

A meeting of the Executive Committee of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in Washington on Tuesday, September 24, 1935, at 10:00 a. m.

PRESENT: Mr. Thomas, Vice Chairman
Mr. Hamlin
Mr. James
Mr. O'Connor (first part of meeting)

Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Goldenweiser, Director, Division
of Research and Statistics
Mr. Smead, Chief, Division of Bank
Operations
Mr. Wyatt, General Counsel

ALSO PRESENT: Messrs. Steele, Perkins, Loeb, Braun, Young, Solomon A. Smith, Walter W. Smith, Wold, Kemper, Frost, and Arnold, members of the Federal Advisory Council from the First, Second, Third, Fourth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh and Twelfth Federal Reserve Districts respectively.

Walter Lichtenstein, Secretary of the Federal Advisory Council.

Mr. Walter W. Smith, President of the Federal Advisory Council, stated that the Council had held a meeting yesterday and had discussed the relation of the System's large holdings of Government securities to excess reserves of member banks and whether the Council should submit a recommendation with regard to open market policy, and that as a result of the discussions a statement had been prepared for submission to the Board. At the request of Mr. Smith, Mr. Lichtenstein read the statement which was as follows:

"The Federal Advisory Council wishes to call the attention of the Board of Governors of the Federal Reserve System to the existence in the system of large amounts of Government bond holdings which have not

9/24/35

-2-

"varied for a long time. The whole theory of open market operations is to have sufficient flexibility to prevent undue expansion and contraction in the credit structure of the country and this may become impossible if the amount of Government bond holdings by the Federal reserve system is allowed to become a constant quantity. The Council would like to know whether the Board agrees with the principle here enunciated."

In connection with the statement, Mr. Smith referred to the fact that approximately \$2,400,000,000 of Government securities have been held by the Federal reserve banks for approximately two years and stated that it was the feeling of the Council that if the System portfolio is maintained at that figure, there is danger that the public will regard the amount as a fixed minimum of securities to be held by the Federal reserve banks, and that this situation might have an adverse effect upon the power of the System to control credit in times of expansion or contraction.

Mr. Thomas stated that, in view of the absence of several of the members of the Board from Washington, he did not believe the Board should undertake to answer the inquiry contained in the statement submitted by the Council, but that if the members of the Council cared to express any views regarding it, the Board would be glad to hear them.

Mr. Walter W. Smith stated that Mr. Frost had presented the matter at the meeting of the Federal Advisory Council yesterday and that he would like to have him make a statement on the subject at this meeting.

Mr. Frost said that, in his opinion, the fact that the Federal Reserve System, while holding large investments in Government

9/24/35

-3-

securities, took no action during the last two years to offset gold imports, the return of currency from hoarding, and the issuance of silver certificates, has led the banks, and the public generally, to believe that the Federal Reserve System is going to protect the Government bond market, with the result that the banks have bid against each other in the purchase of Government securities causing increases in market prices to a point where a large amount of the securities held by the banks were purchased at prices above par.

He stated that he felt that if it should be decided that the System should reduce its holdings of Government securities, the adverse effects upon the market would be greater in present circumstances than if the System had met the situation as it developed and taken action to keep the price of Government bonds from getting as high as it has. The question now presented, Mr. Frost stated, is whether the System has gone so far as to say that in present circumstances it would be unwise to reduce its holdings of Government securities because of possible adverse effects upon the banking structure and that if such is the case how much more serious will the situation be in three, four, or ten years if the holdings of Government securities are maintained at the present figure. He said that it was his opinion that excess reserves should never have been allowed to reach the figure that they have, and that the System should have taken steps to offset gold imports and the return of currency from hoarding, as it did to offset gold exports and currency hoarding. He

9/24/35

-4-

also expressed the opinion that the System should not be afraid to reduce its holdings of Government securities by sales, or by permitting issues to run off, in a sufficient amount to enable the System to ascertain whether the reduction would have an adverse effect, and that if such should be found to be the case, securities aggregating the amount of the reduction could be repurchased.

Mr. Frost then made a statement concerning the effects of the rediscounting of paper by Federal reserve banks and the purchase of securities by such banks on the credit and monetary situation and expressed the fear that if the System's present holdings of Government securities are maintained at a constant figure they will become an integral part of the basis for the credit structure of the country. He added that he felt that there should be close cooperation between the government and central bank of any nation, but that, in view of the large excess reserves held by member banks, he could not see how the United States Treasury Department could feel that there would be any lack of cooperation if the System should allow approximately \$50,000,000 of Government securities to mature without replacement. He also said that he was not advocating that a policy should be adopted which would eliminate excess reserves in a very short period but that he was concerned with the static condition of the System's investment portfolio.

Mr. Perkins suggested that it should be made clear that the Federal Advisory Council was not suggesting that a reduction be made

9/24/35

-5-

in the System portfolio at the present time and Mr. Frost said that he wished to emphasize the fact that he had been expressing his own views and not those of the Council.

Mr. Walter W. Smith stated that the Council had decided at its meeting yesterday to make no recommendation to the Board with regard to open market policy.

Mr. O'Connor referred to an address made by him recently at Atlantic City before the Financial Advertisers Association in which he made the suggestion that steps should be taken to place a larger proportion of the outstanding Government securities into the hands of the investing public. He stated that he felt that serious consideration should be given to the formulation of a plan to accomplish this result and he requested that the members of the Council give him any suggestions which they might have regarding the matter.

Mr. Walter W. Smith stated that because of the present conditions surrounding the Government securities market it would be very difficult to interest the investing public in Government securities and that it had been his experience that the public refuses to pay a premium on securities of any kind which bear a low rate of interest.

Mr. James stated that, in his opinion, the problem presented is whether Government securities should not be offered at a rate which will make them attractive to the investing public.

There followed a general discussion during which the opinion was indicated on the part of some of the members of the Council that

9/24/35

-6-

there would be no difficulty in the distribution of Government securities to the general public at a reasonable price.

Mr. Paulger, Chief of the Division of Examinations, joined the meeting at this point.

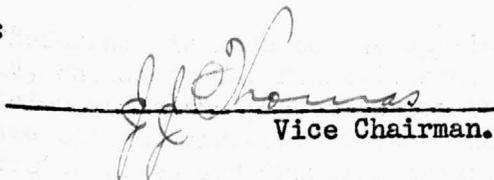
At the request of members of the Board, the members of the Federal Advisory Council present reported briefly on business conditions in their respective districts, each reporting that there were indications of substantial improvement in the general business situation with some activity in the real estate market. During the reports Mr. O'Connor withdrew from the meeting.

At the conclusion of the reports the meeting adjourned.



Assistant Secretary.

Approved:



Vice Chairman.