A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Friday, April 19, 1946, at 10:30 a.m.

Present: Mr. Eccles, Chairman
Mr. Szymczak
Mr. Draper
Mr. Evans

Mr. Carpenter, Secretary
Mr. Hammond, Assistant Secretary
Mr. Morrill, Special Adviser
Mr. Thurston, Assistant to the Chairman
Mr. Vest, General Counsel
Mr. Thomas, Director of the Division of Research and Statistics
Mr. Young, Assistant Director of the Division of Research and Statistics

As stated in the minutes of the meeting of the Board on April 17, 1946, Mr. Vardaman was absent on official business.

In accordance with the discussion at the meeting of the Board on April 12, 1946, each member of the Board had received a copy of a revised draft, prepared by Mr. Thurston, of a reply to the letter received under date of March 28, 1946, from Secretary of the Treasury Vinson with further regard to the elimination of the preferential discount rate, and copies of the draft had been sent to Messrs. Sproul and Leach as members of the executive committee of the Federal Open Market Committee for their comments and suggestions. Following receipt of suggestions as to changes in the draft a further revision was prepared by Mr. Thurston for consideration at this meeting.
Mr. Carpenter stated that the Board had received from the Federal Reserve Banks of Cleveland, Chicago, and San Francisco the usual advices that at the last meeting of the board of directors or executive committee of each of the Banks the existing schedule of rates of discount and purchase had been reestablished without change, and that wires were received yesterday from the Federal Reserve Bank of New York and Philadelphia stating that the board of directors of each of the Banks had voted, subject to review and determination by the Board of Governors, to eliminate the rate of 1/2 per cent now in effect on advances to member banks secured by obligations of the United States maturing or callable in one year or less under the eighth and thirteenth paragraphs of section 13 of the Federal Reserve Act. The telegram from the New York Bank also stated that the action of the directors was taken with the understanding that the rate of 1 per cent which had been applicable to advances to member banks secured by obligations of the United States maturing or callable beyond one year would be applicable, after the effective date of the elimination of the 1/2 per cent rate, to all advances to member banks secured by obligations of the United States irrespective of the date upon which they matured or were callable. The other rates of discount and purchase in effect at the two Federal Reserve Banks were reestablished without change.
Chairman Eccles stated that it would be his suggestion that no action be taken by the Board at this meeting on the rates established by the Federal Reserve Banks of New York and Philadelphia, with the understanding that the Board would approve and send to Secretary of the Treasury Vinson today a reply to his letter of March 28, 1946, and that the rates established by the two Reserve Banks would be taken up for consideration at the meeting of the Board on Tuesday, April 23, when Mr. Ransom, who was ill today, and Mr. Vardaman, who was out of the city, could be present. All of the members of the Board present expressed agreement with this suggestion.

In connection with the advice received from the Federal Reserve Bank of San Francisco of the reestablishment of its existing schedule of rates, the comment was made that that bank was the only one that had not yet eliminated the 1 per cent rate on advances to nonmember banks secured by Government securities under the last paragraph of section 13 of the Federal Reserve Act. The opinion was expressed that the reestablishment by the Bank of its existing rates should be approved but that the Board should ascertain informally the reasons why the Bank had not acted to eliminate the 1 per cent rate.

Thereupon, unanimous approval was given to the telegrams to the Presidents of the Federal Reserve Banks of Cleveland, Chicago, and San Francisco, stating that the Board approves the establishment without change by the Federal
Reserve Bank of San Francisco on April 16, and by the other two Banks on April 18, 1946, of the rates of discount and purchase in their existing schedules.

In taking this action it was understood that the Secretary would call President Clerk on the telephone to ascertain what consideration had been given by the directors of the San Francisco Bank to the elimination of the 1 per cent rate on advances to nonmember banks and what the Bank contemplated doing with respect to it, as it was the feeling of the Board that the rate should be discontinued.

The revised draft of reply to the letter received from Secretary of the Treasury Vinson under date of March 28, 1946, was then read and discussed. During the course of discussion Chairman Eccles read letters dated April 18, 1946, from Messrs. Sproul and Leach as members of the executive committee of the Federal Open Market Committee containing their suggestions with respect to the draft of reply.

Mr. Sproul's letter took the position that the reply should leave the door open to later action which an inflationary situation might demand and should not so bind the System for the indefinite future as to deprive it of all initiative; that System policy, to have a measure of success, must create enough uncertainty about the future course of interest rates to dispel the belief that interest rates could only go down; that the question of the preferential rate had been considered throughout as a System matter since discount rates were a Board-Bank matter and assurances concerning open
market operations could be made by no one but the Open Market Committee, and that, therefore, if the reply was signed by Chairman Eccles as Chairman of the Board it should be made clear that he was signing in that capacity and that the reply did not seem to commit the Open Market Committee to action which it had not taken.

Mr. Leach's letter suggested certain changes in the proposed reply which he thought would preserve for the System some freedom of action, or at least, freedom to discuss possible action with the Treasury, and expressed the opinion that the commitment that the elimination of the preferential discount rate would not be permitted to disturb the market for the 7/8 per cent certificates was one thing but that a commitment to maintain a rigid interest rate structure indefinitely, regardless of economic conditions, was quite another and was both unnecessary and unwise.

Chairman Eccles stated that the two letters raised the question whether the Board should act at this time to send the reply or whether action should be delayed for a meeting of the Federal Open Market Committee at which the matter could be discussed and a reply approved. He pointed out that copies of Mr. Vinson's letter had been sent to the Presidents of all the Federal Reserve Banks and all had had an opportunity to comment, and that the draft of reply had been considered by all of the members of the executive committee of the Federal Open Market Committee and all but three of the members of the Federal Open Market Committee, and appeared to have the approval
of all the members of the Board who constituted a majority of the members of the Federal Open Market Committee. In these circum-
stances he felt that inasmuch as it was desirable that the reply be in Secretary Vinson's hands before action was taken by the Board on the elimination of the preferential rate by any of the Federal Reserve Banks, the Board would be justified in sending a letter today.

In connection with effect of the commitments in the reply on the future freedom of the System to take action that the situa-
tion might require, the comment was made and agreed to by all of the members present, that the proposed reply did not in any way pre-
clude further discussions with the Treasury of any action that might appear to be desirable in the light of changed conditions that might exist in the future. Chairman Eccles stated that so far as he could foresee the problem confronting the System was not one of keeping the certificate rate from going above 7/8 per cent but rather one of keeping it from declining to 3/4 per cent. All of the other members present concurred in Chairman Eccles' comments.

At the conclusion of the discussion, Mr. Evans moved that the letter to Secretary of the Treasury Vinson be approved by the Board as follows, with the understanding that when Chairman Eccles went to the Treasury this after-
noon to attend a meeting of the National Advisory Council on International Monetary and Financial Problems he would deliver the letter to Mr. Vinson:
"My associates and I were surprised by your letter of March 28, not because we were in doubt as to your attitude concerning the elimination of the preferential discount rate, but because of the fundamental misconception of our views which your letter contains. We do not advocate a higher level of interest rates than the Government is now paying, because higher rates would increase the cost of servicing the public debt and increase the earnings of commercial banks growing out of their holdings of Government securities. We do not favor either result.

"While we are reluctant to burden the record with further discussion of this matter, we think it important to emphasize that there is nothing in the record to justify the statement in your letter that the proposal to eliminate the preferential discount rate is "really part of a program to increase short-term interest rates." That is not the purpose. The purpose is to avoid giving further impetus to the inflationary forces which now exist in our economy, among which must be included the supply of money in the hands of the public, particularly in its most active form — currency and bank deposits. We must refuse, therefore, to be ranged on the side of the advocates of a higher interest rate policy. That is not the question here and should not be permitted to confuse the real issue.

"The question is simply whether we propose to perpetuate a wartime measure which no longer serves the purpose for which it was designed but, quite the contrary, tends to aggravate the inflationary pressures which the Government is properly trying to combat. We are at present flying a signal — to borrow your metaphor — which is the direct opposite of the declared policy of the Government. We are, in effect, inviting member banks to come to the Reserve Banks and borrow at a preferential rate on Government securities due or callable in not more than one year, thus encouraging these banks to purchase Government securities as well as to make loans to others for the purpose of purchasing Government securities. This process has made for speculative profits, but it could not reduce the cost of Government financing unless the intention is to countenance and then take advantage of a further lowering of the entire interest rate structure of the country. That, as we understand it, would be contrary to your policy. It would certainly be contrary, in our judgment, to the best interests of the country.

"When the preferential rate was adopted in 1942, the Board felt, and so stated, that in ordinary circumstances such preferential rates should not be established. It was
"recognized, however, that the war financing program would require substantial purchases of Government securities by the banks and it was the belief of the Board that, if there were a preferential rate for advances secured by Government obligations, that fact would encourage member banks, particularly outside the financial centers, to invest more of their then existing excess reserves in short-term Government securities, and that the preferential rate could be eliminated when the need had passed. Today it serves a wholly undesirable purpose, namely, that of facilitating further monetization of the public debt through the commercial banking system. We think you are flying the right signal of discouraging further creation of bank credit, but we find ourselves signalizing through this special rate exactly the opposite course.

"You express the opinion that the elimination of this rate would be interpreted by the market as a first move in the direction of higher short-term interest rates. You will agree, we feel sure, that the adoption of what is the right policy should not be avoided for fear it would not be correctly understood. The boat can be rocked in this critical transition period by failing to do things which ought to be done as well as by doing things which ought not to be done. The important point, however, is that we have assured you that we would maintain the market for the 7/8 per cent certificates of indebtedness so that there would be no question about refunding or refinancing at this rate. Accordingly, if the elimination of the preferential discount rate were misinterpreted, official action through open market operations would promptly disabuse the market of its mistaken interpretation.

"We do not agree that the significance of the preferential rate at this time is almost entirely psychological. The figures on the amount of borrowing under the preferential rate can easily be misleading because bank reserves thus created provide the basis for an expansion in credit of approximately six times the amounts borrowed. Thus, borrowings of 300 to 700 million dollars in recent weeks have provided support for about six times as much additional bank credit, which is by no means insignificant. Moreover, banks are thus encouraged to lend to their customers at excessively low rates which, in turn, makes for speculation in and holding of Government securities on bank credit. For example, current figures for reporting member banks show loans of 1.6 billion dollars to dealers and loans of 1.9 billions to others for the purpose of purchasing
"or carrying Government securities, or a total of some 3.5 billion dollars. Such bank loans represent exactly as much monetization of the public debt as if the banks themselves purchased the Government securities directly. While you are rightly, we believe, utilizing Treasury balances to pay off Government debt, largely that held by the banks, the Reserve System by its preferential rate is inviting the banks to nullify the effect of your action by borrowing from the Reserve Banks for the purpose of purchasing or holding Government securities. Furthermore, to the extent that the interest rate structure is thus being depressed below the levels on which the Treasury's financing has been based since the beginning of the war, the inflationary consequences are real and plainly evident, particularly in the entire field of capital assets, that is, in real estate, including homes, farms and business properties, as well as in the stock market.

"We wish to emphasize with all the force we can command that our purpose and policy are based not on a desire for a higher level of interest rates and hence increased costs of carrying the public debt, but entirely on grounds of discouraging further needless monetization of the debt through a wartime mechanism. Elimination of the rate, far from indicating that the Treasury and Federal Reserve were flying opposite signals, as you put it, would signify that we were in accord instead of working at cross-purposes as we appear to be doing now.

"We do not believe that, when the question is reviewed in this light, the Treasury would wish to ask us to continue following a policy which is unquestionably inflationary and wholly at variance with the President's stabilization program. The Treasury, of course, is properly concerned with any measure that might affect the cost of Government financing. However, we have given assurance that we will not permit elimination of the preferential discount rate to increase the present certificate rate or other rates now paid by the Treasury. Having thus been assured that its interest in the matter will be fully protected, the Treasury, it seems to us, would not wish to be put in the position of objecting to the System's discharge, in accordance with its best judgment, of a statutory responsibility placed upon it by Congress.

"The incorrect premise upon which your letter is based is illustrated by your statement that we made no case as to how increasing short-term interest rates would help in combating inflation. We made no such case, of course,
"because our argument was not based on an increase in short-term rates. The case we sought to make and thought we had demonstrated clearly was based on our earnest desire to stop further creation of inflationary bank credit, both directly and indirectly.

"It should be borne in mind that our increasing production will generate an increasing income that will currently provide means of purchasing what is produced. If this newly created income has to compete not only with the existing excessive supply of liquid funds, but also with further increases in the money supply resulting from bank credit expansion, we can have a destructive inflation no matter what our production may achieve.

"Finally, we believe that an impartial review of the recommendations made by the Board and Open Market Committee to the Treasury from the inception of the defense and war financing programs will demonstrate beyond any possible question that we have consistently advocated policies and measures for financing the war at low and stable rates of interest. The pattern of rates on market issues agreed upon by the Treasury and the Reserve System ranged from the 7/8 per cent rate on certificates to the 2-1/2 per cent rate on the longest term Treasury bonds. There was also the 3/8 rate on 3-month Treasury bills.

The only official recommendations the System has made at any time for any higher rate related exclusively to the bill rate. It became evident early in the war that the banks were less and less interested in buying bills and increasingly disposed to buy the longer-term, higher-yield issues, with the result that they sold the bills to the Reserve System and concentrated more and more in the longer term securities, thus increasing the overall cost of Treasury financing. Our recommendations were made with the expectation that a somewhat improved bill rate would result in the banks holding more of the bills and hence fewer of the longer-term, higher-yield issues, thus reducing the overall cost of Treasury financing. Time has served to confirm the view that the banks would be increasingly uninterested in bills at the 3/8 rate, for at present the Federal Reserve System holds nearly all of the bills outstanding. To construe our suggestions on the bill rate as signifying a purpose on the part of the Federal Reserve authorities to increase the rate structure and the costs of carrying the debt is to misread completely the plain purpose of the proposals."
"As for memoranda exchanged between our staff members and yours, such memoranda were not submitted as official Federal Reserve proposals and are not properly so regarded. They canvassed a variety of ideas and alternatives for dealing with the situation but recommended no particular line of action. They have no place whatever in a discussion of the Board’s own views in connection with the preferential discount rate and were given to members of your staff with that understanding. Continuous study and consultation between our staffs, analyzing and exploring all relevant ideas, seems to us to be highly desirable, but such consultations and staff memoranda connected therewith should not be confused with official policy.

"We are embarked on a joint enterprise. We are all seeking to solve the difficult postwar problems of fiscal policy, monetary policy and debt management in the public interest, and in no other. We know the course that has been set by the Government. We want to discharge our responsibilities effectively as part of the general program of the Government. We believe that the elimination of the preferential discount rate would be in accord with the request of the President in his recent Executive Order when he said:

‘For the duration of the existing emergency all departments and agencies of the government shall, in any matter affecting the stabilization of the economy, in which they have discretion in the use of their powers, exercise such discretion in such manner as will best promote the continued stabilization of the economy.'"

In connection with Mr. Evans’ motion it was stated that before leaving Washington earlier in the week Mr. Vardaman had seen a draft of the proposed reply and had told Mr. Thurston that he approved it in substance and felt that it should be sent as promptly as possible. It was also stated that Mr. Ransom, when he found that illness would prevent his attending this meeting, told Mr. Carpenter that he had read the draft of reply, that he approved it with such changes in form as the Board might wish to make, and that he felt it should be sent immediately.

Thereupon, Mr. Evans’ motion was put by the Chair and carried unanimously.
Chairman Eccles raised for discussion the question of the kind of statement to be given to the press when the Board took action on the elimination of the preferential discount rate by the Federal Reserve Banks of New York and Philadelphia, and suggested that the circumstances were such that a release stating very briefly the principal reasons for the action would be justified. The other members of the Board expressed approval of this suggestion and it was understood that a draft of statement would be prepared by Messrs. Thurston and Thomas for consideration at a meeting of the Board on Tuesday, April 23, 1946.

Thereupon Messrs. Vest, Thomas, and Young withdrew from the meeting and the action stated with respect to each of the matters hereinafter referred to was taken by the Board:

The minutes of the meeting of the Board of Governors of the Federal Reserve System held on April 18, 1946, were approved unanimously.

Memorandum dated April 17, 1946, from Mr. Bethea, Director of the Division of Administrative Services, recommending, for the reasons stated in the memorandum, that Bernard W. Larson be employed as an operating engineer in the Division with salary at the rate of $2,496 per annum, effective as of the date upon which he enters upon the performance of his duties after having passed satisfactorily the usual physical examination. The memorandum stated that it was expected that Mr. Larson would become a member of the Board's retirement plan.

Approved unanimously.
Memorandum dated April 11, 1946, from Mr. Thomas, Director of the Division of Research and Statistics, recommending that Mr. J. Herbert Furth, economic specialist, who has been employed by the Board on a temporary indefinite basis since April 6, 1943, be given a permanent appointment as an economist in the Division without change in the salary which he is now receiving. The memorandum stated that it was recognized that there were a number of temporary indefinite appointments in the Board's organization and that the action recommended in Mr. Furth's case involved special consideration, but that the situation outlined in the memorandum justified special action without waiting for the adoption of a general policy by the Board.

The permanent appointment of Mr. Furth as an economist in the Division of Research and Statistics was approved, effective immediately.

Telegram to the Presidents of all of the Federal Reserve Banks reading as follows:

"Following is a self-explanatory letter received by the Board today from Chairman Martin of the Export-Import Bank with respect to the loan to the Kingdom of the Netherlands:

'Numerous banks throughout the country have evidenced an interest in the loan which the Export-Import Bank of Washington is making to the Netherlands. To enable the Federal Reserve Banks to answer inquiries from interested banks in their district, I take this opportunity to acquaint you with the essential facts which you may wish to transmit to the Presidents of the Banks."
Our Board of Directors has authorized and by formal agreement we will shortly establish a line of credit in favor of the Kingdom of the Netherlands of Two Hundred Million Dollars ($200,000,000). The credit may be drawn against from time to time until June 30, 1947. Each advance to the Netherlands thereunder will be repayable in two equal installments; the first installment one (1) year from the date of the advance, the second two (2) years from such date. Interest will be at the rate of two and one quarter per cent (2-1/4%) per annum, payable semiannually. Advances will be evidenced by the general obligations of the Kingdom of the Netherlands in the form of promissory notes. The notes will not be secured by a pledge of any specific collateral.

Following meetings with New York and Chicago banks at the Federal Reserve Banks in those cities, we have devised a plan whereby banks may participate with us in the credit without any recourse on or guaranty by this Bank. The plan contemplates that all participants, including this Bank, will share substantially pro rata in the making of all advances in proportion to the amount of their participations. On each advance, each participant will receive two (2) promissory notes of the Netherlands of one (1) and two (2) year maturities as mentioned above. Participants other than this Bank will not be a party to the credit agreement with the Netherlands but will enter into a participation agreement with us. They will be permitted to withdraw at any time without penalty. No commitment or other fee will be paid participants.

In view of the amount of the credit as well as the mechanical details involved in allocating each advance pro rata among all participants, the minimum amount of a participation has been fixed at One Million Dollars ($1,000,000). Any institution whose legal limitation will not permit of such a minimum, however, may request consideration of an application for a lesser amount.

Requests for participations shall be made by the close of business Wednesday, April 24, 1946 by telephone or otherwise either directly to us or, if more convenient and with your permission, to the Federal Reserve Banks for transmittal to us. Requests for participations will not be considered binding on
either Export-Import Bank or the applicants until the necessary participation agreement has been approved and executed.'

"In accordance with the request contained in last paragraph of letter, Board would be glad to have your Bank receive from banks in your district requests for participation in the loan with the understanding that they will be sent by you directly to the Export-Import Bank at Washington 25, D. C. Board feels it is important that Federal Reserve Banks do not appear to be promoting participation in this loan but that it would be in order for them to answer inquiries regarding the loan and to receive requests for participations.

"This wire is being sent to all the Federal Reserve Banks."

Approved unanimously.

Letter to Mr. William E. Peterson, Vice President of the Federal Reserve Bank of St. Louis, reading as follows:

"In accordance with the request contained in your letter of March 22, 1946, the Board approves the appointment of Carl V. Adams as an examiner for the Federal Reserve Bank of St. Louis. Please advise us of the date upon which the appointment becomes effective."

Approved unanimously.

Memorandum dated April 18, 1946, from Mr. Thomas, Director of the Division of Research and Statistics, recommending that the Board approve the payment of the cost of two railroad tickets in the total amount of $47.29 purchased by Alvin Hansen in November 1943 and August 1944 and which could not be identified with any particular trips made by Mr. Hansen in connection with the business of the Board. Assurances had been given by Mr. Hansen in a memorandum dated January 24, 1946, that the tickets were used for official travel.

Approved unanimously.
4/19/46
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Thereupon the meeting adjourned.

[Signature]
Secretary.

Approved:

[Signature]
Chairman.