A meeting of the executive committee 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, January 10, 1947, at 10:40 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. Draper
Mr. Evans
Mr. Leach

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Chairman of the Board of Governors
Messrs. Musgrave, Chief, and Smith, Economist, Government Finance Section, Division of Research and Statistics of the Board of Governors

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee of the Federal Open Market Committee held on December 11, 1946, were approved.

Mr. Rouse reviewed briefly the movements and trends of the market during the period since the last meeting of the committee. A copy of a report prepared at the Federal Reserve Bank of New York covering open market operations during the period from December 11, 1946, to January 7, 1947, inclusive, a supplementary report covering commitments made in the account on January 8 and 9, 1947, and a review of the market for United States Government securities for

the period from December 11, 1946, to January 10, 1947, have been placed in the files of the Federal Open Market Committee.

> At the conclusion of Mr. Rouse's statement, upon motion duly made and seconded, and by unanimous vote, the transactions in the System account during the period from December 11, 1946, to January 9, 1947, inclusive, were approved, ratified, and confirmed.

In accordance with the understanding at the meeting of the executive committee on December 11, 1946, memoranda on the following subjects had been prepared and sent to the members of the committee as a basis for a discussion of the various subjects at this meeting:

1. Projected debt retirement program for February-June 1947.
2. Treasury payment to monetary fund.
3. Treasury savings bond program.
4. Issuance by the Treasury of a long-term security (prepared by Messrs. Sproul and Rouse).
5. Treasury bills (prepared by Messrs. Sproul and Rouse).
6. Treasury bill rate.

The memorandum on the debt retirement program was read, and, because of the relationship to Treasury balances during the next few months, Mr. Thomas summarized the memorandum relating to the payment in March by the United States of its contribution to the International Monetary Fund which presented the question whether the $800 million gain to the Treasury's General Fund balance resulting from the transaction should be used for meeting current expenses or debt retirement in the near future or whether it should be carried as free gold for use at some future time.

This question and the recommendation to be made to the Treasury with respect to the amount of maturing February 1 certificates to be retired were discussed. Mr. Sproul said that it would be desirable to keep the reserve position of member banks under pressure during the next few months and that the program for the retirement of Government debt was designed to have that result. In the present case, however, he said that since the Treasury would be taking funds out of the market through tax receipts, use of its balances with the Federal Reserve Banks to retire certificates would ease the immediate pressure on the banks. He, therefore, suggested the retirement of $1.5 billion of the February certificate maturity rather than a larger amount. He also suggested that the $800 million referred to above be used after the completion of the first quarter debt retirement program in March or perhaps not until July, when the payment of that amount into the market would be offset to some extent by the increase in required reserves resulting from the termination on July 1, 1947, of the exemption of war loan accounts from reserve requirements.

Chairman Eccles referred to the prospective levels of Treasury balances during the period ending June 30, 1947, as estimated in the memorandum on the debt retirement program, and suggested that consideration be given to paying off $2 billion of the February 1 certificate maturity and transferring to the Federal Reserve Banks a sufficient amount from war loan deposit accounts so that the

effect on member bank reserves of the larger retirement would be substantially the same as if only $1.5 billion of certificates were paid off. He felt that there was no need in this period for the Treasury to maintain month-end balances of around $3 billion (not including the $800 million resulting from the contribution to the International Monetary Fund) as appeared would be the case if only $1.5 billion of certificates were retired. He expressed a preference for the payment of the larger amount (which would not interfere with the retirement of the $1.9 billion note maturity on March 15), since such a program, in addition to reducing the debt, with the resulting saving in interest cost to the Treasury, would continue to keep the reserve position of banks under pressure, and would reduce the possibility of referring to large existing Treasury balances as an argument for a reduction in taxes.

The suggestions made by Messrs. Sproul and Eccles were discussed and, upon motion duly made and seconded, it was agreed unanimously that Mr. Musgrave should call Mr. Bartelt, Fiscal Assistant Secretary of the Treasury, by telephone and tell him of the conclusions of the committee and that a letter setting forth these conclusions would be sent to the Treasury during the afternoon. The letter prepared in accordance with this action and subsequently approved by unanimous vote during this meeting read as follows:

"Mr. Bartelt has requested the current views of the Federal Open Market Committee with respect to the debt retirement program.

"The Executive Committee of the Federal Open Market Committee believes that it is desirable at this time to use as much of the Treasury balance as possible to reduce the public debt, thus lowering the interest cost. The Committee accordingly recommends that 2 billion dollars of the certificate issue maturing February 1 be paid in cash. Present estimates indicate that this will leave ample funds for payment in full of the March 15 note issue. The Committee also repeats its recommendation that the March 1 certificate issue be refunded in full.

"The Committee recommends that the 2 billion dollar payment of February 1 be distributed between call on war loan deposits and draft on Treasury balance with Federal Reserve Banks so as to neutralize the immediate effect of the retirement payment on the volume of bank reserves. As about one third of the February 1 issue is held by the Federal Reserve Banks, this will mean payment of approximately 700 million dollars out of Treasury deposits with the Federal Reserve Banks and the remainder out of war loan deposit accounts. It is estimated that this will reduce war loan accounts to not below 1.2 billion. Should the Treasury feel that it is not desirable to reduce war loan deposits to such a level, the retirement could be limited to 1.5 billion.

"With respect to the 800 million dollar gain to the Treasury General Fund Balance to be derived from Monetary Fund transaction, the Committee recommends that for the time being this amount be retained in the Treasury balance in the form of gold for use in debt retirement as soon as practicable in conformity with the policy of maintaining steady pressure against bank reserves. When used for debt redemption these new funds will add to member bank reserves and the Committee will be ready at any time to consult with you regarding the timing of their use."

Copies of a memorandum prepared in the Division of Research and Statistics summarizing the President's budget message for the fiscal year 1948 were distributed and read. Copies of the message

were also brought in to the meeting and the paragraphs were read which recommended the payment to the Treasury of the $139 million contributed by the Federal Reserve Banks to the stock of the Federal Deposit Insurance Corporation and the release to the Treasury of the $139 million reserved for loans and guaranties by the Federal Reserve Banks under Section 13b of the Federal Reserve Act. Chairman Eccles related the conversation which he had on December 17, 1946, with Messrs. Webb and Jones, Director and Assistant Director, respectively, of the Bureau of the Budget, at which time they asked whether the Board would have any objection to the inclusion in the budget message of a recommendation that the franchise tax on the earnings of the Federal Reserve Banks be restored and Chairman Eccles expressed the opinion that the question of the franchise tax should not be raised until it had been discussed by the Board, the Federal Open Market Committee, and the Presidents of the Federal Reserve Banks, because of their concern regarding a matter of such importance to the Reserve System.

Reference was also made to (1) the recommendations in the budget message that the authority of the Federal Reserve Banks to make direct loans to industry be repealed and that the powers of the Reconstruction Finance Corporation required for peacetime activities be continued, and (2) the following statement in the message: "Our debt management policy is designed to hold interest

rates at the present low level and to prevent undue fluctuations in the bond market. This policy has eased the financial problems of reconversion for both business and Government. The stability of the Government bond market has been a major factor in the business confidence which has been of such value in achieving full production. Low interest rates have also relieved the burden on the taxpayer. The Treasury and the Federal Reserve System will continue their effective control of interest rates." In connection with the proposed repeal of Section 13b it was stated that this portion of the President's message omitted language which Chairman Eccles had submitted indicating the Board's desire for amendatory legislation under which the Reserve Banks with their own funds could guarantee loans by financing institutions to business enterprises. It was also stated, in connection with the passage on interest rates, that the Board had not been consulted.

At the conclusion of the discussion the meeting recessed and reconvened at 2:25 p.m. with the same attendance as at the morning session.

The memorandum relating to the Treasury savings bond program was read and there was a discussion of the position taken in the following letter sent to the Fiscal Assistant Secretary of the Treasury on December 27, 1946, with the approval of the available members of the executive committee, and of his request for a more detailed

statement of the views of the executive committee to be sent following further discussion of the matter by the committee:

> "I understood from your telephone conversation with Mr. Musgrave that you are prepared to recommend that holders of Series C savings bonds be permitted to reinvest the proceeds of their maturing bonds in Series E savings bonds, without counting such purchases against the $3,750 purchase limit now applicable to investment in Series E Bonds. This is in line with the Executive Committee's thinking on this matter, especially with respect to future maturities of Series E bonds."

Upon motion duly made and seconded, and by unanimous vote, the letter was approved and its transmission to the Treasury was ratified unanimously.

Question was raised whether, in view of the decision which was made by the Secretary of the Treasury on January 3, 1947, to pay off maturing Series C bonds in cash without granting special refunding privileges, any purpose would be served by the submission of a more detailed statement of the committee's views.

Mr. Sproul suggested that it might be well to submit such a statement as a basis for discussion when the question comes up again at a later date. He also suggested that, because of the desirability under present conditions of a wide distribution of savings bonds and reinvestment of funds already in such securities, there should be an incentive for holders of maturing bonds to reinvest, and that, accordingly, the fact that approximately 85 per cent of the maturing Series C securities were in denominations of $500 or over and were

held by larger investors, was not a satisfactory reason for not encouraging reinvestment of funds from maturing securities in new savings bonds.

Reference was made to the draft of statement which was attached to the memorandum on the Treasury savings bond program and which had been prepared for consideration by the committee in the event it should desire to send to the Treasury a more detailed statement of its views. Certain changes were suggested in the statement, including a proposal that consideration be given by the Treasury to permitting the exchange of maturing savings bonds for a ten-year registered coupon bond redeemable, at the request of the holder, at par with interest at the rate of 2-3/4 per cent payable annually.

> Upon motion duly made and seconded, and by unanimous vote, it was agreed that a new statement should be prepared in the form of a letter to be sent to the Treasury after approval by the members of the executive committee.

The memorandum prepared by Messrs. Sproul and Rouse on the subject of the issuance by the Treasury of a long-term security was then read. Chairman Eccles questioned whether the nonmarketable issue proposed in the memorandum would be attractive enough to serve the purpose for which it would be designed of relieving the downward pressure on yields of long-term Government securities resulting from

an inadequate supply of such securities in the market and whether, rather than invest in the proposed new issue, institutional investors would prefer to purchase outstanding issues of long-term Government obligations, municipals, or real estate mortgages, with the resultant pressure on long-term yields.

A discussion ensued of what the maturity and other terms of a nonmarketable security would have to be in order to attract accumulated institutional savings funds and it was suggested that a revised memorandum be prepared with the understanding that, when approved, it would be sent to the Secretary of the Treasury before his forthcoming discussions of Treasury financing policy with representatives of bankers and other groups. Inquiry was also made whether the executive committee or its representatives should meet with the Secretary of the Treasury before his meetings with the bankers and other groups.

> Upon motion duly made and seconded, and by unanimous vote, it was agreed unanimously that Mr. Rouse would prepare a draft of memorandum which, when approved by the members of the executive committee, would be sent to the Treasury by Chairman Eccles with the statement that the memorandum was not a recommendation but represented the tentative results of the thinking of the members of the committee on this subject for about a year, that it was being sent for consideration by the Secretary of the Treasury prior to his meetings with the bankers and other groups, and that, if he desired, representatives of the executive committee would be glad to discuss the matter with him.

Turning to the question of what if any action should be taken with respect to the posted rate of 3/8 per cent on Treasury bills, Chairman Eccles raised the question whether any action should be taken until after the completion of the current Treasury retirement program.

Mr. Sproul suggested that as a preliminary step to the discontinuance of the posted rate a procedure for the direct exchange of maturing bills held by the Reserve Banks for new bills at 3/8 per cent might be perfected and discussed with the Treasury and at the next meeting of the Federal Open Market Committee, and, if approved, put into effect immediately following the meeting of the full Committee. It was his thought that there would also be discussed with the Treasury and at the next meeting of the Federal Open Market Committee the whole problem of the termination of the posted rate and what the policy should be with respect to continuing the existing amount of Treasury bills or replacing them in whole or in part with certificates, and what should be done to meet the problem of the large earnings of the Federal Reserve Banks.

The memorandum on Treasury bills prepared by Messrs. Sproul and Rouse was read and the suggestions contained therein were considered.

Mr. Sproul proposed (1) that the committee discuss with the Treasury immediately the direct exchange of maturing bills for

new issues at 3/8 per cent, and that at the forthcoming meeting of the Federal Open Market Committee approval be obtained for putting the direct exchange procedure into effect as soon as possible, to be accompanied by an appropriate public statement, (2) that the executive committee discuss with the Treasury and recommend to the full Committee that the Committee authorize the abandonment of the posted buying rate on Treasury bills with respect to all new issues of bills after completion of the immediate debt retirement program in April, and that the matter be reviewed in April to determine whether the then existing situation would require or permit of such action, (3) that the executive committee seek an agreement by the full Committee and the Presidents of the Federal Reserve Banks on a recommendation to the Congress that the Federal Reserve Act be amended to restore the franchise tax on the earnings of the Federal Reserve Banks in order to prevent an increase in retained earnings of the Banks as a result of the prospective freeing of the bill rate, and also to reduce the annual dividend on the stock of Federal Reserve Banks from 6 to 4 per cent, and (4) that this amendment be in the form of independent legislation, in connection with the bill being proposed by the Board of Governors to amend Section 13 of the Federal Reserve Act, or as an addition to a bill to be introduced reducing the debt limit.

In a discussion of the suggestion that the dividend on Federal Reserve Bank stock be reduced, it was the consensus that, although any suggestion for the restoration of the franchise tax might raise the question of reducing the dividend, the System should not recommend the reduction at this time, but that it might well be discussed at the forthcoming meeting of the full Committee.

There was also a discussion of other questions that might be raised by the proposal that the franchise tax on the earnings of the Federal Reserve Banks be restored, and the view was expressed that, if the Board of Governors and the Reserve Banks could demonstrate that the budgetary and salary procedures for the control of salaries (which comprised the principal expenses of the Federal Reserve Banks) and other costs of operations are an adequate counterpart of any controls or audits of such expenses that could be provided by the Budget Bureau or the General Accounting Office, there would be less danger of having controls by these two agencies included in any amendment to the law restoring the franchise tax.

In response to an inquiry by Mr. Leach, Chairman Eccles expressed the opinion that, regardless of whether the earnings of the System from its holdings of Treasury bills were reduced by their replacement by 1/4 per cent or 1/8 per cent special certificates, the earnings would be such that it would not be possible to avoid the question of the franchise tax being raised unless some other effective alternative could be found.

In a discussion of the alternative procedures that might be followed and the steps that might be taken in connection with a bill providing for the restoration of the franchise tax, Chairman Eccles suggested that a memorandum be prepared which would discuss the available alternatives and which would serve as a basis for a discussion with the Secretary of the Treasury and at the next meeting of the Federal Open Market Committee along the lines of the program suggested by Mr. Sproul.

Upon motion duly made and seconded, Chairman Eccles' suggestion was approved unanimously.

Upon motion duly made and seconded, and by unanimous vote, the executive committee directed the Federal Reserve Bank of New York until otherwise directed by the executive committee,

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities and allowing maturities to run off without replacement) for the System account, either in the open market or directly from, to, or with the Treasury, as may be necessary in the practical administration of the account or for the purpose of maintaining an orderly market in Treasury securities and a general level of prices and yields of Government securities which will support the Treasury issuing rates of 7/8 per cent for one-year certificates and 2-1/2 per cent for 27-year bonds restricted as to ownership; provided (a) that the total amount of securities in the account at the close of this date shall not be increased or decreased by more than $750,000,000 [exclusive of bills purchased outright in the market on a discount basis at the rate of 3/8 per cent per annum and bills redeemed at maturity, and special short-term certificates of indebtedness pur-

chased for the temporary accommodation of the Treasury pursuant to paragraph (2) of this direction/, and (b) that this paragraph shall not limit the amount of Treasury bills purchased pursuant to the direction of the Federal Open Market Committee issued under date of March 1, 1945, or the redemption of such bills;

(2) To purchase direct from the Treasury for the System open market account 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 $750,000,000; and

(3) Upon approval by a majority of the members of the executive committee, which may be obtained by telephone, telegraph, or mail, to make such other purchases, sales or exchanges for the account as may be found to be desirable within the limits of the authority granted to the executive committee by the Federal Open Market Committee.

In taking this action, it was understood that the limitations contained in the direction included commitments for purchases or sales of securities for the System account.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.