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 Friday, December 30, 1938, at 10:00 a.m.

PRESENT: Mr. Harrison, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Ransom
Mr. Davis
Mr. Draper
Mr. Sinclair
Mr. Schaller
Mr. Peyton
Mr. Leach (alternate for Mr. Newton)

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Wyatt, General Counsel
Mr. Goldenweiser, Economist
Mr. Williams, Associate Economist
Mr. Dreibelbis, Assistant General Counsel
Mr. Sproul, Manager of the System Open Market Account
Mr. Thurston, Special Assistant to the Chairman of the Board of Governors

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 21, 1938, 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 September 15 and 21 and December 7, 1938, were approved, ratified and confirmed.

With the consent of the members of the Committee, Mr. Piser, Senior Economist in the Division of Research and Statistics of the Board of Governors, was requested to attend this meeting.

Mr. Sproul distributed among the members of the Committee copies of a report prepared at the Federal Reserve Bank of New York of open market operations conducted by the bank since the meeting of the Committee on September 21, 1938. He referred briefly to the principal transactions in the account during the period covered by the report and stated that the bank had experienced considerable difficulty during the last three weeks in carrying out the instructions of the executive committee to replace maturing bills by purchases of like amounts of Treasury bills or Treasury notes without paying a premium above a no-yield basis. In this connection, he said that, due to a special and insistent demand for Treasury bills in recent weeks, the discount on outstanding Treasury bills had been eliminated completely and bills were being traded in at prices at or above par, the most recent issue of bills having been sold at par or above.

He added that a somewhat similar situation existed in the Treasury note market, all issues of notes maturing within two years being currently traded in as "rights" on a negative yield basis with the return on longer maturities declining. This condition, he said, had been aggravated by the inability of the reserve bank to obtain sufficient amounts of bills to replace maturities and the resulting necessity of going into the market and making replacements with notes. He said that there had not been a sufficient supply of notes freely available in the market to make these replacements and the bank had been forced to solicit banks and others directly and through dealers to sell notes at advanced prices or from their investment accounts.

This, he stated, had established a presumption in the market that the Federal Open Market Committee would maintain the existing portfolio at all cost, which, so long as the present situation in the bill market continued, would result in cumulative pressure on the market for notes and in a tendency toward forced lengthening of the maturity of holdings in the system account.

He stated further that, as outlined in the report referred to above, it was necessary on December 14 to purchase $3,000,000 of notes to complete replacement of maturing Treasury bills, that on December 21, $12,904,000 of notes were acquired, and that on December 28 a total of $30,044,000 of notes were added to the portfolio, the notes purchased amounting to more than 62% of the replacement purchases as of that date. He anticipated that, because of the expected heavy demand for bills for tax purposes in the early weeks of the new year and the increase in excess reserves which will occur after the first of the new year, the situation described above would continue, at least to some extent, during the immediate future.

> At the conclusion of Mr. Sproul's report, upon motion duly made and seconded and by unanimous vote, the transactions in the system account for the period from September 20 to December 29, 1938, inclusive, were approved, ratified and confirmed.

Mr. Harrison then called upon Messrs. Goldenweiser and Williams for statements with respect to the present business and credit situation.

Mr. Goldenweiser stated that the present recovery movement, which had carried the index of industrial production up from 75 to about 103, was quite general, taking in all the major industrial groups; that the rate of recovery was almost unequalled except for a short period in the early part of 1933; and that the conclusion which he felt could be drawn from the movement was that the decline in business last year and the early part of 1938 was more radical than underlying economic conditions appeared to justify and was principally an adjustment of an inventory situation. He said that the severe downturn did not spread to the whole economic system, as the decline in consumption, indicated by department store sales, was not nearly as sharp as the decline in production, and that the decline in income was considerably less. He pointed out that throughout the year the rate of consumption was greater than that of production and that, therefore, inventories were being cut down, and he said that at the present time the best estimate was that production and consumption were at about the same level, that if this condition continued the upward movement might continue for some time, and that it was the hope that production would continue to increase gradually and that consumption would increase at a comparable rate.

The crucial point in the situation, Mr. Goldenweiser said, was whether there would be a continued upturn in the durable goods industries that supply the greater portion of employment, and, if steel, automobiles, and building continued to advance, the coming year would be a good one, reaching a higher level of production for the year as a whole than the present level. The weak point at present, he added, was the low level of agricultural prices which was not likely to rise in the next year although there might be some improvement. He concluded with an expression of his opinion that, aside from agricultural prices, the fact that prices had been fairly steady during recent months was an element of strength instead of weakness in the situation.

At this point Chairman Eccles joined the meeting.

Mr. Williams expressed general agreement with the statement made by Mr. Goldenweiser. He felt that recent stability of prices was a point of strength as contrasted with the condition existing during the latter part of 1936 when prices advanced very rapidly, resulting in accumulation of inventories and forward buying and creating a situation which lent itself to downward adjustment.

He said he had been interested in the rather general expectation that there would be a decline in activity during the first quarter of 1939, that such declines had occurred in other recent years, but that he felt too much importance should not be attached to such a movement. The strongest single indication, he said, that a downturn might occur was that the rate of recovery has been so rapid that it would not be surprising if it should decline somewhat and if such was the result it would mean that the economy was merely marking time and that activity might be considerably higher by the end of next year than it was at this time. His own opinion was that 1939 might turn out to be a considerably better year than the estimates which, he felt, contained an element of pessimism, that since the late recession was fundamentally an adjustment of inventories it could be expected to be of short duration, and that, inasmuch as building and the durable goods industries were better than they had been, the first quarter of the new year should be a satisfactory one.

While we now have the elements of a genuine recovery, he said, he could not venture a guess as to how long it would last. The outlook in the durable goods industries for the next few years appeared good so far as the demand for such goods was concerned. He referred to the facts that there were no unhealthy speculative elements of any importance in the situation and that the banking situation was better than it had been at times in the past as being among the reasons for expecting a recovery of the economy under its own power. He felt that what was needed more than anything else at the moment was a demonstration that the economy was capable of staging a recovery, and that, while he did not feel that the Government should stop its efforts to maintain consuming power, he did feel that, to the extent that evidences of recovery appear, the primary policy should be one of tapering off Federal deficits and giving a demonstration that the economy is able to bring about a recovery on its own power.

During the discussion which followed of the problems to be considered by the Committee in determining its future open market policy, Mr. Williams made the further statement that he recognized that the country was faced with several important specific problems which presented substantial difficulties such as the railroad situation, social security and public utilities, but that he felt that there was a real possibility that a solution of these problems was not going to be found as long as the temporary expedient of deficit spending was used rather than to work out a sound economic solution of the difficulties.

Chairman Eccles stated that Mr. Sproul had reported to him currently the difficulty that was being experienced by the New York bank in acquiring Treasury bills and notes to replace maturing bills, but that he had been unable to discuss the matter with the Secretary of the Treasury until this morning when he (Chairman Eccles) had gone to the Treasury and reviewed the problem with the Secretary and Assistant Secretary of the Treasury Taylor. He said he had explained that the situation had been brought about by the substantial reduction in the amount of bills in the market following the reduction in the inactive gold account in April, that the total amount of bills now outstanding was about half of what it was formerly, that the system account held approximately half of the bills maturing currently, and that the situation was being aggravated at the present time by the heavy demand for bills for tax purposes and by the pressure for investment of idle deposit balances in bills to enable banks to reduce the expense of assessments of the Federal Deposit Insurance Corporation. He advised the Secretary, he said, that this condition placed the Federal Open Market Committee in a situation where it must choose between the alternative of allowing some of the bills held in the system account to run off without replacement to the extent that replacements cannot be made in bills or short term notes without paying a premium above a no-yield basis and the alternative of buying longer term Government securities. He stated that he had pointed out the difficulty that would follow from replacing maturing bills with bonds, as the bond market was strong and additional purchases would drive it higher with possible adverse reactions later on when the system account might be in a less effective position to lend support to the market. On the other hand, if bills were allowed to run off, Chairman Eccles said, because of the system's inability to replace, the account would show a reduction from week to week which might be difficult to explain in the light of other monetary actions taken by the Treasury and the System and might be construed by the public as a reversal of policy. Chairman Eccles added that he suggested to the Secretary that the Treasury Department could avoid the entire situation by issuing additional amounts of bills, that the reduction in the amount of outstanding bills did not appear to be necessary, and that if the weekly bill offering were increased from

$100,000,000 to $150,000,000 for ten weeks the Treasury would thereby obtain the additional funds needed between now and the first of June, probably without cost to the Treasury.

The reply of the Secretary in which Mr. Taylor concurred, Chairman Eccles said, was that he did not think it would be desirable to issue more bills at this time as to do so would increase Treasury balances beyond their already high level, which would create what would amount to a ridiculous situation, that he was beginning to favor the suggestion that a further increase in the Federal debt be avoided in the near future by having the Reconstruction Finance Corporation borrow in the market to the extent of $500,000,000 and use the proceeds to pay its indebtedness to the Treasury, that if that were done he believed it might be well to have it done before the March refunding of June notes, possibly in February, and that the Treasury might retire an additional $500,000,000 of bills with the funds received from the Reconstruction Finance Corporation. The Secretary did not seem to see any objection, Chairman Eccles stated, to reducing the total amount of outstanding bills, as it was thought the Treasury would then be in a position where it would be assured of a continued favorable bill market.

Chairman Eccles added that the Secretary had stated that the decision whether the Federal Open Market Committee should allow maturities to run off or should replace current maturities with bonds to the extent necessary, with a resultant increase in bond prices, was a responsibility of the Committee and that he would have no comment or criticism to offer at this time or later regarding the decision reached by the Committee in that connection. However, Mr. Taylor felt, Chairman Eccles said, that it would be a mistake for the account to acquire bonds, that the account should be allowed to run off to the extent that it was not possible to acquire bills or notes without paying a premium above a no-yield basis, and that a reduction in the account for this reason could be explained easily.

There followed a considerable discussion of the policy to be adopted by the Committee in the light of the information before the Committee during which Mr. Harrison suggested the adoption of a resolution to instruct the executive committee to replace maturing bills in the account with other bills or with Treasury notes, or to allow such bills to run off without replacement or pending such replacement, (a) when market conditions are such as to make it impossible to procure bills or notes without paying a premium above a no-yield basis or (b) when such other bills or notes are not obtainable without undue disturbance to the market. In making this suggestion Mr. Harrison said that he felt it was important that the New York bank should not be placed again in the position in which it found itself during the last three weeks of having to solicit banks and dealers for bills or notes with which to make replacements, a procedure which disturbs the whole government security market and, if long continued, runs the risk of driving up the price of even the longer term notes to a no-yield basis.

During the discussion there were distributed to the members copies of a draft of a statement which had been prepared by Messrs. Goldenweiser and Thurston at the suggestion of the Chairman as a basis for consideration of a decision not to replace all bills maturing in the system account.

At 1:15 p.m. the meeting recessed with the understanding that it would reconvene in the afternoon and that during the interim Messrs. Eccles and Harrison would prepare drafts of a resolution and press statement for consideration at the afternoon session.

The meeting reconvened at 2:30 p.m. with the same attendance as at the close of the morning session.

Consideration was given to a draft of press statement offered by Messrs. Eccles and Harrison which had been prepared on the theory that there might be a reduction in the system account because of inability to replace maturing bills.

At Mr. Ransom's suggestion Messrs. Goldenweiser and Williams were requested to comment on the action contemplated by the draft of statement.

Mr. Goldenweiser stated that he was not in favor of reducing the amount of securities held in the system account at the present time; that he did not favor the policy which had been advocated of having a fluctuating portfolio; that he did not think that the reasons given in the proposed press statement would be widely accepted; and that the action might be regarded as contemplating a reduction in the portfolio as a matter of policy. He saw no reason why the Federal Open Market Committee should limit itself to the replacement of maturing bills with other bills or with Treasury notes; and he felt that, while the decision would be a fairly close one, the Committee would be less likely to regret an action requiring the maintenance of the present portfolio than it would action contemplating a reduction. He added that if it were decided to allow bills to run off without replacement a full statement should be made for the reason that there has been no reduction in the portfolio for approximately six years and such action would require something more than a brief explanation.

Mr. Williams said that he favored action allowing maturing bills to run off without replacement to the extent they could not be replaced with bills or notes without paying a premium above a no-yield basis; that he felt it would not be regarded as an important action; and that he would favor a brief statement to the press to the effect that the action was taken because of the inability to obtain bills and notes for replacement purposes without paying a premium or without undue disturbance to the market for such securities. He expressed the opinion that in view of the present high prices of Government securities it would not be difficult to explain the Committee's action, and that there was not much danger of its being regarded by anyone as a change of policy, but that if full replacements were continued and the prices of Government securities were driven higher the system would be in danger of criticism for having carried its policy beyond reasonable limits, which might result in discrediting the system's open market policy altogether.

During a further discussion Mr. McKee suggested that consideration be given to the question whether it would be desirable to continue during the next week or two the efforts to make full replacement of maturing bills, by purchasing not only bills and notes but also bonds to the extent that bills and notes were not available in the market, for the purpose of seeing what the effect of that procedure would be.

Chairman Eccles referred to the fact that the President's budget message to Congress would be delivered next week and that if the system account were reduced and there were any unfavorable reaction in the Government securities market resulting from the budget message, the result might be attributed to the action of the Federal Open Market Committee in reducing the account.

After a further discussion, Mr. Harrison read a revised draft of statement for the press, which was considered by the Committee. He also presented a draft of resolution directing the executive committee to effect transactions in the System account which he suggested for the consideration of the Federal Open Market Committee.

During the discussion of Mr. Harrison's draft, consideration was also given to the desirability of (1) continuing the existing directions to the executive committee to make complete replacements of maturing bills during the coming week or two and of recessing this meeting with the understanding that it would reconvene before January 11, 1939 (on which date there would be a maturity of bills held in the account) for reconsideration of the entire matter in the light of the situation then existing, and (2) directing the executive committee to replace maturing bills with bonds to the extent that bills and notes were not available in the market without paying a premium.

At the conclusion of the discussion Mr. Sinclair moved that the resolution offered by Mr. Harrison be adopted as follows:

That the executive committee be directed until otherwise directed by the Federal Open Market Committee, (1) to arrange for the replacement of maturing Treasury bills in the system open market account with other Treasury bills or Treasury notes, or, from time to time, to allow such bills to mature without replacement or pending subsequent replacement (a) when market conditions are such as to make it impossible to procure other bills or notes without paying a premium over a no-yield basis, or (b) when such notes are not obtainable without undue disturbance to the market; (2) to arrange for the replacement of maturing Treasury notes and bonds in the system open market account with other Government securities; and (3) to arrange for such shifts in maturities in the system open market account as may be necessary in the proper administration of the account; provided, (a) that the amount of securities in the account maturing within two years be maintained at not less than $1,000,000,000; (b) that the amount of bonds in the account having maturities in excess of five years be maintained at not less than $500,000,000 nor more than $900,000,000; and (c) that, if Treasury bills in the account are allowed to mature without replacement, the total amount of securities in the account be not decreased by more than $200,000,000.

That, in addition to such authority as may be contained in other resolutions of the Federal Open Market Committee and until otherwise directed by the Committee, the executive committee be authorized, upon written, telephonic or telegraphic approval of a majority of the members of the Federal Open Market Committee, to arrange for the purchase or sale (which would include authority to allow maturities to run off without replacement) of Government securities in the open market from time to time for system open market account to such extent as the executive committee shall find to be necessary for the purpose of exercising an influence toward maintaining orderly market conditions, provided (1) that the total amount of securities in the account be not increased by more than $200,000,000 nor decreased by more than $200,000,000 including such decreases as may result from allowing Treasury bills in the account to mature without replacement, and (2) that the amount of bonds in the account having maturities over five years be maintained at not less than $500,000,000 nor more than $900,000,000.

Mr. Sinclair's motion having been duly seconded, was put by the chair and carried, Messrs. Harrison, Szymczak, McKee, Davis, Sinclair, Schaller, Peyton and Leach voting "Aye", and Messrs. Eccles, Ransom and Draper voting "No".

Chairman Eccles voted "No" for the following reasons:

Last spring, as a part of the Government's program for the encouragement of business recovery, the Board of Governors reduced reserve requirements for member banks by $750,000,000. The Chairman voted for this action for the purpose of cooperating with the Government in its recovery program of last spring. The Chairman's view was that this addition to excess reserves at a time when deflation and credit contraction were in progress could not have an adverse effect and might possibly have a desirable psychological effect. The Government's recovery program is now being carried out and the business situation and prospects are not such as to require a change in policy. Since a failure to replace maturing bills in the System's portfolio would reduce reserves, it might be interpreted as a reversal of policy, which would not be justified under present business conditions, and would be inconsistent with the action taken last spring to increase reserves. The Chairman thought it particularly inadvisable at this time to fail to replace maturing bills for technical operating reasons, unless an effort had first been made to replace them with bonds or long term notes to the extent that it proved impossible to do so with bills or short-dated notes except by paying a premium above a no-yield basis. He also thought that if the effort were made to replace with longer term notes or bonds, it would tend to ease the demand for bills and short-dated notes and thus tend to make them more readily available without paying a premium above a no-yield basis.

In voting against the adoption of the resolutions Mr. Ransom stated that, without reviewing all of the considerations that influenced his vote, he felt that it was preferable under existing circumstances to make no reduction in the portfolio. A reduction should be reserved to be used at such time as a reversal of policy is intended, or at such other time as conditions or reasons other than those now before the Committee would, in his opinion, require a reduction in the portfolio. If the portfolio were now reduced without intending a change of policy, an explanatory statement would be necessary. If later a change of policy were intended in connection with a reduction in the portfolio, it would then appear necessary to issue a further explanatory statement. It seemed to him that the Committee should rely more upon its actions to speak for themselves and less upon the use of statements to give effect to or limit the effect of the actions themselves, and that statements should support and explain rather than controvert action.

Mr. Harrison stated that Mr. Matteson, Assistant Vice President of the Federal Reserve Bank of New York, had just advised Mr. Sproul over the telephone that because of the reduced demand for bills for year-end statement purposes it appeared that it might be possible to replace next week's maturities of bills with other bills that would be available in the market.

Mr. McKee moved that the proposed statement for the press be approved subject to such changes of form as might be thought necessary by Messrs. Sproul and Thurston.

Mr. McKee's motion, having been duly seconded, was put by the chair and carried, Messrs. Eccles, Harrison, Szymczak, McKee, Davis, Sinclair, Schaller, Peyton and Leach voting "Aye", and Mr. Ransom not voting.

(Secretary's note. It had been necessary for Mr. Draper to leave the meeting before the foregoing vote was taken and he advised the the Secretary subsequently that, in view of the earlier action of the Committee, he wished to be recorded as approving the statement.)

The statement as released to the press was as follows:

"The Federal Open Market Committee announced, following a meeting today, that weekly statements of the total holdings in the Federal Reserve System's Open Market Account may at times show some fluctuation depending upon conditions in the market affecting the committee's ability to replace maturing Treasury bills held in its portfolio. The volume of Treasury bills available on the market has declined materially during the year and, owing to the large and increasing demand, such bills are already selling either on a no yield basis or at a premium above a no yield basis. It has, therefore, become difficult and in some weeks impossible for the System to find sufficient bills on the market to replace those that mature. Short term notes are also selling on a no yield basis and longer term notes have at times been difficult to obtain. In these circumstances, it may be necessary from time to time "to permit bills held in the portfolio to mature without replacement, not because of any change in Federal Reserve policy but solely because of the technical situation in the market. Because no change in Federal Reserve policy is contemplated at this time, maturing bills will be replaced to the extent that market conditions warrant."

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.