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, February 17, 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. Thurston, Assistant to the Chairman of the Board of Governors
Mr. Miller, Assistant Vice President of the Federal Reserve Bank of New York
Mr. Musgrave, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

This meeting was called for the purpose of discussing certain open market and Treasury financing matters prior to a meeting at the Treasury this afternoon to be attended by Messrs. Eccles and Sproul, Secretary of the Treasury Snyder, Under Secretary of the Treasury Wiggins, and Fiscal Assistant Secretary Bartelt.

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 January 10, 1947, were approved.

It was agreed that, inasmuch as another meeting of the executive committee would be held next week, prior to the meeting of the full Committee, action should be taken at that time upon the ratification

of the transactions in the System account for the entire period from January 9, 1947.

Upon motion duly made and seconded, and by unanimous vote, the following letter to the Secretary of the Treasury which was sent by Chairman Eccles on February 7, 1947, with the informal approval of the members of the executive committee was approved and its transmission to the Treasury was ratified unanimously:

"In response to Mr. Bartelt's request, I am transmitting to you the current views of the Executive Committee of the Federal Open Market Committee with respect to the debt retirement program.

"The Executive Committee repeats its recommendations of January 10 for retirement in full of the March 15 note issue of 1.9 billion. The Committee now considers it desirable as well to pay in cash at least 1 billion of the March 1 certificate issue.

"Expenditures during the month of January have been considerably lower and receipts higher than had been expected. Because of this and the retirement of only 1 billion dollars of February 1 certificates, it is now estimated that the Treasury balance at the end of February will be at 5.3 billion dollars. If cash payments in March were limited to the March 15 note issue of 1.9 billion, the Treasury balance at the end of March would still be close to 5 billion, not counting 800 million dollars of free gold derived from Monetary Fund transactions. With total cash payments on March maturities of 2.9 billion, including 1 billion dollars of March 1 certificates, it is estimated that the Treasury balance at the end of March will be approximately 3.8 billion, excluding 800 million dollars of free gold. This will be fully adequate to meet requirements for the last quarter of the fiscal year.

"If actual expenditures for the fiscal year as a whole fall short of the revised budget estimate of 42.9 billion, as appears likely, some further debt retirement may well be possible in the second quarter.

"Throughout February and March, the Treasury's balance with the Federal Reserve Banks will be swollen by heavy tax receipts. Accordingly, it will be possible to pay for the March 1 retirement out of these balances, thereby providing an offset to the preceding loss of reserve funds from tax payments. Also, it will be possible to finance a substantial part or about 1 billion of the March 15 retirement out of the Treasury balance with the Federal Reserve. The Committee recommends that the remainder be financed by call on war loan deposits rather than by monetization at this time of the 800 million dollar gold obtained from Monetary Fund transactions. Even without such monetization, the recommended program will more than offset losses of reserves due to tax payments during the month of March."

Mr. Musgrave made a brief report with respect to the present and prospective cash position of the Treasury during the remainder of the current fiscal year and it was the consensus that, when the committee met at the end of February, consideration should be given to further recommendations to the Treasury with respect to retirement of Government debt during the balance of the fiscal year.

In accordance with the action taken at the meeting of the executive committee on January 10, 1947, there was presented a draft of letter to Mr. Bartelt, Fiscal Assistant Secretary of the Treasury, with further regard to the savings bond program of the Treasury. After commenting on various points to be taken into consideration and raising the question whether steps should be taken this year to assure reinvestment of funds invested in Series C bonds maturing next year, the draft of letter read in part as follows:

"In taking such action, two approaches might be considered. Investors in maturing issues might be granted the privilege of reinvesting the proceeds in Series E Savings Bonds without counting such purchases against the $3,750 purchase price limit. As investment in Series E Bonds is available to individuals only, this provision would be limited to personal holdings of maturing C bonds. However, even with such reinvestment privilege, the owner of maturing issues would still suffer some setback at the time of maturity since newly purchased E Bonds would carry a lower rate of interest in initial years. To avoid this, they might be given an option between reinvestment in E Bonds and investment in a special new bond which would extend the approximate yield obtained from the maturing issue for an additional ten-year period. Such a special bond which would be nonmarketable might carry a maturity of 10 years, be redeemable at par by the investor at any time after one year of holding and carry an interest rate of 2-3/4 per cent payable annually.

"The committee is aware that the case for offering special refunding privileges to holders of maturing C Bonds is less compelling than will be the case with future E Bond maturities since holdings of C Bonds are less widely distributed. This is evidenced by the fact that C Bonds were issued mostly in large maturities and purchased predominantly by investors who exhausted the full permissible annual purchase value of $7,500. Nevertheless, the committee believes that it will be advantageous to permit an exchange of maturing C Bonds into Series E Bonds outside the regular purchase limit on E Bonds and to consider the desirability of providing holders of maturing C Bonds with an alternative form of investment as discussed above. Since some of the maturing funds invested in C Bonds would not be reinvested in Treasury debt if no special reinvestment privilege was granted, such a policy would contribute to maximizing debt holdings outside the banks. Also, such action would serve to set a pattern for a longer view on the E Bond program, a pattern which might induce current purchases of E Bonds and discourage redemption of outstanding issues prior to maturity."

Chairman Eccles said that, since the majority of the committee appeared to favor such a letter, he would not object to it but that,

inasmuch as the maturing Series C bonds appeared to be held principally by large rather than small savers, he did not think the suggestion that holders of maturing Series C bonds be permitted to reinvest the proceeds of such bonds in the special 2-3/4 per cent security was desirable or necessary. He felt, however, that it might not be objectionable if such reinvestment were limited to $2,000 or $2,500 annually, as that would permit the smaller saver to reinvest his holdings without making it possible for the large investor to have the same privilege to the full extent of his permissible annual holdings. He questioned whether the Treasury would be willing to accept the suggestion and said that, since the Treasury had already determined what its policy would be for this year with respect to maturing Series C bonds, there was no need to send the proposed letter at this time, and that it might be held for further consideration later in the year when the question of Treasury policy was taken up again when it should be discussed in the light of what the longterm savings rate should be.

The draft of letter was read and discussed and there was unanimous agreement that there was no pressing reason for its being sent at this time and that the matter should be put on the agenda for discussion at a meeting of the full Committee in the fall so that the views of the Committee could be formulated in ample time for consideration by the Treasury before a decision was reached with respect to its policy during 1948. It was also agreed that an interim letter should be sent to Mr. Bartelt stating that

the committee had in mind his request for reasons for the position stated in the letter addressed to him under date of December 27, 1946, but that inasmuch as the matter was not an urgent one at this time the committee would take it up again toward the end of the year when consideration was to be given to the policy to be followed in 1943 and the views of the committee would be discussed at a meeting with representatives of the Treasury in ample time for consideration by the Treasury before a decision on future policy was made.

In accordance with the decision at the meeting on January 10, the following letter, and the memorandum referred to therein, had been prepared and were sent to the Secretary of the Treasury on January 22, 1947, with the informal approval of the members of the committee:

"I am enclosing a memorandum which discusses the possible issuance by the Treasury of a long term security. This memorandum represents the tentative results of the thinking of members of the executive committee of the Federal Open Market Committee and its staff. I am sending it to you, at this time, in case you care to bring up the subject, in general terms, with the investor groups which I understand you are meeting during the course of the next two or three weeks.

"If they are not interested in a bond of the type suggested, it seems to us that the question of a long term issue might well be placed on the shelf for the time being. On the other hand, if they are interested, I think it would be worthwhile for your people and ours to work out the specific terms of such an offering. We could then look at it again, and the Committee would be prepared to discuss it with you in terms of a definite recommendation."

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

In connection with the above matter, Chairman Eccles outlined for the information of the other members of the committee his discussion on January 24, 1947, with the group of bank representatives, which had met with the Secretary of the Treasury the day before, with respect to Treasury financing policy and particularly of the issuance by the Treasury of a long-term security. He said he was satisfied that the group recommended the issuance of a marketable security on the general principle that they were opposed to the type of issue proposed in the committees's memorandum to the Treasury for the reason that it was in effect a demand obligation. Chairman Eccles also said that he discussed with the group the renewal of the authority of the Reserve Banks to purchase up to $5 billion of Government securities directly from the Treasury. That question, he said, had been raised specifically during the discussion by the Treasury, the views of the group having been requested by the Treasury, and there was a sharp division of opinion among members of the group with the final compromise that they would offer no objection to the extension of the existing authority for a period of 3 years. Chairman Eccles made the further statement that a bill which would make permanent the existing authority had been submitted to the Chairmen of the Banking and Currency Committees and it was his understanding that it would be introduced by the Chairman of the Senate Committee and would be taken up by the House Committee shortly together with the proposed amendment of

Section 13 of the Federal Reserve Act relating to industrial loans by the Federal Reserve Banks and proposed legislation giving the Board authority to regulate consumer credit.

In a further discussion of whether the Treasury should issue a long-term security Mr. Sproul stated that the Secretary of the Treasury was meeting today with representatives of the insurance companies and that unless there was a demonstrable need for long-term Treasury securities for the investment of funds of insurance companies and other large holders of savings funds that could not be invested in other desirable ways, the position of the executive committee should be as stated in its letter of January 22, 1947, to the Treasury that the matter be placed on the shelf for the time being.

Chairman Eccles referred to the problem of marketing the securities of the International Bank for Reconstruction and Development and stated that, when determining its policy with respect to the issuance of a long-term Treasury security, the Treasury would consider the effect of such an issue on the willingness of institutional investors in this country to purchase the securities of the International Bank.

Mr. Miller stated that if the Treasury should announce that it had decided not to issue any further long-term securities the market for Treasury obligations would rise sharply, and it was

agreed that the Treasury should not make any definite statement of its plans if it should decide not to offer such an issue.

At this point Mr. Rouse, Manager of the System Open Market Account, who had been in attendance at the meeting of insurance company representatives with the Secretary of the Treasury this morning, joined the meeting.

There were then distributed to the members of the committee copies of the memorandum prepared pursuant to the action taken at the meeting of the committee on January 10, 1947, with respect to actions that might be taken with respect to Treasury bills. The memorandum was read and discussed and a number of changes were made therein.

> At the conclusion of the discussion, upon motion duly made and seconded, and by unanimous vote, the memorandum was approved in the following form, as a basis for preliminary discussion with the Treasury at the meeting this afternoon, preparatory to consideration of policy with respect to Treasury bills at the meeting of the full Committee next week:

"CHANGES IN TREASURY BILL POLICIES

"Treasury and Federal Reserve policies and procedures followed during the war with respect to Treasury bills need to be reviewed now that the period of heavy war finance has passed, with a possibility of adjusting them to changed conditions. Two aspects of these policies should be considered:

(A) Weekly replacement of Federal Reserve maturities, and
(B) Elimination of the posted buying rate and repurchase option.

"(A) Replacement of Federal Reserve Bill Maturities

"Existing arrangements through which the Reserve System purchases the new weekly issues of Treasury bills involve cumbersome procedures and unnecessary expense in order for the System to comply with the law against direct purchases from the Treasury. Since most of the bills are held by the Reserve System, it seems unnecessary to continue the procedure of buying through dealers in order to maintain the formality of a market operation.

"The weekly refunding operations could be simplified by permitting holders of maturing bills to exchange them for the new issue of bills. Under this procedure the Treasury would provide that bills awarded on tenders could be paid for either by cash or by surrender of a like face amount of the maturing issue of bills, with an adjustment for the discount. Pending any other change in policies, the rate could continue to be determined as at present. The Federal Reserve System would offer tenders for the amount of maturing bills held in the System and option accounts and would not need to continue the present arrangement whereby dealers bid for the bills and sell them to the System.

"This change in refunding procedure could be introduced immediately and without other changes in bill policy but in connection with it, a general revision of policy on Treasury bills may also be considered.

"(B) Elimination of Posted Buying Rate and Repurchase Option

"The posted rate of 3/8 per cent on the buying and repurchase of Treasury bills by the Federal Reserve Banks was a wartime measure designed to influence market rates for Government securities and encourage banks to make full use of their reserves. Under current conditions these arrangements no longer serve their original purpose. With a pegged certificate rate and only 2 billion dollars of bill holdings outside the Federal Reserve Banks, certificates have replaced bills as the principal market instrument for investment of short-term funds and for the adjustment of reserve positions of banks.

"In considering the termination of the buying rate and repurchase option, decisions need to be made with respect to:

"(1) Timing of the actions
(2) New policy regarding amounts of bills issued and rates
(3) Added cost to Treasury and effect on System earnings

"(1) Timing -- Because of the emphasis that the market may place on the elimination of the buying rate, the change should be made when it is desired to exert some pressure or restraining influence. Accordingly, it might be postponed until there is a curtailment in the debt retirement program to the point of lifting the pressure on member bank reserve positions, which has prevailed during the period of large-scale debt retirement, or until private credit expansion appears to be proceeding at too rapid a rate. April might be a propitious time for such action. The change whenever made would apply only to bills issued subsequently; existing privileges would continue to apply to issues of bills outstanding at the time of the change until they mature.

"(2) Bill policy -- If the posted buying rate and repurchase option on Treasury bills are eliminated, there are various possibilities as to policies that may be followed in issuing bills and establishing rates.

"(a) One possibility would be to permit the bill rate to rise toward the certificate rate which the Federal Reserve System would continue to maintain at the Treasury issuing rate of 7/8 per cent, and bills would be permitted to find their level in the market. The System would continue to refund its holdings of bills into new bills to the extent that they were not taken by the market. In view of the higher rate, the market probably would take more bills than at present.

"(b) Another possibility would be for the Treasury to discontinue entirely the issuance of bills and replace maturing bills with additional issues of certificates. With the certificate rate supported at a fixed level and the bill rate permitted to rise to approximately the same level, it may be said that there is little reason to have outstanding two short-term instruments serving essentially the same purpose.

"(c) A third possibility would be for the System to stabilize the market for bills not at 3/8 but at approximately a rate which would permit the Treasury to continue to issue one-year certificates with a 7/8 per cent coupon. The certificate rate would be maintained largely and indirectly through the supported bill rate.

"Since bills do not carry a fixed-rate coupon, their rate could be supported without public announcement of a fixed rate; this would have the advantage of permitting some flexibility within a narrow range. The System would engage in open-market operations in bills for the purpose of stabilizing the bill rate at the desired level and would refund its weekly maturities through exchanges as proposed under (A) above. The Treasury would continue to issue bills weekly in amounts required to supply the market demand for bills at the rate maintained and also such amounts as the Reserve System would need to hold. In view of the higher rate, banks and other holders might take more bills than at present. The System might replace some of its holdings with certificates sold by the market.

"If at any time in the future, conditions should make it desirable to permit short-term rates to rise, any change in the rate at which bills are supported by the System would be made only after consultation with and concurrency by the Treasury.

"These changes in policies and practices would make the Treasury bills again a useful market instrument and would permit greater flexibility in monetary and debt management policies, without interfering with the policy of stabilizing interest rates.

"(3) Federal Reserve earnings and interest cost to the Treasury — Elimination of the buying rate and repurchase option on Treasury bills raises questions of Treasury financing costs and System earnings. The rise in the bill rate or the substitution of certificates for bills would increase Federal Reserve earnings, which are already very large, and would also increase the interest cost to the Treasury. Federal Reserve earnings will continue at a high level indefinitely, as it is very unlikely that there will be any substantial reduction in the total amount of the System's holdings of Government securities in the foreseeable future.

"In order for the System to pass on to the Treasury any earnings above its requirements for expenses and surplus, two approaches may be considered:

"(a) Use may be made of a heretofore dormant provision of the Federal Reserve Act. Paragraph 4 of section 16 of that Act authorizes the Board of

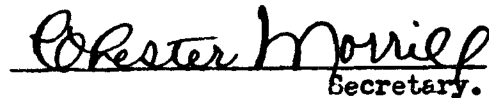
"Governors to charge the Federal Reserve Banks interest on whatever amount of Federal Reserve notes they issue in excess of the amount of gold certificates held by the Federal Reserve Agent as collateral security for such notes. The rate of interest charged could be fixed by the Board from time to time so as to absorb the excess earnings of the Reserve Banks, and the amounts collected could be turned over to the Treasury. This would require no legislation and could be made effective by Board action immediately.

"(b) Another possibility is to impose a tax on the earnings of the Federal Reserve Banks (similar to the old franchise tax). This would require legislation.

"Either provision would make it possible to return to the Treasury not only the additional earnings obtained by the System from higher rates on Treasury bills (perhaps 50 million dollars or more a year) but also some of the earnings of the System on its portfolio at existing rates (from 50 to 75 million dollars a year)."

Inasmuch as the Federal Reserve Bank of New York continued to have ample authority under the direction issued at the meeting of the committee on January 10, 1947, to effect transactions for the System account, and since another meeting of the committee was to be held on Thursday of next week, it was decided to take no action at this time to renew the authority of the New York Bank.

Thereupon the meeting adjourned.



Secretary.

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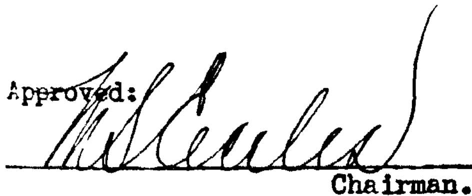

Chairman.