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 on Friday, June 3, 1949, at 2:30 p.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Vardaman
Mr. Leach

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
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. Young, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Arthur 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 May 3, 1949, were approved.

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the committee on May 13, 1949, increasing from $1 billion to $2 billion the limitation on the authority of the Federal Reserve Bank of New York to reduce the total securities in the System account, as contained in the first paragraph of the direction issued by the committee at its meeting on May 3, 1949, was approved, ratified, and confirmed.

Mr. Rouse read a review of the market for United States

ment securities for the period from May 3 to June 1, 1949, inclusive, and submitted a report of open market operations for the System account covering the same period. He also submitted a report covering commitments made for the System account on June 2, 1949. Copies of the review and reports have been placed in the files of the Federal Open Market Committee.

> Upon motion duly made and seconded, and by unanimous vote, transactions in the System account as reported to the members of the executive committee for the period May 3 to June 2, 1949, inclusive, were approved, ratified, and confirmed.

In response to a request from Chairman McCabe that Mr. Sproul report to the executive committee the conference which they had with Secretary of the Treasury Snyder on May 11, 1949, Mr. Sproul stated that at the conference he and Chairman McCabe presented the views of the Federal Open Market Committee and the reasons therefor, as agreed upon at the meeting of the committee on May 3, with respect to refunding the certificates and bonds maturing in June with a 4 or 5-year note. He also said that Secretary Snyder made no statement as to the policies or plans of the Treasury with respect to the management of the debt during the coming months, but that when the conference terminated the statement was made to him that it was assumed that after he had discussed the matter with the committee of the American Bankers Association on Government borrowing another opportunity would be afforded to the representatives of the Federal Open Market Committee to

talk with him. Mr. Sproul added that, following the Secretary's subsequent meeting with the American Bankers Association committee, he called Chairman McCabe and said that he had decided that the June financing should be in the form of a 1-1/4 percent certificate, but did not state the reasons why the Treasury had reached that conclusion.

Mr. Rouse said that he attended the meeting of the American Bankers Association committee with the Treasury, at which time the committee made recommendations substantially along the lines of the views expressed by the Federal Open Market Committee.

Chairman McCabe stated that the members of the American Bankers Association committee asked him to meet with them at which time he was informed that the recommendations of the committee to the Treasury were substantially the same as the recommendations that had been made by the Federal Open Market Committee. He thought that probably the reasons for the Treasury's position were (1) a desire to maintain a low interest rate, (2) a view that in the present economic situation there should be no experimental changes in financing policy, and (3) a preference for waiting until September or December when there would be larger bond maturities to refund with an intermediate issue.

The Chairman went on to say that the question before the executive committee at the moment was whether it would renew its suggestion of a four or five-year note in connection with the July refunding and, in the event the Treasury did not elect to follow that course, what changes should be made in System open market policy. He understood it

to be the opinion of the Federal Open Market Committee that the System should move as rapidly as practicable to discontinue the rate support policy in the short-term area of the market so that bill and certificate yields would more nearly reflect actual market conditions. It was his view that this objective should be discussed with the Treasury.

It was the consensus of the members of the Committee present that there had been no change in the situation since the last meeting of the Federal Open Market Committee that would call for a change in the recommendation that the July refunding be in the form of an intermediate note.

Mr. Sproul stated that such a recommendation would be without information as to what the Treasury had in mind in the way of policy and objectives. He suggested that the Committee's recommendation should be combined with a discussion with the Secretary of the Treasury of the steps that would be necessary or desirable in the event the recommendation was not followed, that one of the questions to be considered in that connection was whether the System was going to continue the present policy of supporting a certain interest rate structure in the face of an upward pressure on prices of Government securities and decline in yields, and that this question presented a second question whether the problem before the System and the Treasury was one on which there was to be cooperation in a joint responsibility or whether the System was to determine its policy separate and apart

from the Treasury and without the benefit of information regarding Treasury policies and objectives.

In the discussion which followed, Mr. Eccles stated that there was no longer justification for a policy of support of a pattern of rates and that future policy should be one of maintaining orderly market conditions. Mr. Sproul concurred adding that he would be willing to take the risk of reverting to an open market policy directed toward making credit policy effective, in terms of the economic situation, and towards maintaining orderly markets in Government securities. They both felt that the determination of the policy question was of greater importance than the July and September refunding and that a decision to refund the July maturities with a new 1-1/4 percent certificate would force an early reconsideration of open market policy for the reason that the System might find itself in a position of continuing to sell securities and taking reserve funds out of the market at a time when there should be further easing of the money market as a means of combating deflation.

In response to inquiries from Chairman McCabe, consideration was given to the steps that might be taken to put the suggested change in policy into effect, Mr. Sproul stating that the System would discontinue its present aggressive policy of supplying securities to the market to fill a demand and purchasing securities when they were in supply in order to support a rate, and would sell and buy only as called for by prevailing economic considerations and to maintain

orderly market conditions. He also said that the change in policy would apply to both bills and certificates, and in fact will cut through the list of maturities, and that the period immediately ahead looked like a good time in which to make the change.

It was suggested that, as long as the present policy was continued, any reduction in reserve requirements of member banks would be used to purchase securities from the System account and that, therefore, a further reduction in reserve requirements would not be particularly helpful at this time. If the business situation continued downward, Mr. Sproul said, and there were signs that the decline was becoming cumulative, the policy of supporting short-term rates should be terminated immediately and, while this action might mean higher or lower rates depending on circumstances, the System would not be taking funds out of the market by the sale or putting them in by purchase of securities to support a rate. He added that he thought as soon as the July financing was out of the way the suggested change in policy could be undertaken.

Mr. Eccles suggested that in proposing that support of the short-term rate be discontinued, and in order to make it clear that the executive committee was not proposing higher rates on Government securities, assurance should be given to the Treasury that in the existing declining business situation there would be no increase in the discount rate, that if the decline continued there might be a reduction in that rate for whatever psychological effect it might

have, and that reserve requirements could also be reduced as a means of counteracting a continuing business decline.

Mr. Sproul suggested that, since we presumably would be adopting a policy for the indefinite future, no assurance should be given that the policy would result in higher or lower rates.

In the course of a discussion of the statement to be made by Messrs. McCabe and Sproul in their meeting with Secretary Snyder which was to follow immediately after this meeting, Mr. Young commented briefly on the present economic situation, stating that there were indications that the decline might go beyond a condition of healthy readjustment.

At the conclusion of the discussion, it was understood that Messrs. McCabe and Sproul would say to the Secretary that it was the recommendation of the executive committee that the July certificates be refunded into a four or five-year note, that the committee had considered abandoning support of the short-term rates, that it felt, for the reasons outlined above, that such a change in policy would be a desirable one particularly in view of the fact that the System's holdings of bills and certificates made it clear that the existing short-term rates did not reflect market conditions, and that the uncertain economic situation indicated a need for a more flexible policy.

Reference was made to the question as to the possible effect of the proposed change in policy and whether it would result in higher or lower short-term rates, and Mr. Eccles renewed his suggestion

that assurance be given to the Treasury that in the existing economic situation it would not result in higher rates. Mr. Riefler suggested that it was important to determine whether the System and the Treasury were going to continue to supply long-term issues to the market and questioned whether that should be done. Mr. Sproul agreed that in making such a change in policy we would have to contemplate the possibility of a decline in the long-term yield, particularly if supplying long-term securities to the market, from our portfolio, meant taking funds out of the market when credit policy suggested a contrary move.

On the question of the use of war loan balances, Mr. Rouse stated that the balances in these accounts at the present time were approximately $1 billion, that as a practical matter it was not possible to reduce them below $750 million, and that it was expected that it might be necessary for the Treasury to borrow from the Federal Reserve Banks on special short-term certificates of indebtedness between now and June 15. He also said that it was planned to build up war loan balances during June to meet a rather heavy deficit in receipts in relation to expenditures during July.

Before this meeting the Division of Research and Statistics of the Board of Governors had prepared memoranda with respect to (1) whether savings bonds should be made eligible as collateral for loans, and (2) the reinvestment of the proceeds of maturing savings bonds in such bonds. It was agreed unanimously that these subjects

should be placed on the agenda for the next meeting of the Federal Open Market Committee.

Another item on the agenda for this meeting was a memorandum prepared in the Division of Research and Statistics of the Board of Governors which made an investment comparison of mortgages and the instalment retirement bonds suggested in the staff memorandum presented at the last meeting of the Federal Open Market Committee on the relative roles of nonmarketable and fully-marketable issues in longer-range debt management and monetary operations. It was agreed that the memorandum would be studied by the members of the Committee in anticipation of the further report to be submitted by the staff committee relating to a longer-term refunding program.

The members of the committee were agreed that, in view of the market situation and the possibility that the authority of the Board of Governors to prescribe supplemental reserve requirements might not be renewed and that approximately $800 million of reserves might be put into the market by the lapse of this authority on June 30, 1949, the limitation in the first paragraph of the direction to the Federal Reserve Bank of New York to effect transactions for the System account should be fixed at $2 billion.

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 stable and 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 $2,000,000,000 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 $1,000,000,000.

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

It was agreed unanimously that the date for the next meeting of the executive committee should be set tentatively for Wednesday, June 29, 1949, at 10:00 a.m., with the understanding that if it should develop that a meeting was not necessary at that time it would not be held.

Thereupon, the meeting adjourned.

Chester Morrill
Secretary.

Approved:

Thomas B. McCabe
Chairman.