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, August 3, 1942, at 10:10 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Szymczak
Mr. McKee
Mr. Ransom
Mr. Draper
Mr. Evans
Mr. Alfred H. Williams
Mr. Gilbert
Mr. Young
Mr. Leedy

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Wyatt, General Counsel
Mr. Goldenweiser, Economist
Mr. John H. 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, Chief, Government Securities Section, Division of Research and Statistics of the Board of Governors
Mr. Berntson, Clerk in the Office of the Secretary of the Board of Governors

Chairman Eccles stated that because of illness Mr. Sproul, Vice Chairman, would not be in attendance at the meetings of the full Committee and the executive committee today.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 22, 1942, were approved.

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the Federal Open Market Committee on July 6, 1942, in increasing from $500,000,000 to $850,000,000 the limitation on the authority granted to the executive committee to increase or decrease the total amount of securities held in the System account, was approved, ratified, and confirmed.

Copies of a report prepared at the Federal Reserve Bank of New York covering open market operations during the period from June 22 to July 29, 1942, inclusive, were distributed, and Mr. Rouse read and discussed the principal sections of the report. He also presented a supplementary report covering transactions for the System account during the period from July 30 to August 1, 1942, inclusive, from which it was noted that the total amount of securities in the account as of August 1, 1942, had been increased to $3,159,963,000.

Upon motion duly made and seconded, and by by unanimous vote, the transactions in the System account during the period from June 22 to August 1, 1942, inclusive, were approved, ratified, and confirmed.

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 held on June 22, 1942, were approved, ratified, and confirmed. Inasmuch as approval of the minutes of the meeting of the executive committee on July 22, 1942 had been deferred by the executive committee, action by the full Committee with respect to approval and ratification of the transactions recorded in those minutes was also deferred.

Chairman Eccles then reviewed for the information of the three representative members of the Federal Open Market Committee who were not members of the executive committee the recent discussions with representatives of the Treasury relating to Treasury financing and action by the Board of Governors of the Federal Reserve System to reduce reserve requirements of member banks in central reserve cities. A summary of the Chairman's statement has been placed in the files of the Federal Open Market Committee.

Following his statement, Chairman Eccles said that Secretary of the Treasury Morgenthau and Under Secretary Bell had accepted an invitation to have luncheon with the members of the Federal Open Market Committee today and that, therefore, it would be desirable to discuss before that time the questions involved in a reduction in reserve requirements. He then asked for the comments of the three representative members, who had not participated in the discussions with the Treasury, concerning (1) the need for reducing reserve requirements prior to the August financing or immediately thereafter, (2) the August financing, and (3) the rate and maturity of the certificate proposed to be offered by the Treasury.

Mr. Young stated that he felt reserve requirements should not be reduced until after the August financing since there was no question that the certificate issue would be successful, the banks were not concerned about a small reduction in requirements, there would be ample reason after the financing to make a reduction, and some banks might borrow if their excess reserves were reduced. The Chicago banks, Mr. Young said, felt that a nine-months maturity on certificates would be about right, but, if it were not for the tax question in April, they would prefer a 12-month maturity. While they were expecting a nine-month 3/4 per cent issue, he felt it should be a 12-month 7/8 per cent certificate which would be more attractive and be what was desired by the banks outside of New York and

Chicago. He added that there was a feeling in the Chicago area that $900,000,000 of the registered 2-1/2s could be sold, especially if provision were made to make the proceeds available for inheritance taxes, and that this issue should be left open for 15 days.

Chairman Eccles indicated that the System representatives had suggested that the registered issue be left open for three weeks to give the Victory Fund Committees an opportunity to do a good job of selling it.

Mr. Young also stated that he felt the existing limitation on the war loan accounts of banks should be increased. It was understood that this point would be discussed with Secretary Morgenthau at luncheon. Chairman Eccles suggested that the limitation might be held not to apply to war loan deposits secured by Government obligations, and there was general agreement with this position.

During the course of his statement, Mr. Young said that he had discussed with some of the banks in Chicago the effect of the practice of the Federal Reserve Bank of New York of purchasing bills at less than 3/8 per cent. The banks had given him a memorandum pointing out that the practice made it difficult for larger banks to give the support to the bill market that they otherwise would, that if they knew at what rate the New York Bank would purchase bills they would be in a position to give greater support to the market, and that what they would like would be for the New York Bank to have an understanding with the dealers as to the rate at which it would purchase short-dated bills, so that they would know at what rate they could support the market. Mr. Young read the memorandum to which he referred, and a copy has been placed in the files of the Federal Open Market Committee.

Mr. Leedy stated that he would not favor a change in reserve requirements before the forthcoming financing, that it would be unfortunate if the impression were given that the Treasury was going to accomplish its financing in the easiest way by a reduction in reserves, and that he felt that a one-year certificate at 7/8 per cent would go over very well.

Mr. Gilbert expressed the opinion that it was unnecessary to make any announcement with respect to lowering reserve requirements in advance of the proposed certificate offering, and that such a reduction in central reserve cities would be only a temporary solution of the problem and would not correct the fundamental trouble. He also said that a rate of 1 per cent would be high on the certificate issue, that 7/8 per cent would go well in the Dallas district, and that banks would prefer a one-year 7/8 per cent certificate rather than a nine months' issue at a lower rate. He favored the removal of any limitation on war loan accounts when the accounts were secured by Government obligations, and felt that the tap issue should be left open for at least three weeks to give the Victory Fund Committees an opportunity to sell it, that the banks would subscribe to the August financing more readily if the discount rate were reduced, and that, although some of them had indicated a willingness to borrow against Government securities, they were holding back because they did not want to be the first ones to do so.

There followed a discussion of what effect an increase in the bill rate to 1/2 per cent and a comparable rate on certificates would have on the distribution of these securities, and Messrs. Young, Leedy, and Gilbert expressed the opinion that increased rates would be helpful because banks and others would be willing to buy bills at 1/2 per cent when they would not take them at a lower rate.

Chairman Eccles asked whether $8,000,000,000 of certificates would be too large a volume to have outstanding of this kind of security, and Messrs. Leedy and Gilbert said they did not think so. The representative members also were in agreement with the position taken by Federal Reserve representatives at the Treasury that the difference between the schedule of rates on the modified tax note and current market rates would have to be small.

Mr. McKee inquired as to the extent to which banks with low capital ratios were unwilling to invest in additional Government securities and whether it would be helpful if the Federal bank supervisory agencies would take the position that examiners in their examinations should regard bills and certificates the same as cash. The representative members of the Committee indicated that such action would be helpful.

Mr. Leedy also suggested that, if the Treasury decided to place an amount of Treasury bills on tap each week at a fixed discount rate, the suggested limit of $25,000 to any one subscriber should be increased. This suggestion was concurred in by the others present.

At 12:55 p.m. the meeting recessed and reconvened at 2:30 p.m.

with the same attendance as at the morning session except that Messrs. Thurston and Berntson were not present.

Chairman Eccles reported that during the luncheon with Secretary of the Treasury Morgenthau it was stated that the representative members of the Federal Open Market Committee had the same opinion as the members of the Board of Governors with respect to the desirability of deferring action on a reduction in reserve requirements of member banks in central reserve cities until after the August financing, with the understanding that action would be taken on or after August 15 to become effective before the end of the month.

Reference was made to the discussion at the meeting of the executive committee on July 22, 1942, and the decision reached at that time to present for consideration at this meeting the question whether the Federal Reserve Bank of New York should continue to purchase bills in the New York market for System account at discount rates less than the posted rate of 3/8 per cent. Mr. Rouse referred to the memorandum on this subject which had been sent to the members of the executive committee by Mr. Sproul under date of July 16, 1942, and stated that the New York Bank had understood the posted rate to be in the nature of a ceiling or a notice to holders of bills that there would always be available a purchaser of their bills at that rate, and that the Bank had not anticipated that very many bills would be acquired at the posted rate. He pointed out that the Reserve Banks conducted two kinds of operations in the bill market, one in which the initiative was in the Federal Reserve Bank of New York in that it went into the market for bills for the purpose of putting funds into the market, and the other in which the initiative was in the holder of the bills in that he offered the bills to a Federal Reserve Bank at the posted rate. He felt that the System had a commitment to establish a broad market for bills and desired to create an instrument by which funds would flow to the area where they were needed; and that, if a situation developed in which the System desired to put a substantial amount of funds in the market in anticipation of drains on individual banks, the New York Bank could do that best by the purchase of bills before the drains on the individual banks actually took place. However, he said, the banks involved would not be willing to sell bills until they were in need of funds unless they were paid a premium, and, by being able to pay this premium, the Federal Reserve Bank had greater freedom in supplying funds to the market in advance of the development of strains, and thus avoiding tight situations in individual cases with their resulting effects on the market, than if it were forced to wait until the need of funds actually occurred and bills were offered at the posted rate. He added that the Federal Reserve Bank had no commitment to purchase at any rate other than 3/8 and that when it purchased bills at a lower rate it was for the purpose of putting funds into the market and because it could get bills at the lower rates. It was his opinion that this situation carried out a pattern of rates on 30-, 60-, and 90-day maturities and that, if the New York Bank were limited to the purchase of bills at 3/8 only when they were offered, the market would be hampered and the Reserve Bank would be denied the best available means under present conditions of putting funds into the market. He made the further statement that in the cases where bills were offered to it the Federal Reserve Bank of New York had stated that it would be glad to take the bills at the 3/8 rate but that it might be possible for the holder to obtain a better price in the market.

In response to an inquiry from Mr. McKee, Mr. Rouse agreed that it would be possible for the Federal Reserve Banks to acquire bills each week through the dealers and by that means put funds into the market, but he said that method did not always furnish the flexible means of giving relief at the time it was needed.

Chairman Eccles stated that the difficulty with purchases at less than the posted rate was that it appeared to banks in other districts that the Federal Reserve Bank of New York was buying on the basis of the lower rates when the interior banks could not get better than 3/8 per cent on the same bills from their own Federal Reserve Bank. Some of the members of the executive committee of the Federal Open Market Committee felt, Chairman Eccles said, that with the posting of the buying rate all bills became demand obligations regardless of maturity and should carry a uniform rate, that it was somewhat inconsistent to talk about different rates for 30-, 60-, or 90-day bills in these circumstances, and that, if purchasers of bills desired to buy short-term bills at a smaller discount, they should be permitted to do so, but the System account should not interfere with that operation by buying bills at the lower rates.

There was a discussion of the effect on the bill market of purchases by the New York Bank at rates less than 3/8 and of a limitation of purchases by the Bank for System account to bills offered at the posted rate. Mr. Rouse emphasized that there would be some market at the lower rates regardless of the course followed by the System account for the reason that there were buyers who preferred to purchase 30-day bills at 1/4 per cent rather than to take new bills with a right to sell them to the System account, that while the New York Bank had purchased at less than 3/8, the rates at which the purchases were made were market rates available to the entire country, and that if such a market could not exist without purchases by the New York Bank he would not favor such purchases. He also expressed the opinion that the New York Bank might not be able to put into the market all the funds that might be needed between now and the closing of the books on the forthcoming financing to insure the success of that financing if it were confined to taking only bills offered at the 3/8 rate.

Chairman Eccles suggested that a decision be reached to discontinue purchases at less than 3/8 per cent with the understanding that, if at any time the executive committee should determine that the New York Bank was unable to supply sufficient funds to the market in any other way, purchases might be authorized at lower rates.

Mr. Pouse stated that he would propose an arrangement under which the New York Bank would limit its purchases (other than of bills offered at the 3/8 per cent rate) to purchases of bills with maturities of 45 days or more at market rates which would be the equivalent of the 3/8 per cent buying rate plus a commission, and if additional bills were desired they would be obtained by means of having the dealers bid for bills to be sold to the System account at the price paid by the dealers plus a small commission charge. He also said that it might be well for him to write a letter to the other Federal Reserve Banks suggesting that they take all bills offered at the 3/8 per cent rate but defer consummation of the transaction until the holder had tried to get a better price in the market. If that were done, he felt that the objection to purchases of bills by the New York Bank at rates lower than 3/8 would be taken care of.

Mr. McKee inquired whether there would be any embarrassment to the other Federal Reserve Banks in an arrangement such as proposed by Mr. Rouse, and the representative members of the Committee indicated that there would not be if the Federal Reserve Banks made it clear to the sellers that they might be able to get a better price in the market.

Chairman Eccles suggested that it be the consensus of the members of the full Committee that the Federal Reserve Bank of New York should try to put the necessary funds into the market by purchasing bills offered at the 3/8 per cent rate and having the dealers purchase new bills for resale to the Federal Reserve Banks with the usual commission, it being understood that if it should appear to the executive committee to be necessary to deviate from that course and purchase bills at rates below 3/8 it could so instruct the New York Bank.

This suggestion was agreed to unanimously.

Mr. Rouse withdrew from the meeting at this point to keep an appointment at the Treasury.

Chairman Eccles then inquired whether there would be any objection on the part of the members of the full Committee to the direct purchase from the Treasury by the System account of a block of bills which would be held for sale to anyone desiring them at 3/8 per cent so that the System account would be in a position of being willing to buy or sell bills at that rate. In the ensuing discussion of this point, it was stated that, if that procedure were followed, it would remove any need for a reduced general discount rate or the establishment of a preferential discount rate, or for any arrangement under which the Federal Reserve Bank would purchase bills with an option or obligation on the part of the seller to repurchase, or for the proposal made by the Victory Fund Committee at Kansas City that the Treasury place bills on tap each week, in addition to the regular weekly offering, at a fixed rate which would be related to the rates on the latest regular offering. In this connection it was stated that, while the Treasury was inclined to accept favorably the Kansas City proposal, there were some legal questions in connection with it that had been referred to the legal division of the Treasury for study. It was suggested that this whole matter was one that might well be left in the hands of the executive committee to work out with the Treasury and that it might be put into effect when the decision was reached by the Treasury to increase the weekly offering of bills.

At the conclusion of the discussion, it was moved and seconded that the executive committee be requested to discuss the matter further with the Treasury with the understanding that, if it were agreed that the arrangement suggested by Chairman Eccles should be put into operation, the executive committee would have authority under the general authorization from the full Committee to make such purchases of bills but that the arrangement would not be put into effect until after the August financing.

This motion was put by the chair and carried unanimously.

Chairman Eccles stated that the members of the executive committee and the other Washington members of the Federal Open Market Committee had been discussing with the Treasury and among themselves the question whether, as a further means of broadening the distribution of bills and possibly certificates, the Federal Reserve Banks should establish preferential discount rates on loans secured by bills and certificates with maturities of 91 days or less, or whether the Federal Open Market Committee should authorize the Federal Reserve Banks to purchase such securities under an agreement to resell.

Mr. Ransom said that in connection with the consideration of this matter, at his request, Mr. Goldenweiser had prepared a memorandum under date of July 31, 1942, giving arguments that might be advanced for and against preferential discount rates, that the memorandum clarified the question whether action should be taken by the 12 Federal Reserve Banks and the Board in the form of a discount rate or by the Federal Open Market Committee in the form of a repurchase authorization, and that the action taken by the Federal Open Market Committee on May 25, 1936, authorizing each Federal Reserve Bank to make temporary purchases of Government securities under resale agreements for periods not exceeding 15 days furnished a precedent for action in the latter form, which he would prefer. At Mr. Ransom's request, Mr. Goldenweiser's memorandum, a copy of which has been placed in the files, was read and discussed.

During the ensuing discussion the following drafts of resolutions were presented for consideration:

> "Supplementing the direction of April 30, 1942, issued by the Federal Open Market Committee to the Federal Reserve Banks to purchase all Treasury bills that may be offered to such Banks on a discount basis at the rate of 3/8 per cent per annum, any such purchases shall, if desired by the seller, be upon the condition that the Federal Reserve Bank, upon the request of the seller before the maturity of the bills, will sell to him Treasury bill of like amount and maturity at the same rate of discount."

> "That the Federal Open Market Committee direct the 12 Federal Reserve Banks to purchase for the System open market account all Treasury certificates with maturities at time of purchase of not to exceed 91 days that may be offered to such Banks on a basis to yield the System account 3/8 per cent per annum; and that any such purchases shall if desired by the seller be upon condition that the Federal Reserve Bank, upon request of the seller before the maturity of the certificates, will sell to him Treasury certificates of like amount and maturity on a basis to yield the original seller 3/8 per cent per annum."

Mr. Gilbert stated that while he was in favor of the resolutions he questioned whether they went far enough for the reason that there were many small banks that did not have Government securities and more that did not have bills and certificates and that they would be barred from recourse to the Federal Reserve Banks in this form. There was also the question, he said, whether approval of the resolutions might not furnish a basis for pressure from member banks that member bank receivables be purchased by the Federal Reserve Banks under repurchase arrangements which would eliminate member bank borrowing in any other form. In the discussion of these questions it was felt that, since the purpose of the resolutions would be to encourage the distribution of bills and certificates, member banks might be influenced to purchase them for the added advantage that they would afford of readily available funds from the Federal Reserve Banks. There was also a feeling that many of the banks in the larger centers which would have wide fluctuations in their deposits during the war period would use the repurchase arrangement and that it would be very helpful in that situation.

Mr. John H. Williams stated that he was in favor of the repurchase arrangement but that he questioned whether it went far enough, and that he would regard it more as a supplement to the discount rate than as a substitute for it. He said that he would prefer a general reduction in the discount rate, and that he felt it was of such importance to get rid of the fixed feeling on the part of member banks and others that there must be a minimum amount of excess reserves in the banking system that he would be willing to take a chance on any abuse that had been feared in the past in connection with low discount rates in order to demonstrate that the banks need abundant reserves rather than excess reserves. In this connection, he suggested that the discount rate was a less effective instrument in dealing with the credit situation than either changes in reserve requirements or open market operations, and that, therefore, a reduction in the rate would not be regarded as being any more inflationary than the use of the other two instruments. He felt that to break down the idea that had grown up during the past 10 years that the banks had to have excess reserves was the most important problem before the System today, and that, as stated in the footnote to Mr. Sproul's memorandum of July 30, 1942, to which reference was made by Chairman Eccles in his statement, it was not the amount of member bank borrowing but the fact that member banks should be willing to borrow that was important as a means of dispelling the false idea that safety requires some amount of excess reserves. In order to avoid involving any loss to the member banks in rediscounting, Mr. Williams favored reducing the discount rate to 3/8 per cent and he would make it unmistakably clear to the banks that we wanted them to borrow whenever necessary without loss to them. Only in that way, he said, could we remove the fixed idea that excess reserves were necessary, and it should be the purpose of the Federal Reserve System to get member banks to realize that that was not true and that they should be free to go to the Federal Reserve Banks whenever necessary to adjust their individual positions through borrowing. He added that the United States was in that position until it accidentally built up a large amount of excess reserves, and that it was the position that every other country was in at the present time.

At this point, Mr. Rouse reentered the room.

In a general discussion of Mr. Williams' statement, reference was made to the possible inflationary interpretation that might be put on a reduction in the discount rate, and Mr. Williams expressed the opinion that that question was involved in whatever form action was taken by the System for the purpose of furnishing funds to banks with which to purchase large amounts of Government securities, and that the important thing from the standpoint of inflation was the large volume of funds that was being created rather than the level of discount rates.

Chairman Eccles suggested that the repurchase arrangement proposed in the resolutions set forth above would be as effective as member bank borrowing in correcting the feeling that it was necessary to have a minimum amount of excess reserves. Mr. Williams responded that if that were the case he would be willing to withdraw his suggestion, but that he questioned whether the repurchase arrangement would go far enough.

Mr. Goldenweiser expressed the opinion that it would be dangerous to try to teach member banks that borrowing in the form of rediscounts was a very desirable thing, that the most important instrument of monetary control was the banks' reluctance to borrow, and that the discount rate had always been below the rate charged by banks to their customers and could not practically be made otherwise. While he agreed that it would be desirable to have no excess reserves and to have member banks borrow from the Federal Reserve Banks for a few days to adjust their positions, he saw no way in which that could be accomplished.

In a further discussion, Mr. Rouse stated that the repurchase arrangement would be an effective instrument in helping to widen the market for bills but that the certificates had been absorbed readily, and he believed it would be better to apply the arrangement only to bills, at least until a further distribution of bills had been achieved.

Mr. Rouse also stated that at the request of Secretary Morgenthau he had gone to the Treasury this afternoon for an informal discussion and that there had been no indication on the part of the Secretary during the conference that he would be willing to consider an increase in the rate on bills.

Chairman Eccles said that he had come to the conclusion that the Federal Reserve representatives should take the position that the question of the short-term rate would not be raised in future Treasury discussions until such time as reserve requirements of central reserve city banks had been reduced to 20 per cent, when the question would be raised whether a further reduction should be made which would have to be applied to the country as a whole. At that time, he said, the System would have had ample opportunity to determine the effect of the 3/8 per cent rate, the posted rate, and of the repurchase arrangement, and the Federal Reserve representatives would be in a better position to discuss the desirability of an increase in the bill rate to 1/2 per cent.

Mr. Ransom inquired whether Mr. Sproul had any opinion with respect to the proposed repurchase arrangement. Mr. Rouse said he did not know.

Mr. McKee raised for discussion the question whether the repurchase arrangement should not be one under which the seller would have only a 15-day option to repurchase. This suggestion was discussed, and it was the feeling of a majority of the members that, if adopted, the arrangement would be for the purpose of broadening the market and, therefore, no limitation should be placed on the time before maturity within which the securities sold to a Federal Reserve Bank could be repurchased.

Mr. Morrill called attention to the fact that the proposed resolution contemplated that the purchases under the repurchase arrangement would be for the System account, and he inquired whether that would present any difficulties. Mr. Rouse's response was that he felt that the matter could be handled in that manner with the understanding that the individual Federal Reserve Banks would hold the individual repurchase agreements.

Chairman Eccles raised the question whether the repurchase arrangement should be open only to member banks, and it was agreed that such a restriction should not be applied.

> Thereupon, upon motion duly made and seconded, the following resolution was adopted by unanimous vote:

> Supplementing the direction of April 30, 1942, issued by the Federal Open Market Committee to the Federal Reserve Banks to purchase all Treasury bills that may be offered to such Banks on a discount basis at the rate of 3/8 per cent per annum, any such purchases shall, if desired by the seller, be upon the condition that the Federal Reserve Bank, upon the request of the seller before the maturity of the bills, will sell to him Treasury bills of like amount and maturity at the same rate of discount.

At this point, Mr. Goldenweiser left the meeting.

Consideration was then given to the authority to be granted to the executive committee to effect transactions in the System account, and in that connection there was agreement that, in order that the executive committee might be in a position to meet any situation that could be foreseen over the next few weeks, it would be desirable to increase the limit on the committee's authority to $1,000,000,000, which would include any special short-term certificates that might be purchased to prevent temporary overdrafts in the Treasury accounts at the Federal Reserve Banks.

Thereupon, upon motion duly made and seconded, the following resolution was adopted by unanimous vote:

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, 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 accound, or for the purpose of maintaining about the present general level of prices and yields of Government securities, or for the purpose of maintaining an adequate supply of funds in the market, or for the purpose of granting temporary accommodation to the Treasury; provided that the aggregate amount of securities held in the account at the close of this date (other than Treasury bills purchased pursuant to the directions of the Federal Open Market Committee issued under dates of April 30 and August 3, 1942) shall not be increased or decreased by more than $1,000,000,000.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.