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, D. C., on Tuesday, December 13, 1949, at 10:05 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Draper
Mr. Earhart
Mr. Eccles
Mr. Gidney
Mr. Leach
Mr. McLarin
Mr. Szymczak
Mr. Vardaman

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Rauber, C. W. Williams, and John H. Williams, Associate Economists
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Youngdahl, Chief, Government Finance Section, Board of Governors
Messrs. Erickson, Young, Peyton, and Gilbert, alternate members of the Federal Open Market Committee
Messrs. Williams and Leedy, Presidents of the Federal Reserve Banks of Philadelphia and Kansas City, respectively
Mr. Roelse, Vice President, Federal Reserve Bank of New York

Upon motion duly made and seconded and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 5, 1949, 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 held on August 5, August 19, September 21, and November 18, 1949, were approved, ratified, and confirmed.

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the Federal Open Market Committee on November 2, 1949, approving an increase to 1.10-1.16 in the range at which Treasury certificates could be purchased and sold for the System account was approved, ratified, and confirmed.

A report of operations in the System open market account covering the period August 5, 1949, to December 8, 1949, inclusive, prepared at the Federal Reserve Bank of New York, was then read in part and discussed by Mr. Rouse, together with a supplementary report covering commitments executed for the System account for the period December 9 to 12, 1949, inclusive.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account for the period August 5, 1949, to December 12, 1949, inclusive, were approved, ratified, and confirmed.

At Chairman McCabe's request, Mr. Sproul reported on developments since the meeting of the Federal Open Market Committee on August 5, 1949, stating that until the meeting of the executive committee on October 15, 1949, operations in the System account were carried on under the policy approved on August 5 of making credit somewhat easy at low rates. By mid-November, however, the business and credit situation had changed sufficiently to warrant a change in open market policy so as to bring some restraint on the availability of credit, and, with the approval of all members of the committee and within the framework of the policy of the June 28 statement, a course was adopted which was designed to place mild restrictions on the availability of bank reserves through open market operations. This took the form of increases in the range of rates within which Treasury bills and certificates were purchased for the System account, and contemplated a possible increase in the one-year certificate rate to 1 1/4 per cent, if subsequent developments seemed to indicate the desirability of such an increase. In this connection, Mr. Sproul read the letter of November 22, 1949, which was sent to the Secretary of the Treasury following the meeting of the executive committee on November 18, 1949.

The next development, Mr. Sproul said, was a telephone call to Chairman McCabe on November 28 from the Secretary of the Treasury, who had been out of the country at the time of the November 18 meeting and who had not received the letter of November 22 until November 26. At that time the rates on 90-day bills and 9-10 month certificates had come together at about 1.11-1.12. The Secretary informed Chairman McCabe that he was thinking of announcing both the December and January financing at once, the December issue to be a two and a half year 1 1/4 per cent note and the January refunding to be a one-year 1 1/8 per cent certificate. After reviewing the conversations which he and Chairman McCabe had with the Secretary of the Treasury on November 28, 29, and 30, Mr. Sproul stated that the terms of the December and January financing were announced by the Secretary on November 30. He said that the Treasury had accepted substantially the Committee's recommendation on the December financing, with a 4 1/4 year 1 3/8 per cent note but had nullified that acceptance so far as market rates were concerned by announcing that the January refunding would be done with a 1 1/8 per cent certificate, despite the urging of Chairman Mc Cabe and Mr. Sproul that the announcement be deferred until the matter could be more fully discussed and the market reaction to the December refunding could be observed.

Mr. Sproul added that these developments brought into sharp focus the difficulties faced in determining open market policies and general credit policies. The question might be posed, he said, as to whether we can even be sufficiently certain that an increase of 1/8 per cent in the short-term rate is of such importance in restraining an expanding business and credit situation as to justify the risk of our causing the failure of a large Treasury refunding operation. Feeling that that risk should not be taken under present conditions, the members of the executive committee on November 30, 1949, informally agreed that rates on the longest bills and certificates should be held at their then existing levels and not allowed to increase further, pending this meeting of the full Committee.

In a further comment on the discussions with the Secretary of the Treasury, Chairman McCabe stated that it was unfortunate that the meeting of the executive committee on November 18 came during the absence of the Secretary of the Treasury from the country when he was not available for a conference during which he could have been informed currently of the discussions of the executive committee and the reasons for the actions that were taken.

Chairman McCabe then called upon Mr. Thomas who made a statement on recent economic developments and their relationship to Federal Reserve policies. Mr. Thomas said that recent expansion in economic activity and prospects for further expansion supported the steps taken by the Committee late in November toward a somewhat firmer policy with respect to interest rates. He felt that the likelihood of a higher level of economic activity during the next few months, and possibly throughout 1950, accompanying substantial deficits in governmental budgets (Federal and other), presented the System with a situation different from any previously faced except in war periods, that under these conditions the advisability of continuing to keep down money rates would be questionable, and that greater flexibility in rates was needed in order that policies could respond to changes in the economic situation. Mr. Thomas indicated that currently the problem was to prevent rates from rising in view of the announced Treasury refunding, while in January the money markets were likely to be extremely easy for temporary reasons. The problem before the Committee then would be whether, in view of the economic situation, to permit rates to decline accordingly. If it should be desired to absorb reserves, this could be done (1) by selling bills and certificates, either at declining rates or at present rates, (2) by permitting bill holdings to mature without replacement, or (3) by selling restricted bonds.

In connection with Mr. Thomas' statement, there was distributed a memorandum dated December 12, 1949, on the Current Economic Situation and Outlook, prepared by the Division of Research and Statistics of the Board of Governors, a copy of which has been placed in the files of the Federal Open Market Committee.

During Mr. Thomas' statement, Mr. Davis joined the meeting.

Reference was made to the action at the meeting on August 5, 1949, authorizing the Federal Reserve Banks to enter into repurchase agreements covering short-term Government securities with nonbank dealers at a rate not below 1 3/8 per cent pending a decision to reduce the discount rate at Federal Reserve Banks from the existing level of 1 1/2 per cent, and to the understanding that, if the discount rates were reduced under sections 13 and 13a of the Federal Reserve Act, the authority granted at the meeting of the executive committee on January 20, 1948, pursuant to the authorization of the full Committee at a meeting on December 9, 1947, with respect to repurchase agreements with dealers would again apply. During September it was decided that for the time being the discount rates in effect at the Federal Reserve Banks should not be changed and the question before the Committee at this meeting was whether any change should be made in the authority granted to the Federal Reserve Banks on August 5 with respect to repurchase agreements.

Mr. Rouse stated that the authority had been of material assistance in handling situations which arose in August, September, and early October, that it had operated to keep rates on bank loans to dealers lower than they otherwise would have been which had made it possible for dealers to carry their positions in short-term issues without too great a loss, that the authority had not been used in recent weeks, but that if present discount and certificate rates continued in effect such standby authority would be useful.

> It was agreed unanimously that no change would be made at this time in the authority granted on August 5, 1949.

Chairman McCabe requested a discussion of the policy with respect to sales of long-term restricted bonds from the System account. Mr. Sproul stated that the alternatives were (1) to allow funds coming into the long-term market to have their full effect on the rate structure which would mean the System would do little, if any, selling of long-term bonds, (2) to decide that long-term rates are low enough and to prevent further decline in long-term yields by market sales, or (3) to determine this question in the light of general credit policy, in which case, if a restrictive credit policy were desired, we would sell restricted bonds in the market when the opportunity was presented, thus absorbing reserves without providing the banks with a short-term asset. He suggested that the full Committee grant the executive committee relatively full discretion to follow any one or all of these alternatives, depending upon the situation as it developed in the next few weeks.

This suggestion was discussed in the light of the effect on the market of the Treasury decision to refund the January maturities with a 1 1/3 per cent one-year certificate, the tendency of the long-term issues to move to higher levels as a result of that decision as well as other factors, and an increased demand for bonds which would come into the market during the next 30 to 45 days for investment purposes.

In that connection, Mr. Sproul stated that the recent policy of the committee had been to purchase short-term securities so as to provide reserves to banks to meet increased demands for loans, rising currency circulation, and other factors; that during the same period the market demand for long-term issues had been light, and it had seemed undesirable to try to sell restricted issues from the System account which would have taken funds out of the market. He also said that during the rest of December it would be necessary to continue to supply the market with reserves but that the market for long-terms could be expected to broaden somewhat and might afford an opportunity to sell restricted issues from the System account without conflicting with the System's credit policy or the requirements of an orderly market in Government securities. Unless, he said, the System should wish to reverse its present mildly restrictive policy, it would be necessary in January to sell a very substantial amount of securities to absorb funds coming into the market and it would be in order to use all the means at the disposal of the Committee to accomplish such absorption including the sale of long bonds from the System account.

He went on to say that while there were some "doubtful spots" in the indications as to which way the economy would move next year, he felt that for the time being the System should follow a policy of neutrality or mild restraint which would suggest the opportunity to take funds out of the market by the sale of long-terms as well as other market issues.

There was agreement with the analysis presented by Mr. Sproul and it was understood that in carrying out the general direction to be issued by the Federal Open Market Committee today the executive committee would have the discretion suggested by Mr. Sproul which it would exercise in the light of the discussion at this meeting.

Referring again to the decision of the Treasury to refund the January maturities with a 1 1/8 per cent certificate, Chairman McCabe stated that he felt that the obligation of the Federal Open Market Committee to support that rate was only a temporary one and that when the refunding operation was out of the way the executive committee should consider the course to be followed thereafter.

There was agreement that the policy to be followed after the turn of the year would depend on the economic and credit situation and outlook, that in future discussions with the Treasury there should be a more complete exploration of the importance of small changes in interest rates, and that every effort should be made to persuade the Treasury to concur that such changes were important as part of System credit policy and that they had substantial psychological value and a marked effect on the willingness of lenders to lend.

In a brief consideration of the status of discussions with respect to a long-range financing program, Mr. Thomas stated that the System Committee on Banking and Credit Policy was meeting this afternoon to discuss the "framework" memorandum presented at the meeting of the Committee on August 5, 1949. It was also stated that at the meeting of the executive committee on November 18, 1949, it was agreed that the System Research Advisory Committee should continue to study the problem of long-term debt management, and that the members of the staff who had worked on the problem should prepare a memorandum containing all the suggestions that had been made by the Federal Reserve staff on the subject without any implication of approval of any of these suggestions, with the understanding that when the memorandum was prepared it would be submitted to Messrs. Bartelt and Haas of the Treasury Department with the statement that the memorandum did not in any way commit the Open Market Committee, the Board of Governors, the Federal Reserve Banks, or their staffs, but was submitted by the staff as a means of presenting to the staff of the Treasury for consideration the various suggestions that had been made in connection with the problem.

Reference was then made to a memorandum prepared in the Board's offices under date of December 12, 1949, with respect to the question whether Treasury savings bonds should be made eligible collateral for bank loans and to a memorandum dated December 8, 1949, prepared at the Federal Reserve Bank of New York, relating to the question of recommending additional inducements to holders of maturing savings bonds to reinvest the proceeds of such bonds in new savings bonds. Both memoranda were distributed and copies have been placed in the files of the Federal Open Market Committee. After a brief discussion, during which no conclusions were reached, Chairman McCabe suggested that the two topics be given further consideration at the joint meeting of the Board and the Presidents to be held tomorrow.

Mr. Vardaman withdrew during the foregoing discussion to keep another appointment.

On the question of Government fiscal policy, Chairman McCabe expressed the opinion that every effort should be made to reduce Federal expenditures, that the tax structure should be revised to eliminate inequities and place it on a basis which would be in harmony with present day conditions, and that tax rates in the revised structure should be at levels which in times like the present would permit of a balanced budget or produce a surplus for debt retirement. While he realized that such a program would be a difficult one in an election year, he felt it was important that the Federal Reserve should urge its adoption at every opportunity. He also said that in connection with the preparation of the President's messages to the Congress, he (Chairman McCabe) undoubtedly would be questioned on these points and that if the Presidents of the Federal Reserve Banks had any other views he would like to have them before the Presidents left Washington. In the ensuing discussion no different views were expressed and it was understood that the Presidents and the Board would give some thought to the subject and be prepared to discuss it at the joint meeting of the Presidents and the Board tomorrow.

Consideration was then given to the policy to be followed in the interim before the next meeting of the executive committee with respect to the replacement of maturing Treasury bills. Mr. Sproul referred to the understanding at the meeting of the executive committee on November 18, 1949, that the Federal Reserve Bank of New York should be guided in the redemption or replacement of System bill holdings by what would be required in the light of current conditions in the money market to carry out the general credit policy of the Federal Open Market Committee. After a discussion, at his suggestion, no change was made in this understanding.

In a discussion of the policy to be followed by the Committee, there was agreement that the policy of mild restraint should be continued within the limits imposed by the necessity of supporting a 1 1/8 per cent one-year rate in connection with the January refunding operation. It was also agreed that, as soon as the refunding was out of the way, the executive committee should consider whether the situation was then such as to call for some further increase in the short-term rate, and, if so, the matter should be discussed with the Treasury with a view to permitting the rate to increase prior to the February refunding. In line with the decision to prevent the rates on bills and certificates from rising above 1 1/8 per cent until after the January refunding was out of the way, there was also agreement that the upper limits of the ranges at which Treasury bills and certificates would be purchased and sold for the System account should be fixed for the time being at 1.12.

> Subject to the foregoing limitation, the executive committee was authorized to determine from time to time the exact ranges at which bills and certificates would be purchased by the Federal Reserve Bank of New York for the System open market account. In taking this action it was understood that if, following the January financing, there should be agreement among the members of the executive committee, after consultation with the Treasury, that the short-term rate should be increased to 1 1/4 per cent on one-year obligations, the upper limits of the ranges on bills and certificates could be increased to not to exceed 1.24.

In connection with the general direction to be issued to the executive committee with respect to the execution of transactions for the System account, it was suggested that no change be made in the wording of the direction, but that the limitation contained in the first paragraph be set at $2 billion and in the second paragraph at $1 billion.

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 the System open market account:

The executive committee is 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 light of changing economic conditions and the general credit situation of the country, for the practical administration of the account, for the maintenance of orderly conditions in the Government security market, and for the purpose of relating the supply of funds in the market to the needs of commerce and business; provided that the aggregate amount of securities held in the account at the close of this date other than 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.

The executive committee is 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 total amount of such certificates held in the account at any one time shall not exceed $1,000,000,000.

It was agreed that the next meetings of the Committee would be held on Tuesday, February 28, and Wednesday, March 1, 1950, with the understanding that actions at the meeting on February 28 would be confined to routine matters, including the ratification of previous actions and transactions for the System account and that discussions of questions of policy would be deferred until the meeting on March 1.

Thereupon the meeting adjourned.

Chester Morrill

Secretary.

Approved:

Thomas B. McCabe

Chairman.