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Final Minutes

CONFIDENTIAL

12/17/67

MINUTES OF THE MEETING OF THE FEDERAL OPEN MARKET COMMITTEE
HELD AT WASHINGTON, D. C., DECEMBER 17-18, 1935

The meeting was called to order on December 17 at 10:10 a. m., there being present:

From the Board of Governors of the Federal Reserve System,

Chairman Eccles,
Governors Hamlin, Miller, James, O'Connor, Thomas and Szymczak.

From the Federal reserve banks;

Governor Harrison, chairman, Governors Young, Norris, Fleming, Seay, Newton, Schaller, Martin, Geery, Hamilton, McKinney, and Calkins.
Deputy Governor Burgess.
Messrs. Williams (New York) and Strater (Cleveland).

From the staff of the Board of Governors,

Messrs. Morrill, Clayton, Goldenweiser, Thurston, Thomas, Curry, Gardner, Garfield, Bethea, Carpenter, and Thompson.

Governor Harrison stated that it was proposed that this first joint meeting with the Board of Governors should be devoted to hearing the reports of specialists who had been studying the credit and financial situation and the problems before the System. He then turned the meeting over to Chairman Eccles, who first called upon Dr. Goldenweiser for a review of the credit situation.

Dr. Goldenweiser then reviewed fully various aspects of the business and credit situation and discussed alternative policies which might be adopted by the Federal Reserve System.

After the completion of Dr. Goldenweiser's statement, there ensued a brief general discussion of some of the points in his statement.

Chairman Eccles then called upon Dr. Williams, who reviewed the general question of excess reserves and the methods which might be adopted for dealing with them.

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At the conclusion of Dr. Williams' statement, there was a brief general discussion and a number of those present asked questions which were answered by Dr. Goldenweiser and Dr. Williams.

In the course of the discussion Mr. Miller pointed out that the powers granted by the law to raise reserve requirements were granted "to prevent injurious credit expansion." Mr. Miller raised the question how far action under this law could be justified at a time when no injurious expansion had yet taken place, and there was some brief discussion of this question in the course of which Dr. Goldenweiser suggested that the discussions at the time the legislation was passed made it clear that the legislation was specifically directed to dealing with the problem of excess bank reserves. Others pointed out that the power was one of prevention rather than correction and this implied action in advance of expansion.

At 11:50 a. m., the Board of Governors of the Federal Reserve System and staff members left and the meeting reconvened with only the representatives of the Federal reserve banks present.

A final form of the preliminary memorandum on credit conditions was distributed in substitution for the tentative draft which had been circulated by mail.

It was thereupon unanimously

VOTED that the report on operation be accepted and placed on file and the operations since the last meeting of the full committee be ratified.

It was also unanimously

VOTED that the preliminary memorandum in its final form be accepted and placed on file.

Governor Harrison reviewed the action of the Board of Governors on the resolution adopted at the last meeting of the committee as to shifts between maturities of government securities in System account. He reported that at first the Board had limited its approval to the action necessary to replace maturities between the date of approval and the next meeting of the committee, and that when the difficulty of operating under that approval had been pointed out, the Board had reinterpreted its action to extend its approval to shifts in maturities of Treasury bills and Treasury notes in an aggregate amount not exceeding $300,000,000. Governor Harrison reported that he had made this question the occasion for discussing with Chairman Eccles the desirable procedure to be followed with respect to questions of this sort, and had pointed out that just as the committee gave the Board an opportunity to make suggestions with respect to its minutes and the form of its resolutions, it was also desirable that the Board of Governors should give the committee an opportunity to make suggestions with regard to proposed Board action before it was finally taken. Chairman Eccles had informally agreed to this suggestion.

After some informal discussion of the action which the committee should take with respect to operating authorities, it was agreed to leave such action until after a consideration of general credit policy.

Governor Young then raised the question whether the committee did not have before it the resolution adopted by the Federal Advisory Council, which had asked that its action be referred to the Federal Open Market Committee.

Governor Harrison reported that he had requested the Board to send a copy of the resolution of the Federal Advisory Council to all governors and he read the letter from Chairman Eccles, with which the Council's recommendation had been transmitted to him as chairman of the Open Market Committee.

After further informal discussion of the Council's action, Governor Norris presented the following resolution which was seconded by Governor Young. (this form includes later changes).

> That the participation of the Federal Reserve System in the Treasury Bill market no longer serves any useful purpose; that the System retire from this market by allowing the present holdings of these Bills to run off as they mature and that public notice be given to that effect, with such explanatory statement as may seem advisable.

In discussing the motion, Governor Norris pointed out that while action was not necessary, it was highly desirable as the excess reserves constituted a source of danger. He indicated that even now there was some evidence of inflationary results from the excess reserves, especially in the bond market, where a 2 3/4% bond of a rural county seat could be sold at a premium. This kind of situation constituted an incentive to communities to spend money unwisely.

Governor Norris stated the belief that a reduction in the Treasury bill holdings of the Federal reserve banks would have a more desirable effect on the public, the Treasury, the banks, and the reserve banks than an increase in reserve requirements, which he believed would make banks more cautious in making loans and would constitute a hardship on some banks with only moderate amounts of excess reserves. He believed that the limitation of any reduction in securities to the Treasury bill market would avoid most of the possible harmful effects. With respect to the earnings of the reserve banks, he pointed out that an addition of $50,000,000 to the five year note holdings of the banks would bring in as much yield as $500,000,000 of Treasury bills.

There ensued a general discussion of Governor Norris' resolution, during the course of which Governor McKinney pointed out that country banks had available considerable excess funds outside of their excess reserves on deposit with the reserve banks, and Governor Calkins raised the objection that the resolution attempted to lay down a policy for eight months ahead, which went beyond the province of the present committee. There was further objection that the Treasury bill was almost ideal for holding by the Federal Reserve System and it was undesirable that the System should dispose of all of its Treasury bills. Governor Calkins also raised the point that any action, either in reserves or securities, might be misinterpreted as a reversal of policy, and that the most that should be considered would be some very moderate and tentative proposal.

Governor Martin read a statement, a copy of which is attached to these minutes, advocating that no action should be taken at the present time because of danger of discouraging efforts toward recovery.

The meeting adjourned at 1:17 p. m.

The meeting reconvened at 2:37 p. m.

Governor Norris' motion was reread, in slightly revised form from the first reading and there ensued a general discussion of this resolution and of the reasons which might be cited in its support in the record of the committee.

In the course of discussion Governor Harrison pointed out that in order to deal fully with the problem of excess reserves, it will probably be necessary, sooner or later, to use both methods of control. He raised the question of what would be the effect on banks if reserve requirements are increased after the sale of a large amount of government securities had materially reduced the amount of excess reserves leaving individual banks less prepared to stand an increase in requirements.

Governors Norris and Calkins took the position that the more flexible method should be used first and the more rigid method afterwards, whereas Governor Harrison favored the adjustment of reserve requirements first, leaving later adjustments to be made by open market operations.

Governor Seay made the point that allowing maturities of bills to run off would not have any appreciable effect on the amount of excess reserves.

Governor Harrison presented for consideration the question whether there might be any advantage in adjourning until the middle of January, when some present uncertainties might be more clear, including,

1. The effect of the removal from the market of more than $600,000,000 by the Treasury through an increase in its balances with the reserve banks.

2. The nature of the budget message.

3. The extent that business might be affected by a slack season.

After further general discussion, Governor Harrison asked and received permission to read a memorandum on Excess Reserves and Federal Reserve Policy. A copy is attached to the minutes.

After some further discussion a vote was taken on Governor Norris' resolution and it failed of adoption by a vote of seven to five, as follows:

Yes	No
Governors Young	Governors Harrison
Norris	Fleming
Schaller	Seay
Geery	Newton
Hamilton	Martin
	McKinney
	Calkins

Governor Calkins wished the records to show that he voted no because the resolution would commit the System too far into the future.

Governors McKinney and Harrison wished the record to show that they believed an increase in reserves should precede a reduction in security holdings as a means of reducing excess reserves.

Governor Martin then presented, tentatively, for consideration, the following motion:

> At this time the danger of discouraging recovery is of such weight that it is desirable to take no action until the general factors in the business situation become more settled. The possibility at this time has not developed into a probability though it may do so at any time. It is therefore moved that this meeting adjourn until some day in the middle of January for a review of the situation.

After further discussion Governor Schaller read the following motion, which had been agreed to by the board of directors of the Chicago reserve bank:

> After a careful review of the report of the meeting of the Federal Open Market Committee held in Washington, D. C., October 22 to October 24, 1935, inclusive, and presented to us by our member of that committee, the Board of Directors of the Federal Reserve Bank of Chicago expresses concurrence in the conclusions reached at said meeting and especially as set out in the resolution prepared and delivered to the Board of Governors.

This Board fully realizes that the application of any of the methods of credit control suggested lie within the power of the Treasury Department and the Board of Governors, to be used when, in their judgment, it is necessary. However, in a spirit of cooperation with both of these agencies we desire to call their attention to a feeling of growing uneasiness in the minds of the public as to possible credit inflation, caused by repeated reference to this danger by our press and public speakers.

We cannot help but feel that for the moment our greatest potential danger is from our excessively large bank reserves, caused by a rapid rise in bank deposits, through gold imports and governmental financing, the control of which might well be considered our first objective.

We, therefore, as a Board, desire to respectfully suggest for earnest consideration by the Board of Governors of the Federal Reserve System, an increase in required reserves against bank deposits in Central Reserve and Reserve City banks to possibly twenty-five per cent of the increase now permitted by law, thereby not only fortifying our banking structure to this extent, but giving assurance to business and the public that the levers of control are operative and in the hands of authorities who are ready to use them. We believe that such action accompanied by a proper statement of its objectives would be favorably interpreted by the financial and business interests rather than otherwise.

We recognize that in addition to the measure referred to, that of an increase in required reserves, consideration may properly be given to another effective power in the control of inflationary tendencies, under which credit may be withdrawn from the market either by the sale or by the maturity without replacement of Government securities held in the Federal Reserve System. However, because it is considered that the application of such a measure might be reflected in the market for Government bonds at this particular time, we are disposed to suggest the primary consideration of an increase in reserve requirements.

There ensued a discussion of these different proposals.

The discussion of this general question was suspended in order to deal with the necessary operating resolutions.

After discussion it was agreed that authority voted to the executive committee of the Federal Open Market Committee at two previous meetings to make shifts of maturities in the System open market account, should be continued as necessary in the proper administration of the account to enable the executive committee to replace maturities from time to time and to make shifts in maturities to meet changing market conditions. With respect to the amount of authority which the committee should have in shifting from shorter maturities to bonds, it was agreed that some limited authority was advisable in order to deal with any market situation that might arise. It was therefore unanimously

> VOTED that superseding previous authorizations, the executive committee be authorized to make shifts between maturities of government securities up to $300,000,000, provided that the amount of securities maturing within two years be maintained at not less than $1,000,000,000 and that the amount of bonds be not over $300,000,000.

It was also agreed that authority should be given to the executive committee to buy or sell (which would include authority to allow maturities to run off) securities for System account within limits as to amount, in order that the committee might be in a position to act promptly if circumstances not now foreseen should make action appear desirable before a further meeting of the full committee. It was therefore unanimously

> VOTED that the executive committee be authorized to buy or sell up to $250,000,000 of government securities, subject to telegraphic approval of a majority of the Federal Open Market Committee and the approval of the Board of Governors of the Federal Reserve System.

This motion continued in effect a similar authority voted at the meeting of the committee on October 22-24, 1935.

Governor Young wished to be recorded as voting in favor of both of these motions on the belief that failure to act on the recommendation of the Advisory Council might create a situation under which these authorizations might be necessary.

There followed a renewed discussion of the proposals read by Governor Schaller.

At 4:25 p. m., by agreement, a recess was taken to attempt to draft a motion which would embody this proposal.

At 4:37 the meeting reconvened and a vote was taken on the following resolution:

RESOLVED that it is the sense of this committee that for reasons outlined in the resolution adopted by this committee at its meeting last October, supplemented by the memoranda presented to the committee, that the Board of Governors should now favorably consider some early increase in the reserve requirements of member banks.

The resolution was lost by a vote of seven to five, as follows:

Yes	No
Governors Harrison	Governors Young
Fleming	Norris
Schaller	Seay
Geery	Newton
McKinney	Martin
	Hamilton
	Calkins

Governor Norris asked to be recorded as voting no on the ground that he favored some action, but preferred action in the open market.

Governor Seay asked to be recorded as voting no because he prefers to see action deferred until after the first of the year, when the situation might be clearer.

Governor Hamilton indicated that he voted no because the resolution included country banks. He said that he would vote for a resolution limiting the increase to reserve city and central reserve city banks.

Governor Martin indicated that his negative vote was on the ground that the situation was such as to make it undesirable to act at this time.

Governor Harrison left the room for a few minutes to confer with Chairman Eccles.

At 5:10 Governor Harrison returned and reported that Chairman Eccles expressed the hope that the open market meeting would not finally adjourn tonight but would reconvene in the morning. It was so voted and the meeting adjourned at 5:12 p. m., to reconvene as a Governors' Conference.

In the course of the Governors' Conference a discussion arose as to the interpretation of the Banking Act of 1935 with respect to the power of the reserve banks to exchange government securities directly with the Treasury when an exchange offering was made. It was agreed that it would be undesirable at this time to raise the legal question and that instead it would be better to replace all maturing issues in the open market.

The meeting reconvened at 10:15 a. m., on December 18, there being present the Governors of all the reserve banks, Deputy Governor Burgess, Secretary, and Mr. Strater of Cleveland.

Governor Harrison indicated that he was concerned about adjourning the meeting with the record as it was. It was clear that the majority wanted to take some action, but were divided as to the method. They had before tham a unanimous recommendation of the Federal Advisory Council to take some action. The committee would appear to be functioning badly if it favored some action but was unable to agree upon the method to be employed. The question might be asked why those who favored action through the raising of reserve requirements did not support open market action. His response would be that the greatest likelihood of agreement on action on the part of the reserve System lay in the proposal to increase reserve requirements.

After some further discussion, a draft resolution was read (this form includes later revisions).

> The Committee has considered the preliminary memorandum and a memorandum on excess reserves and Federal reserve policy and has discussed various aspects of the credit situation.
>
> The Committee finds that continued improvement has been made in business and financial conditions since its last meeting but the country is still short of a full recovery and there does not appear to be anything in the situation which makes it necessary for the reserve system now to reverse its policy of easy money. It is still the unanimous opinion of the Committee that the primary objective of the reserve system should be to lend its efforts toward the furtherance of recovery.

It is the view of the Committee, however, that the amount of excess reserves of member banks constitutes a source of danger for the reasons expressed in the reports before the Committee at its October meeting and those considered at this meeting. The Committee believes, therefore, that action should be taken as soon as possible without undue risk to absorb a part of these excess reserves as a safeguard against possible dangers, and not as a policy of credit restraint.

Two principal methods of accomplishing this have been discussed by the Committee: (a) permitting the present system holdings of Treasury bills to mature without replacement, and (b) raising reserve requirements. Some of the members of the Committee would prefer the employment of method (a) and others would prefer method (b).

Those members of the Committee who prefer method (a), that is, the reduction of holdings of short-term Government securities by the system, are so strongly of the opinion that some early action should be taken that they join with those members favoring method (b), an increase in reserve requirements, in a recommendation that the Board of Governors of the Federal Reserve System should consider some early and substantial increase in the present reserve requirements of member banks which were fixed at a time when the gold base of the country was substantially lower than it is now. The Committee refrains from recommending or suggesting any precise time or percentage of increase or the classes of banks to be affected believing that the time or amount and character of action would, of course, have to be determined by the Board of Governors in the light of all the conditions as they appear at the time action is actually taken, not only business and credit conditions but also the banking situation particularly as it may be affected by the Government's fiscal policy.

Governor Calkins indicated that he feared the psychological effect on the banking fraternity of an increase in reserve requirements, even if it were confined to reserve and central reserve cities. There ensued a general discussion of this question in the course of which Governors Martin and Newton stated their belief that there was no need for action at the present time, and Governors Hamilton and Geery stated a preference for action in the open market.

Governor Geery suggested tentatively a proposal to allow Treasury bills to run off without replacement until the next meeting, but to recommend that if the Board of Governors does not approve this action, the recommendation be made that the Board should consider an early increase in reserve requirements.

There ensued some discussion of this general proposal, in the course of which Governor Norris stated that he believed some action was desirable and that he was therefore prepared to approve action by a method different from the one he preferred for the sake of securing agreement to some action.

By an informal vote, ten of those present, all except Governors Martin and Newton, indicated that they favored some action at this time.

Governor Young moved that the action taken in all the votes of yesterday be rescinded. This motion was defeated by a vote of nine to three, as follows:

Yes	No
Governors Young	Governors Harrison
Hamilton	Fleming
Seay	Newton
	Schaller
	Martin
	Geery
	Norris
	McKinney
	Calkins

Governor Harrison then read, as amended, the resolution presented earlier, on pages 10 and 11, and this resolution was moved and seconded.

Governor Geery made a substitute motion as follows:

RESOLVED that the System allow its holdings of Treasury bills to run off without replacement as they mature between now and March 1st. If, however, the Board of Governors does not approve of this method, the committee then recommends that the Board give consideration to some early substantial increase in reserve requirements.

After discussion, a vote was taken on this motion and it was lost by a vote of eight to four, as follows:

Yes	No
Governors Young	Governors Harrison
Geery	Fleming
Hamilton	Newton
Calkins	Schaller
	Martin
	Norris
	McKinney
	Seay

There ensued a discussion of the earlier motion in the course of which Governor Hamilton made the following motion, as an amendment:

> While the committee has agreed that it is necessary to take steps to curb or correct the condition of excess reserves, the committee is of the opinion that should reserve requirements be raised, the Board of Governors should give due consideration to the inadvisability of raising reserve requirements for other than reserve city or central reserve city banks.

In supporting this motion, Governor Hamilton stated that an increase in reserve requirements of member banks would be a handicap tending to prevent nonmember banks from joining the Federal Reserve System.

The motion was not seconded, a number of those present pointing out that in their districts the reserve requirements of nonmember banks were higher than those for member banks. It was also suggested by a number that it would be better to avoid detailed suggestions in a recommendation to the Board of Governors regarding the increase in reserve requirements.

There was further consideration of the possibility of adjournment without definite recommendation and a motion to that effect by Governor Young was lost by a vote of nine to three, as follows:

Yes	No
Governors Young	Governors Harrison
Newton	Fleming
Martin	Seay
	Schaller
	Norris
	Hamilton
	Geery
	McKinney
	Calkins

A vote was then taken on the original resolution in its revised form as given on pages 10 and 11, as follows:

Yes	No
Governors Harrison	Governors Young
Fleming	Newton
Norris	Martin
Seay	Calkins
Schaller	
Geery	
Hamilton	
McKinney	

It was understood, as at the meeting of October 22-24, that any action of this sort should be taken only in coordination with Treasury policy.

It was then moved that the Chairman of the committee be requested to call a meeting on or about January 15. This motion was passed by a vote of eleven to one, Governor Fleming voting no.

Governor Fleming wished to be recorded in the negative on the ground that he was opposed to the fixing of a date until after the committee had been informed of the reaction of the Board of Governors.

The meeting adjourned at 12:15 p. m., to reconvene as a Governors' Conference.

At 12:55 p. m., the meeting reconvened as a joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System, there being present:

From the Board of Governors of the Federal Reserve System:

Chairman Eccles,
Governors Hamlin, Miller, James, Szymczak and Thomas.

From the Federal reserve banks:

Governors Harrison, Young, Norris, Fleming, Seay, Newton, Schaller, Martin, Geery, Hamilton, McKinney and Calkins,
Deputy Govermor Burgess, Secretary, and Mr. Strater.

From the staff of the Board of Governors of the Federal Reserve System:

Messrs. Morrill, Clayton, Goldenweiser, Thurston, Carpenter and Thompson.

The resolution adopted by the committee was read and there ensued a general discussion of the meaning of the resolution.

The meeting adjourned at 2:35 p. m., with the understanding that the Board of Governors would meet by itself to consider any suggestions it might have to make to the Committee with respect to the resolution or with respect to a public statement.

The meeting was again called to order at 4:15 p. m., as a joint conference, the same people being present, ~~except that~~ Mr. ~~Bethea~~ of the staff of the Board of Governors of the Federal Reserve System was also present.

Chairman Eccles read a draft of a proposed statement to the press and there ensued a general discussion of this statement.

It was then moved and unanimously carried that a committee consisting of Chairman Eccles, Governors Miller, Harrison and Young and Messrs. Goldenweiser, Thurston and Burgess be asked to draft a statement.

The members of the Board of Governors of the Federal Reserve System and the staff representatives then left the meeting.

Governor Harrison stated that he feared that any press statement might be a source of embarrassment to future action though it was agreed that there was nothing inconsistent between a press statement of the sort proposed and the resolution which had been adopted. Governors Young and Harrison and Deputy Governor Burgess were authorized to confer with the representatives of the Board of Governors and agree on some form of public statement and also to make any slight modifications in the resolution which might be necessary to bring the two into conformity.

At 5:10 p. m., the meeting adjourned.

At 5:29 p. m., the meeting reconvened with the same attendance and the following press statement was read and unanimously agreed upon.

> The Board of Governors of the Federal Reserve System and the Federal Open Market Committee have given extended consideration to the general business and credit situation and to the recommendation of the Federal Advisory Council and are of the opinion:
>
> 1. That continued improvement has been made in business and financial conditions but that the country is still short of a full recovery.
>
> 2. That the primary objective of the System at the present time is still to lend its efforts to a furtherance of recovery.
>
> 3. That there is at the present time no evidence of over-expansion of business activity or of the use of business credit.

4. That the present volume of member bank reserves, which have been greatly increased by imports of gold from abroad, continues to be excessive, far beyond the present or prospective requirements of credit for sound business expansion.

Therefore, the special problem created by the continuing excess of reserves has had and will continue to have the unremitting study and attention of those charged with the responsibility for credit policy in order that appropriate action may be taken as soon as it appears to be in the public interest.

At 5:40 p. m., the meeting adjourned.

W. Randolph Burgess,
Secretary.