

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 Wednesday, May 3, 1950, at 10:10 a.m.

PRESENT: Mr. Sproul, Vice Chairman
 Mr. Eccles
 Mr. Young
 Mr. Szymczak (Alternate for Mr. McCabe)

Mr. Morrill, Secretary
 Mr. Carpenter, Assistant Secretary
 Mr. Thomas, Economist
 Mr. Rouse, Manager of the 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. Youngdahl, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
 Mr. Willis, Special Assistant, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee held on April 12, 1950, were approved.

Before this meeting members of the committee had been furnished a report of open market operations prepared at the Federal Reserve Bank of New York covering the period from April 12 to April 27, 1950, inclusive, and Mr. Rouse presented at this meeting a supplementary report covering commitments executed from April 28 to May 2, 1950, inclusive, commenting upon developments during the period

5/3/50

-2-

covered by both reports. Copies of these reports have been placed in the files of the Federal Open Market Committee.

Mr. Sproul then made a statement substantially as follows:

The Chairman and I saw the Secretary of the Treasury on the afternoon of the day of the meeting of the executive committee on April 12, 1950, at which time we discussed various possibilities for Treasury financing. However, we made no definite recommendations inasmuch as the committee had reached no definite opinions or conclusions and inasmuch as it did not seem likely that the Treasury would need to make an immediate decision. Again, there was no indication that there had been any decision or even an approach to a decision by the Treasury as to how new money would be raised during the next few months.

On April 26 Chairman McCabe received a telephone call from Secretary Snyder asking what was happening in the bill market and at the Chairman's request I called the Secretary. He said he had gotten the impression from our conversation on April 12 that we would keep the long bills at 1.17 and commented that they were then 1.18. I told him that we had had to buy \$200 million of bills that week, that the pressure had continued, and that we had moved our buying rate up to 1.17 which meant an open market rate of 1.18. I also pointed out that we were working under an instruction of the Federal Open Market Committee which permitted purchases within a range with an upper limit of 1.17. He referred to previous conversations in which we assured him of the maintenance of the existing market and I told him that related to the maintenance of a 1-1/4 per cent rate for one-year certificates, that this contemplated some fluctuation in the bill rate in response to market pressures, and that with the additional \$100 million of bills being issued each week it was to be expected that there would be some pressure in the market. The Secretary said he had made no statement or commitment regarding the amount of bills that would be issued and I asked about the statement that had appeared in the morning papers indicating that he had made no plans for obtaining additional funds during this fiscal year. He

5/3/50

-3-

replied that this statement had come from his response to a question and that his comment that he had no plans had been interpreted that there would be no new financing before July. I informed him that we had arranged for a meeting of the executive committee this week.

Mr. Sproul then referred to material which had been furnished the members of the committee as follows: (1) a letter from Mr. Sproul to Mr. Morrill dated April 25, 1950, supplementing his letter of April 7, 1950, with respect to the use of marketable versus nonmarketable securities, (2) a memorandum from Messrs. Thomas and Youngdahl dated April 28, 1950, with respect to forthcoming Treasury financing, (3) a memorandum addressed to Mr. Sproul by Messrs. Willis and Rosa of the Federal Reserve Bank of New York under date of May 1, 1950, with respect to the Treasury's first major new offering to nonbank investors in 1950, and (4) a memorandum dated May 2, 1950, from the Government Finance Section of the Board of Governors giving estimates of Treasury receipts and expenditures and Treasury financing needs during the remainder of 1950. Copies of the letter and memoranda have been placed in the files of the Federal Open Market Committee.

Mr. Sproul stated that matters to be considered at this meeting included recommendations to be made to the Treasury regarding financing and open market operations to be conducted during the next few weeks. He referred to a memorandum which Mr. Thomas handed him this morning which stated that matters to be considered with respect to recommendations for financing were (a) refunding of \$5 billion of

5/3/50

-4-

short-term securities maturing on June 1, (b) refunding of \$5.6 billion of short-term securities maturing July 1, and (c) whether new money should be obtained from medium-term bank-eligible securities, a restricted marketable issue, or a nonmarketable tap issue.

Mr. Sproul went on to say that he was thinking in terms of the Treasury issuing about \$1 billion of new bills up to the middle of June, perhaps having to issue about \$500 million of special certificates around June 15, and getting about \$2 billion during the latter half of June with a long-term bond to carry it through the summer. He felt that it was not necessary now to decide the long-term policy question of marketable versus nonmarketable issues, and that if the discussion were confined to the immediate problem of the raising of about \$2 billion in the long-term market he would favor a restricted marketable bond of about 20-25 years, bank eligible five years in advance of call date. He thought that it would be possible with such an issue to get more nonbank money, both immediately and over a period of time, than with a nonmarketable bond, and while it would involve the question of fixing subscription formulas he felt they could be devised. He expressed the view that an issue of \$2 billion of restricted marketable bonds would not cause an undue or serious amount of churning in the market and stated that he would prefer that risk of churning to the more extended market disorders likely to result from the issuance of an open-end tap issue. He felt

5/3/50

-5-

that some indirect bank financing would be associated with a new long-term issue in any case.

Mr. Sproul did not feel that it was possible to figure out some residual amount of nonbank funds which would be available and must go into Governments, nor did he think it likely that there could be devised a tap issue which would continuously drain off accumulating nonbank funds in just the right amounts. He thought that the System was dealing with possible alternative uses of funds and that it wanted to attract some nonbank funds from other uses. It was his view that any offering that might be made would not be on terms which would seriously upset the private capital market, since the Treasury's competitive bid for funds would be a mild one.

With respect to the question of Federal Reserve support, Mr. Sproul expressed the view that that question had been answered as well as it could be answered last June and that he saw no reason why the System should, and every reason why it should not, make statements about support or non-support of the Government securities market at par or any other price.

As for the June 1 maturity of \$5 billion and the July 1 maturity of \$5.6 billion, Mr. Sproul stated that he did not think it made much difference which of the suggested refunding issues were offered so long as the June 1 maturity was gotten rid of. However, he had some preference for refunding the June maturity with a 22-month 1-3/8 per

5/3/50

-6-

cent note and the July maturity with a 12-month 1-1/4 per cent certificate but felt it could be done the other way around using a 13-month note in June and a 21-month note in July.

Mr. Vardaman joined the meeting during Mr. Sproul's statement.

Mr. Thomas stated that he had the same view as Mr. Sproul concerning the June-July refundings but that reports from the money market had indicated that the issuance of a 1-3/8 per cent 22-month note for the June refunding would be interpreted immediately as an approach to a 1-3/8 per cent one-year rate and would make difficult the selling of a 1-1/4 per cent 12-month certificate in July. He expressed the view that it would be better to offer a 1-1/4 per cent 13-month note for the June refunding and announce at that time that the July maturities would be refunded with a note of a somewhat longer maturity without, however, stating what the terms would be.

Mr. Rouse stated that he was inclined to go along with Mr. Sproul's reasoning provided both issues were announced simultaneously but that it was not an important matter and the June-July refunding could be done either way.

Mr. Szymczak withdrew from the meeting at this point.

In this connection, there was a brief discussion of the Treasury needs during the remainder of the year, it being stated that, except for new money raised by the issuance of bills, little additional financing would be needed between now and the end of June and that

5/3/50

-7-

new borrowing needs during the remainder of 1950 were expected to be in the neighborhood of \$3 billion--about \$1.2 billion in July and August and \$1.7 billion in the last quarter of the year.

Mr. Eccles stated that the real issue was not the June-July refunding but the type of Treasury financing that was to be done to finance Government deficits, which it appeared would continue for an indefinite period, that it was agreed that this financing should be by nonbank money as much as possible, and that if bank money was to be raised additional issues of Treasury bills, certificates, and notes should be used to obtain it. He felt that some of the arguments against an offering of nonmarketable bonds presented by Mr. Sproul applied equally to marketable issues. He went on to say that he would prefer a marketable issue if it were possible to get away from a pattern of rates and if there could be sufficient flexibility in the market to permit of wider fluctuations in the prices of long-term bonds. Since he could not see any possibility of that degree of flexibility, he did not feel the committee should advocate that the Treasury issue a marketable bond at this time since it would only add to the total volume of marketable issues which might have to be supported by the Federal Reserve System. He also referred to the problem of "free riding" and to the necessity for an allocation procedure to offset heavy over-subscriptions to a marketable bond, expressing the view that it would be much more difficult to work out such an alloca-

5/3/50

-8-

tion on a satisfactory basis than it would be to determine a satisfactory formula for subscriptions to nonmarketable bonds. Mr. Eccles felt that the amount of nonbank money available for investment was not such as to require restrictions on subscriptions to nonmarketable bonds issued on a tap basis. With respect to churning in the market, he doubted that there would be as much selling of outstanding marketable issues for the purpose of buying a nonmarketable issue, such as that proposed by the Board's staff, as there would be in connection with an offering of marketable bonds of the type suggested by Mr. Sproul. He also felt that a tap issue had the advantage of taking savings as they accumulated from month to month which would not be the case with a large offering of marketable bonds. An issue of nonmarketable bonds on a tap basis, Mr. Eccles said, would avoid both the problems of extensive selling of present holdings of marketable issues for the purpose of buying the more attractive new issues and of an immediate drop in prices of outstanding marketable issues to levels below par with the resulting necessity for System support.

Mr. Thomas stated that while the Treasury would need to raise a considerable amount of new money between now and the end of the year it would not be necessary to raise a large part of it at one time, and that it would be preferable to obtain the new money from month to month as savings became available through the offering of a non-

5/3/50

-9-

marketable tap issue rather than to announce a large issue of marketable bonds at one time, which might cause a considerable amount of shifting and perhaps upset the entire bond market.

Mr. Vardaman preferred to defer until after the first of the year, if possible, any pronounced change in policy such as would be involved in a long-term marketable or nonmarketable issue.

Mr. Young suggested the desirability of raising new money by opening up the F and G bonds following the savings bond drive, stating that that would be his preference to either a marketable or type A nonmarketable issue.

There ensued a general discussion of the various proposals that had been made, of the reception that the various issues discussed might have in the market, and of their possible effects on the Government security and money markets. There was also a discussion of the amount of funds that might be available to go into the various issues and of the possible attitude of the Treasury on the different types of securities that had been proposed. Consideration was also given to the possible effect of the different issues on the future freedom of the System to permit of flexibility in prices and yields of Government securities in the market and thus to carry out monetary and credit policies.

At this point Chairman McCabe joined the meeting.

Mr. Sproul stated that before the Chairman came in there had been a discussion of the June and July refunding and that it was the

5/3/50

-10-

consensus that it did not make much difference whether the June 1 refunding consisted of a 1-1/4 percent 13-month note followed by July 1 refunding with a 1-3/8 percent 21-month note, or whether the June refunding was done with a 1-3/8 percent 22-month note and the July 1 refunding by a 1-1/4 12-month certificate.

Following a further discussion it was unanimously agreed that Chairman McCabe and Mr. Sproul would present these two suggestions to the Secretary, indicating that either would be satisfactory to the committee, with the possibility that if a 13-month note were offered in June the announcement of the July refunding might be deferred until early in June with the thought that it might be preferable at that time to offer a long note.

Mr. Szymczak returned to the meeting at this point.

In a further discussion of the recommendations to the Treasury with respect to issues to be offered for the purpose of raising new money, Mr. Thomas referred to a memorandum prepared by Mr. Youngdahl under date of May 3, 1950, summarizing the differences between the views expressed in the memoranda presented by the staff of the Federal Reserve Bank of New York and the Board of Governors. A copy of the memorandum has been placed in the files of the Federal Open Market Committee.

The reasons for the different suggestions that had been made were amplified and Mr. Riefler said that, on balance, he felt the suggestions of Mr. Eccles and Mr. Thomas were most likely to give the

5/3/50

-11-

System flexibility, and that adding to the outstanding market issues at this time would not increase flexibility of System action. He stated that in recent weeks he had been impressed with the fact that the market for municipal and corporate bonds had not reacted to the new rate levels on long-term Government securities as much as might have been expected, and that as a result he was concerned that new Treasury securities should not be issued in a volume which would cause great turnover in the market. He feared that a large Treasury issue under these conditions might set off an over-rapid readjustment in the corporate bond market with undesirable effects on business psychology. He stated that much of the sustained business volume reflected high level operations in the automobile and housing industries, but that capital investment expenditures, though rising, were still below recent levels. He felt that the corporate bond market should be kept in a position where industry would be encouraged to undertake new plant investments and to obtain the funds through issuing corporate securities. Mr. Riefler added that even if a marketable issue were offered by the Treasury, he felt it would be a mistake to announce an issue of anything like \$2 or \$3 billion at one time, feeling that perhaps a maximum of \$500 million a month should be offered so as to avoid a severe shock to the corporate securities market.

Mr. Rouse stated that it was true, as Mr. Riefler said, that

5/3/50

-12-

the corporate and municipal bond market had not reacted to recent declines in prices of Government securities but that there was no problem with respect to underwriting common stocks or bonds convertible to common stocks and that in his opinion a single shock to the corporate securities market which would result from a moderately large issue of \$2 to \$3 billion of new Treasury restricted bonds would be better than a series of shocks that would result from sales of a few hundred million dollars of securities at a time through a nonmarketable tap issue.

At the conclusion of the discussion, Chairman McCabe suggested that, in view of the differences in views, he and Mr. Sproul inform Secretary of the Treasury Snyder of the different suggestions with respect to the issuance of marketable versus nonmarketable bonds and that they say to him that a majority of the executive committee would favor a type A nonmarketable tap issue as first choice, with the opening of F and G bonds as a second choice, and that Mr. Sproul felt very strongly that a restricted market issue should be used.

Chairman McCabe's suggestion
was approved unanimously.

It was the view of the members of the committee that the general direction to be issued to the Federal Reserve Bank of New York to effect transactions for the System account should be renewed with the same limitations as contained in the existing direction.

5/3/50

-13-

Thereupon upon motion duly made and seconded, the executive committee voted unanimously to direct 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 light of changing economic conditions and the general credit situation of the country, for the practical administration of the account, for the maintenance of orderly conditions in the Government security market, and for the purpose of relating the supply of funds in the market to the needs of commerce and business; provided that the total amount of securities in the account at the close of this date shall not be increased or decreased by more than \$1 billion exclusive of special short-term certificates of indebtedness purchased for the temporary accommodation of the Treasury pursuant to paragraph (2) of this direction;

(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 million.

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

Question was raised as to the ranges at which purchases and sales of bills and certificates for the System account might be made, during which Mr. Rouse stated that, in view of the fact that the buying rate of the New York Bank on the longest bill had now been increased to 1.17 and of the prospect for some additional pressure on

5/3/50

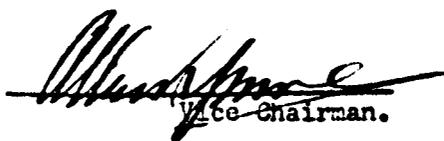
-14-

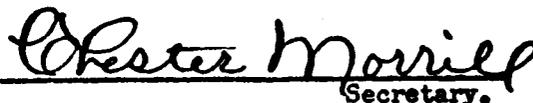
the market during the next several weeks, he would recommend that the range on bills be changed from 1.10-1.17 as authorized at the meeting on March 1, 1950, to 1.12-1.19. He stated that he did not feel any change in the range of 1.12-1.24 at which the New York Bank was authorized to purchase and sell Treasury certificates was necessary at this time.

Upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York, operating under the general direction issued earlier during this meeting, was authorized to purchase and sell Treasury bills within a range of 1.12-1.19.

There was a brief discussion of the instruction to be given to the Federal Reserve Bank of New York with respect to sales of long-term securities from the System account. It was stated that if the Treasury should decide to issue a long-term nonmarketable security it would probably be desirable for the System to discontinue sales of long-term securities from the open market account. It was the consensus, however, that no change should be made in the existing understanding at least until the plans of the Treasury with respect to deficit financing were more definitely known. It was also agreed that the present understanding with regard to the replacement of maturing Treasury bills held in the System account should continue unchanged.

Thereupon the meeting adjourned.


Vice Chairman.


Secretary.