

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 Thursday, September 28, 1950, at 10:00 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Davis
Mr. Eccles
Mr. Erickson
Mr. Evans
Mr. Norton
Mr. Peyton
Mr. Powell
Mr. Szymczak
Mr. Vardaman
Mr. C. S. Young

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Langum, Peterson, Stead, and John
H. Williams, Associate Economists
Mr. Rouse, Manager, System Open Market
Account
Mr. Thurston, Assistant to the Board of
Governors
Mr. Riefler, Assistant to the Chairman,
Board of Governors
Mr. Sherman, Assistant Secretary, Board
of Governors
Mr. Ralph A. Young, Director, Division
of Research and Statistics, Board
of Governors
Mr. Youngdahl, Chief, Government Finance
Section, Division of Research and
Statistics, Board of Governors
Mr. R. F. Leach, Economist, Board of
Governors
Mr. Arthur Willis, Special Assistant,
Securities Department, Federal
Reserve Bank of New York
Messrs. Williams, Gidney, Gilbert, and Leedy,
alternate members of the Federal Open
Market Committee

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Messrs. Leach, McLarin, and Earhart, Presidents
of the Federal Reserve Banks of Richmond,
Atlanta, and San Francisco, respectively

Mr. Townsend, Solicitor, Board of Governors

Chairman McCabe stated that it had not been possible to arrange for a conference with Secretary of the Treasury Snyder before this meeting, as suggested at the meeting of the executive committee yesterday, but that he and Mr. Sproul had an appointment with Mr. Snyder for 11:30 this morning.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 18, 1950, were approved.

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the Committee on August 22, 1950, increasing from \$2 to \$4 billion the limitation contained in the first paragraph of the direction issued to the executive committee on August 18, 1950, authorizing transactions for the System account was 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 August 18, 1950, were approved, ratified, and confirmed.

Before this meeting there had been distributed to the members of the Committee a report of open market operations prepared at the Federal Reserve Bank of New York covering the period from August 18 to

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September 21, 1950, inclusive. Mr. Rouse presented a supplementary report covering commitments executed on September 22 through 26, inclusive, and commented briefly on both reports. Copies of the reports have been placed in the files of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account for the period August 18 to September 26, 1950, inclusive, were approved, ratified, and confirmed.

Chairman McCabe said that there had been no meeting with the Secretary of the Treasury since he and Mr. Sproul called to inform him of the action taken by the Committee on August 18, and that he had had no telephone communication with any Treasury representative, relative to the action taken at that time, since Secretary Snyder informed him by telephone later in the afternoon of August 18 of his decision with respect to the refunding of the Treasury securities maturing in September and October.

Chairman McCabe went on to say that the executive committee had a full discussion of open market policy at its meeting yesterday and, although it had not adopted any formal recommendations to be made to the full Committee, that there appeared to be general agreement that the Committee had a grave responsibility in the light of the further rapid expansion of bank credit in recent weeks, that it was quite obvious that appeals of supervisory agencies and bankers associations for restraint in granting credit had had little effect, and that it

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was felt that serious consideration should be given to allowing the short-term interest rate to rise further to continue to carry out the policy adopted at the meeting on August 18, 1950, in an effort to restrain, if possible, the selling of Government securities to the System.

In his comments, Chairman McCabe referred to the report of open market operations submitted by Mr. Rouse and discussed earlier at this meeting and to memoranda prepared in the Board's offices under date of September 21, 1950, with respect to an increase in reserve requirements and the outlook for Treasury cash requirements, copies of which had been distributed to all members of the Committee before this meeting.

At Chairman McCabe's request, the members of the Committee and the Presidents of the Federal Reserve Banks who were not members of the Committee expressed their views as to whether action should be taken to permit a further increase in the short-term rate and whether the Board of Governors should use its authority to increase reserve requirements of member banks. There was general agreement that there should be a further increase in the short-term rate to continue to carry out the policy adopted by the Federal Open Market Committee on August 18, 1950. With respect to the question whether the Board of Governors should increase reserve requirements of member banks as an additional or alternative means of placing restraint on

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credit expansion, all of the Presidents of the Reserve Banks expressed the view that an increase should not be made at this time. Several of the Presidents felt that, if the Board decided that such an increase were desirable in dealing with the current inflationary situation, action should be deferred until after the results of the increase in the short-term rate and other System actions could be observed.

Messrs. Eccles, Szymczak, Vardaman, and Powell thought that the increase should be made effective very promptly after the short-term rate had been allowed to rise. Mr. Evans was of the opinion that it should precede an increase in the short-term rate, which he felt would be of little value in restraining credit expansion.

The members of the Committee who commented on the long-term rate felt that the 2-1/2 per cent rate on Government bonds would have to be held during the present emergency. Several of the Presidents felt that System policy should not be held indefinitely to the 2-1/2 per cent rate.

During the foregoing discussion Messrs. McCabe and Sproul withdrew to keep their appointment with Secretary of the Treasury Snyder.

The members of the staff of the Board's Division of Research and Statistics made an oral and visual presentation by charts of economic developments since the invasion of South Korea commenced on June 25, 1950, and a memorandum dated September 27, 1950, on the current

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economic situation and outlook was distributed. A copy of the memorandum has been placed in the files of the Federal Open Market Committee.

Mr. Thomas made a statement on problems of Federal Reserve policy in which he said that economic developments and prospects continued to be dangerously inflationary, that pressures so far were due primarily to private spending and investment rather than to an actual increase in Government spending, and that inflationary pressures were likely to increase for a while as private activities and increases in Government spending added to incomes and there were reductions in supplies of certain products for civilian use. Mr. Thomas said that measures to prevent inflation, such as the increase in income taxes effective October 1, 1950, allocations and inventory controls, consumer credit controls, and real estate credit restrictions, were not yet effective, and that general credit restraint through the open market policy adopted August 18, 1950, had been frustrated through the necessity of supporting Treasury refunding operations, the System having supplied a substantial amount of reserves which would provide for further credit expansion since that date, in addition to having supplied reserves to meet an outflow of gold and an increase in demand for currency. There had, however, been some adjustment in the rate structure since August 18, and now that it was no longer necessary to support Treasury refunding and since there probably would be no

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need for new Treasury funds until next summer, Mr. Thomas felt that an additional small increase in short-term rates could be permitted. A small rise in rates could have a restraining effect, Mr. Thomas said, the important thing being that the economy worked through the marginal borrower and it was necessary to affect only a small percentage of loans in order to make System policy effective. Mr. Thomas went on to suggest that the System permit an increase in rates on 12- and 13-month Treasury issues as a means of encouraging market purchases which would widen the spread between the bill rate and the 12-month rate, absorb some of the reserves in the market, and permit adjustments in the System's holdings of securities. It might be necessary for the System to purchase some long-term bonds, but the amount of such purchases should be kept small. Other possible measures included an increase in reserve requirements which would be more effective if it was preceded or accompanied by an increase in the short-term rate, adoption of a Treasury financing policy which would reduce the supply of short-term securities in the market, and, in the event institutional and other investors should sell large amounts of long-term bonds for the purpose of making loans of an inflationary character, consideration of abandonment of par support for long-term Treasury bonds.

The meeting then recessed and reconvened at 2:10 p.m. with the same attendance as at the beginning of the morning session.

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Chairman McCabe said that he and Mr. Sproul met with Secretary of the Treasury Snyder at 11:30 this morning and that Mr. Haas, Director of the Technical Staff of the Treasury, and Mr. Bartelt, Fiscal Assistant Secretary of the Treasury, were also present. He then made a statement substantially as follows:

We told the Secretary that we had tried to see him at 9:30 this morning before the Committee met, that the Committee was now in session, and that we would like to have the benefit of any views that he might have on how we could curb inflationary forces, particularly as they were operating in the banking field. We pointed out the expansion in bank credit and said that had given us very much concern and that we needed his counsel as to how the expansion could be curbed. He immediately asked if we would give him any thought we had in mind on what might be done, so we mentioned an increase in reserve requirements, and the possibility of restricting bank reserves by being reluctant buyers of securities and allowing a moderate further increase in short-term rates. During the course of the conversation he took up each of these points.

On reserve requirements, he was quite emphatic in ruling that out as not being particularly effective at this time. On the question of an increase in the short-term rate, he questioned us at great length as to what effect we thought that would have. There was a big question in his mind whether the recent increase of 1/8 per cent had had any value whatever, or whether it, plus other things taking place, had simply resulted in keeping the market upset. Both the Secretary and Mr. Bartelt brought up the cost to the Government of an increase in the short-term rate, asking in different ways what proof we had of the effectiveness of the increase. He seemed pretty emphatic that any further increase in the short-term rate would be a step of a very doubtful character.

Then we asked the Secretary if he could suggest anything else that possibly could be done to curtail bank credit. He mentioned the American Bankers Association 1948 voluntary campaign and suggested we might get the new President of the association and other officials to put on a strong campaign to restrain credit. We talked of other controls, such as on consumer credit

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and real estate credit, and he expressed hope that these controls might be effective.

We pointed out the desirability of discussions of this character and expressed the hope that we could have them more frequently, that there should be a meeting of minds, and that we should try to settle these questions in this way. There was some discussion also of the relative responsibilities of the Treasury and the Federal Reserve and he indicated that he thought it highly desirable at some time for this whole question of responsibility to be reviewed by the proper authorities because conditions had changed so materially since action by the Congress creating the Federal Open Market Committee as now constituted. At the time of that action, he said, we did not have a public debt of anything like the present magnitude, and in view of the problems involved in the handling of the debt, he felt there should be a review of the Congressional authority and the responsibilities of the agencies should be re-defined. We spent considerable time discussing the long-term rate and brought out that we did not want to carry the short-term rate up to a point that would affect the 2-1/2 per cent rate.

At the end, the Secretary said that he would like to have a couple more days to think about the matter and that he would get in touch with us and give us the benefit of his views. Mr. Sproul and I discussed this afterwards and felt that he had given us a clear indication of his views both on reserve requirements and the short-term rate. We felt that we should report back to this Committee and perhaps we should see him later today and tell him the action of the Committee or we could give him a couple of days in which to express his point of view.

In a further comment on the conversation, Mr. Sproul stated that the Secretary was unequivocal in indicating that an increase in reserve requirements would be useless and ineffective at this time and would simply shift earning assets from commercial banks to Federal Reserve Banks, and that the increase in the short-term rate had gone too far already. Mr. Sproul also said that Secretary Snyder made the statement that the Treasury considered that cooperation

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in these matters was a two-way street and that the Treasury had gone along with the Committee when it did not agree and felt the Committee was wrong, and that he thought the Treasury should have its way some of the time.

There followed an extensive discussion of the report by Chairman McCabe and Mr. Sproul and of the possible courses of action that might be taken by the Committee.

During the discussion Chairman McCabe stated that if the Committee felt the short-term rate should be permitted to increase further as a restraining influence it could either authorize him and Mr. Sproul to call on Secretary Snyder again today and tell him the decision arrived at after having considered his views, or it could authorize the executive committee to proceed to carry out the policy at a time that was agreed upon by the executive committee after hearing from Secretary Snyder again. Chairman McCabe expressed the view that, for reasons which he stated, it would be preferable to wait a couple of days before permitting the short-term rate to rise further in order to give time to hear from Secretary Snyder. He also said that if the decision of the Committee was at complete variance with the views of the Secretary of the Treasury the matter would probably go to the President of the United States, that in his judgment the President would not be likely to take a position against the views of the Secretary of the Treasury, and that the System would then have to decide what its course of action should be.

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Mr. Evans said that he thought the Committee could delay action a few days until it had heard from the Secretary of the Treasury and that if the Secretary was opposed to the action which the Committee felt should be taken he should be requested to state his views in writing.

Mr. Szymczak felt that the Committee would be in a better position in its relations with the Secretary of the Treasury if no action were taken until it had heard from him again.

Mr. Sproul felt that time was of the essence and that delay would be unfortunate if not damaging to the results the Committee hoped to accomplish, that it had gotten the Secretary's reaction to the Committee's views and knew beyond any reasonable doubt that there was going to be no change in his attitude on either the short-term rate or an increase in reserve requirements, and that it would be better for the Federal Open Market Committee to decide now what it was going to do and take the action today. Failure to take action today, he said, would run the risk not only of still further delay but of added pressure not to take the action at all even though it was the judgment of the Committee that it was necessary if it was to discharge its responsibilities properly. Mr. Sproul felt that the question should not go to the President of the United States as he should not be called upon to decide questions of this kind, and that the members of the Board and the Federal Open Market Committee could not avoid their responsibility for making decisions.

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Mr. Eccles said that, if the Committee could not get agreement with the Secretary of the Treasury, the Committee must decide upon a course of action in the light of its responsibilities under the Federal Reserve Act and take action, going to Congress later if necessary. He went on to say that he would like to see action taken by the full Committee today authorizing the executive committee to permit an increase in the short-term rate with the understanding that the executive committee would defer action until it had given the Secretary of the Treasury opportunity to express his views in a few days, as he had indicated he would do.

Mr. Vardaman said that he welcomed intercession of the President in time of war, that he thought the Committee should give the Secretary of the Treasury time, and that if it could not get agreement with him it should go to the President and if he could give a good reason for delaying action the Committee should delay and go to the Congress in November.

There was also a discussion of the effect of an increase in the short-term rate on the price of the longest term restricted Treasury bonds and it was agreed that, for the reasons discussed, the System should not at this time permit the longest term restricted Treasury bonds to go below par even though a policy of supporting such bonds at or slightly above par meant that use of traditional central banking methods for putting restraint on bank credit expansion could have only a limited effect.

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Mr. Davis stated that the picture had not been changed by the introduction of any new factors since the meeting of the Committee on August 18, 1950, that in his judgment the Committee should go ahead with the policy adopted at that time, and that this called for a further increase now in the short-term interest rate and, when in the judgment of the Board of Governors it was timely, an increase in reserve requirements of member banks. He thought that the Committee ought to state its position and give the executive committee authority to act. He felt there could still be a short delay in carrying out the action, but that there was no reason why the Committee should recede from the policy adopted August 18.

Mr. Davis moved that, in accordance with the policy announced by the Federal Open Market Committee and the Board of Governors on August 18, 1950, it be understood that (after the conference which Chairman McCabe and Mr. Sproul are to have with the Secretary of the Treasury early next week at which they will advise the Secretary of the views as expressed at this meeting, and in the absence of the submission of any new information by the Secretary of the Treasury which in the judgment of the executive committee would call for further consideration by the members of the full Committee) (1) the executive committee, acting under the general direction issued at this meeting, will take such action as may be necessary over such period as may be desirable to allow the market yields for Treasury securities on a one year basis to move up to the highest point, not exceeding the Federal Reserve Bank discount rate of 1-3/4 per cent, which will not result in such pressure on the longest term restricted bond as would cause continuing purchases in substantial amounts of such bonds for the System account, (2) the longest term restricted bond would not be allowed to decline beyond a point slightly above par, and (3) an orderly market would be maintained;

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That it be further understood that the foregoing motion is predicated on the understanding that as promptly as practicable in the discretion of the Board of Governors after short-term rates were increased in accordance with number (1) above (but not necessarily waiting until such increase reached the highest authorized point) the Board would announce an increase in reserve requirements of all member banks by two percentage points on demand deposits to be effective at such times as the Board determined to be advisable; and

That it be further understood that (1) a statement would be prepared setting forth fully the reasons for the Committee's views in a form satisfactory to the executive committee and the Board of Governors and suitable for the policy record, which could be furnished to the Secretary of the Treasury following the conference with him next week, and (2) a meeting of the executive committee would be held early next week.

Mr. Davis' motion was put by the Chair and carried unanimously.

Reference was then made to the general direction to be issued to the executive committee to arrange for transactions in the System account and it was suggested that the direction be in the same terms and amounts as the existing direction.

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 current and

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prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to maintaining orderly conditions in the Government security market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; 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 \$4,000,000,000.

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.

In a discussion of the policy to be followed in the replacement of System maturing bill holdings, it was understood that the executive committee should be guided 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.

It was also understood that, acting under the general direction of the full Committee in carrying out the understanding referred to in clause (2) of the first paragraph of Mr. Davis' motion, i.e., that the longest term restricted bond would not be allowed to decline in an orderly market beyond a point slightly above par, the executive committee would be authorized to permit the market price of the longest term restricted bond to decline to between $\frac{1}{32}$ and $\frac{8}{32}$ above par.

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The time of the next meeting of the Federal Open Market Committee was tentatively set for November 27, 1950.

Thereupon the meeting adjourned.

Chester Morris
Secretary.

Approved:

Thomas B. McCall
Chairman.