A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Monday, June 10, 1946, at 11:05 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. Szymczak
Mr. Draper
Mr. Evans
Mr. Vardaman
Mr. Leach
Mr. McLarin
Mr. Young
Mr. Clerk

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Kincaid, Langum, Rauber, Wheeler, and John H. Williams, Associate Economists
Mr. Rouse, Manager of the System Open Market Account
Mr. Kennedy, Special Assistant to the Chairman of the Board of Governors
Mr. Musgrave, Chief of the Government Finance Section of the Division of Research and Statistics of the Board of Governors

Messrs. Whittemore, Gidney, and Peyton, alternate members of the Federal Open Market Committee

Messrs. Alfred H. Williams, Leedy, and Gilbert, Presidents of the Federal Reserve Banks of Philadelphia, Kansas City, and Dallas, respectively

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on February 28 and March 1, 1946, were approved.

Upon motion duly made and seconded, and by unanimous vote, the actions of the executive committee of the Federal Open Market Committee as set forth in the minutes of the meetings of the executive committee on February 28 and March 1, 1946, were approved, ratified, and confirmed.

Mr. Rouse distributed to all present copies of a report prepared by the Federal Reserve Bank of New York of open market operations during the period from March 2 to June 4, 1946, inclusive. He also presented a supplemental report covering open market operations, including commitments, on June 5, 6, and 7, 1946. Mr. Rouse discussed the important sections of the reports, calling particular attention to the statement of reasons on page 1 of the principal report for the changes in the System account since the last meeting, to the transactions by the Federal Reserve Bank of New York in bankers' acceptances and the maintenance of a minimum buying rate at 1/2 per cent for such transactions, and to the comments on page 3 of the report with respect to the elimination of the dealer practice of limiting daily price changes in the over-the-counter market to 1/4 of a point.

In connection with the report of acceptance transactions, Chairman Eccles inquired why the Federal Reserve Bank of New York should continue a buying rate of 1/2 per cent on bankers' acceptances when the preferential rate on advances secured by short-term Government obligations had been eliminated as a means of discouraging the use of Federal Reserve Bank credit. While he realized that the amount of acceptances available was small, he felt that there was a question of principle involved and questioned whether the System should be in the position of encouraging the use of Federal Reserve Bank credit through the continuation of a 1/2 per cent buying rate on acceptances when by the elimination of the preferential rate it had acted to discourage the use of Federal Reserve Bank credit in the form of advances on short-term Government securities.

Mr. Sproul stated that the Bank wanted to watch developments in the market following the elimination of the preferential rate, feeling that if market rates adjusted to the new situation and if the acceptances in the market could be sold without recourse to the Federal Reserve Bank the continuation of the buying rate on bankers' acceptances would not be important, but that, if an increased volume of acceptances were sold to the Federal Reserve Bank, consideration should be given to increasing the buying rate. In this connection he referred to the special efforts which had been made by the Federal Reserve System years ago to encourage the use of acceptances, and stated that if the Bank's buying rate were increased to 1 per cent it would result in an over-all cost of acceptances sold to the System which would adversely affect such credits in relation to other forms of credit, and that the Federal Reserve Bank did not want to take that action until it was determined whether the market would absorb the existing volume of acceptances without recourse to the Federal Reserve Bank in important amounts. He also said that since the Bank could buy bills at rates above the fixed minimum buying rate, it was in a position quickly to adjust to a change in market conditions.

There followed a brief discussion of the question whether it was any longer necessary or desirable to encourage the creation of acceptance credits as compared with other forms of commercial credit.

Mr. Sproul referred to the action of the dealers in discontinuing the limit of 1/4 of a point on daily price changes in the over-the-counter market and elaborated briefly on the comments contained in the report referred to above with respect to the situation which led to that decision by the dealers.

> At the conclusion of the discussion, upon motion duly made and seconded, and by unanimous vote, the transactions in the System account during the period from February 28 to June 8, 1946, inclusive, were approved, ratified, and confirmed.

At this point Mr. Young, Assistant Director of the Division of Research and Statistics of the Board of Governors, joined the meeting.

In response to a request for statements by the economists, Mr. Thomas said that various proposals had been made for dealing with the problems in the monetary and credit field which had been created by war financing, and that it was proposed to discuss some of these at this meeting instead of reviewing the present economic outlook which had not changed in any of its fundamental aspects since the last meeting of the Committee except to emphasize the dislocations brought about by the war. He then read a statement in which he discussed principally proposals that had been suggested for additional controls by authorizing (1) a further increase in reserve requirements of banks, (2) a requirement that banks maintain a secondary reserve of Treasury bills and certificates equal to a specified percentage of net demand deposits, and (3) a limitation on the amount of long-term bonds that commercial banks could hold.

Mr. Langum amplified the manner in which the secondary reserve plan referred to by Mr. Thomas could be made more effective and objections to the plan could be eliminated.

Mr. John H. Williams made a statement in which he discussed the desirability of an approach to the problem of monetary and credit controls under existing powers which would not call for legislation but which would result in unfreezing the interest rate structure to a limited extent, as compared with a more elaborate program requiring legislation. He also suggested a possible method of supplementing the proposals which he understood the Board of Governors was to present to Congress, so as to remove the guarantee to the Treasury and recapture interest rate variability without increasing the cost of the debt to the Treasury.

Copies of the statements by Messrs. Thomas, Langum, and Williams have been placed in the files of the Federal Open Market Committee.

The meeting then recessed and reconvened at 2:20 p.m. with the same attendance as at the end of the morning session.

In a discussion of the statements made by the economists, question was raised as to the commitment made by the Board of Governors, with respect to future support of the existing rates on Government securities, in the letter which it addressed to the Secretary of the Treasury on April 19, 1946, regarding the proposed elimination of the preferential discount rate on advances secured by short-term Government obligations and in the press release issued by the Board on April 24, 1946, when the preferential rate was discontinued at the Federal Reserve Banks of New York, Philadelphia, and San Francisco.

Chairman Eccles stated that the press release made it clear that the Board did not favor a higher level of interest rates on United States securities than the Government was then paying, but that that did not mean that the Board was committed for all time or in the event conditions should change to such an extent as to require the adoption of a different policy. He did feel that the Board was committed for some time to come and that nothing would injure the Federal Reserve System more under present conditions than to let interest rates rise. He did not think that was the way in which the problem should be met unless Congress and the public should favor it, and he stated that the Board proposed to present the problem in its annual report so that it could be discussed publicly, and that, if it appeared that the public preferred an increase in rates to any other solution, then the System should have no hesitancy in taking that course.

Mr. Sproul expressed the opinion that the Board's letter of April 19, the press release of April 24, and the Treasury press release of the same date with respect to the preferential discount rate, when taken together, constituted a statement that the maintenance of the 7/8 per cent rate was guaranteed by the System. He said that he had not been in favor of any commitment to the Treasury other than for the time being, for the reason that the basic situation might change in such a way as to make System action desirable, and that any commitment for the indefinite future would take the initiative out of the hands of the System and place it with the Treasury on a matter which was the responsibility of the System. He recognized that credit policy was a subordinate part of the fight against inflation, but felt that it would be necessary for the country to use every means at its disposal to meet the problem, that to ignore the credit factors in the picture was a mistake, and that to await the verdict of Congress or the public as to what should be done, would probably mean failure to meet our responsibilities in the immediate future. He said that there had been two lines of policy open to us in checking a further increase in bank credit and a further decline in interest rates:

(1) To proceed by modest steps

(a) Removing the encouragement to borrowing at Federal Reserve Banks.

(b) Reintroducing some element of flexibility and unpredictability in interest rates by which he meant, at an appropriate time, permitting some modest increase in short rates while maintaining the 2-1/2 per cent long-term rate.

(c) Repaying Government debt out of accumulated balances and looking forward to a balanced budget or surplus in the next fiscal year.

(d) Stepping up campaign for sale of savings bonds, and

(e) Later provision of a restricted 2-1/2 per cent bond which could not be made part of a "roll-over" operation.

(2) A more ambitious plan to maintain present short and long rates and to control expansion of bank credit and combat a further decline in rates by means of new and substantial powers over bank investments and reserves.

The modest program, he thought, would have been a possible means of meeting the situation effectively; the ambitious program would not unless more prompt legislative action than seems likely was forthcoming, and unless a more complete control, than the program itself included, over the credit machinery and capital markets of the country was envisaged. He said that in the existing circumstances once the market became convinced that the existing rates would stand it would resume the previous practice of "playing the pattern of rates". He added that the response to the elimination of the preferential rate and the program for the retirement of Government debt indicated that the situation might have been met by the more modest approach, and he felt that the System could have given a commitment, for the time being only, without causing the Treasury to precipitate a public issue on that point.

He also expressed the opinion that a commitment of that kind should not be given without a meeting of the Federal Open Market Committee so that there would be an opportunity to exchange views and opinions, that the Federal Open Market Committee was drifting into a situation in which action was being taken by majority caucus without a meeting of the Committee, and that that was contrary to the intent when the Committee was created. It was his belief that whatever action was necessary to reverse that tendency should be taken and that if more meetings of the Federal Open Market Committee and its executive committee were necessary they should be held.

If a commitment had been made to the Treasury which resulted in the System losing its freedom of action, Mr. Sproul thought that the appointment of a new Secretary of the Treasury afforded an excellent opportunity to seek a reconsideration of the matter, the abandonment of the commitment, and a return to the simpler policy which he had suggested. He added that the decision seemed to be an urgent one for the reason that the System might soon need to be concerned with the expansion of credit for private use, in undesirable ways, as well as with the further monetization of the public debt, and that considerable time might elapse before the necessary legislation could be enacted to make possible the more elaborate methods of credit control that had been proposed. He also said that if either policy was to have any right to be called monetary policy or monetary control it must aim toward making credit less easily available and therefore more costly, and that this could not be done with a frozen pattern of rates. He said he would like to have the Federal Open Market Committee take the whole problem up with the new Secretary of the Treasury as promptly as possible to see if a program could be worked out which would leave the System with some discretion with which to meet an imminent situation. He concluded with the statement that an increase in the rate on certificates from 7/8 to 1 per cent or 1-1/8 per cent would not be a large increase nor a large price to pay if it would help combat inflation, and that it would restore flexibility in the rate structure and get away from a frozen pattern of rates.

Chairman Eccles stated that there was a fundamental difference in Mr. Sproul's approach to the problem and his own, and that he would be opposed to taking the matter up with the new Secretary of the Treasury at this time. He thought that the situation was not one that would justify such action, that the Government security market was stable at the present time and prices were at a lower level than in the recent past, and that any action to reopen the rate question would be considered as an attempt on the part of banks to get a higher rate.

Mr. Sproul did not agree that the step would be so interpreted if it were made clear that it was for the purpose of exercising proper credit controls.

Chairman Eccles did not think that a higher rate of interest—unless it was a very much higher rate—would have any substantial effect in curbing the demand for credit for private purposes. He saw no way of stopping an expansion of private credit by rate action except by such high rates as would seriously affect the Government security market, and if such action were taken by the System it would be received in much the same way as action to increase rates was received following the last war. He added that to deal with the problem by rate action would be to overemphasize the importance of credit policy in relation to other matters.

Mr. Sproul recognized that there were other things such as a balanced budget, all out production, and perhaps temporary maintenance of some of the war-time controls that were more important than credit policy but that some of these controls were breaking down rapidly and that the interest rate would be one of the instruments that should be used in the whole program against inflationary pressures.

Chairman Eccles referred to the fact that the question of the preferential discount rate was fully discussed at the last meeting of the Federal Open Market Committee as well as at previous meetings. He also said that the Presidents were furnished with copies of the correspondence with the Treasury relating to the matter; that the last letter from the Treasury regarding it was the result of the position taken by the Presidents at the time of the last meeting of the Federal Open Market Committee that they could not give the Treasury the assurance that the Banks would not act on the preferential rate in the near future; and that when the action of the Banks came to the Board for decision another meeting of the Federal Open Market Committee or its executive committee was not called for, as the matter was one for approval or disapproval by the Board. He added that the release was submitted to Messrs. Sproul and Leach as members of the executive committee, that they did not agree that the commitment with respect to rates should be made, that their views were presented to the Board of Governors and considered by it, and that the press release was issued by the Board after it had had the benefit of their views. He went on to say that, in view of that situation, he did not want the Presidents of the other Federal Reserve Banks to get the impression that proper consideration had not been given to the matter or that the Board had exercised any authority that it did not have.

Mr. Sproul stated that in connection with the elimination of the preferential rate there was a discussion of open market operations to support the 7/8 per cent rate in the event the preferential rate were discontinued and that, while the elimination of the rate was a matter within the authority of the Board, the question of supporting the rate through open market purchases was a matter for consideration by the Federal Open Market Committee. He also said that when he and Chairman Eccles went to the Treasury to discuss the matter with representatives of the Treasury, the two points of view were expressed but there had been no action by the Federal Open Market Committee to give the Treasury a commitment with respect to support of existing rates.

Chairman Eccles suggested that if any of the members of the Federal Open Market Committee felt that a satisfactory record had not been made they should make a motion and vote on the matter and, if the majority of the Committee wished to vote not to support the rate, that decision would be controlling.

Mr. Leach said that when the matter of the press release came up he suggested that it take the position that the elimination of the preferential rate would not be permitted to disturb the market for the 7/8 per cent certificates, without making the commitment to maintain the 7/8 per cent rate indefinitely.

In a further discussion Mr. Sproul stated that no one knew what the credit situation might be in the next few months, that a further movement into real estate, securities, and commodities might create a situation that would be difficult to handle, and that in the absence of further discussion with the Treasury the System's hands would be tied in the event Congress had not acted to give the System additional powers.

Chairman Eccles said that if that situation should arise and it appeared that an increase in rates was desirable and the System could make a case, the Committee would not be estopped from taking the matter up with the Treasury and, if necessary, with the President of the United States.

Mr. John H. Williams was of the opinion that if there should be a strong demand for credit from private sources and if on top of that there were a strong demand for business and speculative credit the movement could not be controlled by monetary means, but that the large volume of debt was a new factor in the situation which made the market more sensitive. Therefore, if some minor flexibility were introduced in the rate structure—and he did not think the System could do more than that—it would have a greater retarding effect than in the past. He felt that in the adoption of any of the programs that had been discussed he would like to see the System recapture some flexibility in interest rates. In response to an inquiry, he said this action would not involve allowing Government securities to go below par.

Chairman Eccles advanced the thought that neither the Board nor the System had frozen the existing rate structure, but that it had become frozen by the war financing program during the war years and its accompanying tremendous increase in the public debt. It was his opinion that there was nothing that the System could do to unfreeze the rate structure, and that the best thing it could do would be to present the problem to Congress and point out the basic change that had taken place since the System's existing powers were conferred which made the use of those powers under present circumstances entirely inappropriate.

Mr. Thomas observed that the commitment made by the Board was that the short-term rate would not be permitted to increase which made it difficult to keep the yields on long-term securities from declining further. However, he said, there were some things that could be done that would help in that direction such as debt retirement and increasing reserve requirements of central reserve city banks, which would keep the banks under pressure and make them hesitant about expanding further.

Mr. Sproul agreed with the generality of Mr. Thomas' views, although not on the specific question of increasing reserve requirements of central reserve city banks but said that he did not like to have these steps vitiated by a commitment that would eventually lead the public to understand that the door was open for expansion at the existing rates.

After some further discussion, Chairman Eccles stated that the Presidents had received copies of the correspondence with the Treasury since the last meeting of the Federal Open Market Committee with respect to the elimination of the preferential discount rate, the retirement of Government debt, and the authority granted by the Treasury to commercial banks to hold a limited amount of restricted issues for trading purposes, and that there were no other developments with respect to these matters since the last meeting that should be reported at this time.

Consideration was then given to what if any action should be taken with respect to the direction issued at the meeting of the Committee on March 1, 1945, relating to the purchase of Treasury bills at a discount rate of 3/8 per cent per annum. Chairman Eccles expressed the belief that the direction should be continued for the time being but that, inasmuch as bills had ceased to be a market instrument, the discontinuance of the direction might be discussed with the Treasury when the current program for retirement of debt had been completed, at which time he hoped a program could be worked out which would avoid the necessity for the weekly offering of bills which were taken from the dealers by the Federal Reserve Banks.

Mr. Sproul inquired whether, since the market for bills had almost disappeared, there would be any point in eliminating the buying rate and repurchase option and raising the question of direct financing of the Treasury by the central banks. This point was discussed and

Mr. Gilbert raised the question whether it would be desirable to discontinue the option on the part of sellers of bills to repurchase bills at the same discount rate. In the discussion of this point it was the consensus that the existing direction should be continued in its present form until it was eliminated altogether.

> Thereupon, it was agreed unanimously that no action should be taken at this time to change the direction issued by the Committee on March 1, 1945.

In a discussion of the authority to be granted to the executive committee to execute transactions for the System account, it was suggested that, in view of the change which had taken place in the policy with respect to the maintenance of market prices, the pertinent portion of the direction issued to the executive committee should be changed so as to authorize such transactions for the System account as might be necessary for the purpose of maintaining an orderly market in Treasury securities and a general level of prices and yields of Government securities which would support the Treasury issuing rates of 7/8 per cent for one-year certificates and 2-1/2 per cent for 27-year bonds restricted as to ownership.

Mr. Rouse stated that, while the operations in the account before another meeting of the Committee including redemption of securities being retired would be substantial, it was believed that a limitation of 2 billion dollars on the authority of the executive committee to increase or decrease the total amount of securities in the account would be adequate to meet the situation, assuming that the next meeting would be held in September.

Thereupon, upon motion duly made and seconded, the following direction to the executive committee was approved unanimously, with the understanding that the limitations contained in the direction would include commitments for purchases and sales of securities for the System account:

The executive committee be directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), as may be necessary in the practical administration of the account or for the purpose of maintaining an orderly market in Treasury securities and a general level of prices and yields of Government securities which will support the Treasury issuing rates of 7/8 per cent for one-year certificates and 2-1/2 per cent for 27-year bonds restricted as to ownership; provided that the aggregate amount of securities held in the account at the close of this date [other than (1) bills purchased outright in the market on a discount basis at the rate of 3/8 per cent per annum and bills redeemed at maturity and (2) special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury] shall not be increased or decreased by more than $2,000,000,000.

That the executive committee be further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase for the System open market account direct from the Treasury of such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the amount of such certificates held in the account at any one time shall not exceed $1,500,000,000.

Chairman Eccles stated that the Treasury had been giving consideration to the desirability of eliminating the 6-months coupon on Treasury certificates and paying the interest at the time of redemption. If this change were made, he said, there would be no change in the 7/8 per cent rate, although it was recognized that it would reduce the yield slightly, but it would eliminate a great deal of unnecessary work and expense in issuing the coupon certificate and paying the coupon when it became due.

All of the members of the Committee concurred in the opinion that the change would be a desirable one.

It was also suggested that it would be desirable for the Treasury to provide for a one million dollar denomination in all issues of Government securities and Mr. Kennedy stated that that was being done.

Turning to the date for the next meeting of the Federal Open Market Committee, Mr. Sproul stated that the annual convention of the American Bankers Association would be held in Chicago on September 22-25, that some of the Presidents would like to attend the Convention, and that it had been suggested that, in the absence of developments calling for earlier meetings, the meetings of the Presidents' Conference and the Federal Open Market Committee be held following September 25. There was agreement that the date for the next meeting of the Federal Open Market Committee should be set tentatively for Thursday, October 3.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.