

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, April 21, 1948, at 10:30 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Szymczak
Mr. Williams

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager of the System Open Market Account
Mr. Bopp, Vice President of the Federal Reserve Bank of Philadelphia
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

On April 15, 1948, Mr. McCabe took his oath of office as a member of the Board of Governors for the unexpired portion of the term ending February 1, 1956, and on the same day was designated as Chairman of the Board of Governors for a term of four years. Accordingly, on that date Mr. McCabe became Chairman of the Federal Open Market Committee and of its executive committee by virtue of the action of the Federal Open Market Committee at its meeting on March 1, 1948, when he was elected, effective as of the date of assumption of his duties as Chairman of the Board

4/21/48

-2-

of Governors, to serve as Chairman of the Federal Open Market Committee until the election of his successor at the first meeting of the Committee after February 28, 1949.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the executive committee on February 26 and March 1, 1948, were approved.

Mr. Rouse presented a review of the market for United States Government securities covering the period March 1 to April 19, 1948, a report of transactions for the System open market account during the same period, and a supplemental report of operations for the account on April 20, 1948. He read the more important sections of the review, and copies of the review and the two reports have been placed in the files of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account as reported to the members of the executive committee for the period February 26 to April 20, 1948, inclusive, were approved, ratified, and confirmed.

Before this meeting Mr. Rouse sent to the members of the executive committee, pursuant to the action taken at the meeting of the committee on February 26, 1948, a memorandum prepared at the Federal Reserve Bank of New York under date of April 15, 1948, concerning the relationship of the Federal Reserve Bank of New York as agent for the System open market account with dealers in

4/21/48

-3-

United States Government securities and the problem presented by the unqualified dealers. After reviewing (1) the procedure developed by the Federal Reserve Bank of New York in 1939, (2) the action of the Federal Open Market Committee in 1944 in approving a statement of terms upon which the Federal Reserve Bank of New York, as agent for the System account, would transact business with brokers and dealers in United States Government securities, and (3) recent experience under the statement of terms, the memorandum stated that the problem of the smaller dealers appeared to be less formidable and more temporary than some had suggested and that after reviewing the terms and conditions of qualification requirements established by the Federal Open Market Committee in 1944 and examining the market situation which had recently developed, the Federal Reserve Bank of New York had no changes to recommend either with respect to the substance of the conditions or their interpretation. The reasons for this conclusion were stated in the memorandum.

Mr. McCabe inquired whether there was much pressure at the present time from the unqualified dealers for action, and Mr. Rouse responded that there were only three or four dealers who had commented on the question recently and that they could not qualify because they did not do a national business and, in some instances, did not have the required capital to operate on a national basis

4/21/48

-4-

and take positions in securities from time to time as would be required of dealers who assumed the responsibility of making a market for securities. He expressed the view, however, that since market prices had moved away from the support prices the smaller dealers were losing little business because of their inability to deal with the Federal Reserve Bank. He added that none of the dealers had followed up the suggestion that they be permitted to split fees with qualified dealers and that apparently that suggestion had been forgotten since the market moved away from the support prices. He also said that none of the small dealers appeared to favor a solution of their problem by merging in order to provide capital in an amount which would justify their undertaking to do a national business.

There was a general discussion of the consideration which had been given in the past to changes in the functions performed by the dealers and the Federal Reserve Banks, in relation to the Government security market, as well as of the conditions which prompted the adoption in 1944 of the statement of terms upon which the Federal Reserve Bank of New York would do business with brokers and dealers for the System open market account.

At the conclusion of the discussion, upon motion duly made and seconded, and by unanimous vote, the executive committee concurred in the conclusion reached in Mr. Rouse's memorandum and agreed to recommend to the full Committee that no change be made at this time in the statement of terms or in their interpretation.

4/21/48

-5-

In reviewing developments since the last meeting of the executive committee, Mr. Sproul stated that at the meeting with Secretary of the Treasury Snyder, Under Secretary Wiggins, and Fiscal Assistant Secretary Bartelt on March 11, Mr. Eccles and he presented the views of the committee as outlined in the letter sent to the Secretary of the Treasury under date of March 8, 1948, that the conference was just prior to the President's speech before the Congress with respect to the international situation and the prospective increase in military expenditures, and that while the Treasury officials stated that they would consider the proposals they did not appear to be inclined to make any change at such an apparently critical time. Mr. Wiggins called on the telephone on March 16, 1948, Mr. Sproul said, and indicated that in the circumstances the Treasury was still reluctant to increase the short-term rate further and inquired whether it would be possible to accomplish the desired purpose by allowing the yields on bills and certificates to go up at the appropriate time in April to pave the way for a 1-1/4 per cent 12-months' certificate on June 1 if that seemed to be desirable at that time. Mr. Sproul added that he outlined the reasons why it was felt that the change should be made in connection with the April 1 refunding, why the committee felt more strongly than usual as to the desirability of that action, and why the risks of action were minimum risks and the rewards

4/21/48

-6-

might be important. Mr. Sproul went on to say that the Treasury finally decided on a 12-months' 1-1/8 per cent certificate for the April refunding and that he felt the decision was a reflection of the very cautious attitude of the Treasury. Since that time, he said, Mr. Eccles' testimony before the Joint Committee on the Economic Report had suggested an impending increase in the rate and, according to reports in the papers this morning, a Treasury official at the meeting of the Executive Council of the ABA at French Lick this week had given a similar impression, with the result that the market appeared to be taking it for granted that there would be such an increase and selling was taking place in the issues which would be affected adversely by the change.

In the discussion which followed it was the unanimous view of the members of the committee that it would have been better if the Treasury April 1 refunding had been through the medium of an 11-months' 1-1/8 per cent certificate, and Mr. Sproul stated that, while failure to take that action was not an irretrievable loss, a transition to the 1-1/4 per cent rate would have been a much smoother operation than would now be possible.

In connection with a discussion of operations to be carried out by the executive committee under the authority granted at the last meeting of the full Committee, reference was made to a memorandum prepared by Mr. Sproul under date of April 15, 1948, in

4/21/48

-7-

which he discussed problems with respect to open market operations and debt management.

Mr. Sproul stated that the immediate question was the proposed increase in the short-term rate and that the matter should be discussed with the Treasury with a view to determining the program to be followed in preparation for the issuance of a 1-1/4 per cent 12-months' certificate in replacement of the June 1 maturing certificates.

Mr. Eccles said that the recent statement of the Board of Governors before the Joint Committee on the Economic Report emphasized the importance of a further increase in the short-term rate and that in his testimony before the Committee he stated the reasons why the short-term rate should be permitted to seek its own level. He expressed the view that representatives of the committee should discuss this matter with the Treasury and also the question of permitting the 2-1/4's of 1959-62 to decline slightly below par to bring them into line with the rest of the market.

At this point there were distributed copies of a memorandum prepared in the Division of Research and Statistics of the Board of Governors under date of April 20, 1948, which discussed the Treasury financing outlook for the period April through July and for the fiscal year 1949. Mr. Thomas amplified the statements contained in the

4/21/48

-8-

memorandum, and stated that the Treasury would have no substantial amount of funds during the remainder of the calendar year that could be used to retire maturing debt. It appeared that until the end of June Treasury operations could be prevented from adding to bank reserves by means of calls on war loan accounts, that in July there would be a substantial addition to bank reserves resulting from Treasury operations, and that after July the Treasury would stand in a substantially neutral position so far as the money market was concerned.

After discussion of the outlook in the light of possible further sales of securities by nonbank holders and the effect on the volume of outstanding banking credit of the desire of banks for increased earnings, consideration was given to matters to be discussed with the Treasury.

Mr. Sproul suggested that it should be recommended that the Treasury be prepared to replace the maturing June and July maturities with a 1-1/4 per cent 12-months' certificate and that in connection with that change there should be a new series of savings notes with a scale of rates which would be in line with the 1-1/4 per cent rate on certificates. He added that the yields on outstanding bills and certificates and on other securities with maturities of less than 5 years should be adjusted so that they

4/21/48

-9-

would be in line with the new rate and that the support basis for the 2-1/4's of 1959-62 should also be brought into a more appropriate relationship with the market, which would mean breaking par on this issue.

During the ensuing discussion it was also suggested that it would be desirable at the appropriate time to discontinue purchases of bonds with maturities of less than five years at fixed support prices and to return to the policy followed prior to December 24, 1947, of purchasing these maturities to the extent necessary to maintain orderly conditions in this area of the market. In connection with the discussion Mr. Thomas distributed a chart showing changes in the yields on taxable Treasury bonds since the System's support prices were dropped on December 24, 1947, and these changes were reviewed.

In connection with a reference to the discount rates at the Federal Reserve Banks, Mr. Eccles expressed the view that an increase in these rates should not be made until after the 1-1/4 per cent rate on certificates had been established, that to increase the discount rate before that had been done would be unrealistic and premature, but that if the certificate rate were increased to 1-1/4 per cent the discount rate should be increased to 1-1/2 per cent. This would result, he said, in higher rates on bank loans, thereby increasing bank earnings and removing to

4/21/48

-10-

some extent the incentive to sell short-term certificates for the purpose of purchasing longer term issues carrying higher rates.

Mr. Sproul suggested that, since the Presidents of all of the Federal Reserve Banks would meet in Washington during the week of May 17, the question of increasing the discount rates at the Reserve Banks could be considered at that time.

Mr. Szymczak raised the question whether in the discussions with the Treasury there should be mentioned the possibility of further increases in reserve requirements of member banks in central reserve cities. In the ensuing discussion the view was expressed by Mr. Sproul that such an increase would put additional pressure on the banks which needed it the least, that under present circumstances the increase probably would result merely in a shift of securities from the central reserve city banks to the Federal Reserve Banks, and that it could be argued that the threat of the increase was probably more effective as a credit instrument than the actual increase would be.

In response to an inquiry as to what should be done with the rate on Treasury bills, Mr. Rouse stated that it was the general feeling that the existing rates were not far out of line with a 1-1/4 per cent rate, that these rates might move up to 1.03, 1.04, or 1.05 per cent, and that if the short-term rate were increased he would be inclined to permit the bill rate to go to perhaps 1.05 per

4/21/48

-11-

cent and see if any pressure developed to carry the rate above that point.

Mr. Sproul suggested that the policy in that connection should be one of continuing to let the market determine the rate at which it would take Treasury bills.

At the conclusion of the discussion it was agreed that the staff should prepare a draft of letter to the Treasury along the lines of the discussion, that when the letter was in a form satisfactory to the members of the committee it would be sent to Secretary of the Treasury Snyder, and that sometime next week Messrs. McCabe and Sproul would discuss the suggestions contained in the letter with representatives of the Treasury.

Following a discussion of the authority to be given to the Federal Reserve Bank of New York to execute transactions in the System account during the period before another meeting of the committee, it was agreed that the direction to the Bank should be renewed in the same form as the direction issued at the meeting of the committee on March 1, 1948, except that the limitation contained in the first paragraph of the direction should be reduced to \$1 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:

4/21/48

-12-

(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 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 \$1,000,000,000 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 \$750,000,000.

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.

There was unanimous agreement that the next meeting of the executive committee should be called for 9:30 a.m. on May 20, followed by the meeting of the full Committee at 10:30 a.m. on the same day.

Thereupon the meeting adjourned.

Chester Morrie
Secretary.

Approved:

Thomas B. Leitch
Chairman.