A meeting of the Board of Governors of the Federal Reserve System with the members of the Executive Committee of the Federal Advisory Council was held in Washington on Wednesday, July 1, 1942, at 10:15 a.m.

PRESENT: Mr. Ransom, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Evans

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman

Messrs. Brown, Harrison, Kurtz, Huntington, and Ragland, members of the Executive Committee of the Federal Advisory Council

Mr. Lichtenstein, Secretary of the Federal Advisory Council

Mr. Brown stated that, on the assumption that pending legislation which would authorize the Board of Governors to reduce reserve requirements in central reserve cities would be passed promptly, the members of the Executive Committee had considered the desirability of a reduction in required reserves of member banks in New York and Chicago and had reached the conclusion that such action would not be warranted at this time.

Mr. McKee stated that he was about ready to recommend to the Board that reserve requirements be decreased for all classes of banks. He added that policies with respect to Government financing were a matter for the determination of the Treasury, and that if it were decided by the Treasury to do a major part of the necessary financing

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through open market issues rather than by the use of issues which would attract nonbank funds and which could be placed in the hands of the Victory Fund Committees for sale, the Federal Reserve System could not stand by and see that program jeopardized for want of the necessary reserves, but would have to reduce reserve requirements to the extent necessary to carry out the program decided upon. He said that the rate of Government expenditures was increasing rapidly and that the System might be faced with the necessity of taking action to reduce reserve requirements in the near future. He felt that the only way Treasury financing would succeed with the present higher short-term rates would be through the sale of a large amount of securities to the public and that if issues designed for that purpose were not to be made available the financing would have to be done through the open market, which would require a large amount of excess reserves and result in a sloppy money market.

Mr. Ransom supplemented Mr. McKee's comment with the statement that whether action were taken in the form of a reduction in reserve requirements or otherwise the System, of course, would do whatever was necessary on its part to insure the successful financing of the war effort.

Mr. Brown expressed the opinion that a great deal more could be done to bring about a wider distribution of Treasury bills outside of New York and Chicago, particularly by banks in the larger centers reselling bills to their correspondent banks who were unwilling to bid

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for them in the market. He said that, although excess reserves in Chicago had been reduced to around $60,000,000, which appeared to be very low, the banks had found that that amount was amply sufficient to enable them to function. While he concurred with the position that within the next month or two the Federal Reserve System might be faced with the necessity of reducing reserve requirements at least in New York and Chicago, he felt that an immediate reduction would take the pressure off the short term market and defeat the objective of getting a wider distribution of bills.

Mr. Ransom stated that the most effective way of postponing the necessity for a reduction in reserve requirements would be for the bankers who advise the Treasury and the representatives of the Federal Reserve System to agree in their recommendations to the Treasury; that whenever, as was the case recently, there were substantial differences in the advice given to the Treasury by these bodies, it was only natural that the Treasury should take longer to reach a decision; and that he was unable to understand why anyone would object seriously to supporting the recommendation of the Federal Reserve System that every possible type of security that might be sold be tried out, particularly in view of the fact that there was nothing to be lost by such a course.

Mr. Brown responded with the statement that the representatives of the banks had the feeling that it would be easier to sell fully marketable securities to corporations and individuals than it would be

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to sell registered redeemable bonds. He also said that the members of the Executive Committee did not have any doubt that reserve requirements would have to be reduced eventually, that he did not know whether they had any opinion as to whether requirements should be reduced generally or only in New York and Chicago, and that they were fearful that there might be pressure upon the part of the Treasury, upon passage of the pending legislation, for an immediate reduction in the two central reserve cities.

Mr. Ransom replied that he did not anticipate that that would be the case. He went on to say that once the Federal Reserve System acted to reduce reserve requirements it would probably have to continue along that road, which eventually would place the System in a position where it no longer would be able to function through the over-all control of reserves and might be forced to attempt to exercise more generally the control of credit through direct or specific methods, which would create most difficult and disturbing problems.

Mr. Harrison suggested that, even if the decision were reached to offer a short-term nonmarket issue and $2,000,000,000 of that issue were sold, the amount would be so small in relation to the entire problem that the fundamental approach to the problem would not be changed.

Mr. McKee stated that, because of increased incomes, liquidation of debts and inventories, etc., substantial amounts of funds were available that might be reached by these issues. Mr. Ransom said that,

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while he agreed with Mr. Harrison's position, he felt that the offer of such an issue would clear up one of the uncertainties and enable the System and the Treasury better to analyze the problem, and for that reason he could not see why there should be any objection to it on the part of the bankers.

Mr. Harrison stated that the arguments that he had heard both here and at the Treasury were that there was a choice between a short-term obligation which would be a potential demand directly on the Treasury and an open-market security which would be equivalent to a demand obligation on the Federal Reserve System. He said he had never agreed that open-market issues were equivalent to a demand obligation on the Federal Reserve System and that there was a growing feeling at the Treasury that the System was trying to shift the demand obligation from the System to the Treasury. Some of the bankers felt, he said, that since the job had to be done in any event, and if the objective was to protect the banking system, market issues should be sold to the banks rather than redeemable issues to the public. Mr. Harrison made the further statement that, regardless of the decision reached, the System would have to consider a reduction in reserve requirements sonner or later, that he did not think that decision had to be reached today, and that the logical thing to do would be first to allow short-term rates to go up a little further.

Mr. Szymczak stated that the Victory Fund Committees had been organized for the purpose of selling Government securities to the

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public and that, in addition to giving these Committees something to do, the offering of a short-term nonmarket issue would answer the question as to the amount of funds that could be obtained from this source and the problem of the financing to be done in the market would be further clarified.

Messrs. Ransom and McKee asked Mr. Harrison what the open market policy of the System should be if market issues were not to be regarded as equivalent to a demand obligation on the Federal Reserve System. Mr. Harrison's response was that he did not think the System could take the position that long-term bonds would not be allowed to go below par; that the time might come when the Treasury, the System, and everyone else would agree that it would be wise to allow rates to go up; and that it was not within the responsibility of a central bank to make a commitment to undertake to maintain the price of Government securities for too many years in the future.

The members of the Board stated that the System policy related to the immediate foreseeable future and not to an indefinite period.

In the further discussion there was general agreement that it would be desirable to permit the rate on bills to increase to 1/2 per cent. Mr. Ransom did not agree on this point and stated that misunderstandings were being created repeatedly because we were constantly giving the impression to the Treasury that we were concerned with increasing rates, and that he felt the job of Government financing might be more expeditiously handled if the Federal Reserve representatives and the

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banks would take the position that present rates were to be continued for the duration of the war.

Mr. Brown inquired whether the Board had given consideration to the effect that the financing of war contracts by large concerns under Regulation V might have on Federal revenue. He stated that it had been pointed out that advances by the services to a war contractor were not recognized by the Treasury as part of invested capital of the contracting concern and could not be included in determining excess profits, whereas borrowings of the concern even though guaranteed by one of the services in certain circumstances were so recognized; that a number of large concerns which had been opposed to financing under Regulation V and which were in a position to arrange for their credit needs without resorting to Government guarantees were considering financing on a guaranteed basis in order to take advantage of this situation; and that if that movement gained much headway it might result in a substantial loss of revenue to the Government in the form of reduced excess profits taxes.

Mr. McKee stated that this was not as serious as might be thought because of the right of the Government to renegotiate contracts to eliminate excess profits.

Mr. Kurtz stated that financing under Regulation V was also becoming attractive for the additional reason that in the case of cancellation of the contract the maturity of the loan was suspended and interest from the date of cancellation was waived.

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In a discussion of the effect of price controls on profits and Federal revenue, Mr. Brown stated that the Executive Committee felt that a larger portion of the Government's needs should be financed by current revenues than was the case at the present time, and Mr. Ransom stated that he did not believe there was any difference of opinion on that point.

Mr. Ransom also said that he had received a suggestion from Chairman Eccles that there be furnished to the members of the Federal Advisory Council who were present copies of a memorandum prepared by Mr. Piser of the Board's staff under date of March 19, 1942, on the subject of Canadian financing. The copies were thereupon distributed.

Mr. Harrison stated that last week he talked with Mr. Sproul, President of the Federal Reserve Bank of New York, with respect to the possibility of using some of the more qualified insurance agents throughout the country in the sale of series F and G war savings bonds, that at Mr. Sproul's suggestion he also discussed the matter with Secretary Morgenthau, and in turn with Mr. Graves, Assistant to the Secretary in charge of the war savings campaign for the Treasury, who felt that the suggestion was a good one, and that thereafter he discussed it with the National Association of Life Underwriters, which was also interested. He felt that an organization might be set up on a State basis and that agents who had had contacts with individuals of some wealth would be in a position to make a real drive on series F

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and G bonds.

Mr. Ransom stated that a similar suggestion had been offered recently by representatives of some of the midwestern insurance companies during a discussion which he had had with them on the subject of discouraging insurance policy loans and encouraging the payment of existing loans and that the representatives stated that the matter had been discussed with representatives of the Treasury, including Mr. Bell.

In connection with the question of discouraging insurance policy loans, Mr. Harrison stated that insurance companies had large amounts of funds of policy holders on deposit on which they were paying a high rate of interest, that they hesitated to suggest the withdrawal of these funds, but that, if the Treasury would indicate that it would like to have the companies take such action, it might be found that between $175,000,000 and $200,000,000 of funds would be made available for investment in Government securities.

In response to inquiries by Mr. Ransom, members of the Federal Advisory Council expressed the opinion that all types of consumer credit were being reduced substantially at the present time.

Mr. Ragland suggested that consideration be given to offering bills on fixed price basis. There was some question whether this could be done under the law.

Mr. McKee inquired whether it would be desirable for the System

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to post a buying rate on certificates of indebtedness when the volume of outstanding certificates approached the present volume of Treasury bills. This was discussed in the light of its possible effects on the rate and demand for bills particularly when the maturity of the certificates was 90 days or less, and Mr. Brown expressed the opinion that such action would not be advisable at this time.

In response to a question by Mr. McKee whether it would be desirable to issue 4 months' bills, Mr. Kurtz said he felt that a 4 months' bill at a 1/2 per cent rate would be more successful than a 90-day bill at a 3/8 per cent rate.

Mr. McKee then asked whether the banks would be interested in borrowing on the security of Treasury bills instead of selling bills for the purpose of meeting a temporary need for funds, and Mr. Brown said that his bank had been assured that if it sold bills to the Federal Reserve Bank of Chicago they could be repurchased. In relation to this it was pointed out that the Federal Open Market Committee had taken no action on which such an assurance might be based, and that whether the bills could be repurchased would depend on their availability in the System account at the time.

Under date of June 29, 1942, copies of a memorandum relating to reasons for the issuance of a short-term nonmarket Treasury security, which had been prepared in response to the suggestion made by Mr. Fleming at the meeting of the Executive Committee of the Council with the Board on June 3, 1942, were sent to Mr. Brown as President of the Federal

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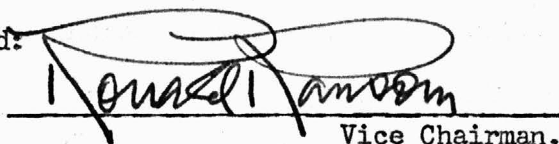
Advisory Council and to Mr. Lichtenstein as its Secretary, and at this meeting copies of the memorandum were handed to the other members of the Council who were present.

> Secretary's Note: Following the meeting, at the request of Mr. Lichtenstein, copies of the memorandum were also sent to Mr. Fleming and to the members of the Federal Advisory Council who were not members of the Executive Committee.

Following a brief informal discussion of a preferential rate for loans by Federal Reserve Banks to their member banks on the security of Government obligations, the meeting adjourned.

Secretary.

Approved:



Vice Chairman.

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