of the Congress, there was greater uncertainty in the market than otherwise would be the case, and that probably after the session had recessed the market would be quieter and provide a better situation in which to act.

He said that if the System could get through the period of the special session with purchases of between one and two hundred million of securities a week action might be deferred that long at which time if there was continued selling, indicating an opinion in the market that the System would not support existing rates, he would favor letting the market decline immediately. He felt strongly that action should not wait as long as four months and Mr. Sproul agreed that it was not a question of waiting for any such period but of choosing our time in the immediate future.

There was a discussion of the suggestion that the market be allowed to decline 1/32 or 2/32 before Congress recessed which might make for an easier adjustment later and Mr. Rouse expressed the view that that would result in increased selling to avoid further declines in price and that it would be better to be prepared to let prices decline by 1/4 or more of a point at one time.

There was general agreement with the suggestion that there would be less selling if the market were held at the present level until action was taken to let prices fall immediately to a point at which they would be aggressively supported than would be the case if prices were allowed to go off more gradually.

At this point Mr. Thurston, Assistant to the Chairman of the Board of Governors, joined the meeting.

During a discussion of these alternatives and of the point to which prices should be allowed to decline it was suggested that the restricted 2-1/2's should be held at par or slightly above and that the rest of the market should be allowed to find its level in relation to that price and the 1-1/8 per cent certificate.

Mr. Szymczak inquired whether there had been any discussion with representatives of the Treasury of the question whether any issues should be allowed to decline below par, and it was agreed that before a decision was made on this point it should be taken up with the Treasury.

At the conclusion of the discussion, it was agreed that, in the event the market continued substantially as at present, the executive committee should carry out the existing policy with respect to support of the market until after the Treasury's January refunding had been completed, at which time prices of bonds should be permitted rapidly to decline, if the market did not support itself, to a level of not more than 100-1/2 and not less than par on the longest restricted 2-1/2 per cent issue and to not less than par on a 1-1/8 one-year certificate. If, in the interim, market selling should increase substantially, the executive committee would be authorized to permit prices to decline as rapidly as was consistent with the maintenance of orderly market conditions. If it should appear in carrying out these instructions that some issues of bonds might go below par, the Committee would be authorized, after consultation with appropriate representatives of the Treasury, to determine whether these issues would be allowed to decline below par or whether they should be held at or above par.

Chairman Eccles then reviewed the seven point program outlined at the meeting of the Federal Open Market Committee on October 7, 1947, stating that a letter setting forth the program had been sent to the Secretary of the Treasury under date of October 14, 1947. With respect to specific steps in the program, he stated that the Treasury had accepted the Committee's recommendations as to Treasury financing during the remainder of this year, that the Treasury was following the recommendations with respect to transfers of funds from war loan deposit accounts to the Federal Reserve Banks, that the statement stressing the dangers inherent in an excessive expansion of consumer credit and urging the adoption of self-imposed restraints had been issued by the Board and each Federal Reserve Bank, and that a joint statement from the bank supervisory agencies relating to credit extensions had been prepared, issued, and favorably received. He went on to say that the only parts of the program which had not been put into effect were (1) an increase in discount rates at the Federal Reserve Banks, (2) an increase in reserve requirements for central reserve city banks, and (3) the proposed policy with respect to refunding maturing savings bonds.

Chairman Eccles stated that the Board of Governors had given consideration at a recent meeting to action to be taken to increase the discount rates at the Reserve Banks and felt that they should be increased to 1-1/4 per cent within the near future. He went on to say that he and Mr. Sproul had had an exchange of correspondence on the question whether the discount rate should be raised to 1-1/8 or 1-1/4 per cent, Mr. Sproul taking the position that the increase should be to 1-1/8 per cent and he taking the position that it should be to 1-1/4 per cent.

The reasons which Chairman Eccles and Mr. Sproul gave for their respective positions were discussed and the effect of an increase in rates to either suggested level and of its timing was considered in the light of conditions existing in the Government security market and the possible effects upon System open market operations. It was the consensus of those present that, for the reasons discussed, an increase in discount rates should be deferred until after the announcement of refunding of Treasury securities maturing in January and that action might be taken by the Banks in time for approval by the Board on Friday, December 19, 1947, for announcement after the market closed, to become effective on Monday, December 22.

The meeting then recessed and reconvened at 2:30 p.m. with the same attendance as at the end of the morning session except that Messrs. Vardaman and Vest were present and Mr. Thurston and Mr. Stead were not in attendance.

During a discussion of the program to be followed with respect to the retirement of the Government debt, including the retirement of securities held by the Federal Reserve Banks, there was distributed a copy of a memorandum prepared in the Division of Research and Statistics of the Board of Governors under date of December 4, 1947, on the financing outlook. The memorandum stated that the Treasury cash balances during the period December 1, 1947, through June 30, 1948, would be large enough to permit the retirement of $100 million of bills each week through the first week of January and $200 million a week thereafter through May and that if full exchange were offered for every maturing issue of certificates and bonds during that period it would be possible to retire System holdings of these maturing issues except in June. If this program were followed, there would be a retirement of $4.9 billion of certificates and bonds and $4.7 billion of bills, all but $800 million of which would be held by the Federal Reserve Banks.

Chairman Eccles expressed the opinion that in view of the changing situation it would be desirable for the full Committee not to plan too far ahead but to authorize the executive committee, depending on the amount of Treasury balances available, (1) to retire Federal Reserve holdings of maturing securities during the first quarter of 1948, including $100 million of bills through the first week of December and $200 million a week thereafter, (2) to propose to the Treasury the refunding of the remaining certificates and bonds maturing in that period into 12- to 14-month securities which would have a proper relationship to a 1-1/8 per cent one-year certificate, unless in the meantime it should become evident (which was not expected) that a higher rate would be desirable, and (3) to recommend, in consultation with representatives of the Treasury, the amounts to be held in Treasury war loan accounts during the period.

Messrs. Sproul and Rouse questioned whether the entire amount of System holdings of January 1 and February 1 certificates should be retired and whether the program of retirement of System holdings should be as rapid during the first quarter of 1948 as Chairman Eccles had proposed. Mr. Rouse stated that it might be found, after careful analysis, that the situation in the market would be such that it would be desirable to pay off some of the February certificates and March 15 bonds held outside the Federal Reserve Banks and thus relieve the pressure on the market resulting from March tax payments, and that it would be desirable to examine the situation from week to week to determine what the program should be.

In a discussion of his suggestion, Mr. Rouse stated that he agreed that the program followed should be one of keeping unremitting pressure on the reserve position of member banks during the first six months of 1948, with the exception of a short period around the first of February when he would put funds back into the market to relieve the extreme pressure which would exist at that time.

The matter was also considered in the light of the possible return flow of currency following the year end and of further gold imports.

Chairman Eccles indicated that he would not be willing to follow Mr. Rouse's suggestion unless action were also taken by the Board of Governors during the period to increase reserve requirements of banks in central reserve cities.

The proposal was made that, because of the substantial changes in the situation that might occur before another meeting of the full Committee, the best procedure to follow would be to have a general understanding with respect to the program which the executive committee would follow. This suggestion was agreed to unanimously and it was understood that, in carrying out the direction of the full Committee with respect to operations in the System account, the executive committee, in consultation with representatives of the Treasury, would follow a program of retirement of Federal Reserve Bank held securities, and submit recommendations to the Treasury with respect to the maintenance of Treasury balances in the war loan accounts and with the Federal Reserve Banks which, in the judgment of the executive committee in the light of conditions as they develop during the period, would be appropriate to keep pressure on the market and utilize to the best advantage the large Treasury cash balances that would be available during the period.

In a discussion of the authority to be granted by the full Committee to the executive committee Mr. Rouse suggested that because of conditions that would prevail in connection with Treasury refunding operations and tax collections it would seem desirable that the executive committee have authority to increase or decrease the amount of securities held in the System account by as much as $3 billion.

After a discussion of this suggestion, upon motion duly made and seconded, and by unanimous vote, the following direction to the executive committee was approved with the understanding that the limitations contained in the direction would include commitments for the System open market account:

> The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), as may be necessary, in the light of the general credit situation of the country, for the practical administration of the account, for the maintenance of stable and orderly conditions in the Government security market, and for the purpose of relating the supply of funds in the market more closely to the needs of commerce and business; provided that the aggregate amount of securities held in the account at the close of this date other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury shall not be increased or decreased by more than $3,000,000,000.
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> The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase for the System open market account direct from the Treasury of 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 $1,500,000,000.

Chairman Eccles stated that, in accordance with the action at the last meeting of the Federal Open Market Committee, the executive committee at its meeting just prior to this meeting agreed to propose to the full Committee that it approve the following recommendation which had been made by Messrs. Rouse and Smead, Director of the Division of Bank Operations of the Board of Governors, with the understanding that (1) the complete details would be worked out and the changed procedure would be put into effect on January 1, 1948, and (2) a full written statement of the procedure would be submitted at the next meeting of the executive committee and the Federal Open Market Committee for ratification:

1. That interest bearing securities in the Account be allocated at the first of the year on the basis of the expense and dividend ratio of each Bank as against all the Banks; that this allocation be the only one for the year; and that the same basis of allocation continue in use. However, profits and losses on interest bearing securities would continue to be allocated on the basis of the average holding ratio for the preceding five years.

2. Holdings of Treasury bills would likewise be allocated on the expense and dividend ratios to the extent that the several Reserve Banks were able to acquire such securities within the limits of maintaining the reserve ratio of 35 per cent or such other percentage as the Committee may determine. Profit and loss on Treasury bills would be allocated on the basis of the current Treasury bill holding ratio of each Bank as of the day profit or loss is realized.

Chairman Eccles also said that the executive committee would recommend that the executive committee be authorized, should circumstances develop between meetings of the Federal Open Market Committee requiring some adjustment in the allocation procedure, to take such action as appeared to be desirable pending the next meeting of the Committee.

In discussing the recommendation Mr. Rouse stated that an effort had been made to simplify the procedure of allocation and make it more understandable to those who have to deal with it only occasionally and to reduce the amount of work involved in carrying out the allocations.

> Upon motion duly made and seconded, and by unanimous vote, the recommendations of the executive committee were approved.

Mr. Leedy suggested that consideration be given to adopting a procedure of allocation that would tend to equalize the surplus accounts of the Federal Reserve Banks in relation to their paid in capital accounts.

Chairman Eccles stated that, in accordance with action taken at the meeting on October 7, the executive committee had discussed the proposal made in a memorandum from Mr. Rouse to Mr. Sproul under date of September 30, 1947, that the authority given by the Federal Open Market Committee to the Federal Reserve Banks to purchase Government securities under resale agreements be restored, and that, while it had not reached agreement as to the action to be taken, the executive committee had approved unanimously a suggestion that a memorandum be prepared which would state fully the reasons that might be advanced for and against action by the Federal Open Market Committee granting the authority, that the memorandum be sent to all members of the Federal Open Market Committee before the next meeting of the executive committee, and that the recommendation be made at this meeting of the full Committee that the executive committee be authorized to grant the authority if, after consideration of the reasons for and against such action, the committee felt at its next meeting that the authority should be granted.

> Upon motion duly made and seconded, and by unanimous vote, the recommendation of the executive committee was approved.

It was tentatively agreed that the next meetings of the Federal Open Market Committee should be held on February 27 and March 1, 1948, with the understanding that the next meeting of the Presidents' Conference would be held in Washington on February 24-26, 1948.

Chairman Eccles stated that the matters which had been discussed at this meeting were of very great importance from the standpoint of their possible effects on the Government security market, that there were many people who would like to know the actions the Committee proposed to take, and that it would be very unfortunate if anyone present should talk about or make any statement in connection with the Committee's discussions which would disclose in any way the nature of the discussions. Accordingly, he suggested that everyone present be on his guard not to make any statements, inadvertent or otherwise, which might give any indication of what the future policies of the System might be with respect to open market operations or discount rates.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.