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~~CONFIDENTIAL~~
Final minutes

MINUTES OF THE MEETING OF THE OPEN MARKET POLICY CONFERENCE
WASHINGTON, D. C., JANUARY 11 and 12, 1932.

1/11/32

The meeting was called to order at 10:35, there being present:

Governor Harrison, Chairman,
Governors Norris, Seay, Black, Fancher, McDougal,
Martin, Geery, McKinney, and
Deputy Governors Day and Burgess (secretary).

The preliminary memorandum of the Chairman was submitted to the conference together with the Secretary's Report of Operations.

On motion the members of the Federal Reserve Board were invited to join the Conference, and the following entered the meeting:

Governor Meyer, Messrs. Hamlin, James, and Magee, together
with Messrs. Floyd Harrison, Goldenweiser, and McClelland.

Governor Meyer reported that Mr. Herman Langworthy, newly appointed director of the Kansas City bank, had been designated by the board of directors of that bank to represent the bank at this meeting, and Mr. Langworthy was invited to join the meeting, which he did.

On opening the meeting Governor Harrison called attention to the arrangement that had been made previously for a meeting in January and indicated that recent developments made it particularly important for this meeting to review the whole financial picture.

Governor Harrison pointed out that the deflation of bank credit in the United States had amounted to more than $6,000,000,000 in two years in addition to a decrease of $6,000,000,000 in brokers' loans by others than banks. In the past three months the deflation had become still more rapid and was at the rate of 20 per cent per annum. A continuation of this deflation might be expected to lead to still further serious price declines. There had been some interruption of bank failures in November following the inauguration of the National Credit Corporation but lately the number of failures had again increased and currency withdrawals for hoarding appeared to have begun again to some extent.

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The gold situation, he indicated, was fairly quiet but likely to become active again if bank failures continued.

The question now was what could be done to prevent a further deflation and to bring about some improvement in conditions. With developments already begun or in prospect there seemed some possibility of getting an upward movement started by combined effort. Recent important developments included an improvement in the condition of the bond market, prospects for a readjustment of wage rates for railroad employes, and prospects for the passage of a bill providing for the Reconstruction Finance Corporation.

It seemed clear, however, that these steps to stop deflation would not be sufficient alone, and active Federal reserve cooperation would appear to be necessary to bring about some increase in credit.

A discussion of purchasing Government securities raised immediately the question of the System's free gold position. Governor Harrison had discussed somewhat with Senator Glass a possible amendment to the provisions of the Federal Reserve Act respecting collateral requirements against Federal reserve notes that would have the effect of broadening these requirements to include any of the assets of the reserve banks and so increase the amount of free gold.

In informal discussion a proposed amendment of this sort to the Federal Reserve Act was approved in principle by most of those present.

Governor Harrison referred to the Treasury program and indicated that the Treasury would require about one and a half billion dollars of new money between now and June 30 and that under present conditions it would be difficult for the Treasury to borrow this amount without a serious effect on the government security market and the general bond market. He stated that he believed a successful Treasury sale of these securities would require

(1) General strength in the bond market

(2) Direct discussions with the member banks as to the importance of their cooperating

(3) Discount rate adjustments to enable banks to borrow at a profit

(4) Probably some purchases of Government securities by the Reserve banks.

Any program to be successful must also include a definite policy by the administration as to the total amount of borrowing to be undertaken and also a definite policy as to balancing the budget after June 30, 1932.

Governor Harrison believed that through successful issues of government securities, purchased largely by the banks aided by Federal reserve co-operation, it might be possible to stop the deflation of credit.

With reference to the Reconstruction Finance Corporation Governor Meyer indicated that the speed with which the corporation could be put into operation depended on the form of the bill and particularly whether under it the Reserve banks would be authorized to assist the corporation in its initial activities.

The meeting then adjourned as a meeting of the Open Market Policy Conference and reconvened as a meeting of the Governors' conference. Thereupon the following resolution was adopted:

> "RESOLVED that the passage of the Reconstruction Finance Corporation Act at the earliest possible date is most desirable in the interest of the financial and business situation which now exists in all of the Federal Reserve Districts; and that in order to expedite the operation of the Reconstruction Finance Corporation, if and when authorized, the assistance of the operating facilities and services of the Federal reserve banks should be available to the Corportion, with the understanding that the Corporation should reimburse the Federal reserve banks for such facilities and services in such manner as may be agreed upon."

In the discussion some of the Governors expressed the opinion that the proposed new corporation should not be authorized to finance municipalities. It was also agreed by those present that the Federal Reserve Banks should not be expected to act formally as the loaning agencies of the corporation and that there should be a proper dissociation of the functions of the reserve banks and the new corporation.

The resolution was passed with the understanding that Governor Meyer would be free to use it if and when it appeared desirable.

The meeting then adjourned as a Governors' Conference and reconvened again as the Open Market Policy Conference.

Governor McDougal presented a memorandum opposing further purchases of Government securities, giving his reasons therefor, and suggesting that the $42,000,000 of such securities acquired in December be gradually disposed of in the market, this on the ground that in view of conditions now current efforts should be made to strengthen the position of the Federal Reserve System. He further suggested that the $83,000,000 of Government securities due March 15 be sold gradually, and that Treasury bills due in January and February be allowed to run off.

Governor Seay suggested that under the present form of the Federal Reserve Act he would be opposed to buying further bonds as such purchases would tend to weaken the strength of the system. Member banks should get what funds they required by borrowing.

Governor Harrison suggested that it would be desirable in future discussions to decide whether the system should follow a purely defensive course or should take affirmative action designed to stop liquidation and bring about some increase in credit.

The meeting adjourned at 12:50 p. m.

Afternoon Session

The meeting reconvened at 2:18 p. m., there being present:

Governors Harrison, Norris, Seay, Black, Fancher,
McDougal, Martin, Geery, and McKinney,
Deputy Governors Day and Burgess, Mr. Langworthy, and
Messrs. Magee and Goldenweiser.

There was further informal discussion of a proposed amendment to the Federal Reserve Act designed to release larger amounts of free gold. The two alternatives discussed were to remove altogether the provisions of the Act requiring collateral for Federal reserve notes or simply to take out the definition of the types of collateral which could be accepted. The Governors generally favored some such modification of the Act and those who expressed an opinion preferred the second alternative. Governor Meyer, Mr. Hamlin, and Mr. James entered the meeting at this point.

There followed discussion of administrative methods which could be used to increase the amounts of free gold available prior to any modification of the law, including the appointment of Acting Assistant Federal Reserve Agents at branches in order that unissued notes might be returned to the custody of the agents and that discounted bills held at branches might be available as collateral. It was also suggested that the Federal reserve notes currently received at each Federal Reserve Bank might be returned to the agent each night without serious difficulty. Members of the Board present indicated that they saw no objections to the suggested procedures.

Under Secretary Mills and Assistant Secretary Ballantine entered the meeting at 3:00 p. m., and Mr. Mills discussed the problem of Government financing in coming months. He indicated that the Treasury felt that the problem to be dealt with was much larger than merely financing the Treasury but was rather one of preserving Government credit and of restoring a normal functioning of credit machinery.

The Treasury faces a problem of raising about one and a half billion dollars additional money between now and June 30 to meet current expenditures and the requirements of the Reconstruction Finance Corporation, the farm loan banks, and the proposed home loan banks. The effects of increasing the national debt during the past year had not been inflationary as might have been expected but rather the reverse. Funds appear to have been withdrawn from other necessary uses to finance Treasury requirements. We suffered the evils of an unbalanced budget without any of its advantages.

If the Treasury and the Federal reserve banks do not now work in close harmony it will not be possible to obtain the one and a half billion dollars required except by very sharp increases in interest rates, which would in turn result in severe depreciation in government and other securities and further impair the credit of the Government, which must be restored. We now have to deal with an emergency only comparable with the emergency of war and are justified in returning to war techniques in the sale of government securities.

If war techniques are followed, June 30 next must be a deadline beyond which the national debt will not be increased. The inclination of banks to subscribe would be increased by reductions of Federal reserve discount rates to give some differential between those rates and the yields on government securities. If banks can be induced to borrow and buy the net effect must be an expansion of credit. This could not fairly be called an inflation of credit in view of the recent unprecedented deflation which has occurred.

Mr. Mills felt that, in the interest of maintaining the credit of the government, maintaining the value of securities, strengthening the credit structure, and reversing deflationary trends, the Treasury was justified in asking cooperation in the use of methods used in the last great crisis of the country. Any danger such a program might involve can be avoided if it is a temporary expedient to terminate definitely at the end of this fiscal year. He said this termination would be supported firmly and definitely by the Executive and he had reason to hope by Congress.

In informal discussion the question was raised as to whether flat discount rate reductions would be better or simply reductions of rates on loans against Government securities, thus establishing preferential rates. It was agreed that this question would have to be decided by each bank for itself.

The question also was raised whether in the sale of these securities a drive should be made to bring money out of hoarding, and Mr. Mills and others suggested that the danger of such a course would lie in its bringing money out of weaker banks instead of out of hoarding.

The question was raised whether the collateral requirements for postal savings deposits could not be liberalized as a means of making postal savings deposits available to more banks which need them.

Governor Harrison raised the question of the flexibility of bill rates and indicated that the New York Bank would probably desire to precede any change in discount rate by a reduction of bill rates and that, furthermore, there was a considerable advantage in putting money into the market through the purchase of bills as far as possible because these bills would serve as collateral against Federal reserve notes. Governor Harrison suggested that it might be desirable to drop the bill rate to 2 3/4 or 2 7/8 and asked if anybody saw any objection to this program. No objections were made.

Governor Harrison suggested that the following appeared to be the program for consideration to stop deflation and encourage some credit increase:

(1) Passage of the Reconstruction Finance Corporation bill

(2) Organized support of the bond market predicated upon railroad wage cuts

(3) Federal reserve and member bank co-operation with the Treasury program

(4) Buying bills when possible

(5) Reduction in discount rates

(6) Buying of Governments, if necessary, facilitated by an alleviation of the free gold position.

He believed that the system's hands should not be tied on any one of the last four points and that it was important to have a definite cooperative program in order that progress might be made.

In a discussion of the policy of the several reserve banks on loaning against Governments the following reports were made:

These banks lend against Governments at par in all cases:

New York
Atlanta
Minneapolis
Dallas
Cleveland

This bank lends against Governments at market in all cases:

San Francisco

These banks lend at market in some cases and at par in others:

Boston
Richmond
Philadelphia
Chicago
St. Louis

The meeting adjourned at 4:25 to reconvene in the morning.

Meeting Tuesday, January 12, 1932.

The meeting was called to order at 10:30 a. m., there being present the following:

Governor Harrison, Chairman,
Governors Norris, Seay, Black, Fancher, McDougal,
Martin, Geery, and McKinney, and
Deputy Governors Day and Burgess (secretary).

Governor Harrison reviewed his recent discussions with the Treasury and others concerning the government budget and indicated that as a preliminary to any program of government financing there had been emphasized the necessity, first, of the government balancing its budget after June 30, next, and second, of arriving at an outside aggregate figure for the increase in the national debt prior to that time. Governor Harrison believed much progress had been made towards these objectives.

Governor Harrison then raised the question as to the extent to which the different governors were prepared to recommend to their boards of directors cooperation with the general program which had been discussed, including as one feature a reduction in rediscount rates either in the form of a differential rate on government securities or a flat reduction of rate. Governor Harrison indicated that the New York bank favors a flat rate reduction; that whatever action was taken would be taken not simply for the benefit of the government, but as a part of a broad general program to combat credit deflation. A differential rate might on the other hand give the impression that it was being done simply to aid Treasury financing.

There ensued a discussion of the desirability of discount rate reductions. Governor McDougal raised the question of what alternative there was to reducing rates and Governor Black replied that it appeared to him that the alternative was that the Treasury would do the best it could and would issue securities at constantly advancing rates to the point where the difficulties of sale and the reaction upon the bond market would be so great that the Reserve banks would be practically forced to cooperate.

Governor Fancher raised the question whether the Reserve banks could consistently reduce rates in the face of present large demands for Federal reserve credit. In this situation it might be advisable to make a special rate for new issues. In the course of discussion the difficulties involved in a special rate for particular issues were brought out. It was suggested that such a procedure would discriminate unfairly against recent issues and would be ineffective. What was required to sell government securities was not so much attractive terms for any single issue but an easy money position and a good government security market generally.

After further discussion it was agreed that without any formal resolution the minutes should contain an informal statement that it was the unanimous individual opinion of those present,

(1) That in view of all the circumstances and especially the important place the Treasury program occupied in the general credit situation and in any program to check credit deflation, the Reserve banks should generally cooperate with the Treasury program, and

(2) That the governors present would recommend to their boards discount rate reductions either in the form of flat reductions or preferential rates on government securities.

It was agreed that in any cases where preferential rates might be adopted they should apply to all government securities and not to specific issues alone. It was further made clear in the course of the discussion that those present regarded reductions in discount rates not so much as a means of aiding the sale of government securities but as an important step towards stopping credit deflation.

Undersecretary Mills entered the meeting at this point and Governor Harrison reported to him the views of the governors with regard to cooperating with the Treasury program. In response to questions Mr. Mills stated,

(1) That the administration proposed that the government budget should be balanced after June 30, next,

(2) That the administration program called for sales of approximately $1,500,000,000 of additional government securities before June 30, 1932,

(3) That it seemed likely that new issues would take the form of short term issues rather than bonds.

There ensued discussion as to whether the Treasury should advance the interest rate it receives on government deposits in depositary banks. Mr. Mills asked the opinion of the governors present and their consensus of opinion was in favor of leaving the deposit rate at 1/2 of 1 per cent.

Governor Harrison presented a resolution designed to summarize the conclusions of the discussions of the two days' meetings, and in the ensuing discussion particular attention was given to the proposal for possible purchases of government securities.

At this point Mr. Mills left the meeting and Governor Meyer joined it.

Governor Meyer stated that he believed in the present situation the Reserve System should be prepared to use all of its powers if and when necessary.

Governor Black asked whether the members of the Federal Reserve Board were in accord with the suggestion for lower discount rates, and Governor Meyer replied that the matter had received no formal attention in meetings of the Board but that the members of the Board with whom he had discussed the matter were in favor of lower rates for the purpose of facilitating the general program.

He also suggested that any lower rates which were established should not, in fairness to the member banks cooperating with the program, be withdrawn too quickly.

Governor Black suggested that definite action should be taken with regard to the $42,000,000 of government securities purchased for System Account at the year-end. A motion to sell these $42,000,000 of securities was made by Governor McDougal but did not receive a second.

Governor Harrison's resolution was then considered and, after a number of amendments, was adopted in the following form, Governors Seay and McDougal, and Deputy Governor Day voting in the negative.

> The Conference has considered the preliminary memorandum and discussed at length the current business and banking situation. It gave particular attention to the increase in bank failures and the pressure upon the business and price structure of the country resulting from or coincident with the huge deflation in bank credit during the past year, the contraction of bank loans and investments during the last quarter of 1931 being at the rate of about 20% per annum. The Conference believes that this deflation cannot continue without most serious damage to the business and financial structure of the country. While the Conference is of the opinion that the proposed Reconstruction Finance Corporation will be of material help in checking the failure of sound banks and in thus tending to relax further unnecessary pressure for liquidation, and that while the further acquisition of bills by the Federal reserve banks may be encouraged by Federal reserve bank rate adjustments, nevertheless because of the seriousness of the general situation and the importance of relieving the drastic pressure on the credit structure now inspired largely by fear of further liquidation, the System should be prepared, if necessary, to supplement these other steps by the purchase of government securities. It, therefore, resolves that the Executive Committee be authorized if and when desirable to purchase for System account not to exceed $200,000,000 of government securities, such purchases to be made only after the approval of the executive committee at a meeting to be called for the purpose of considering the occasion or need therefor.

At 12:50 the Open Market Policy Conference was adjourned, and the meeting reconvened as a Governors Conference.

The meeting proceeded to consider Senate Bill S-2310 providing for relief of depositors of closed banks and involving the direction to the Federal reserve banks to subscribe from their surplus $50,000,000 of the capital of the corporation to be organized for this purpose.

On invitation Deputy Comptroller of the Currency Awalt entered the meeting and there ensued a general discussion concerning the legality of the provision with regard to the use of Federal reserve surplus for this purpose.

Mr. Awalt then left the meeting and the following resolution was adopted:

It is the sense of the Governors Conference that quite apart from the question of the constitutionality of Congressional appropriation of surplus of Federal reserve banks already accumulated in accordance with law, the proposal in Senate Bill 2810 to require Federal reserve banks to subscribe $50,000,000 of their surplus to the capital stock of a corporation designed to pay off deposits in closed banks is detrimental to the best interests of the Federal reserve banks, their member banks, and the public at large, and, without expressing any dissent whatever to the objects of the bill in question, the Conference believes it would be unwise to retain in the bill any provision which would appropriate any of the accumulated surplus of the Federal reserve banks for the purposes of the proposed corporation.

On motion it was agreed that discussion of the recommendations of the Reserve committee should be put over until another meeting.

At 1:45 p. m. the meeting adjourned.

W. Randolph Burgess,

Secretary.