BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

October 16, 1950.

Honorable John W. Snyder,
Secretary of the Treasury,
Washington 25, D. C.

Dear John:

Two weeks ago Mr. Sproul and I discussed with you the problems of the Treasury and the Federal Reserve System in the fields of debt management and credit policy, as parts of the broader anti-inflationary policy and program of the Government. At that time, the Federal Open Market Committee was in session and we conveyed to you its thinking on open market operations, as well as the thinking of the Board of Governors on reserve requirements and selective controls. Your views, which you then expressed to us, were in turn conveyed to the Federal Open Market Committee, as was your suggestion that you would like a couple more days to think over the matters we had talked about.

The Federal Open Market Committee, in response to our report of our conference with you, asked its Executive Committee to carry forward these discussions, and it was in response to this direction that Mr. Sproul and I again sought a conference with you before a meeting of the Executive Committee of the Federal Open Market Committee on October 5. In that conference, we told you of the unanimous view of the Federal Open Market Committee, and of the Board of Governors, that further action should be taken in the field of general credit control to put a brake upon the prevailing ease with which banks can obtain reserve funds for further credit expansion. You told us of your concern about the success of the forthcoming Savings Bond Campaign and of the discussions which have been started to put in motion voluntary action by the commercial banks to restrain credit expansion. At that meeting you also said that you would like to have an opportunity to talk with me again on the following Monday.

You and I have since talked two or three times on the telephone and, in the light of these conversations and of our earlier conferences, a meeting of the Federal Open Market Committee was called for Wednesday, October 11. At that meeting your views, as they had developed in our talks, were given fully and frankly to the Committee. As you know, the Committee also expressed its willingness to have you present these views in person if you so desired. You decided, and I think properly, not to deviate from the established procedure which we have adopted for mutual consultation.

After giving thoughtful consideration to your views, the Committee again canvassed the business and credit situation as developed by the reports and studies of its research staff and through the contacts of members of the Committee in various parts of the country. It seemed clear to the Committee that, despite some signs or prospects of moderate abatement of inflationary pressures which might be detected in certain fields, the underlying forces in our economy are still strongly inflationary and will be accelerated by increasing Government expenditures as the rearmament program really begins to bring its huge demands upon our economy, unless stern fiscal policies such as you have advocated and further credit restraints are adopted.

The President announced the anti-inflationary policy of the Government when, in the Midyear Economic Report, he stated that:

> "First of all, for the immediate situation, we should rely in major degree upon fiscal and credit measures. These general measures can be helpful not only in restraining inflationary pressures, but also in reducing the civilian demand for some specific products, such as automobiles and housing, thus making available for necessary military use a larger proportion of an already short supply of some critical materials. The more prompt and vigorous we are with these general measures, the less need there will be for all of the comprehensive direct controls which involve the consideration of thousands of individual situations and thus involve infinitely greater administrative difficulties and much greater interference with individual choice and initiative."

In the light of this policy and of the statutory responsibility of the Federal Open Market Committee, which provides that the time, character, and volume of open market operations shall be governed with a view to accomodating commerce and business and with regard to their bearing upon the general credit situation of the country, the Committee felt that it had no option but to proceed with the action we had advised you orally, two weeks ago, that it had in mind. Since the Treasury will have no refunding operations until December, the present is an especially propitious time for the System to proceed with this somewhat more restrictive open market policy, even though the action results in a moderate increase in short-term rates. Any resultant increase in the costs of carrying the public debt will be directly saved, many times over, if it helps to curb the rising costs of Government procurement, and the benefits to the people of the country, of course, will be greatly multiplied.

We realize that the action we are taking in our open market operations will need to be supplemented in order to exercise effective restraint on the mounting inflationary pressures that threaten the economy. Consequently, we are unanimous in the conviction that we can only meet our responsibilities by going ahead with the weapons at our command, including increases in reserve requirements, application of real estate credit controls, and tightening up of consumer credit regulations. We sincerely believe that the combination of these restraints on credit expansion will have a profound effect in the effort to hold the line until the heavier taxation promised for next year begins to bite into incomes.

We can assure you that these actions will not affect the maintenance of the 2 1/2 per cent rate for the outstanding longest term Government bonds, and we are convinced that this further evidence of a resolute will to fight inflation and to protect the purchasing power of the dollar will promote, not discourage, the sale of E bonds. No one knows better than you that confidence in E bonds, as well as all other types of savings, is based on confidence in the purchasing power of the dollar.

Although in this instance we have not been able to bring about a complete meeting of minds in our discussions with respect to System policy and debt management, we have both thoroughly considered all of the aspects of the difficult problems confronting us and we have earnestly sought to achieve that accord which I know you desire as much as we do in meeting our respective responsibilities. At your convenience we would like to sit down with you to explore further the problems for which we both seek solutions that are in the best interests of this country.

With warmest regards, I am

Sincerely,

Tom

Thomas B. McCabe
Chairman.