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 Monday, June 10, 1946, at 9:30 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. Kennedy, Special Assistant to the Chairman of the Board of Governors

In accordance with the suggestion at the meeting of the executive committee on February 28, 1946, consideration was given to the questions relating to brokers and dealers in Government securities on which action had been deferred at previous meetings of the committee and a draft of proposed solutions to the questions was read.

The questions were discussed and the suggested solutions were approved unanimously, as follows:

1. Whether the executive committee should be advised of any instance in which the position of a dealer reaches an abnormally high level, of any action taken by the New York Bank regarding the position of a dealer, and of the response by the dealer to this action.

The Federal Reserve Bank of New York should include in its regular weekly report a statement that, during the period covered by the report, the position and borrowings of individual dealers or of all dealers combined, in its opinion, had or had not been excessive as the case might be. In the event the position and borrowings of an individual dealer or of all dealers taken together were believed to be excessive, the statement should include a report of any action considered by the New York Bank, the action taken by the Bank, and the response by the dealer or dealers thereto.

> 2. Whether the committee should recognize, at least informally, the present commission of 1/64 of a point on transactions with dealers for the System account in notes and bonds and the present limitation to exceptional cases of transactions in these securities on a net basis, and whether the committee should establish a commission of perhaps 0.01 per cent on transactions in certificates.

Transactions in notes and bonds on an agency basis for the System account with qualified dealers should be handled in such a manner as to permit the dealers a spread of not more than 1/64 of a point, and such transactions where the dealers act as principal should be limited to exceptional cases and the transactions together with the reasons therefor should be reported separately by the New York Bank in the weekly report. Transactions in certificates should be handled in such a manner as to permit the dealers a spread of not more than 0.01 per cent (in relation to the price to the customer when on an agency basis and in relation to the current market price when the dealers act as principal) on the longest maturity of certificates and the equivalent in dollars on shorter maturities.

> 3. Whether the statements of condition of qualified dealers should be required to include certain additional information.

The New York Bank should send to the members of the Federal Open Market Committee information similar to that contained in Mr. Rouse's letter of April 19, 1946, with respect to the financial condition of the qualified dealers, at least once each year or oftener if statements of condition are received from the dealers at more frequent intervals.

> 4. Whether the Reserve Bank Presidents should be requested to furnish the executive committee any information they may obtain regarding violations by dealers of the terms upon which the New York Bank will transact business with dealers in Government securities.

Each Federal Reserve Bank should report to the Manager of the Account any information, which in its judgment is pertinent and comes from reliable sources, in connection with the operations of any dealer that would be in violation of the established terms. For example, a report should be made of instances in which dealers in violation of the established terms have influenced customers to sell when the System has been buying, have made recommendations to customers that had the effect of disturbing the market, or have manipulated quotations in order to increase transactions.

In connection with the first question, it was stated that the procedure as approved would not place any additional obligation on the Federal Reserve Bank of New York, as there had been instances in the past when the Bank had taken action with respect to excessive dealer positions, and that the procedure was largely a formalization of what had been the informal understanding heretofore.

Mr. Rouse commented that the arrangement would result in formal reports to the executive committee which would tend to relieve the Federal Reserve Bank of New York of some responsibility by placing it on the executive committee.

On the second question, the spread on shorter certificates equivalent in dollar amount to 0.01 per cent on the longest maturity was authorized for the purpose of enabling dealers to meet their operating expenses on transactions in these securities, it being realized that on the shorter maturities the spread would amount to as much as 0.04 per cent.

Mr. Rouse stated that the Federal Reserve Bank of New York in the near future probably would receive two or three applications from dealers to qualify as dealers with which the Federal Reserve Bank of

New York would transact business in Government securities for the System open market account. He said that an application was expected from Blair and Company which now had an adequate capital and did a diversified national business, and that the management was now satisfactory from the standpoint of the terms and conditions upon which the New York Bank could do business for the System account. This concern, he said, had been on the approved list at one time but had been removed for cause. However, Mr. Rouse felt that the matters which were subject to criticism previously had been corrected and with changed management the firm would be entitled to restoration as a qualified dealer. Mr. Rouse also said that if this application were received it would be sent with a full report to the members of the committee for their approval. The two other firms which he had in mind were Briggs, Schaedle and Company, and J. B. Roll and Company, and he thought that they would be satisfactory.

> Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the executive committee of the Federal Open Market Committee held on February 28 and March 1, 1946, were approved.

Since the last meeting of the committee the Federal Reserve Bank had sold a substantial amount of short-term securities to satisfy market demand, and the program for the retirement of Government debt had resulted in a further reduction in holdings in the System account. In order that the Federal Reserve Bank of New York might have the necessary authority to handle these transactions the members of the executive committee on March 8, 1946, approved an increase from $500 million to $1 billion in the limitation on the authority granted to the Federal Reserve Bank of New York to execute transactions for the System account as contained in paragraph (1) of the direction issued at the meeting of the committee on March 1, 1946; on March 21 the members of the committee approved an increase in the limitation to $1,250,000,000; and on April 19, 1946, the limitation was increased to $1,500,000,000.

Upon motion duly made and seconded, and by unanimous vote, the actions of the members of the executive committee on March 8 and 21 and April 19, 1946, were approved, ratified, and confirmed.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account during the period February 28 to June 8, 1946, inclusive, as reported by the Federal Reserve Bank of New York to the members of the executive committee, were approved, ratified, and confirmed.

In response to informal requests from the Treasury the members of the executive committee had made recommendations with respect to the retirement of Government securities maturing in April, May, June and July of this year as a part of the program of the Treasury for the retirement of Government debt. These recommendations were contained in letters sent to Secretary of the Treasury Vinson by Chairman Eccles under date of March 6, April 4, May 9, and June 6, 1946, copies of which were sent currently to the Presidents of all of the Federal Reserve Banks. These letters were as follows:

Letter of March 6, 1946.

"I am enclosing herewith a memorandum concerning the refunding of the April 1 certificates. Mr. Bartelt phoned to Mr. Piser on March 4 regarding the opinion of the executive committee on this question. Mr. Piser took the question up with the executive committee, and it was decided to submit this memorandum to you. If we have any other views with reference to this matter before the time for announcement, we will communicate them to you."

REFUNDING OF CERTIFICATES THAT MATURE ON APRIL 1

"In view of the favorable developments in the budget picture since the Budget Message was issued, the executive committee of the Federal Open Market Committee recommends that the Treasury on April 1 redeem for cash at least 2.5 billion dollars of the maturing certificates, instead of the 1.5 billion indicated in our previous recommendation.

"Our present estimate is that between March 1 and December 31, 1946, budget expenditures will total 34 billion dollars and receipts 32 billion, leaving a deficit of only 2 billion. We estimate that a billion dollars of this deficit will be met by net sales of nonmarketable securities, which will comprise an excess of net sales of special issues and savings bonds over net redemptions of savings notes. It, therefore, appears from these estimates that the Treasury's present large cash balances will be reduced by only about a billion dollars during the balance of this calendar year.

"On February 28 the cash balances totaled 25.6 billion dollars. Unless the Treasury desires to maintain unnecessarily large balances, it should redeem for cash 18 to 20 billion dollars of marketable securities by the end of December. Excluding the March retirement of nearly 3 billion dollars of certificates, notes, and bonds, this leaves 15 to 17 billion of additional redemptions during the remainder of the calendar year. Of this total, about 5 billion dollars consists of bonds in June and notes in December, leaving 10 to 12 billion of certificates that could be retired. Since the small size of the May 1 certificate issue indicates that none of this issue should be redeemed for cash, we feel that at least 2.5 billion dollars of the April 1 issue should be retired. A further consideration in suggesting that the April cash redemption should be at least 2.5 billion dollars is the fact that an exceptionally large proportion of the 4.8 billion of this issue is held by the banking system, 2.7 billion by commercial banks and 1.3 billion by the Federal Reserve."

Letter of April 4, 1946.

"In response to a request made by Mr. Bartelt, the members of the executive committee of the Federal Open Market Committee have considered the question of the handling of the 1.6 billion dollars of certificates that mature on May 1. In view of the large cash balance that the Treasury is still carrying, we unanimously recommend that the entire issue be redeemed for cash."

Letter of May 9, 1946.

"As requested by Mr. Bartelt, I am pleased to give you the views of the executive committee of the Federal Open Market Committee covering the June maturities and the debt retirement program.

"The Committee recommends that 2 billion dollars of the June 1 certificates be redeemed for cash, that the remaining 2.8 billion of certificates be exchanged, and that all of the 1.9 billion of maturing June 15 bonds be redeemed for cash. There would be no difficulty in handling a total retirement of 3.9 billion on two dates, June 1 and 15, as demonstrated by previous experience. This total is almost exactly the same as the total retirement on March 15 and April 1.

"Our present estimate is that the Treasury cash balance, after the proposed debt retirement, will be nearly 15 billion dollars on June 30. With the budget picture as favorable as it appears at present, the Treasury could possibly pay off as much as an additional 12 billion dollars of debt between July 1 and December 15 and still have a balance of from 2 to 3 billion dollars at the end of the year.

"It is our view that a cash balance of from 2 to 3 billion dollars would be adequate under existing conditions. The volume of public expenditures has been greatly reduced and the budget is approximately in balance, making a large cash balance unnecessary. If an emergency should arise where the Treasury might need additional funds, the amount of outstanding certificates could be increased in any month or the Treasury could borrow up to 5 billion dollars from the Federal Reserve Banks under the direct borrowing authority.

"Again let me say that we appreciate having an opportunity to express our views in this matter. For your information, I am enclosing figures showing a projected debt retirement program for 1946 which was prepared for the benefit of the Board by our research staff."

Letter of June 6, 1946.

"I am pleased to give you the views of the executive committee of the Federal Open Market Committee regarding the maturing July 1 notes and the debt retirement program as requested by Mr. Bartelt.

"The committee recommends that 2.5 billion dollars of the July 1 notes be redeemed for cash and that the remaining 2.4 billion be exchanged for a one year certificate. This represents some acceleration of the debt retirement program which we previously had considered, but is deemed appropriate in view of the experience we have now had with this debt retirement operation, and desirable in view of its restrictive effect upon bank credit at a time of inflationary pressure.

"For your information I am enclosing figures showing a debt retirement program for 1946. This suggested program is only tentative and might have to be altered as conditions change. The table brings up to date a similar table enclosed with my letter of May 9 and shows figures for months subsequent to July. It will be noted that this proposed schedule of redemptions would retire, prior to November 1, about the amount which would have been retired by the end of the year under the earlier schedule, thus bringing the cash balance to a reasonable working level of about 3 billion dollars by the end of October. This would result in an interest saving to the Treasury as well as have a further restrictive influence on bank credit, which is particularly desirable under present inflationary conditions."

Upon motion duly made and seconded, and by unanimous vote, the above letters were approved and their transmission to the Secretary of the Treasury was ratified and confirmed.

In May the Treasury requested the informal views of the members of the executive committee on a draft of press statement relating to the authority proposed to be given by the Treasury to commercial banks to permit them to hold restricted issues of Government securities for trading purposes in an amount equal in each case to 1 per cent of the bank's demand deposits, excluding war loan and interbank deposits, or $500,000, whichever was less. Changes were suggested by members of the executive committee in the press statement and the statement was approved informally by them in the form in which it was issued on May 17, 1946, which contained the comment that the authority was granted after consultation with the Federal Reserve authorities who agreed that it might be helpful particularly to small nonbank investors.

Mr. Sproul stated that the new arrangement was discussed at the meeting of the Presidents' Conference which was held on June 7 and 8, and that there was some evidence that banks were inclined to take advantage of the authority to increase their long-term holdings of securities, that at the beginning there appeared to be some doubt in the minds of commercial banks as to what had been intended by the Treasury, that consideration had been given at the meeting of the Presidents' Conference to what should be done in cases where it appeared that the banks had been abusing the privilege, and that it was admitted that it would be difficult definitely to determine whether a bank was meeting the needs of its customers or holding the long-term securities for the additional earnings.

> Upon motion duly made and seconded, and by unanimous vote, the action of the members of the executive committee in connection with the above matter was approved, ratified, and confirmed.

In April, 1946, the Federal Reserve Bank of New York suggested the desirability of sending a letter to banks in the Second Federal Reserve District calling attention to the assumption that loans made for the purpose of purchasing Government securities during the Victory Loan Drive were to facilitate permanent investment in Government securities and not for the purpose of speculative purchasing or carrying of securities, and suggesting that loans should not be made or continued for the latter purpose. Chairman Eccles had felt that it would be desirable to send a letter on this subject to the Presidents of all of the Federal Reserve Banks and a draft of such a letter had been prepared. The draft was read at this meeting and Chairman Eccles stated that when the suggestion was first made he felt that the situation in the market was such that it would not be desirable to exert any additional pressure at that time, as such a letter would do, that the prices of Government securities had declined as a result of the elimination of the preferential rate and the Treasury program for the retirement of Government debt, and that, while there was a good argument for sending the letter before renewals of existing loans had been made, the letter would be more effective from the standpoint of the market if sent at a later date.

In response to an inquiry, Mr. Rouse stated that the indications were that a large portion of the loans that had been made for speculative purposes had been renewed, and that in cases where pressure had been brought by the banks for payment the loans had been transferred to other banks with the result that no appreciable amount of them had been paid off.

Mr. Sproul said that the American Bankers Association sent out a letter on the matter but found that it was difficult to get results because of the ease with which the loans could be transferred from one bank to another in the absence of an indication of national policy.

There was some question as to how effective a letter along the lines proposed would be. Chairman Eccles stated that he had suggested that the letter include some reference to the sanctions that the Federal Reserve System might impose if it were found in any case that a member bank was making undue use of the credit facilities of the Federal Reserve System.

During the discussion the suggestion was made that if the letter was to be of maximum effectiveness it should be addressed to all banks, and Chairman Eccles raised the question whether the matter should be taken up with the Comptroller of the Currency and the Federal Deposit Insurance Corporation with a view to a joint letter being sent over the signatures of the three agencies to all member and nonmember banks. It was agreed, however, that the Board of Governors might, after consultation with the Treasury, request the Federal Reserve Banks to send the letter to all banks in their respective districts as a logical follow-up on the war loan drives.

At the conclusion of the discussion, it was understood that the draft of letter to the Presidents of all of the Federal Reserve Banks would be revised in the light of suggestions made at this meeting and submitted to the members of the executive committee.

Thereupon the meeting recessed to reconvene following the meeting of the Federal Open Market Committee.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.