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 Friday, July 21, 1950, at 9:35 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Evans
Mr. C. S. Young
Mr. Vardaman (alternate for Mr. Eccles)
Mr. Davis (alternate for Mr. Sproul)

Mr. Szymczak, Member of the Federal Open Market Committee

Mr. Carpenter, Assistant Secretary
Mr. Thomas, Economist
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman, Board of Governors
Mr. Ralph A. Young, Director, Division of Research and Statistics, Board of Governors
Mr. Kenyon, Assistant Secretary, Board of Governors
Mr. Youngdahl, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Arthur Willis, Special Assistant, Securities Department, Federal Reserve Bank of New York

Chairman McCabe stated that this meeting had been called for the purpose of considering what action should be taken by the executive committee in the light of the policies agreed upon at the last meeting of the Federal Open Market Committee and the conditions growing out of developments in the international situation.

In this connection, he reported that hearings would be held beginning next week before the Banking and Currency Committees on bills to carry out the recommendations of the President for new legislation needed to meet the present emergency and that it appeared that if the authority were given to the President to regulate consumer credit and to revive the Regulation V program those authorities would be delegated by the President to the Board of Governors. There was also a possibility, he said, that authority to regulate real estate credit would be placed in the Board. He added that the Board had been asked to submit a statement on these matters to the Banking and Currency Committees and that it had been arranged for Mr. Evans to be available at the hearing before the House Banking and Currency Committee next week to answer questions on consumer credit and the V-loan program. The Chairman went on to say that a very preliminary draft of the Board's statement had been prepared and a copy sent to Mr. Symington, Chairman of the National Security Resources Board, and Mr. Sawyer, Secretary of Commerce, who were to be Government witnesses at the hearing.

The Chairman then referred to the reply received from the Secretary of the Treasury under date of July 17, 1950, to the letter sent to him under date of July 12, 1950, relating to Treasury financing. The reply, copies of which were sent to the Presidents of all of the Federal Reserve Banks on July 17, 1950, read as follows:

"Thank you very much for your letter of July 12, expressing your thoughts and those of the Executive Committee of the Federal Open Market Committee with respect to new financing and the current situation in the Government bond market.

"As I asked Mr. Bartelt to transmit to the Open Market Committee on June 26, I feel that everything possible should be done to maintain a basically strong position in the Government bond market during the present period of international disturbance. The firmness with which the market has withstood the impact of the events of the past three weeks is certainly a testimonial to good management. It is also the best possible evidence of the confidence which has been built up in our ability and determination to maintain a stable market for Federal securities.

"I know you will agree with me that it is of the utmost importance at the present time to maintain that confidence and, in addition, to do everything possible to strengthen it. This involves, first of all, avoiding any course which would give rise to a belief that significant changes in the pattern of rates were under consideration. The operations of the Open Market Committee since the beginning of the crisis have been well adapted to this end.

"As I have studied the situation, I have become convinced that present circumstances call for one further precaution which is, perhaps, of even greater importance than maintaining a good balance in current market operations. In my view, we must take extreme care to avoid introducing any factor which would run the risk of producing unsettlement in the broad market for Federal securities represented by investors throughout the Nation. It is my belief, in particular, that no new financing program should be undertaken at the present time without maximum assurance that it will be well received and can be carried through to a successful conclusion.

"Our future tasks, whatever they may be, would be made very much more difficult by anything less than 100 percent success in a program for raising new money. In my judgment, we can not attain the maximum assurance of success until the outlook with respect to both the international and the domestic situations has become considerably more clarified.

"At present, the defense needs which may have to be financed in the near future are not known. Our expectations as to revenues are also subject to considerable change as the situation develops. For these reasons, as you know, I recommended that the Congress postpone action on the tax bill now under consideration in the Senate Finance Committee. The same basic considerations lead to my strong belief that no new financing program whose reception is to any considerable extent unpredictable should be introduced into the market at the present time.

"There are, of course, occasions which call for quick and bold action. These occasions have occurred with respect to the Federal security market and they may occur again. But every appraisal of the present situation indicates that the maintenance of stability should take priority over all other market considerations. A stable and confident situation in the market for Federal securities is our first line of defense on the financial front, no matter what may be ahead of us.

"As you know, developments in the Government bond market have repercussions which fan out through the entire economy. Both the size and the wide distribution of the Federal debt are unprecedented in comparison with the situations which faced us at the start of other periods of crisis. Under these circumstances, we have an obligation of the highest order not only to maintain the finances of the Government in the soundest possible condition, but also to fulfill our responsibilities to the millions of Federal security holders throughout the Nation.

"There is one further consideration which confirms my view that the present situation calls in the highest degree for caution and prudence. During the present stage of the emergency, it is vital to make use of every opportunity for assuring our citizens that those at the head of their Government have a strong and steady hand on the helm. The response of the Nation to the President's courageous action in the Korean crisis was one of the greatest demonstrations of unity that we have ever had in this country. The Nation is now waiting to learn what domestic programs may be needed in order to utilize our full strength in the interests of national defense. When these programs are brought "forward, it will take time for the public to assimilate them. In view of these facts, it is of the utmost importance that no action be taken at the present time which could be construed in any sense as anticipating proposals for defense which may later be outlined by the President.

"In short, every circumstance at the present time calls for steadiness and manifest strength in the Federal security market as a primary measure of economic preparedness. That is the net of the situation as I see it. And, as you will note, I am sending my thoughts on to you just as they have occurred to me, in order to let you know the course of my thinking as events unfold."

On July 19, 1950, Chairman McCabe sent to the President of each of the Federal Reserve Banks a telegram requesting his views and the views of the member of the Federal Advisory Council from his district on whether, in the light of developments in the international situation, any change should be made in the recommendations of the Committee to the Treasury with respect to Treasury financing. The telegram was read at this meeting and copies of a summary of the replies thereto were distributed and discussed. A majority of the responses were to the effect that the committee should continue to recommend that the Treasury issue a nonmarketable tap issue. Two Presidents, however, suggested a restricted marketable bond and one proposed that the limit on F and G bonds be raised and that the term be extended. One suggested that recommendations be deferred pending a test of restrictions of the President's program and presentation of tax proposals.

Chairman McCabe stated that even under the program of enlarged spending recommended by the President on July 19, it would be two or three months before the Treasury would require any substantially larger amounts of funds than those contemplated before the Korean incident, and that, therefore, the present offered an excellent opportunity to test out the nonmarketable issue which had been recommended to the Treasury. On that basis, he said, and on the basis of the telegrams received from the Presidents of the Federal Reserve Banks, a draft of another letter to the Secretary of the Treasury had been prepared for consideration at this meeting.

There was a discussion of the possible size of the Treasury deficit during the current fiscal year and of the reasons that might be advanced for offering a long-term restricted marketable bond and why, particularly in the light of the possible pressure for a return to the pattern of financing followed during the last war, it would be desirable to meet the needs of the Treasury to the fullest extent possible by the issuance of nonmarketable securities.

During the discussion Mr. Rouse stated that the demand for long-term securities was becoming more general and that, in the absence of some announcement by the Treasury with respect to the securities to be offered in the long-term area of the market, it would not be possible, by continuing System sales, which had been in increased amounts lately, to keep the prices of existing long-term issues from going higher if it was decided to peg the short-term end of the market. There was general agreement with the view expressed by Mr. Rouse.

Reference was also made to the advice which would undoubtedly be given to the Treasury from other sources as to the desirability of a restricted or fully marketable bond and to the belief that the Treasury should not commit itself to undertake future long-term financing only in the form of a nonmarketable tap issue.

After consideration of the possible market effects of various forms of financing, the draft of letter to the Secretary of the Treasury was read and discussed and a number of changes were suggested. During the discussion, Messrs. Riefler, Thurston, and Thomas withdrew from the meeting to redraft the last part of the letter and the discussion turned to what action should be taken in the open market in the event the Treasury was not willing to offer the proposed nonmarketable bond.

Mr. Rouse stated that inflationary pressures had been sharply increased by recent international developments, that it would require some time to get the program of the Government for meeting this situation into operation, and that in the meantime there should be action on the part of the Federal Reserve System and the Treasury to assist in counteracting these increasing pressures. He pointed out that if the proposed letter were sent to the Secretary of the Treasury he probably would not be willing to make a decision on the financing until after his meeting with the Committee on Government Borrowing of the American Bankers Association, scheduled to be held on August 9 and 10, and that, if any action was to be taken by the executive committee to increase short-term rates, a decision should be reached before that date in order not to interfere with the September financing. If action were not taken by that time, he said, it would not be possible to move toward higher short-term rates until after the October financing was out of the way. Accordingly, he said, there should be a prompt reply from the Secretary of the Treasury to the proposed letter from the committee and an early discussion with him of what the program is to be. Mr. Rouse also emphasized the view that until there was a better balance between long and short-term rates there should be no commitment with respect to any pattern of rates other than to assure the success of a particular offering.

Chairman McCabe stated that he had discussed the financing with Secretary Snyder by telephone and would meet with him either Friday of next week or on Monday of the following week.

During the ensuing discussion of the responsibilities of the Federal Open Market Committee in the existing situation, Messrs. Riefler, Thurston, and Thomas returned to the meeting with the revised draft of letter to the Secretary of the Treasury.

Upon motion duly made and seconded and by unanimous vote, it was agreed that a copy of the draft of letter should be handed to each member of the executive

> committee, that the members of the committee would advise not later than Monday, July 24, of any changes that they felt should be made in the draft, and that Chairman McCabe would present the letter at his conference with Secretary Snyder.

Reference was made to a telegram just received by the Board of Governors from the Federal Reserve Bank of New York in which it was stated that the directors had voted to increase the discount rate of the Bank on discounts and advances under sections 13 and 13a of the Federal Reserve Act from 1-1/2 to 1-3/4 per cent. The members of the Federal Open Market Committee present indicated the view that no action should be taken by the Board of Governors to approve the increase, at least until after further discussions with the Treasury.

There was also agreement that, pending the discussions with the Secretary of the Treasury, no change should be made in the current understandings with respect to the short-term rate or the sale of long-term securities from the System open market account, except that it would be expected that while the Federal Reserve Bank of New York might increase sales of long-term bonds somewhat to meet the increased demand, it would not be possible through that means to keep prices in the long-term market from rising.

Thereupon the meeting adjourned.

S R Carpenter
Assistant Secretary.

Thomas B. McCabe
Chairman.