A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in Washington on Tuesday, October 10, 1939, at 10:30 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Ransom, Vice Chairman
Mr. McKee
Mr. Davis
Mr. Draper

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Thurston, Special Assistant to the Chairman
Mr. Wyatt, General Counsel
Mr. Paulger, Chief of the Division of Examinations
Mr. Smead, Chief of the Division of Bank Operations
Mr. Goldenweiser, Director of the Division of Research and Statistics
Mr. Parry, Chief of the Division of Security Loans
Mr. Dreibelbis, Assistant General Counsel
Mr. Leonard, Assistant Chief of the Division of Examinations

Messrs. Thomas M. Steele, Leon Fraser, Howard A. Leob, T. J. Davis, Edward Ball, Edward E. Brown, John Crosby, John Evans, R. E. Harding, and Paul S. Dick, Members of the Federal Advisory Council representing the First, Second, Third, Fourth, Sixth, Seventh, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts.

Mr. C. E. Rieman, President of the Western National Bank, Baltimore, Maryland, as alternate for Mr. Robert M. Hanes, representing the Fifth Federal Reserve District.

Mr. Sidney Maestre, President of the Mississippi Valley Trust Company, St. Louis, Missouri, as alternate for Mr. Walter W. Smith, representing the Eighth Federal Reserve District.

Mr. Walter Lichtenstein, Secretary of the Federal Advisory Council.

Mr. Loeb stated that he wished to express the regrets of Mr. Walter W. Smith, President of the Federal Advisory Council, that because of illness he would be unable to attend the meeting.

Mr. Loeb then said that, since the Board's letter of August 18, 1939, to the Secretary of the Council stated that it was felt that it would be desirable to devote the greater part of the time of this meeting to a detailed consideration of the various aspects of the subject of the easy money policy, the Council had confined its deliberations at its separate sessions on October 8 and 9 very largely to the consideration of that subject and had developed a resolution which had been approved unanimously by the members of the Council. The Secretary of the Council, at Mr. Loeb's request, read the following statement:

"In connection with further consideration of the 'easy money' policy, as suggested in the letter of the Secretary of the Board of Governors of the Federal Reserve System to the Secretary of the Federal Advisory Council, dated August 18, 1939, the Federal Advisory Council was led to examine the recent changes in the yields of corporate and Government bonds. As to the general topic of extreme easy money, the Council reaffirms the views expressed in its recommendation to the Board of Governors dated June 6, 1939.

"While the Council fully recognizes the need in a grave emergency, such as that recently experienced, of taking steps designed to preserve an orderly market in Government securities, it also believes that the market price of Government bonds should be allowed to find its natural level, free of official intervention, as rapidly as possible consistent with an orderly market.

"The operations of the Open Market Committee, acting for the Federal Reserve banks, in maintaining an "orderly natural market (as distinguished from a pegged market) should not be influenced by its judgment as to what the proper price level should be, but that level should be the result of general operations of willing normal buyers and sellers. Neither should it be influenced by any considerations of maintaining or extending the former policy of extremely easy money.

"The Council believes that any policy of maintaining an orderly natural market in Government securities makes advisable the sale of the bonds and notes bought in the process of maintaining an orderly market as and when the free market will absorb them, and that these bonds and notes should not be withheld with a view to forcing the price of bonds back toward pre-September prices."

Mr. Loeb stated that the above statement had been prepared in the form of a resolution and not as a recommendation and was being offered to the Board at this time for discussion.

Mr. McKee inquired whether it was to be taken from the resolution that the Federal Advisory Council was not in sympathy with the actions of the Federal Open Market Committee to date. Mr. Loeb responded that it was not the Council's intention to give that impression. Mr. McKee then stated that he would like to know whether the Council was unanimous in the thought that the actions taken, generally speaking, were sound under the circumstances.

Mr. Ransom said that he would be interested in hearing the views of the members of the Council as to what constituted an orderly market. He stated that, inasmuch as that term had been used several times in the resolution submitted, he would assume that somebody had been able to define that term satisfactorily to the members of the

Council and that he was inquiring because he thought it would be helpful to him in his approach to the problem of determining what is actually an orderly market. He added that he wished to know whether the members of the Council thought there had been an orderly market in Government securities since the time of the German invasion of Poland or, to express it somewhat differently, whether the Council thought there might have been a disorderly market had the Federal Open Market Committee not intervened.

Mr. Loeb stated that it was his opinion that an orderly market is a market that is the result of normal operations, not short-selling, and not raiding, but that he would find it difficult to define it in any narrower sense.

Mr. Ransom referred to the fact that occasionally when there was a large volume of offerings the decline in the market was less than at a time when there was a small volume of offerings, and inquired whether, when there were small offerings and a large decline, the market was orderly.

Mr. Loeb said in reply to Mr. Ransom's inquiry that, while a market is affected by volume, it was the nature of the market rather than the volume that determined whether or not it should be regarded as being orderly.

Mr. Evans expressed the opinion that an orderly market was a natural self-supporting market, that in panicky or emergency times it should be tested out on either the up side or the down side, that if on the down side the market should be permitted to recede a little to see if it would settle at a given point, and if not, it should be tested out as it went down, and that he knew of no other way to prevent a panicky rush of selling. Mr. Evans stated in response to Mr. McKee's inquiry as to whether there was any criticism of the procedure followed by the Federal Open Market Committee, that the criticisms he had heard were confined more or less to details. He said, however, that he knew that one of the small country banks in his territory had been called on the telephone by one of the brokers in New York during the recent decline and advised that the Federal Reserve System was out of the market, that it was "swamped" with offers to sell and that it could not maintain the market any longer. He added that there was a panicky feeling when the Federal Reserve withdrew from the market. He said that he personally felt it was a great mistake for the Federal Reserve to get out of the market when it did, and that he considered it a technical mistake in the procedure of the Federal Open Market Committee to announce either that it was in or out of the market.

Chairman Eccles stated that the Federal Open Market Committee had not announced that the Federal Reserve System was either in or out of the market, to which Mr. Evans responded that that had certainly been announced by the brokers.

Mr. T. J. Davis stated that he thought the fact that the Federal Open Market Committee was in the market was a bulwark of strength during the grave crisis which had arisen, that it helped to instill a sense of confidence and that it dissipated what might have been an overwhelming fear had there been no support in the market at all. He felt that the market for bonds was like a market for anything else, that those who had been close to the market for many years had seen how issues were supported and markets controlled and would realize that any hour during a war might bring fresh news or rumors that might affect the market very suddenly and one had to be on the alert for whatever emergency might occur. He stated that the market might get disorderly in an hour or two because of some unexpected happening of war, that he thought the only thing to do in a case like that was to have a committee, just as we have, to watch and take care of the market. He said that he knew of no reason why the dealers should be left alone to handle the market the way they want to, and the fact that the Federal Reserve did enter the market was a reassuring fact to him, as it was to hundreds of others with whom he had corresponded.

Mr. Ransom stated that, while he did not take the reference in the Council's resolution to pegging the market as an indication that the Council felt that the Federal Open Market Committee had pegged the market, he was not sure how that might be construed by an outsider, and that while he did not know the Council's views with respect to the publication of the resolution he felt that in time what the Council did might become public.

Mr. Loeb replied that the resolution was not intended as a recommendation but had been developed here as a matter for discussion.

Mr. Harding stated that in his opinion an orderly market was hard to define, that the Federal Open Market Committee had not been in the market for the last two weeks, yet trading in the market had been more or less normal and that buyers had been taking care of the offerings without any outside help. Mr. Ransom inquired of Mr. Harding whether he felt the market had been disorderly in the recent period during which the System was purchasing securities, to which Mr. Harding replied in the affirmative.

Mr. Brown referred to the report that names of large sellers of Government bonds had been required while the Federal Open Market Committee was trying to maintain an orderly market, and stated that he thought the Federal Open Market Committee did the greatest possible service in stepping in and buying when it did, that it was foolish for anybody to try to say whether the Committee should have bought more or less on certain days, but that when one tries to put on pressure to restrain sellers he does not create an orderly market because he artificially restrains some selling that would otherwise take place, selling which is not panicky in a good many cases.

Chairman Eccles stated that he thought that, in view of the unusual and exceptional situation with which the Federal Open Market Committee was confronted, the requirement that names of sellers be given was fully justified during the period it was in effect, that he felt confident that it had been a deterrent to selling on the part of some concerns, that if they had been able to realize substantial profits there would have been a great deal more selling than there was, and that the Committee would either have had to buy more securities or let the market drop more rapidly than it did.

Mr. Steele stated that he intended no criticism by the resolution, that the Council was not aware of all of the motives of the Federal Open Market Committee, but generally speaking, he would agree that there was an emergency and he would agree with the objectives of the Committee, but that he did not agree with some of the mechanics. He said that he did not agree with the practice of requesting the names of sellers, that he did not quite see how he could agree with bailing out the investment houses which he understood was done, but that he certainly was in accord with the general plan. He stated that he thought that it was extremely difficult to define an orderly market and that just where the dividing line between an orderly and disorderly market was, he did not know. He said, however, that he thought some of the characteristics of an orderly market and some of the characteristics of a disorderly market could be named, and that he would say the most essential characteristic of an orderly market is one where the purchases and prices are determined by the free operation of the law of supply and demand which always includes willing buyers and willing sellers, not people who were selling in a panic, and not sharks who attempt to buy when prices are very low. He said that he thought some of the characteristics of a disorderly market might be when prices begin to go up very fast, that normally, when the Government bond market rises, it rises slowly and that it tends to go down rapidly, that he did not think a sudden drop on a single day should be taken as indicating a disorderly market and that you have to wait and see what the next day brings forth. Mr. McKee inquired of Mr. Steele whether he knew of any one who had been embarrassed by the Federal Open Market Committee's request for the names of sellers, and Mr. Steele replied that he did not know of any individuals, but that he had been told on authority that there were people who were prepared to buy who were driven out by the requirement because they felt that, if they bought at that time, they might themselves have to give their names when they sold securities, and that they did not propose to have their motives investigated.

Mr. Dick stated that in the Council's discussion of what would constitute an orderly market, it was understood that that would be one that was self-sustaining and free from panic. He said that he believed the Council was in sympathy with the objectives of the Federal Open

Market Committee and felt that the Committee's activities were perfectly in order and that, without full knowledge of the motives behind all of the Committee's actions, the Council could not offer any definite criticisms. He said that he thought, by and large, the banks would feel that the requirement of furnishing names probably could be withheld without any disadvantage to the Board or the System if another situation should arise, and that the thought of the Council in developing the resolution was that it was in sympathy with the action of the Federal Open Market Committee and that they had no disposition in any part of the resolution to criticise the Committee's action, but wanted to point out certain phases which the Council thought might be properly emphasized in its attempt to answer the last query from the Board.

Mr. Crosby stated that his experience with the Government bond market was so limited that it would not be in order for him to try to define what an orderly or disorderly market was. He said, however, that he did know there was a sense of satisfaction in his district in knowing that the Federal Open Market Committee was in the market, and that he was gratified that Chairman Eccles had described at the meeting yesterday the steps taken by the Committee and the basis for them.

Mr. Evans stated that he thought the requirement of giving names was a two-way sword and that he could see the purpose of the

Committee, thinking that it would result in a more orderly market. He stated that he certainly would have had no objection to giving names to anyone in authority at his Federal Reserve bank, but that he thought it was extremely unfortunate that the Board had put the banks in the position of reporting to brokers. He said that he thought it would be quite reassuring to many small member banks if some machinery could be developed whereby in buying and selling operations there might be a confidential relationship between the local Federal Reserve bank and the individual member bank. He said that that was the only thought he had about the matter, that he knew that it would have had a very serious effect if he had given the name of the First National Bank of Denver to brokers through whom they were selling, that it might have affected many small banks in his district if those people who had but one object, that is, to stir up selling and buying for commission purposes, could say that the First National Bank was selling. He stated that, during the period of recent System purchases, brokers were wildly making statements that there was friction between the Treasury and the Federal Reserve Board, that the Treasury compelled the Board to get out of the market, and that the Federal Open Market Committee was swamped with offers, all of these things being said to make volume in the situation. He suggested that some direct relation be studied out, at least in times of emergency, as an additional service to be offered by the Federal Reserve System to small member banks. He said that it was difficult, perhaps, for people in Washington or New York or Chicago to realize the effect of a long distance telephone call on a small bank telling them that they ought to get out of the market or that things were going to pieces or that the Federal Reserve System was withdrawing from the market, and he thought that ought to be really considered by the Board. He stated that he was critical of the publicity that came out and of giving names because he did not feel that was the proper thing, and that it was unfortunate under those circumstances if there was any legitimate reason for a bank selling its portfolio or any part thereof.

Mr. McKee stated that the dealers had been bailed out because they had a lot of securities they might dump on the market, that in bailing them out an agreement was made that they would not take a position, that the only way the Federal Open Market Committee could assure itself as to offers made to the Federal Reserve was to have them tell it they had legitimate orders, and that there was only one way to keep them out of the market and that was knowledge that their offerings to the Federal Reserve Bank for purchase were based on legitimate orders.

Governor Davis stated that he would like to have Mr. Evans develop a little further his thought that it might be well for the Federal Open Market Committee to consider whether a system could be adopted by which each Federal Reserve bank, either while the Federal Open Market Committee was conducting operations in the market or during normal times, would furnish a market within its district for its member banks if they wished to sell Government bonds. Mr. Evans stated that small banks had said that they would not sell their bonds except to the Federal Reserve and that they did not know what the price might be.

Governor Davis inquired whether Mr. Evans' thought was that member banks in his district would feel easier and much more confident if they could call upon the Federal Reserve Bank of Kansas City and know that they had a market there at the same price at which the market was at that time, without paying a commission. Mr. Evans stated that he did not think there would be any bank which would have occasion to sell bonds which would hesitate to give its name to the President of the Federal Reserve bank.

Mr. Ransom then called Mr. Evans' attention to his reference that the Federal Open Market Committee had been "swamped" and inquired how any one could develop that feeling. Mr. Evans said that when he heard of it the brokers were saying that the Federal Reserve was out of the market and that it was swamped with offers and that consequently the brokers did not know where the market was going.

Mr. Ball remarked that, in his opinion, the answer to Mr. Ransom's inquiry as to what was an orderly market was very simple, that an orderly market was a market on which he was on the right side and that he thought that could be carried right on through all of the deliberations of those present at this meeting. He said that if bonds were bought at a high premium and the market went off, there would be a disorderly market from the buyers standpoint and that he believed that that was the way most individuals looked at the market.

Mr. Rieman said that he did not believe he could add anything to what had already been said, but that he did not think it was a very good practice for a bank to have its name published when it had to sell Government securities, while on the other hand he realized the reason for the requirement of the Federal Open Market Committee.

Mr. Maestre stated that it seemed to him that an orderly market was one in which at all times bids or offerings were in the market at a price not too far from the last sale, that it did not seem to him the market was normal so long as there was a buyer or seller in the market whose one purpose was to maintain a market and that a normal market could not be had until there was a price level that would bring willing buyers and willing sellers into the market.

Mr. Fraser stated that he thought it would be a very unhappy situation if the Board had any conception that the Council's resolution was written in any critical spirit of what had recently happened, with one possible exception, that it seemed to him that it was obvious that the reason for the Committee's action was because of a grave emergency and that had the Federal Open Market Committee done nothing it would surely have exposed itself to criticism and the results might have been rather serious for everyone concerned. He said he thought the Committee should have intervened and that it did intervene, that anyone to whom the job had been entrusted would have made a lot of mistakes, that a great many criticisms were heard with respect to the mechanics of the action of the Committee, which criticisms may have been based on false information. He stated further that some people felt that the market was not permitted to drop rapidly enough. He referred to the situation as it existed in the corporate bond market and said that everyone realized that the Government bond market was a different situation because banks were very much interested in Government bonds, but that at the same time there was quite a wide spread between corporate bonds and Government bonds, the corporate bonds having gone down more rapidly than Government bonds, and that the fact that the Federal Reserve was in the Government bond market had a certain effect on buyers. Mr. Fraser stated that there was no intention of criticising what had been done by the Committee. He then referred to the last two paragraphs of the Council's resolution and said that there might have been a little implication of criticism in those paragraphs, particularly in the last, that there had been a feeling among some members of the Council that there was much to be said for gradually disposing of some of the bonds which the Federal Open Market Committee had purchased since September 1 as the market slowly rises and that it had been the unanimous suggestion of the Council therefore that consideration should be given to the release of bonds as the market went up. He stated that if the war continues the same situation may arise again where the Committee will have to enter the market again, that the idea was prevalent that the Committee purchases but never sells bonds and that it was the feeling that the Committee should sell bonds occasionally as well as buy them. Mr. Fraser referred to rumors, with respect to the actions taken by the Federal Open Market Committee, that such action had been taken in pursuance of the easy money policy.

Mr. Ransom inquired whether the members of the Council had had occasion to consider the record of the Board of Governors since its reorganization in February, 1936, in relation to the problem of easy money. He referred to the fact that in statements which the Board had issued there had been reference to the existing policy of easy money, but said that, on the other hand, it was quite obvious that the action of the Board in raising reserve requirements, even though to some extent offset by the subsequent lowering of reserve requirements and the recent purchases of bonds, had not been contributory to the maintenance of extremely easy money and that it seemed to him that the rumors could be offset by the record.

Mr. Draper stated that as he read the Council's resolution and thought of the first hectic days of the crisis, he would say that he could not see anything in the statement to criticise, and that he felt the resolution stated very clearly just about the objectives that were in the minds of the members of the Federal Open Market Committee with the possible exception of the statement regarding easy money. He said that during all of the considerations by the Committee of the situation the phrase easy money had never been used, that the Committee was thinking of the emergency with which it was directly confronted and that as a member of that Committee he would like to say that he thought the Council's resolution was a statement of the objectives that the Committee were trying to bring about.

Governor Davis stated that he did not regard the resolution as a critical statement and that nothing that had been said by the members of the Council had changed his mind. He said, however, that he would be interested in knowing whether other members of the Federal Advisory Council had given any thought or formed any opinions with respect to the desirability of the Board considering whether or not individual Federal Reserve banks might serve their member banks advantageously along the lines suggested by Mr. Evans.

Mr. Brown stated that the question had been discussed in Chicago and that it was the sentiment there that some effort should be made to see if direct dealing with the Federal Reserve banks could be put into effect in a situation such as the present one.

Mr. Ransom said that he thought the resolution of the Council, as elaborated by the comments of the members of the Council, was very interesting and helpful and that it was rather consoling to know that there were twelve men in the country who realized that the problem was not an easy one.

Chairman Eccles stated that there appeared to be an assumption that the operations of the Federal Open Market Committee were intended to affect the general interest rate structure. He said that, while the Committee might temporarily influence the interest rate, over a long range he did not feel that it could. He said that, in order to accomplish that, the Federal Open Market Committee would have to be very much closer to the market than it now was, that it would have to be in a position where a change in existing excess reserves would influence the interest rate structure. He said that the fact that the Committee had added to the excess reserves of member banks as a result of recent operations meant nothing in the excess reserve picture, that the reason why the Federal Open Market Committee went into the market was not for the purpose of providing additional funds so as to maintain easy money, and if that on the up side of the market the Committee were to sell all of the bonds it had recently purchased the ultimate effect on the interest structure would be practically nil. He stated further that, if the United States continued to receive the world's silver and the foreign gold, even though we sold our entire portfolio, we would probably in another year have more excess reserves than we now have.

After some further discussion the meeting was adjourned.

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.