

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 Monday, November 27, 1950, at 10:10 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Erickson
Mr. Evans
Mr. Peyton
Mr. Powell
Mr. Szymczak
Mr. Vardaman
Mr. C. S. Young
Mr. Gilbert (alternate for Mr. Davis)

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. J. M. Peterson, Associate Economist
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. Ralph A. Young, Director, Division
of Research and Statistics, Board
of Governors
Mr. Wurts, Assistant Vice President,
Federal Reserve Bank of New York
Mr. Youngdahl, Chief, Government Finance
Section, Division of Research and
Statistics, Board of Governors
Mr. R. F. Leach, Economist, Board
of Governors
Mr. Arthur Willis, Special Assistant,
Securities Department, Federal
Reserve Bank of New York

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

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

11/27/50

-2-

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on September 28 and October 11 and 30, 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 September 27 and 28 and October 9 and 11, 1950, were approved, ratified, and confirmed.

Mr. Wurts presented and commented upon a report of open market operations prepared at the Federal Reserve Bank of New York covering the period from October 11 to November 21, 1950, inclusive, and a supplementary report covering commitments executed during the period November 22 to 26, 1950, inclusive. Copies of both reports were distributed to the members of the Committee and 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 October 10 to November 26, 1950, inclusive, were approved, ratified, and confirmed.

Chairman McCabe stated that the most important action taken by the Committee since the meeting when all of the Presidents were in attendance was the decision at the meeting on October 30, 1950, to send a letter to Secretary of the Treasury Snyder in which the Committee stated that it was in complete agreement that under present

11/27/50

-3-

conditions it was necessary to protect the 2-1/2 per cent rate (par) on the longest term Treasury bonds now outstanding and stated that for the present the Committee would endeavor to maintain an orderly and flexible market with a maximum of 1-1/2 per cent per annum for any securities maturing within one year. He went on to say that at a meeting of the executive committee on November 17, 1950, approval was given to a letter to the Secretary of the Treasury, in response to a request from him, giving the views of the executive committee on the December and January refunding operations of the Treasury, and that the letter had been included in the draft of minutes of that meeting a copy of which had been sent to the Presidents of all of the Federal Reserve Banks. Chairman McCabe also said that he delivered the letter to Secretary of the Treasury Snyder at noon on Monday, November 20, 1950, at which time he discussed the suggestions of the committee for refunding securities maturing in December and January along the lines stated in the letter.

Continuing, Chairman McCabe said that he received a telephone call from Secretary Snyder on Wednesday, November 22, at which time the Secretary stated that he had in mind offering a five-year 1-3/4 per cent note and asked for the reaction to that proposal, to which he (Chairman McCabe) responded that he would like to check the matter again and call back. After talking with Mr. Sproul and Mr. Thomas, Chairman McCabe said, he called Secretary Snyder's office and left word (the Secretary not being available) that he felt the proposed refunding

11/27/50

-4-

was very satisfactory. The Treasury subsequently announced a refunding issue of five-year 1-3/4 per cent notes.

Chairman McCabe then called upon Mr. Thomas who stated that recent economic developments and prospects had been in line with previous expectations, that there was still no evidence of a general abatement of inflationary pressures, that production was being maintained at levels close to capacity, that consumer demands were continuing at a high level, and that it was apparent that demand for goods must be reduced when production of consumer goods is curtailed in the near future. He also said that defense expenditures were beginning to increase and that bank credit expansion has also continued, although there has been some slackening in expansion of consumer and real estate credit. Real estate and consumer credit loans directly and indirectly accounted for approximately half the increase of \$6.5 billion in bank credit since June, and the remainder was mostly in the form of business loans. Continued substantial expansion in business credit has been in large part to cover fabricators' needs for material, some of which represented speculative activity. Mr. Thomas then presented the results of a spot check made through the Federal Reserve Banks pursuant to a request of the Board of Governors on November 14, stating that the most striking result was the increase in loans to dealers and processors of agricultural commodities, which aggregated \$1,233 million or 60 per cent of the total increase covered by the

11/27/50

-5-

survey, and from which it was concluded that speculative motives were an important factor in the loan expansion which, in turn, contributed to price rise. Most of the remaining increase was in loans to retailers and wholesalers and to finance companies.

Mr. Thomas stated that the price rise had been resumed in nearly all groups of commodities after some slackening during October in prices of farm products and foods. Wages were also gradually rising, average weekly hours of work had increased slightly, and, in general, the labor market was tight with military and defense demands strong. It was still a question, he felt, whether consumer buying would slacken more rapidly than defense demands would increase, but whatever slackening in consumer buying took place would probably be relatively slight and short-lived. In sum, prospective consumer demand appeared likely to exceed probable supplies during the next year, Government expenditures would increase, and Mr. Thomas expected that deficits would begin to show in the second quarter of 1951, although the surplus of receipts during the first quarter would more than offset the probable deficit during the second quarter of the year, and new Treasury borrowing was unlikely until midsummer of 1951.

The most important problem for the Federal Reserve, Mr. Thomas said, continued to be the question of restraint on credit expansion. If credit expansion continued, it would be a definite sign of an excessive demand for credit. The ordinary seasonal pattern would call for a decline in bank loans of at least \$1.5 billion during the first

11/27/50

-6-

two months of 1951. Possible measures of restraint included voluntary action by lenders, which, however, Mr. Thomas felt was unlikely to have much effect in holding down credit expansion in view of competitive pressures. The higher interest rates recently established had had some effect and might be expected to have more effect in restraining some lenders and borrowers, although such effects would be limited if rates had to be rigidly pegged at their present level. If further credit expansion continued it might become necessary for the Committee to face the issue of a further rise in the short-term rate. Meanwhile, fluctuation in rates might be encouraged and a wider spread between System buying and selling rates on short-term issues might be desirable. Bank liquidity had been reduced somewhat by the recent increase in loans and sale of short-term securities by banks, Mr. Thomas said, and would be reduced further by the new Treasury refunding. An increase in reserve requirements could be used to make another cut in bank liquidity. Mr. Thomas felt that a decrease in the liquidity of banks was a step in the right direction in terms of monetary policy at this time.

With respect to demand for Government securities by nonbank investors, Mr. Thomas felt that on the whole purchases of securities from the banks by corporations, which have recently been substantial, were a helpful influence in exerting restraint on bank credit expansion. It would also be desirable to promote sales of savings bonds to individuals, particularly as large personal and business savings become

11/27/50

-7-

available during the next year. The question was, he said, to what extent such savings could be attracted into Government securities in view of the outlook for inflationary pressures.

Mr. Gidney, President of the Federal Reserve Bank of Cleveland, joined the meeting at the conclusion of Mr. Thomas' report.

There ensued a general discussion of the further actions that might be taken by the System in the period of continuing inflationary pressures that would exist in the months ahead, including the initiation of voluntary agreements by financing institutions to limit nonessential credit, a further increase in the short-term rate, an increase in member bank reserve requirements, and recommendations that might be made to the Congress as to additional powers in a period when the opportunities of the System to use the traditional methods of credit control were limited by its decision for the time being to support the long-term Government securities market. There was also a discussion of why action was not taken by the Board last October or earlier in November to increase reserve requirements, and the opinion was expressed that there was no reason why consideration should not again be given to a further increase in the short-term rate and in reserve requirements of member banks after the current refunding operation was out of the way.

During the discussion, Mr. Sproul made a statement in which he expressed the view that credit was only one of the factors in the rise of prices and that while credit and the rise in prices were

11/27/50

-8-

certainly interrelated, the one could not be said to be definitely and mechanically the cause of the other. A sound fiscal policy is also required, he said, and if wages and other costs rise without relation to increased productivity, credit policy and fiscal policy together, will not be enough. While it was necessary to go ahead with credit measures, he said, the System should not lose sight of the other factors and thus acquire or create a false sense of what could be accomplished by credit restrictions. As to the effectiveness of credit measures, Mr. Sproul felt there was a real chance through making bank reserves less readily available, which means continued flexibility in the short-term interest rate, to restore some of the effectiveness of the central bank in the market. He said that after the present Treasury refunding was out of the way consideration should be given to some further rise in the short-term rate.

Mr. Eccles responded that not only had the supply of credit increased but also its velocity had moved upward in recent months, that he had favored permitting the short-term interest rate to increase but felt that by itself it was very unimportant in curbing credit expansion since Federal Reserve funds had been made readily available through support of the long-term bond market, that reserve requirements of member banks should have been increased within the limits of the present authority of the Board, and that the System should be prepared to call the attention of Congress and the public

11/27/50

-9-

to the fact that the System had used all its powers short of letting the long-term bonds to go below par and that, since it was unable to use the traditional methods for restricting credit so long as it supported long-term bonds at par, it was necessary that additional authority be provided in the form of the special reserve plan or something along that line if the System was to carry out its responsibilities in the credit field.

Mr. Sproul stated that he had less regard for changes in reserve requirements than was indicated by Mr. Eccles, and more regard for the effectiveness of small changes in interest rates, an effectiveness which he said could not be measured statistically but lies within the realm of judgment and opinion. He agreed that we must look toward unfreezing the long end of the rate pattern as well as the short end; the hope and expectation here must be that the outstanding 2-1/2 per cent restricted bonds, which are now only 17 years to call date, will soon take care of themselves. He added that the moves thus far made toward greater flexibility represented a major accomplishment and should be pursued whenever the credit situation warranted. The System should continue to make use of general credit controls, he said, supplemented by such selective credit controls as Regulation W and X, and after the System had exhausted such moves would be the time to consider an increase in reserve requirements. Mr. Sproul also said he thought the present Treasury savings bonds would not retain existing

11/27/50

-10-

holders and attract new holders and he said that the requirements of a long range rearmament program, under present conditions, demands a new product and an invigorated sales organization.

Chairman McCabe stated that the Treasury had taken a very adamant position against any increase in reserve requirements at this time, that for reasons which he stated he felt the System had gone about as far as it could go at present in taking independent action in permitting the short-term rate to rise to 1-1/2 per cent, that after the present Treasury refunding was out of the way there was the possibility of a further increase in the short-term rate without letting the restricted bonds go below par, and that he did not feel that the delay in increasing reserve requirements obviated the question being taken up in January.

Mr. Eccles agreed with Chairman McCabe as to the difficulties of the situation but said that he did not believe inflation was going to be controlled by actions that had been or were likely to be taken in the credit field, that this would lead to direct controls, and that he felt such controls would be a mistake because they would not prevent inflation but would only delay its effect. He reiterated the view that the System should be prepared to present the matter to Congress and that the Congress should decide whether the System was to use the traditional methods of restricting credit with the accompanying effects on prices of long-term Government securities, whether as an alternative

11/27/50

-11-

it should be given additional authority over reserves of member banks, or whether inflation should be permitted to continue unrestrained.

During the discussion, Chairman McCabe referred to the possibility of action in the field of voluntary agreements by financing institutions to limit the growth of credit, and he reviewed the discussions with Attorney-General McGrath and with the Federal Advisory Council on the subject.

There followed a brief discussion of recommendations that might be made to the Treasury with respect to its 1951 financing program and there was agreement with Chairman McCabe's suggestion that it would be premature to discuss this matter with the Treasury at the present time.

In connection with a possible program for refunding maturing savings bonds, Mr. Thomas stated that a memorandum being prepared by the staff would be completed shortly. There was a discussion of the problem of refunding such securities, of the recommendation made by the Committee on Government Borrowing of the American Bankers Association, and of the procedure which might be followed in presenting the recommendations of the Federal Open Market Committee to the Treasury. It was understood that the memorandum referred to by Mr. Thomas would be distributed to the members of the Committee as soon as it was available after which the matter would be given further consideration by the Federal Open Market Committee.

11/27/50

-12-

Reference was also made to a memorandum on suggested policy on Treasury savings notes prepared in the Board's offices prior to the meeting of the executive committee on November 17 and distributed to members of the Federal Open Market Committee under date of November 24, 1950. The memorandum, a copy of which has been placed in the files of the Federal Open Market Committee, concluded, for the reasons outlined, that the present series of Treasury savings notes should be continued for at least the next six to nine months unless net cash redemptions of present issues should become excessive or cash needs of the Treasury should change sharply from what the present military program suggested. There was general agreement among the members of the Committee with this conclusion.

Mr. Sproul suggested that the general direction of the full Committee to the executive committee to arrange for transactions in the System account be changed by reducing the limitation in the first paragraph from \$4 billion to \$3 billion.

Thereupon, upon motion duly made and seconded, the following direction to the executive committee was approved unanimously with the understanding that the limitation 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

11/27/50

-13-

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 \$3,000,000,000.

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.

Following a discussion of the rates at which short-term securities should be purchased and sold for the System account, there was unanimous agreement that the understanding reached at the meeting of the Committee on October 11 on this point would continue in effect with the further understanding that, in accordance with the letter sent to the Treasury following the meeting on October 30, 1950, the executive committee for the time being would not permit the rate on any securities maturing within one year to rise above 1-1/2 per cent.

There were then distributed copies of a memorandum from Mr.

11/27/50

-14-

Thomas dated November 24, 1950, transmitting two memoranda on the "Cost of Raising Reserve Funds Through Bill Operations", one prepared in the offices of the Board of Governors and one prepared at the Federal Reserve Bank of New York. Mr. Thomas stated that the two memoranda were in general agreement that substantial fluctuations should be permitted to develop in the bill rate in accordance with changing market circumstances as a means of reinforcing restrictive credit measures.

In a discussion of the memoranda, Mr. Sproul suggested that the full Committee indicate to the executive committee its general approval of the idea of a wider spread between the buying and selling rates on Treasury bills, leaving it to the executive committee to fix the effective buying and selling rates.

Mr. Sproul's suggestion was approved unanimously.

It was unanimously understood that the understanding with respect to the replacement of maturing Treasury bill holdings should be continued unchanged and that the executive committee should 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.

Reference was made to the discussion at the meeting of the executive committee on November 17, 1950, and the understanding reached at that time of the circumstances under which the price of the longest-

11/27/50

-15-

term restricted bonds should be permitted to decline to slightly above par. In the light of that discussion, it was agreed unanimously that the present understanding with respect to transactions in long-term securities for the System account should be continued, i.e., that the longest-term restricted bond would not be allowed to decline beyond a point slightly above par, and that an orderly market would be maintained.

It was agreed that the next meeting of the Committee would be subject to call by the Chairman.

Thereupon the meeting adjourned.

Chester Mowle
Secretary.