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, D. C., on Friday, August 18, 1950, at 11:10 a.m.

PRESENT: Mr. Sproul, Vice Chairman
Mr. Davis
Mr. Draper
Mr. Eccles
Mr. Erickson
Mr. Evans
Mr. Peyton
Mr. Szymczak
Mr. Vardaman
Mr. C. S. Young

Mr. Morrill, Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. John H. Williams, Associate Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Kenyon, Assistant Secretary, Board of Governors
Mr. Ralph A. Young, Director, Division of Research and Statistics, Board of Governors
Mr. John Wurts, Assistant Vice President, Federal Reserve Bank of New York

Mr. Sproul stated that Chairman McCabe was returning from Maine but that word had been received that his plane had been delayed by weather conditions and that he had requested that the meeting proceed.

Upon motion duly made and seconded and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 13-14, 1950, 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 June 14, July 10, and July 21, 1950, were approved, ratified, and confirmed.

Upon motion duly made and seconded and by unanimous vote, the following letter sent to the Secretary of the Treasury under date of July 31, 1950, with the approval of the individual members of the executive committee, was approved and its sending was ratified and confirmed:

"The executive committee of the Federal Open Market Committee has given consideration to your letter of July 17, 1950, in reply to mine of July 12, 1950, which outlined the serious problems now faced by the Federal Open Market Committee in maintaining an orderly market for Treasury financing. My letter explained why, in our judgment, it was urgent that the Treasury make an early announcement that it had decided to raise funds by means of a long-term 2-1/2 per cent nonmarketable issue on a tap basis.

"The views expressed in your letter show concern that no move be made in the Government security market which would disturb confidence at this critical juncture. We share this concern.

"We think it will greatly contribute to confidence in the value of the dollar and hence in Government bonds to offer such a tap issue. It would signalize the Government's purpose to rely primarily on nonbank financing, thus avoiding as far as possible resort to the highly inflationary process of financing through the banking system. Experience has shown that it is not technically difficult for the Treasury to raise money by selling securities which are either bought directly or indirectly by banks, provided the Federal Reserve supplies banks with the necessary reserves. The market and "the public are now fully educated to these technical possibilities and they know that a procedure of this sort feeds the fires of inflation.

"In our judgment, every development in the economic situation and the international situation since our letter of July 12 reemphasizes what we said at that time, particularly in paragraph four. It seems more urgent than ever that an early announcement be made of the offering of the long-term bond of the type suggested. We think it will give confidence to the market at this stage. It will constitute notice both to the market and to the country that the Government intends to back up its anti-inflationary tax and other programs by financing its requirements as far as possible with nonbank funds. There is no more effective way to meet these requirements with a minimum of inflationary impact on the economy and also with less repercussion on the level of interest rates.

"After consulting the presidents of the Federal Reserve Banks last week, we are confident that funds will be available for the purchase of such bonds in substantial amounts. This is particularly true if the issue is continued on tap over the period of emergency. As defense expenditures mount and avenues of peacetime investment are cut back, investment funds will pile up in the hands of institutional investors who will welcome an outlet for these funds such as we have suggested. If the Treasury makes provision to tap these funds from day to day as they accrue, there will be less pressure to undertake huge bond drives, which necessarily involve a temporary congestion in the market as well as a large amount of indirect bank financing. Inevitable public discussion of the fiscal policies of the Government and the absolute size and rate of increase of the debt during drives do not make for confidence.

"We do not mean to imply that a tap nonmarketable issue should be the sole medium of Treasury financing during the emergency which lies ahead. We regard it, however, as important to the maintenance of public confidence in the value of money and as the instrument of Treasury financing particularly appropriate to a situation in which normal investment outlets are being curtailed.

"The period immediately ahead will be a critical one due to the time which will inevitably be consumed in the legislative processes and in the creation of the administrative organization needed to bring into operation the necessary controls. In the interval the stimulation of private spending, "already out of hand, will be accelerated. The President has stated in his Midyear Economic Report to the Congress that we should rely in major degree upon fiscal and credit measures, and that the more prompt and vigorous we are with these general measures, the less need there will be for comprehensive direct controls. We share a joint responsibility to cooperate with respect to credit and debt management policies and it is in these two fields that positive and effective action can now be taken to meet the international crisis and its economic effects. The nation at large has received the President's program in the same spirit with which it acclaimed the President's vigorous reaction to the military crisis posed by the invasion of Southern Korea. We are confident that prompt purposeful action by the Treasury and the System in furthering the same objectives would receive the same wholehearted support.

"In our judgment, the problem of new financing for the Treasury will not soon abate. We must face the long-run implications to the stability of the American economy and the welfare of the American people of the methods of financing we adopt in this critical period. Logic, as well as the bitter experience of recent years, both demonstrate what it means to the ecomony to rely too heavily on deficit financing through the banks. We believe that you share with us the conviction that at this time, when the needs of our country for defense are paramount, the Government should seek to provide the needed funds with a minimum of reliance on bank finance. The Government's main instruments to this end must be an adequate tax program and a program of debt financing directed primarily to tap nonbank funds.

"In view of the extremely important implications for the future that underlie the initial policies to be adopted in meeting the heavy financial requirements of the defense program, we hope that we may have a full discussion of the subject with you at your earliest convenience."

Copies of a report of open market operations prepared at the Federal Reserve Bank of New York covering the period June 12 to August 15, 1950, inclusive, were then distributed. Mr. Rouse commented briefly on this report and also on a supplemental report covering commitments executed for the System account on August 16 and 17, 1950. Copies of both reports have been placed in the files of the Federal Open Market Committee.

> Upon motion duly made and seconded and by unanimous vote, the transactions in the System account for the period June 12, 1950, to August 17, 1950, inclusive, were approved, ratified, and confirmed.

Mr. Sproul referred to the letter sent to the Secretary of the Treasury under date of July 12, 1950, to the Secretary's reply, dated July 17, 1950, and to the additional letter to the Secretary dated July 31, 1950, quoted above, stating that copies of these letters had been furnished all members of the Committee and Presidents of Federal Reserve Banks who were not members of the Committee. Mr. Sproul went on to say that the written record represented in essence a continuing unwillingness on the part of the Treasury to try to sop up available nonbank funds by issuing a long-term security and also indicated a desire to sit tight and do nothing in terms of a change in the existing rate structure. He then called upon Mr. Rouse for a statement with respect to the meeting which Chairman McCabe and Mr. Rouse had with Secretary of the Treasury Snyder on August 10, 1950, and Mr. Rouse made a statement substantially as follows:

> Chairman McCabe and I met with Secretary Snyder at 4 o'clock the afternoon of August 10. Mr. Haas, Director of the Treasury's technical staff, was also present. Chairman McCabe reviewed various aspects

of the developing inflation with the Secretary, illustrated by up-to-date figures and charts. He also reviewed with the Secretary some of the thinking at the Board with respect to credit controls which the Board may be called upon to administer if the pending legislation becomes effective, and he invited comment from the Secretary. With respect to consumer credit, at first Secretary Snyder appeared to favor a down payment greater than 33-1/3 per cent and a limitation of succeeding payments to 18 months. After further discussion, including Chairman McCabe's report on his visit with the President, he agreed that in the first instance it might be wiser to make the initial regulation less restrictive, tightening it up later if necessary.

Following this, Chairman McCabe inquired whether the Treasury had come to any conclusion with respect to the executive committee's recommendation for an announcement of a long-term restricted tap issue. The Secretary replied that they had given the matter earnest consideration; that they had analyzed carefully our operations; had consulted with various groups representative of the market; and had concluded that on the basis of facts at their disposal which the Treasury regards as most complete there were not sufficient nonbank investment funds available to assure a successful offering at the present time.

Following this, there ensued a spirited discussion as to the correctness of this interpretation. It resulted in an impasse. This was followed by the suggestion of the Secretary that it should be a factual matter and determinable, and he suggested that the System avail itself of the data which Mr. Haas had at his disposal. We agreed that this should be done.

Secretary Snyder and Mr. Haas also had obviously been irritated by the publicity given the staff memorandum sent to the Joint Committee on the Economic Report at the latter's request, and it prompted remarks by them to the effect that periodic pressure on the short-term market frequently derived from comment by the Federal Reserve, leading the market to consider the possibility of increases in the short-term rate, and so leading people to dispose of such securities in the hope of avoiding possible losses later on.

The Secretary then remarked that he had attended a meeting of the National Security Council that afternoon and that at this time there was no way of knowing what might come out of the Korean situation, that even if that did not increase the debt the management of the $257 billion debt was still a heavy responsibility, and that the cost of carrying the debt could not be treated lightly; and that he saw no reason currently for any change in interest rates. Again referring to pressure on short-term rates that has developed from time to time, he stated that he sometimes thought it might be wise to ask the Congress to put the responsibility for handling the debt in the Federal Reserve which had the money market tools, adding that, of course, he realized the Congress wouldn't do that and the Federal Reserve would not want to take that responsibility.

Chairman McCabe then reviewed the volume of our sales and purchases, remarking that we had provided through our purchases upwards of $400 million of reserves in the last three months. He then asked the Secretary just how far he thought the System could go in providing hot money. The Secretary replied that it wasn't a question he should try to answer but that he did not like hot money any better than anyone else and that in the natural course of things reserves needed to be supplied to the market. The Secretary stated that inasmuch as he had changed his plans and had postponed his trip to Europe there would be time for further discussion.

By this time it was clear that the Treasury had no intention now of making any new effort to absorb nonbank money or of voluntarily agreeing to a change in short-term rates.

In conclusion, Chairman McCabe remarked to the Secretary that in the circumstances there was nothing further that he could say except that he would report this conversation to his committee.

During the meeting there was no discussion of the refunding operation which the Treasury faces in connection with its September and October maturities.

Mr. Sproul stated that, subsequent to the meeting with the Secretary of the Treasury on August 10, it was suggested that members of the Federal Open Market Committee should see the slides prepared by the

Treasury staff showing distribution of Treasury securities since the beginning of this year and that a tentative appointment had been made at the Treasury to present the slides to the Committee between 2 and 3 o'clock today.

Mr. Sproul then called upon Mr. Thomas, who stated that he called Mr. Haas of the Treasury on the telephone on August 11 but was informed he was out of the office that day, and that he talked with Mr. Tickton, Assistant Director of the Treasury's Technical Staff. He said that he explained to Mr. Tickton that he would like to arrange for some of the members of the Board's staff to see the Treasury figures of funds available for purchase of Government securities and to discuss with the Treasury staff the sources, assumptions, and methods of derivation used in making them up, so that there would be an opportunity to analyze them before the Committee met. Mr. Tickton responded, Mr. Thomas said, that the figures were all on work sheets and not in form which he could make available at this time and that it would not be possible to make them available that day because of pressure of work, but that he would have Mr. Haas call next Monday. Mr. Thomas said that he received a call from Mr. Haas at noon on Monday, August 14, at which time he again asked that their figures underlying the slides showing distribution of Treasury securities be made available for the Federal Reserve staff to study before the Committee saw the slides, and that Mr. Haas stated that, while he would be glad to show the slides to members of the Committee and the staff, he and his staff could not spare the time for a discussion of the figures. Mr. Haas also said that because of pressure of work he would not be able to make the figures available for study before then, adding that he thought they were the same as those Mr. Thomas had and simply showed that all available nonbank funds had been absorbed by mortgages and other investments and that the Government could not raise additional amounts without depressing those activities, which he felt was not desirable. Mr. Thomas stated that memoranda covering his telephone talks with the Treasury on August 11 and 14 had been placed in the files of the Federal Open Market Committee.

Mr. Thomas went on to say that, in the absence of the Treasury figures, the Board's staff had prepared a memorandum dated August 17, 1950, analyzing the ownership of Government securities, a copy of which had been distributed to the members of the Committee before this meeting together with a memorandum dated August 17, 1950, on the current economic situation and outlook. The estimates presented indicated that, to meet the deficit and cash redemptions of maturing securities, the Treasury might need to borrow as much as $2 billion in new money during the last half of 1950, in addition to small net sales of savings bonds and notes and withdrawals from the Treasury's cash balance. The analysis of ownership of Government securities made by the Board's staff, which used substantially the same data available to the

Treasury Department, Mr. Thomas said, led to the conclusion that a substantial volume of nonbank money would become available for investment during the next few months, and that the additional funds needed can and should be raised by offering long-term securities to nonbank investors. Mr. Thomas emphasized that there should be no need for the Treasury to borrow from banks.

There followed a discussion of the data presented in the memoranda referred to by Mr. Thomas on ownership of Government securities and the current economic situation.

Mr. Sproul then made a statement substantially as follows:

> The question today is what we are going to do in our sphere of primary responsibility, not what we are going to recommend to the Treasury that it do in its primary sphere. It is not a question of the long-term bond issue or of refunding the September-October maturities, but what are we going to do about making further reserve funds available to the banking system in a dangerously inflationary situation. The increase in war expenditures will be gradual, no doubt, and the Treasury may not need new funds for some time except what it will get from savings bonds and notes. Nevertheless, inflationary pressures of higher income and anticipatory consumer and business spending and possible expansion of private capital investment have been added to an already buoyant situation. Bank loans are expanding rapidly despite the exhortation of banker organizations and supervisory authorities. These trends may change later, particularly if the Korean situation takes a turn for the better, but right now the economy is in the grip of strong inflationary pressures. Over-all direct controls have been held to be unnecessary unless and until more of our economy is involved in war and war preparations. Reliance is to be on fiscal and credit measures. Fiscal measures, I think we all agree, will be slow to bite and probably less than the situation requires. It is apparent that the Treasury is unwilling to try for nonbank funds with a long-term issue, particularly

in advance of its actual need. Credit measures are both particular and general. There will be a lag in the selective measures being proposed before they become effective and in any case they only cover a part of the problem. General credit measures, to be effective, must be timely and prompt. I think we all agree that drastic credit measures are not in the picture. We can't do the whole job with general credit measures but in view of our responsibility and the national program I think that general credit measures should now be used. They would have the added advantage of being quickly reversible if the situation would change. We have marched up the hill several times and then marched down again. This time I think we should act on the basis of our unwillingness to continue to supply reserves to the market by supporting the existing rate structure and should advise the Treasury that this is what we intend to do--not seek instructions. If we don't act we will have failed to take the action required by the economic situation and the national program for meeting the present emergency. We will have exposed ourselves to a worsening of the rate structure, which will intensify our problems and our dangers, and will have given support to the growing belief that effective steps to curb inflation will be too little and too late, that the purchasing power of the dollar is bound to decline further and drastically, and that Government bonds are a poor investment and the dollar in the form of cash a poor gamble. It seems to me that our course is clear: we should move to an immediate adjustment of market rates toward a 1-3/8 per cent basis for one-year money and should advise the Treasury that this is what we propose to do. If we allow ourselves to be diverted from our main responsibility we will only expose ourselves to further delay and frustration.

Mr. Evans stated that he doubted that an increase of 1/8 per cent in the one-year rate for money would be sufficient, by itself, that he felt a much broader program was needed, that this program should include, in addition to a raise in discount rates, an increase in reserve requirements of member banks, and that it should also include a request to Congress for additional authority with respect to reserves of member banks, perhaps something along the lines of the special reserve plan previously discussed.

Mr. Sproul stated the Committee had expressed its views at previous meetings and through the Chairman concerning a broad program for restraining the present situation, and that he was addressing his remarks to the primary sphere of responsibility of the Federal Open Market Committee without attempting to say that it covered the entire program. He went on to say that so long as the present level of short-term rates was maintained he felt it would be useless to request additional authority from Congress and that higher reserve requirements imposed upon member banks would be relatively ineffective. His emphasis on discussic of a change in the rate structure reflected the fact that such a change immediately involved relationships with the Treasury, and, if the Committee were committed to a program of higher short-term interest rates, the other steps suggested in an over-all program would seem to follow.

Mr. Eccles stated that he agreed with Mr. Sproul, that he felt it was time the System, if it expected to survive as an agency with any independence whatsoever, should exercise some independence, that the country today was faced with the probability of an even greater expansion in military expenditures then had been announced and therefore with an increasing deficit, that while he felt an increase in taxes to meet the additional expenditures was essential it was also essential that credit expansion be curbed, especially since it would take time for additional taxes to become effective, and that such credit restraints should be applied on all fronts--selective controls in the consumer and housing fields, and general restraints on the banking system as a whole. Mr. Eccles went on to say that while he felt an increase in the short-term rate alone would not stop acquisition of additional reserves by banks, it was desirable to let the short-term rate go up in order to take the pressure off the long-term rate, especially since the System was running out of long-term bonds that it could make available to investors seeking such securities. He felt it also would be desirable to increase Reserve Bank discount rates and to consider an increase in reserve requirements, and, if necessary, to request additional authority from Congress to help the System to immobilize reserves of banks. Mr. Eccles said that, before additional authority was requested from Congress, however, the System should use its present powers, including authority under selective credit controls proposed in pending legislation.

Mr. Szymczak stated that he agreed with what had been said, that he felt the first step to be taken was a change in open market operations so as to get started on a program of greater flexibility in the short-term rate structure. This, he said, should be tied to an increase in the discount rate. After these steps had been taken, and perhaps after present authority to increase reserve requirements had been used, it probably would be necessary to request Congress to give additional authority to immobilize bank reserves.

Mr. Vardaman stated that he agreed with the proposal made by Mr. Sproul but questioned how it would affect the Treasury's ability to obtain new money during the next year. He also questioned whether the action proposed would encourage the Treasury to issue a long-term bond on a tap basis for nonbank investors along the lines previously recommended by the Committee.

Mr. Sproul replied that the proposed action would not interfere with the ability of the Government to finance itself under any circumstances that might arise, that the only question would be one of the method of financing and the cost, and that that would depend on a number of factors. As to the issuance of a long-term bond, Mr. Sproul felt the proposed action would not encourage or discourage the Treasury from offering such a security.

Mr. Eccles then referred to the statement appearing in the separate report by Senators Douglas, Fulbright, and Flanders of the Senate Banking and Currency Committee, on the Defense Production Act of 1950, which stated in part that:

> "The primary method of dealing with inflation should be the coordinated use of proper monetary, credit and fiscal policies, which can actually prevent inflation. Higher taxes, on personal and corporate incomes, and excess profits taxes should be given an opportunity to work their effect, preferably before the country is placed in the economic strait-jacket

"of another OPA, or at least simultaneously with such controls. Credit should be restrained by controls on instalment buying, real estate credit, and general bank credit; and these controls should be coordinated with each other. The Treasury's debt-management policies should be reexamined, especially in view of the new situation, and they should be coordinated with the duties of the Federal Reserve Board to restrain credit."

This statement, Mr. Eccles said, indicated the support of at least some of the members of the Banking and Currency Committee for a program such as that proposed.

Mr. Sproul stated that the proposed action would be in accordance with and would support the Government's announced program in the present situation and he quoted from the President's mid-year economic report dated July 26, 1950, which said:

"First of all, for the immediate situation, we should rely in major degree upon fiscal and credit measures..... The more prompt and vigorous we are with these general measures, the less need there will be for all of the comprehensive direct controls which involve the consideration of thousands of individual situations and thus involve infinitely greater interference with individual choice and initiative."

Mr. C. S. Young stated that he favored the proposed change in open market operations which would permit the short-term rate to rise above the present 1-1/4 per cent level and that he felt an increase in discount rates at the Federal Reserve Banks should accompany that action.

Mr. Peyton stated that he favored both the proposed open market action and the increase in the discount rate and that he also believed that a whole series of procedures should be planned which the System might employ so as to present a full program if it became necessary to request additional authority from Congress.

Mr. Davis felt that action should be taken today to change open market operations along the lines suggested and that discount rates of the Federal Reserve Banks should be increased promptly. He also favored issuance of a statement which would show clearly why such steps were being taken and how they were related to the other powers the System has for future use, as well as a statement indicating that if necessary the System would go to Congress to request additional powers.

Mr. Erickson felt that the first step should be a change in open market operations along the lines suggested by Mr. Sproul and that the other steps indicated should be taken as necessary.

Mr. John H. Williams stated that the basic question was how far the Committee would be willing to see interest rates rise in order to curb monetary inflation and that everything else proposed would be ineffective unless there was a rise in interest rates. While, in view of the large public debt, the extent to which rates might rise would be limited, he said, the significance of an increase in the short-term rate and especially in the discount rate would be recognized by many persons. Mr. Williams agreed that monetary and credit policy were secondary to a sound fiscal policy, but he emphasized the necessity for a rise in interest rates as an essential part of the program.

The discussion then turned to the question of timing of the proposed actions and the kind of statement that might be issued if these actions were taken.

At this point Mr. Sproul stated that word had been received that Chairman McCabe was expected to reach Washington during the noon hour and he raised the question whether the Committee wished to see the slides prepared at the Treasury showing changes in the distribution of the public debt and, if so, whether all members of the Committee or only part of the Committee should go.

It was the consensus that the members of the Committee who could arrange to do so should go to the Treasury at 2:00 p.m., and that upon their return to the Board's building, at which time it was expected Chairman McCabe would be present, the Committee would reconvene for further consideration of actions to be taken.

The meeting then recessed.

> Secretary's Note: In accordance with the foregoing understanding, the members of the Committee and of the staff went to the Treasury between 2:00 and 3:00 p.m. to see the slides and hear an explanation of their significance, following which they returned to the Board's building.

The meeting reconvened at 3:05 p.m., with the same attendance as at the close of the morning session except that Chairman McCabe was also present.

At Chairman McCabe's request, Mr. Sproul reviewed the discussion and tentative conclusions at the morning session, stating that it appeared to be the feeling of all members of the Committee that open market operations should be changed immediately with a view to breaking through the 1-1/4 per cent one-year rate in the expectation that the market would almost immediately adjust to a 1-3/8 per cent basis for one-year Treasury securities, and that it was felt that this course should be taken with the expectation that the Board of Governors would approve an increase in the discount rates of the Federal Reserve Banks. It was also the consensus, Mr. Sproul said, that if these actions were taken the Secretary of the Treasury should be informed of them today and that a brief statement announcing and commenting upon the actions should be made public.

Chairman McCabe asked Mr. Thomas whether, after seeing the Treasury presentation, he would alter the figures which he had prepared for the Committee or his conclusions as to the desirability of the Treasury issuing a long-term tap bond, and Mr. Thomas stated that the information presented on the slides did not change the situation so far as he could see, that the question was partly one of interpretation, and in his opinion the Treasury was not interpreting the figures correctly. As to when the Treasury would need additional funds, Mr. Thomas stated that it did not appear that any additional cash would be required by the Treasury until the fourth quarter of the year, and that, while it was only one element in the situation and not the most important, he would still favor the issuance of a long-term tap bond which would obtain a substantial amount of funds from nonbank investors from month to month and, with funds from sales of savings bonds and notes, would provide the Treasury with the new money it might need during the remainder of the year.

In response to a similar question from the Chairman, Mr. Sproul stated that he felt there was nothing in the Treasury figures to alter the views previously expressed by the members of the Committee as to the situation or the course of action that should be taken at this time.

Chairman McCabe then questioned the extent to which the Committee discussed the possibility of letting the short-term rate increase and at the same time providing the market with additional reserves through the purchase of securities if that became necessary to preserve orderly market conditions or to keep a Treasury financing operation from failing.

In response, Mr. Sproul stated that the Committee had considered the results of such action and felt it should permit the short-term rate to go as high as 1-3/8 per cent immediately, with a decision as to any further rise subject to further discussion of the Committee. In the present market, he said, if the short-term rate were to go through 1-1/4 per cent it would probably go to 1-3/8 per cent immediately and at that point he felt the System would be in a slightly less bad position than at present, in that the spread between the long-term and short-term rates would be narrowed and some indication would have been given that credit instruments were to be used in the present situation. He also stated that the ability of the System to withstand a downward pressure on yields in the long-term market was fast coming to an end with the reduction in its holdings of long-term bonds that might be sold to meet demand for that type of investment.

Mr. Evans then raised the question as to the policy that would be followed in connection with long-term bonds and how far the prices of such securities would be permitted to decline.

In a discussion of this question, the view was expressed that if the yield on short-term securities increased there might be a temporary lessening of demand for long-term securities with a resultant decline in price.

Mr. Rouse stated that he felt such a decline in price might take place and that he assumed that the operations would be guided by the direction issued by the Committee on June 14, that if the price of the longest restricted issue should decline to between 100-1/2 and 100-3/4, the executive committee would direct only such operations as were necessary to maintain orderly market conditions pending a meeting of the full Committee which would be called promptly to consider how far any further decline that would be brought about by market conditions would be permitted to go.

Mr. Evans reiterated his view that an over-all program of restraint should be decided upon by the Committee, that he would be in favor of the action proposed with respect to the short-term rate, but that he felt the long-term bond rate should not be permitted to increase above a yield of 2-1/2 per cent. He also stated that he felt the System should increase the discount rate, that it should continue to advocate the issuance of a long-term restricted tap issue by the Treasury, that it should use its remaining power to raise reserve requirements, and that it should request Congress to grant additional powers for immobilizing reserves.

Mr. Peyton agreed with Mr. Evans on the necessity for having such a program in mind and Mr. Sproul said that he felt there was general agreement upon this necessity; that he had concentrated on the first steps of such a program of credit restraint--open market operations and the increase in the discount rate at the Federal Reserve Banks--because these are actions which can and should be taken immediately. Mr. Sproul also stated that it was his understanding that the proposed statement to be issued by the Board of Governors and the Committee should emphasize the subordinate character of monetary measures in dealing with the inflationary situation, but would say that the System would use such powers as it has to restrain further expansion of bank credit and ask for additional authority from the Congress if needed.

Mr. Eccles agreed that a statement along the lines outlined by Mr. Sproul was as far as the Committee could go at this time.

Chairman McCabe asked whether any member of the Committee differed with the views expressed as to the actions that should be taken with respect to open market operations and the change in the discount rate and there was no indication of disagreement. The Chairman then stated that he and Mr. Sproul had a tentative appointment to see Secretary Snyder at 4:30 p.m. today and that they would plan to keep it, and he suggested that it might be desirable to have a copy of the announcement to be released to show the Secretary at that time.

There followed a discussion of the timing of the proposed actions and their announcement, as well as the form of statement to be released. During the discussion Mr. Riefler read a draft of possible statement which he had prepared during the meeting and a number of suggestions were made for its revision.

A question was raised as to what the procedure should be if, upon being informed of the policy adopted by the Committee, the Treasury were to announce a refunding of securities maturing in September and October with an offering at the 1-1/4 per cent certificate rate. It was the consensus that, in such event, the System would not let the Treasury financing fail, that it should purchase the new securities offered to the extent necessary to assure that the issue would not fail, and that so far as possible it should offset such purchases by the sale of other securities to the extent necessary to prevent increases in bank reserves.

Mr. Sproul suggested that the Committee direct the executive committee to arrange for transactions in the System open market account, commencing on Monday, August 21, 1950, with a view to discontinuing support of the one-year Treasury certificate rate at 1-1/4 per cent and to allowing the rate to adjust to 1-3/8 per cent as rapidly as it would, assuming that the Board of Governors would act immediately to approve an increase in the discount rate of the Federal Reserve Bank of New York and the other Federal Reserve Banks as rapidly as they could take action and that, immediately following this meeting, the Board of Governors and the Federal Open Market Committee would issue a joint statement of the policies adopted with respect to curbing further inflationary expansion of bank credit by use of the existing powers of the Federal Reserve System and, if necessary, requesting additional powers from the Congress.

Upon motion duly made and seconded, the foregoing suggestion was approved by unanimous vote.

Thereupon a draft of statement along the lines discussed earlier in the meeting, to be issued jointly by the Board of Governors and the Federal Open Market Committee immediately following this meeting, was discussed.

Upon motion duly made and seconded, it was voted unanimously to approve the statement with such perfecting changes as would be satisfactory to Messrs. McCabe, Sproul, and Eccles, and with the understanding that it would also be approved by the Board of Governors.

Secretary's Note: The statement, as perfected by Messrs. McCabe, Sproul, and Eccles, and thereupon approved by the Board of Governors, was released to the press at 6:10 p.m. on Friday, August 18, 1950, in the following form:

"The Board of Governors of the Federal Reserve System today approved an increase in the discount rate of the Federal Reserve Bank of New York from 1-1/2 per cent to 1-3/4 per cent effective at the opening of business Monday, August 21.

"Within the past six weeks loans and holdings of corporate and municipal securities have expanded by $1-1/2 billion at banks in leading cities alone. Such an expansion under present conditions is clearly excessive. In view of this development and to support the Government's decision to rely in major degree for the immediate future upon fiscal and credit measures to curb inflation, the Board of Governors of the Federal Reserve System and the Federal Open Market Committee are prepared to use all the means at their command to restrain further expansion of bank credit consistent with the policy of maintaining orderly conditions in the Government securities market.

"The Board is also prepared to request the Congress for additional authority should that prove necessary.

"Effective restraint of inflation must depend ultimately on the willingness of the American people to tax themselves adequately to meet the Government's needs on a pay-as-you-go basis. Taxation alone, however, will not do the job. Parallel and prompt restraint in the area of monetary and credit policy is essential."

In order to carry out the change in policy adopted at this meeting by the Committee, the wording of the first sentence of the general direction of the Committee to the executive committee to arrange for transactions in the System account was changed to provide that such transactions should be in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to maintaining orderly conditions in the Government security market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account. Mr. Rouse stated that he would not now recommend a change in the limits contained in the existing direction.

Thereupon, upon motion duly made and seconded, the following direction to the executive committee was approved unanimously 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 current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to maintaining orderly conditions in the Government security market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; 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 $2,000,000,000.

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 $1,000,000,000.

Reference was then made to the ranges within which bills and certificates would be purchased and sold by the Federal Reserve Bank of New York for the System account and it was suggested that the Federal Open Market Committee continue the existing authority to the executive committee to determine from time to time the ranges within which such purchases and sales would be made with an upper limit of 1.36 per cent for both bills and certificates and a lower limit in the case of bills of 1.16 per cent and in the case of certificates of 1.20 per cent, the authority to be exercised within the framework of the general credit policy of the Federal Open Market Committee.

Upon motion duly made and seconded, the foregoing suggestion was approved unanimously.

In connection with transactions in long-term securities, it was agreed unanimously that the executive committee should continue to arrange for such transactions with a view to maintaining orderly market conditions and that, should the price of the longest restricted issue decline to between 100-1/2 and 100-3/4, the executive committee would direct only such operations as were necessary to maintain orderly market conditions pending a meeting of the full Committee which would be called promptly to consider how far any further decline that would be brought about by market conditions would be permitted to go.

It was also agreed that the existing understanding with respect to the replacement of System maturing bill holdings should be continued and that the executive committee would be guided by what would be required in the light of current conditions in the money market to carry out the general credit policy of the Federal Open Market Committee.

It was agreed that the next meeting of the Federal Open Market Committee should be subject to call by the Chairman.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

Thomas B. McCabe
Chairman.