

A meeting of the Board of Governors of the Federal Reserve System with the Federal Open Market Committee was held in Washington on Tuesday, December 17, 1935, at 10:30 a. m.

PRESENT: Mr. Eccles, Chairman
 Mr. Thomas, Vice Chairman
 Mr. Hamlin
 Mr. Miller
 Mr. James
 Mr. Szymczak
 Mr. O'Connor

Mr. Morrill, Secretary
 Mr. Bethea, Assistant Secretary
 Mr. Carpenter, Assistant Secretary
 Mr. Clayton, Assistant to the Chairman
 Mr. Thurston, Special Assistant to the Chairman
 Mr. Goldenweiser, Director of the Division of Research and Statistics
 Mr. Currie, Assistant Director of the Division of Research and Statistics
 Mr. Thomas, Assistant Director of the Division of Research and Statistics
 Mr. Gardner, Research Assistant, Division of Research and Statistics
 Mr. Garfield, Research Assistant, Division of Research and Statistics

ALSO PRESENT: Governors Young, Harrison, Norris, Fleming, Seay, Newton, Schaller, Martin, Geery, Hamilton, McKinney, and Calkins, members of the Federal Open Market Committee
 Mr. Burgess, Secretary of the Federal Open Market Committee
 Mr. Strater, Secretary of the Governors' Conference
 Mr. Williams, Economist, Federal Reserve Bank of New York

Governor Harrison stated that he had discussed with Chairman Eccles yesterday the procedure that should be followed in connection with the meeting of the Federal Open Market Committee and that it had been agreed that it might be helpful if, before the Federal Open Market

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Committee met in separate session, there could be a joint meeting of the Committee and the Board for the purpose of hearing statements from Mr. Goldenweiser, and any other members of the Board's staff whom the Board may wish to call upon, regarding the present business and credit situation, gold movements, and other factors which enter into the consideration of credit policy, and perhaps a statement from Mr. Williams, Economist of the Federal Reserve Bank of New York. He added that he had not had an opportunity to consult with the other members of the Committee with regard to this suggestion, but that, if it was agreeable, such a procedure would be followed at this meeting. It appearing that this suggestion was satisfactory to the governors present, Chairman Eccles suggested that Mr. Goldenweiser make a statement.

Mr. Goldenweiser reviewed the business situation, indicating that it had not changed materially since the Open Market Committee met in October. The index of industrial production, which had been stable from the beginning of the year until October, had advanced rapidly since that time, but business in general was still less than half way back to the prosperity level. There was no evidence of over-expansion in any line of industry, and though stock market prices had advanced rapidly, it was still largely on cash purchases with no substantial growth in security loans.

There are five courses of action, Mr. Goldenweiser said, that the System could pursue: (1) Do nothing; (2) Diminish the System's portfolio of Government securities; (3) Raise reserve requirements;

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(4) Raise margin requirements on security loans; (5) A combination of two or more of the preceding four actions. He then commented on the possible actions as follows:

1. To do nothing would be a positive action if it were a deliberate policy to continue monetary ease and to continue the pressure of excess reserves on the money market and the capital market. Such a course of action could be justified, provided it was understood that firm and vigorous action would be taken when the circumstances demanded it.

2. Reduction of the System's portfolio of Government securities is on the whole undesirable at the present time because it should be used only as a flexible instrument of credit control when such control became necessary. At the present time it would do no good; would use up the System's ammunition for flexible control; would have unfavorable effects on the market for Government securities, and would transfer earning assets from the Reserve banks to the member banks without any gain to the public good. The Federal Advisory Council's statement that a central bank should not hold a large volume of Government securities is a mechanistic statement without support in experience. So long as a central bank's policy is directed towards influencing the supply and cost of money, rather than to help finance the Government, it is a matter of relative unimportance in what form its earning assets are held, so long as they are sound.

3. To raise reserve requirements would be a form of action better

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adapted to present conditions. It would bring the Reserve banks into closer proximity to the market and enable them to use open-market operations effectively when the time comes. It would be justifiable on the ground that the whole reserve position of the country had greatly changed since the present reserve ratios were established in 1917. It might, however, have an undesirable effect psychologically, and that should be taken into account. An alternative proposal to hold excess reserves at the relatively low level that they will reach seasonally just before Christmas, by raising reserve requirements to absorb the return flow of currency and the disbursements of the Treasury, might have merit.

4. Applying margin requirements to security loans by banks and possibly raising the requirements for both brokers and banks would be a course of action directed at the situation where some evidence of unhealthy activity had appeared. It would be consistent with maintaining easy money conditions and, in fact, would safeguard business from the bad effects of high rates which develop when market activity becomes excessive.

5. A combination of the other courses could conceivably be undertaken, but would probably be undesirable because it would lend itself to the interpretation that the Federal Reserve is moving along several fronts to restrain expansion.

Whatever course of action may be adopted, Mr. Goldenweiser said, it would be desirable to issue a statement indicating the position of

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the Board and the Open Market Committee in the matter. He added that the statement should indicate that the System sees no reason for restraint in either the business or the credit situation; that it feels that it should still lend its efforts to further recovery, and that if any action were taken on reserve requirements, it would be in the nature of a precautionary measure and a readjustment to changed conditions, rather than a reversal of the System's easy money policy.

After a brief discussion, based upon inquiries made by Mr. Miller, regarding possible future gold movements, Governor Harrison asked Mr. Williams to make a statement to the meeting.

Mr. Williams stated that he agreed with the analysis presented by Mr. Goldenweiser and that he was of the opinion that the problem presented three questions: (1) the need at some time of adjusting excess reserves; (2) the method to be used in accomplishing that end, and (3) the timing of the action decided upon.

In connection with the first point he referred to the large increase in member bank reserves since 1929 which makes the potential credit base incredibly large, and stated that he felt there was no room for debate on the question of the necessity for taking action at some time to reduce excess reserves.

In connection with the method to be used he referred to certain elements in the monetary picture which are beyond the sphere of the Federal Reserve System, and stated that it appeared that the courses of action available to the System were to increase reserve requirements

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or sell securities from the System portfolio, and that between the two methods there could be no question as to which was the correct procedure at this time. He said that open market procedure had always been regarded as an instrument of close control and was a flexible weapon that should be retained for the time when the System would be trying to adjust credit control to the actual needs of the situation. He stressed the point that eventually it would be necessary to use both methods in order to prevent inflationary credit expansion and stated that, in his opinion, reserve requirements should be raised first, rather than to attempt later to make minor adjustments through changes in reserve requirements instead of open market operations.

The question of when action should be taken, Mr. Williams said, appeared to be the most difficult of all. He referred to the unmistakable signs of recovery that were evident and stated that there was no certainty as yet that recovery would resume full dimensions and that care should be exercised not to take action which would adversely affect recovery. He stated that the present volume of excess reserves was considerably greater than anyone considered necessary for the furtherance of the present easy money policy, and expressed the opinion that action could be taken to reduce excess reserves to the point where they were about a year ago. He added that this action would remove the dangers that might arise from excess reserves and would reduce excess reserves to an amount where they could be controlled by the use of open market operations. He concluded with the statement that he would like to see any action that the Federal Reserve

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System might take accompany or follow the message on the budget for the fiscal year 1937.

After a further brief discussion, the members of the Board and its staff withdrew and the Federal Open Market Committee met in separate session.

Chester Brown
Secretary.

Approved:

W. H. C. [Signature]
Chairman.