7/26/51

INTEREST RATES

WASHN--DJ-- PRESIDENT TRUMAN MET FOR MORE THAN AN HOUR TODAY WITH TREASURY AND FEDERAL OFFICIALS PRESUMABLY FOR A DISCUSSION OF INTEREST RATE POLICY

MEETING WITH THE PRESIDENT WERE CHAIRMAN MC CABE OF THE FEDERAL RESERVE BOARD UNDER-SECRETARY OF TREASURY FOLEY AND CHAIRMAN MC DONALD OF THE SECURITIES & EXCHANGE COMMISSION

THERE WAS NO IMMEDIATE WORD AS TO WHAT TURN THE INTEREST RATE DISCUSSION TOOK

THE FEDERAL RESERVE OFFICIALS HAVE RECENTLY BEEN AT ODDS WITH THE WHITE HOUSE AND TREASURY OVER INTEREST RATE POLICY

THE ADMINISTRATION HAS BEEN SUPPORTING CONTINUATION OF THE TREASURY--S PRESENT LOW INTEREST RATE POLICY WHILE THE FEDERAL RESERVE HAS WANTED TO INCREASE INTEREST RATES AS AN ANTI--INFLATIONARY DEVICE TO CURB BANK CREDIT EXPANSION

February 27, 1951
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These are notes on the meeting held at the White House at 11:00 a.m. yesterday.

The President opened the meeting by reading the memorandum attached and said that he would like a full and frank discussion.

Mr. Clark of the Council of Economic Advisers spoke of what he considered would be the disastrous consequences of Federal Reserve policy to the whole economy and to the Government's credit.

I spoke of what we are trying to do, why time is of the essence, and the long history of delay and obstruction in putting our program into effect. I said that what we think we should do and even must do in the light of our statutory responsibilities would not interfere with the rearmament program and would increase rather than destroy confidence in the Government's credit. The President, as at his previous meeting with the F.O.M.C, referred to his World War I experience with Liberty bonds and said that he did not wish that to happen again. I pointed out the difference between World War I Liberty bonds and World War II savings bonds and said that fluctuations in market prices, even if as wide as they were after World War I which no one contemplates, would not affect savings bonds.

Mr. Foley spoke of the possible destruction of confidence if there were declines in prices of Government securities and of the exposure created by a $250 billion debt. He also spoke of the difficulty of carrying on negotiations in the absence of the Secretary of the Treasury since they do not wish to worry the Secretary unduly, but he said that the Secretary might be back at his desk for a few hours later in the week. In the meantime he said the Treasury would be glad to explore all avenues toward a possible accord and would like to help to get this problem off the President's mind. He said that if the Secretary is not immediately available the Treasury would be glad to have Mr. Wilson call together the committee suggested by the President to start work on the problem.

Chairman McCabe spoke of our policy and our objectives. He said that we cannot go on monetizing the Federal debt and that it is not just a question of interest rates. He spelled out the fact that we are paying a premium to holders of market bonds when they wish to sell them, whereas holders of savings bonds must take a reduction in the rate of interest if they redeem them. He also mentioned the suggestion in the memorandum about legislative authority to increase reserve requirements and reminded the President that when the Board of Governors had suggested this in the past it had not had the full support of other agencies of Government. The Chairman also emphasized that time is of the essence in making our policy more effective.

Mr. Wilson said it is essential to his job that something be done about the expansion of bank credit. The President asked Mr. Wilson to act in bringing the committee together in Secretary Snyder's absence.

Mr. Keyserling made a brief statement about the desirability of getting together and working out a mutually agreeable program.

There was some discussion of the time element, the memorandum mentioning March 15th for at least a preliminary report. Mr. Wilson said he thought if anything could be done it ought to be possible to do it in not more than ten days. The President closed the meeting by asking the committee to come up with something which he could approve. He said he did not like to use the power of his office to force or direct action.

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Mr. McCabe and I talked last night with Mr. Wilson and Mr. Weinberg. We told them that this morning's meeting had all the appearances of another delaying action, that we had been through this once before with the President, and that we had had to tell the President and the Treasury that the F.O.M.C. could not commit itself to the maintenance of fixed rates in prices in the Government security market for any period regardless of what that might mean in terms of expansion of bank credit. We said that we wanted Mr. Wilson to know this because we would not want him to think that we were flouting him and the committee which the President had asked him to put to work on the problem. Mr. Wilson said he understood this and he also expressed doubts as to whether the problem could be resolved by this committee setup; in fact, it looked as if he might be caught in the middle of an irreconcilable dispute and one which he would not have time to study in all of its many aspects because of the many other more direct demands upon his time. He seemed to think that a possible method of going forward is to have the actual study of the problem made by a special consultant he had already asked to do just this sort of job, with the committee receiving the report from the special consultant.

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During the day Chm. McCabe wrote out his resignation, and sent it to the President late in the afternoon

2-26-51

1. What are we trying to do?

Quit providing easy reserves to the banking system to feed an inflationary expansion of credit. Quit monetizing the Federal debt.

2. How do we propose to do it?

(a) By cutting down our ready buying of short securities so that the discount rate becomes effective and the strong tradition of the banks against borrowing heavily and continuously comes to our aid.

(b) By relieving ourselves of rigid support of the long term market, either by allowing the price of outstanding issues to decline to a point where rigid support will not be necessary, or by getting rid of weakly held outstanding bonds with an exchange offering.

3. Why is this the time to do it?

Because expansion of credit is still a strong inflationary factor, because further tax increases seem to be some months off, because direct controls are in a preliminary and ineffective state, and because the Treasury has no need to come to the market for refunding or new money until second half of year.

4. Is this a new policy on our part?

Quite the reverse. This is the policy and program we forecast in June 1949 with Treasury blessing, which we reiterated in August 1950 over Treasury opposition, and which we have made the basis of our subsequent struggle against pressure and intimidation. It is the only policy consistent with the present economic situation and our responsibilities to the Congress and to the nation.

5. Does such a policy usurp the debt management functions of the Treasury?

Certainly not. The essence of debt management is to tailor your offerings to the market in terms of the existing economic situation, not to have the market tailored to your offerings by the central bank. When the Treasury has to come to the market later in the year we hope it will tailor its offerings to the market. If it doesn't, however, we shall have to see that they go over.

6. What harm can come from such a policy?

The steps we have already taken to implement such a policy in the short area have been beneficial not harmful. In nearly every other country with an economic organization similar to ours, adjustments upward in long rates and downward in prices, in response to market forces, have taken place without disaster - in fact quite the reverse. We have created our own support and par bogey, but we ought to quit being frightened into an inexcusable credit policy by it.

7. What benefits would come from such a policy?

It would not stop inflation, but it would restrain the expansion of bank credit and it would make inflation less easy and less certain, while we are passing tax legislation to make "pay-as-we-go" a reality, while price and wage controls are being perfected for whatever they are worth as a temporary obstacle to inflation and while production is being increased. It might also encourage the Treasury to adopt a debt management program which will concentrate on mopping up savings - individual and institutional - and minimize the use of bank credit. (The cost to the Treasury would be many times less than the costs of further inflation.) It would give the country a welcome injection of courage in fighting inflation. There isn't much faith in us or anyone else on this score now.

8. What is there to hold us back?

Nothing but our own inhibitions and strong Administration pressure. If what we do is not what Congress and the country wants we shall soon find out. Meanwhile the rearmament program will go on, production and employment will continue to bump the ceiling, and when the Treasury has to come to the market it will have a better market than it has now and than it will have if we do nothing.

Underneath the surface, of course, there is a dangerous situation which might be exposed if there were a definite improvement in the international situation. Consumer and business inventories, consumer indebtedness, real estate speculation. This emphasizes need for credit restraint now. Policy could be quickly reversed if the unlikely happened.

Pls. return to Mr. Sproul

IMMEDIATE RELEASE FEBRUARY 26, 1951

The President met this morning with the following:

- Mr. Thomas McCabe, Chairman, Board of Governors, Federal Reserve System
- Mr. Charles Wilson, Director, Office of Defense Mobilization
- Mr. Edward Foley, Under Secretary of the Treasury
- Mr. Charles Murphy, Special Counsel to the President
- The Council of Economic Advisers, Mr. Leon H. Keyserling, Chairman; Mr. John D. Clark and Mr. Roy Blough
- Mr. William McChesney Martin, Assistant Secretary of Treasury
- Mr. Allan Sproul, Vice Chairman, Federal Reserve Open Market Committee
- Mr. Harry A. McDonald, Chairman, Securities and Exchange Commission

The President read the attached memorandum to the group and there was a general discussion of the subject covered by the memorandum. The President did not ask any of those present for any commitments on the subjects under discussion, but expressed the hope that they would go ahead speedily with the study requested.

Mr. Wilson expressed the hope that a report could be made to the President within ten days or two weeks.

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MEMORANDUM FOR: The Secretary of the Treasury,
The Chairman of the Board of Governors of the Federal Reserve System,
The Director of Defense Mobilization,
The Chairman of Council of Economic Advisers.

I have been much concerned with the problem of reconciling two objectives: first, the need to maintain stability in the Government security market and full confidence in the public credit of the United States, and second, the need to restrain private credit expansion at this time. How to reconcile these two objectives is an important facet of the complex problem of controlling inflation during a defense emergency which requires the full use of our economic resources.

It would be relatively simple to restrain private credit if that were our only objective, or to maintain stability in the Government security market if that were our only objective. But in the current situation, both objectives must be achieved within the framework of a complete and consistent economic program.

We must maintain a stable market for the very large financing operations of the Government. At the same time, we must maintain flexible methods of dealing with private credit in order to fight inflation. We must impose restraints upon non-essential private lending and investment. At the same time, we must maintain the lending and credit facilities which are necessary to expand the industrial base for a constant build-up of our total economic strength. Instead of fighting inflation by the traditional method of directing controls toward reducing the overall level of employment and productive activity, a defense emergency imposes the harder task of fighting inflation while striving to expand both employment and production above what would be regarded as maximum levels in normal peacetime.

What we do about private credit expansion and about the Government securities market is, of course, only a part of the problem that confronts us. A successful program for achieving production growth and economic stability in these critical times must be based upon much broader considerations.

We must make a unified, consistent, and comprehensive attack upon our economic problems all along the line. Our program must include, in proper proportion, production expansion policy, manpower policy, tax policy, credit policy, debt management and monetary policy, and a wide range of direct and indirect controls over materials, prices and wages. All of these policies are necessary; each of them must be used in harmony with the rest; none must be used in ways that nullify others.

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We have been striving in this emergency to develop such a unified program in the public interest. Much progress has already been made, both on the production front and on the anti-inflation front. Many peacetime activities of Government, including the activities of lending and financing agencies, have been pruned down. Cutbacks of civilian supplies and allocations of essential materials have been successfully undertaken. Important expansion programs for basic materials and productive capacity needed in the defense effort have been gotten underway. Price and wage controls have been initiated. Restraints on consumer and real estate credit have been applied. Large tax increases have been enacted, and additional tax proposals are now pending. In all these fields further action is being planned and will be taken as needed.

One outstanding problem which has thus far not been solved to our complete satisfaction is that of reconciling the policies concerning public debt management and private credit control. Considering the difficulty of this problem, we should not be discouraged because an ideal solution has not yet been found. The essence of this problem is to reconcile two important objectives, neither of which can be sacrificed.

On the one hand, we must maintain stability in the Government security market and confidence in the public credit of the United States. This is important at all times. It is imperative now. We shall have to refinance the billions of dollars of Government securities which will come due later this year. We shall have to borrow billions of dollars to finance the defense effort during the second half of this calendar year, even assuming the early enactment of large additional taxes, because of the seasonal nature of tax receipts which concentrate collections in the first half of the year, and because of the inevitable lag between the imposition of new taxes and their collection by the Treasury. Such huge financial operations can be carried out successfully only if there is full confidence in the public credit of the United States based upon a stable securities market.

On the other hand, we must curb the expansion of private loans, not only by the banking system but also by financial institutions of all types, which would add to inflationary pressures. This type of inflationary pressure must be stopped, to the greatest extent consistent with the defense effort and the achievement of its production goals.

The maintenance of stability in the Government securities market necessarily limits substantially the extent to which changes in the interest rate can be used in an attempt to curb private credit expansion. Because of this fact, much of the discussion of this problem has centered around the question of which is to be sacrificed -- stability in the Government securities market or control of private credit expansion. I am firmly convinced that this is an erroneous statement of the problem. We need not sacrifice either.

Changing the interest rate is only one of several methods to be considered for curbing credit expansion. Through careful consideration of a much wider range of methods, I believe we can achieve a sound reconciliation in the national interest between maintaining stability and confidence in public credit operations and restraining expansion of inflationary private credit.

We have effective agencies for considering this problem and arriving at a proper solution.

Over the years, a number of important steps have been taken towards developing effective machinery for consistent and comprehensive national economic policies. One of the earliest steps in this century was the establishment of the Federal Reserve System before World War I. At that time, under far simpler conditions than those now confronting us, the Federal Reserve System was regarded as the main and central organ for economic stabilization. After World War II, in a much more complex economic situation and a much more complex framework of governmental activities affecting the economy, the Council of Economic Advisers was established by the Congress under the Employment Act of 1946 to advise the President and help prepare reports to the Congress concerning how all major economic policies might be combined to promote our economic strength and health. Still more recently, in the current defense emergency, the Office of Defense Mobilization has been established to coordinate and direct operations in the mobilization effort. In addition, some of the established departments, such as the Treasury Department, have always performed economic functions which go beyond specialized problems and affect the whole economy.

Consequently, I am requesting the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Director of Defense Mobilization, and the Chairman of the Council of Economic Advisers to study ways and means to provide the necessary restraint on private credit expansion and at the same time to make it possible to maintain stability in the market for Government securities. While this study is underway, I hope that no attempt will be made to change the interest rate pattern, so that stability in the government security market will be maintained.

Among other things, I ask that you consider specifically the desirability of measures: (1) to limit private lending through voluntary actions by private groups, through Government-sponsored voluntary actions such as was done in a narrow field by the Capital Issues Committee of World War I, and through direct Government controls; and (2) to provide the Federal Reserve System with powers to impose additional reserve requirements on banks.

Under the first heading, I am sure that you are aware of the efforts that are already underway by the American Bankers Association, the Investment Bankers Association, and the life insurance association. I want you to consider the desirability of this or other kinds of private voluntary action in bringing about restraint on the part of lenders and borrowers.

I should like you to consider also the establishment of a committee similar to the Capital Issues Committee of World War I, but operating in a broader area. The objectives of such a Committee would be to prevail upon borrowers to reduce their spending and to curtail their borrowing, and to prevail upon lenders to limit their lending. The activities of this committee could be correlated with those of the defense agencies under Mr. Wilson with the objective of curtailing unnecessary uses of essential materials.

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Furthermore, I should like you to consider the necessity and feasibility of using the powers provided in the Emergency Banking Act of 1933 to curtail lending by member banks of the Federal Reserve System. These powers are vested in the Secretary of the Treasury subject to my approval. The Secretary could by regulation delegate the administration of this program to the 12 Federal Reserve Banks, each to act in its own Federal Reserve District under some flexible procedure. The program could be extended to institutions other than member banks, if desired, by using the powers provided by the Trading with the Enemy Act.

Under the second heading, you will recall the recommendation I made to the Congress anumber of times in recentyears to provide additional authority for the Federal Reserve System to establish bank reserve requirements. I should like you to consider the desirability of making that or another recommendation with the same general purpose at the present time.

You are all aware of the importance of this problem, and the need for an early resolution. I should like your study to proceed as rapidly as possible in order that I may receive your recommendations at a very early date. I am asking the Director of Defense Mobilization to arrange for calling this group together at mutually convenient times.

At the same time that we are working to solve this problem of maintaining the stability of the Government securities market and restraining private credit expansion, we shall, of course, continue vigorously to review Government lending and loan guarantee operations. Since the middle of lastyear, we have taken aseries of steps to curtail such operations and limit them to amounts needed in this defense period. I am directing the agencies concerned to report to me by March 15 on thenature and extent of their current lending and loan guarantee activities, so that these operations may again be reviewed as part of our over-all anti-inflationary program.