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STRICTLY CONFIDENTIAL

January 28, 1946

To: Board of Governors

Subject: Meeting with Treasury staff

From: Woodlief Thomas

On Friday Mr. Piser, Mr. Kennedy and I had an extended meeting with several members of the staff of the Treasury, including Assistant Secretary Bartelt, Commissioner of the Public Debt Kilby and Messrs. Heffelfinger, Haas, Murphy, Lindow, Tickton and Bernstein.

I outlined to them the general situation that the System is facing, indicating that while the System did not wish to take action which would raise the general level of interest rates, it felt that some action was necessary to check continued expansion in bank holdings of Government securities and the resulting decline in long-term interest rates. It would be contrary to the System's responsibilities to permit such expansion to continue in the face of inflationary developments. The question before the System is how to check the expansion without raising the level of short-term interest rates and thereby the cost to the Treasury of carrying the public debt.

((The Treasury economists [of the Treasury] questioned the need for any action and also felt that nothing could be done that would have any effect upon inflation. Mr. Murphy made a strong case for lower interest rates and indicated belief that long-term rates should go lower than they are now. He thought long-term rates might in the near future reach 2 per cent and later might approach zero. His case for low interest rates is that they not only reduce the cost of carrying the public debt, but also that they encourage consumption and investment and result in a more equitable distribution of income. Although admitting the desirability of discouraging spending during a period of inflation, he preferred to use other methods and not permit interest rates to rise, because that would delay the desirable long-run downward adjustment of rates.))

With respect to the inflationary influence of bank credit expansion, they presented the view that sales of securities to banks would be made by a relatively small number of holders, who would not be deterred by restrictions on bank credit expansion nor encouraged particularly by further decline in interest rates. Rate of spending or investment by such holders would not be influenced by the form in which they held their liquid assets, i.e. by whether they were Government securities or bank deposits.

After considerable discussion of the need for action, the Treasury people wanted to know what line of action the System might want to follow. I outlined the Chairman's four-point program, emphasizing that these measures would be adopted in sequence and that the System would give any support that the market might require to hold the 7/8 per cent rate on certificates and the 2 1/2 per cent yield on long bonds.

With respect to the preferential rate, they took the position that the amount of borrowing at that rate was so small as to be inconsequential, but that removal of the rate might weaken the certificate market. Mr. Bartelt had difficulty in understanding how borrowing leads to multiple expansion of credit and expressed an interest in looking into that matter more fully. Mr. Haas wanted to know if there would be a posted rate on certificates.

As to the change in Treasury bill procedures, they were dubious about public reception of a special issue for the Reserve Banks.

They did not seem averse to the idea of using some of the Treasury balance to pay off debt. Mr. Murphy wanted to know if only the maturing certificates held <u>outside</u> the Federal Reserve Banks could be retired. He doesn't like any tightening effect, even though temporary, that might result from the reduction in Federal Reserve holdings.

No strong objection was expressed to the bill-certificate requirement for banks, and I got the feeling that they were sympathetic to the idea. Murphy said that he preferred a special-certificate scheme, but thought that the one proposed had merit in that it might have the desired effect on the market before legislation could be obtained.

In retrospect, I get the general impression that they are favorable to measures that would reduce bank earnings but not to those that would tend to keep interest rates from falling.

When we suggested another meeting to work out an agenda to be presented to the Secretary of the Treasury and the Open Market Committee for joint consideration they were not inclined to join in such a proposal. Mr. Bartelt suggested that the four-point program, together with a discussion of the need for action, would provide an adequate agenda. Mr. Haas said that the Treasury staff would need much more time to consider the questions that had been raised before being prepared to present proposals for consideration by the Secretary. They indicated willingness to consider the matter and will let us know if they think that anything can be accomplished by having another meeting before Wednesday. It is my opinion that they will not want another meeting.

W. T.