Form F. R. 511

TO ______________________________

FROM ______________________________

REMARKS:

Left with Secretary Snyder by Chairman Eccles - after Open Market Executive Committee meeting 10/14/47

CHAIRMAN'S OFFICE

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

CONFIDENTIAL

Honorable John W. Snyder,
Secretary of the Treasury,
Washington, D. C.

Dear John:

The Federal Open Market Committee, at its meeting on October 7, which was attended by the Presidents of all of the Federal Reserve Banks, discussed at length the present economic situation of the country, in its domestic and international aspects, and the relation of monetary and credit factors, and of debt management, to what presents itself to us as a clearly developing accentuation of inflationary tendencies. In the light of this discussion it was the opinion of the group that a constructive recommendation to you, with respect to the November 1st financing, could be made only as part of a broader program of bringing to bear on this situation all of the weapons of control which are now available to us in the field of monetary policy and debt management.

COPY

Inflationary pressures have been strong in our economy during the past few months and there is ample indication that these pressures will continue strong, and perhaps be accentuated, in the months immediately ahead. The basic causes of this situation are well known. A vast supply of money and other liquid assets was created during the war and there have been additions to this accumulation of purchasing power since the end of the war. There has also been an inadequate supply of goods and services, both domestic and foreign, growing out of the destruction of war and the deferment of civilian demands when a large part of output was destined for military use. The obvious consequence has been that, at current prices, the supply of purchasing power in the hands of active spenders is far in excess of the value of even present high levels of output.

The existing situation, therefore, spells continuing pressure toward higher prices. In addition we must take cognizance of the fact that conditions are highly favorable to further credit expansion. Continued heavy demands for bank loans are likely from

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

business, from mortgage borrowers, and from consumers. The means of such additional credit expansion are readily at hand in the form of gold imports and too easy access to Federal Reserve credit, both of which provide the banking system with the reserves on which a not less than six-fold expansion of credit can be based. In view of the decline in earnings, banks are under considerable pressure to increase their assets or to shift from low-yielding to higher-yielding assets. In such circumstances, it is too much to expect that further increases in bank credit will be confined to productive loans; the more likely outcome, in the absence of repressive measures, will be an increase in speculative credit.

The Committee recognizes that the strongest forces working toward inflation lie outside of the field of current monetary policy and debt management, and that the means of control which are at our joint disposal can be of only limited effectiveness. The Committee feels, however, that further credit expansion would augment the existing forces of inflation. The situation is now so critical as to warrant our taking every action, within the power of the Treasury and the Federal Reserve System, to eliminate or moderate excessive credit expansion. The vigorous action which in former times could have been relied upon to check the progress of inflation is now denied to us because of the necessity of maintaining the stability of the market for Government securities, and all that depends on such stability, but this should not deter us from taking whatever action lies within the area of practical discharge of our responsibilities.

In the light of this background and this forecast the Committee wishes to place its recommendations with respect to the November 1st financing within the framework of a broader program of credit policy and debt management. The group is strongly in favor of a program which would comprise the following:

1. It is of prime immediate importance that measures be adopted to offset the expansionary effect of gold inflow on bank reserves and also to put some pressure on banks by requiring them to sell securities to maintain their reserve positions. This can best be accomplished by a reduction in Federal Reserve holdings of Government securities. Since it would be difficult for the Federal Reserve to reduce its portfolio by selling securities in the market, the best procedure would be for the Treasury to use its cash balances to retire Federal Reserve holdings of maturing bills and certificates. It is estimated that the Treasury will have in November and December about 2.5 billion dollars available for retirement of marketable debt,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

and another billion dollars in January. The Federal Reserve portfolio holds a little over one billion dollars of the next three issues of maturing certificates. Depending upon the needs of the situation, the Federal Reserve could present these certificates for retirement and funds would still be available for the retirement of bills to the extent found to be desirable.

2. The policy of raising short-term rates of interest should be continued so as to lessen the urge on the part of banks either to reach out for longer-term Government securities, or to make undesirable loans and investments, in order to maintain earnings. This would mean moving up issuing rates on certificates, and permitting the current rate on Treasury bills and market yields on outstanding certificates to rise in accordance with market demands and the coupon rates adopted on newly issued certificates. In view of large maturities of high-coupon issues, during the next few years, a large part of which are held by banks, the Treasury is in a position to reduce its interest burden by refunding into lower-rate short-term issues. If, however, the rates are too low commercial banks will seek other assets and shift more of their Government securities to the Reserve System. Moderately higher short-term rates will diminish this tendency and at the same time not raise the Treasury's interest costs.

The policy of grouping all certificates into four quarterly issues and of gradually raising rates should be continued as follows:

(a) Certificates maturing November 1 should be refunded with either a one per cent 11-month certificate or a 1-1/8 per cent 14-month note.

(b) Certificates maturing December 1 should be exchanged for a 1-1/8 per cent 13-month note and those maturing January 1 for a 12-month certificate at the same rate.

(c) Holders of bonds maturing December 15 should be offered the privilege of exchange into the 1-1/8 per cent notes issued on December 1.

3. It is recommended that the Treasury adopt measures to encourage holders of maturing savings bonds to reinvest the proceeds into additional issues for the purpose of keeping these

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

funds out of the spending stream. This may be accomplished by giving the holders of maturing savings bonds the option to use the funds obtained to purchase either (a) series E bonds above the limit of $3,750 for total purchases in any one year; or (b) a special nonmarketable 10-year bond, with an annual interest coupon of 2-1/2 per cent and the option of redemption at par after six months on 60 days' notice.

4. Increase the Federal Reserve Bank discount rates to 1-1/4 or 1-1/2 per cent in line with market conditions after a further increase in the rate on certificates is indicated.

5. Increase reserve requirements for central reserve city banks (New York and Chicago) from 20 to 26 per cent in three 2-per cent steps. These increases, which would put considerable pressure on banks in these cities and make it necessary for them to shift Government securities to the Reserve System in order to maintain reserves, should be timed in accordance with the need for pressures on the central money markets so as to obtain the full benefit of the psychological as well as the actual effect of the increases.

6. In view of the pressures for consumer credit growth from buyers, sellers, and lending agencies and the end of Regulation W on November 1, the Board of Governors will prepare a strong statement stressing the dangers inherent in an excessive expansion of such credit and urging the adoption of self-imposed restraints. The Board will give this statement a national release and will send copies to the various national credit organizations. Each Federal Reserve Bank will send copies of the statement over the signature of the President to Regulation W registrants in its district and will give the statement wide local publicity. Wherever practicable the matter will be discussed with representatives of the various credit organizations.

7. An agreement is being sought among Federal and State bank supervisory agencies to direct bank examinations toward discouraging expansion of bank loans, especially consumer loans, real estate loans, and what may appear to be speculative business loans. They should also urge the maintenance of a high degree of liquidity and, where banks reduce liquidity and increase risk assets, the building up of their capital positions.

This program would, of course, require constant consultation between representatives of the Federal Open Market Committee and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the Treasury, and Mr. Sproul and I would expect to hold ourselves at your disposal so that we may be able to time the various steps of the program in relation to the demands of the situation as it develops.

Sincerely yours,

M. S. Eccles,
Chairman.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis