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, September 27, 1940, at 2:40 p.m.

PRESENT: Mr. Harrison, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Ransom
Mr. Davis
Mr. Draper
Mr. Sinclair
Mr. Parker
Mr. Schaller
Mr. Day

Mr. Morrill, Secretary
Mr. Wyatt, General Counsel
Mr. Goldenweiser, Economist
Mr. Williams, Associate Economist
Mr. Dreibelbis, Assistant General Counsel
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Special Assistant to the Chairman of the Board of Governors
Mr. Piser, Senior Economist in the Division of Research and Statistics of the Board of Governors

Messrs. Young, Fleming, Leach, Martin, and Peyton, Alternate Members of the Federal Open Market Committee

Messrs. Hamilton and Gilbert, Presidents of the Federal Reserve Banks of Kansas City and Dallas, respectively

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 27-28, 1940, 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 meeting of the executive committee on May 27-28, 1940, were approved, ratified, and confirmed.

There were distributed to the members of the Board and the Presidents of the Federal Reserve Banks copies of a report prepared at the Federal Reserve Bank of New York of open market operations covering the period from May 27 to September 25, 1940, both dates inclusive. Mr. Rouse reviewed and commented on the important features of the report. He said that there were no transactions effected for System account on Thursday, September 26, except the exchange of the System's holdings of $92,500,000 of 1-1/2 per cent Treasury notes due December 15, 1940 for 2 per cent Treasury bonds of 1953-55 under the Treasury offering dated September 25, 1940, referred to in the last paragraph on page four of his report, this exchange having been authorized previously by the members of the executive committee.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System's account for the period from May 27 to September 26, 1940, both dates inclusive, were approved, ratified, and confirmed.

Vice Chairman Harrison then called upon Messrs. Goldenweiser and Williams for their reports on the business and credit situation.

Mr. Goldenweiser made a brief report, a copy of which has been placed in the files of the Federal Open Market Committee and, at the suggestion of several members, Vice Chairman Harrison requested that Mr. Goldenweiser send copies of it to all of the Presidents of the Federal Reserve Banks.

Following the conclusion of Mr. Goldenweiser's report, a statement was also made by Mr. Williams, a copy of which has been placed in the files of the Federal Open Market Committee.

Following the conclusion of Mr. Williams' statement, Vice Chairman Harrison said that it must be borne in mind that there is the possibility of some sort of an inflation following a business recovery together with the preparedness program. He felt that we might find it difficult to use in any substantial volume the only practical implement of control that we have, which is the portfolio, at a time when the Treasury might be borrowing large amounts from the market to finance the defense program. If we do approach inflation there may be some rise in interest rates, whether because of necessity or because of psychology, and we might be faced then with an effort on the part of banks and other institutions gradually to liquidate some of their holdings of Government obligations in preparation for the use of their funds in other channels. Query, therefore, whether at that time because of deficit financing and because of our own responsibility for the banking situation we might not have to begin to bail out some of their holdings of bonds and possibly envisage an increasing System portfolio rather than a shrinking portfolio. Mr. Harrison said that the question as to whether or not we should take advantage of every opportunity to improve the position of our portfolio in order to meet such developments brought up for consideration a question raised by Mr. Ransom in connection with a possible change in the language of the existing instructions to the executive committee.

Mr. Draper stated that with the defense program beginning to get under way and the business economy shifting into high gear he felt that it would be a mistake for the Committee to take an action at this time which might be construed as having deflationary implications. He added that he felt caution was particularly necessary at this time not only because of the domestic situation but also because of the dangerous war conditions abroad.

Mr. Harrison explained that he meant only liquidating some of the portfolio and that he had not suggested how much or anything as to details or duration of the operation. He pointed out that the existing resolutions were to sell or to buy when necessary for the purpose of exercising an influence toward maintaining orderly market conditions and that there was a discussion at the last meeting of the full Committee of the interpretation of this language. He called attention to the statement which he had made during the session on May 28, 1940, to the discussion of that suggestion, and to the agreement on the part of all the members of the Federal Open Market Committee that the existing directions of the Committee should be interpreted as authorizing the New York Bank to sell securities, which had been purchased in a period of market weakness for the purpose of exercising a stabilizing influence, whenever there was a strong buying market and there were not sufficient offerings. He said that the executive committee and the New York Bank had acted in accordance with that interpretation. He stated that he felt that we should now consider whether we should not sell from the portfolio, not only for the purpose of exercising an influence toward maintaining orderly market conditions, but to the extent that such sales can be made without adversely affecting the market, putting a limit on the extent to which the executive committee can go with the understanding that the executive committee will put a lower limit on the New York Bank. In response to a question, Mr. Harrison said that the New York Bank had been selling under the existing instructions as interpreted at the last meeting of the full Committee and that he was not suggesting that greater authority be given than that conferred by the existing instructions as thus interpreted. However he raised the question whether it was not desirable to change the language of the resolution so that it would conform more closely to that interpretation.

Mr. Ransom said he thought the objective he had in mind could be achieved under the existing resolution or at least with some slight change in the resolution. On the question raised by Mr. Draper as to whether the proposal of Mr. Harrison meant a change in policy, Mr. Ransom said so far as his own point of view was concerned it might be considered a change in policy because he had a very definite feeling that he would like to get the portfolio down to the point where it would not be more than sufficient to meet the earning requirements of the System, whatever that figure might be, with due regard to the fact that the System could not go into the market and sell merely for the sake of selling. If the objective were to sell as substantial an amount as possible regardless of whether the selling was directed at what some one might regard as a disorderly condition in the market or as a sale for the purpose of substantially reducing the portfolio, there might be some difference of opinion, but if it is the policy of the Committee to go steadily ahead with a selling policy the directions of the Committee would then be in a form, Mr. Ransom said, where he would feel that the instructions to the executive committee were even clearer than they were under the present directions. He said that he had had some rewording of the resolution in mind, which he intended to submit to the present meeting for consideration but which he did not think should be acted upon necessarily until the next meeting of the Committee, but that Mr. Harrison had suggested the possibility of slightly rewording the existing instructions so that there could be no possible misunderstanding on the part of the executive committee and the New York Bank and that he thought perhaps that would be the best thing to do. Mr. Ransom stated that merely for the sake of discussion and not as a motion he would read the language which he had in mind. He then read as follows:

Be it resolved that the Federal Open Market Committee instruct the executive committee to direct the New York Bank to make sales from the System's portfolio whenever such sales can be made without adversely affecting the market, provided that: (1) the total of such sales does not exceed $400,000,000, and (2) that sales of United States bonds maturing in more than ten years do not exceed $100,000,000.

Following a brief discussion Vice Chairman Harrison suggested that the language of the present resolution might be changed by striking out the words "necessary for the purpose of exercising an influence toward maintaining orderly market conditions" and substituting therefor the words "advisable in the light of existing conditions".

Thereupon Mr. Ransom moved that the following resolution be adopted:

"That 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 (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement) as in its judgment from time to time may be advisable in the light of existing conditions; provided that the aggregate amount of securities held in the Account at the close of this date shall not be increased nor decreased by more than $500,000,000."

Mr. Ransom's motion was seconded by Mr. Sinclair.

At this point Mr. McKee and Mr. Davis raised the question whether the Manager of the System Open Market Account should not be selling some of the notes maturing in March 1941, which otherwise might have to be exchanged for a new issue of Treasury obligations, so as to relieve the portfolio to that extent of the necessity for such an exchange.

Mr. Draper said that in the light of the discussion he would vote against the proposed new instructions because the change might be misconstrued by the public as a change in policy with deflationary implications.

Mr. Parker said that occasionally there is heard some criticism of the System for keeping its portfolio up to the present level when the banks want securities and they would like to see some reduction in the portfolio.

Mr. Ransom said that he did not have in mind the desire of banks for additional securities as the reason for the line of action that he was suggesting. He then asked whether the New York Bank would continue in the market under the proposed change in instructions in exactly the same manner as it had been operating in the market under existing instructions. Mr. Harrison said he did not think there would be any difference in the attitude of the New York Bank under its instructions in view of the interpretation unanimously agreed to at the last meeting of the full Committee, his only point in the matter being that he felt that it was wiser to have the language of the directions of the full Committee to the executive committee and of the executive committee to the New York Bank changed to conform to the interpretation placed upon those directions rather than rely solely upon the interpretation which would appear in the minutes of the Committee but not in the public record.

Mr. McKee said that he thought that the portfolio would have been reduced to a greater extent under the existing instructions to the executive committee and from the executive committee to the New York Bank if it had not been for the fact that during the intervening period there had been substantial sales of Government securities by the Treasury.

During the foregoing discussion Mr. Young withdrew from the meeting.

> Mr. Ransom's motion, having been duly seconded, was put by the chair and carried, Messrs. Harrison, Szymczak, McKee, Ransom, Davis, Sinclair, Parker, Schaller and Day voting "aye", and Mr. Draper voting "no".

There was then presented a report by Messrs. Smead and Rouse on the basis for the allocation of securities in the System Open Market Account and the various accounting procedures that might be adopted for the account.

> Copies of the report were distributed to all members of the Board of Governors and to all Presidents of Federal Reserve Banks, and, upon motion duly made and seconded, it was agreed that it should be placed upon the docket for consideration at the next meeting of the Federal Open Market Committee.

Mr. Ransom reported that Mr. Eccles had requested him to say that Mr. Eccles was very much concerned about the provisions of the Revenue Act of 1940 which would earmark certain taxes for the payment of certain new Government obligations under the defense program, and that he would like to have the members of the executive committee consider that problem when they are called to consult with the Treasury Department, for the purpose of determining what if anything they will want to say about it. In that connection Mr. Harrison called attention to his letter of September 4, 1940, to the Secretary of the Treasury on this subject.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved: Geo. L. Harrison
Vice Chairman.