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 Wednesday, September 8, 1948, at 10:00 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Szymczak
Mr. Williams
Mr. Vardaman (alternate in absence of Mr. Eccles)

Mr. Morrill, Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager of the System Open Market Account
Mr. Riefler, Assistant to the Chairman, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Draper, Clayton, and Young, Members, Federal Open Market Committee
Mr. McLarin, Alternate Member, Federal Open Market Committee

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee held on August 11, 1948, were approved.

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 August 11 to September 7, 1948, inclusive, were approved, ratified, and confirmed.

Chairman McCabe stated that the executive committee had been asked to meet today instead of on September 15, as was agreed at the meeting on August 11, because the Board of Governors, at a meeting yesterday, had reached informally the conclusion that reserve requirements of member banks should be increased 2 per cent on net demand deposits and 1-1/2 per cent on time deposits, effective September 16, 1948, for member banks in nonreserve cities and September 24, 1948, for member banks in reserve and central reserve cities, and that, before final action in the matter was taken, the Board would like to know whether the executive committee felt there should be any change in open market operations by reason of such an increase in reserve requirements. He stated that members of the Federal Open Market Committee who were not members of the executive committee had been advised of this meeting so that they might attend and participate in the discussion if they wished to do so.

Chairman McCabe went on to say that, in accordance with the discussion at the meeting of the executive committee on August 11, 1948, he informed Secretary of the Treasury Snyder yesterday afternoon regarding the action proposed by the Board.

At Chairman McCabe's request, Mr. Thomas reviewed the background of the proposed increase in reserve requirements, stating that throughout the remainder of this year continued demand for credit and capital funds was likely on the part of business, individuals, and real estate borrowers, and that seasonal demands for credit for industry and agriculture would be close to the demands in the fall of 1947 when those factors were the principal element which brought about a spurt in industrial and commercial loans. He added that insurance companies had been selling Government securities in order to make other investments, that the prospects were that such sales would continue, and that the Federal Reserve System probably would be called upon to continue substantial purchases of Government securities from nonbank investors which would supply banks with additional reserves which, in turn, would permit further credit expansion. The increase in reserve requirements, he stated, would absorb the reserves which would be supplied by Reserve System purchases from nonbank investors as well as increased reserves that would result from gold imports, and, in addition, it would put banks in a position where they would have to sell securities if they wished to expand loans further. The fact that banks would have to sell securities might make them somewhat more reluctant to expand credit, Mr. Thomas said, and this constituted substantially the only instrument of restraint which the System could exercise at this time.

During a discussion of the probable effects of the proposed action, Mr. Williams suggested that preceding or along with the announcement of the increase in reserve requirements it would be desirable to communicate with leading insurance companies with a view to urging them to reduce their sales of Government bonds which they were making in large volume for the purpose of putting the funds into loans which might be made by banks. He explained that the suggestion was made not so much because he felt it would actually keep the insurance companies from such sales, but because he felt it would be desirable from the standpoint of the effect on the attitude of member banks who were concerned because of the restrictions they were under and would be under with a further increase in reserve requirements, while insurance companies seemed to be taking advantage of the opportunity to take business from the banks.

Chairman McCabe stated that he had been considering such a move, that he had thought of the possibility of making an appeal to the insurance companies on a personal basis, and that he would like the views of the other members of the Committee who were present as to the advisability and the possible effectiveness of such a move.

Mr. Sproul said that he felt that any approach to the insurance companies by Chairman McCabe might, by reason of his position as Chairman of the Board and of the Federal Open Market Committee, be interpreted as an official request, that he considered the matter to be within the competence of the Federal Open Market Committee, and that while insurance companies were the most important factors in this market there were also savings banks, trusts, and pension funds to which similar appeals might be made. He questioned whether the Committee would wish to give the impression that by Government action the insurance companies and other holders of securities were now to be frozen into their portfolios in order to protect a particular rate, namely the 2-1/2 per cent rate on long-term restricted bonds which had been set by the Government. He added that, while he was very doubtful about making such a request by letter, there might be no objection to a very informal discussion of the subject with some of the insurance company officials. He commented that it was questionable whether such a request would dampen sales of Government bonds and that it would run the risk of giving the impression that the Committee was trying to enforce without the compulsion of law a policy which would freeze the insurance company portfolios. No conclusion was reached in the discussion that followed.

During this discussion Mr. McLarin, alternate member of the Federal Open Market Committee, entered the meeting.

In connection with the discussion of possible effects of an increase in reserve requirements on open market operations, Mr. Williams said such action had already been anticipated to some extent among member banks who had become much more circumspect in making loans since the authority to increase reserve requirements was approved, that some banks in nonreserve cities were thinking of meeting the increase by shifting balances from correspondents, and that they were concerned mainly with how their position in relation to nonmember banks would be affected.

Mr. Young stated that he felt the effect of the proposed increase would be mainly to cause withdrawals of banks from membership, or at any rate to prevent getting new members, and that the increase would not do much good as an anti-inflationary move because banks would only sell securities which the System would buy in order to give them the reserves to meet the increased requirements. He also felt action to increase reserve requirements should be delayed a month or two until the effects of the increase in short-term interest rates could be observed more fully.

Mr. Sproul said that, on the basis of the figures and estimates presented, and in view of the history of the Board's increased authority to increase reserve requirements, some action should be taken. The contemplated action, he said, would, in his opinion, have its heaviest effect in central reserve cities where it was least needed, and would set up a lot of cross-currents in the money market; some banks would sell short-term securities to get funds to meet the increased requirements and others would sell long-term bonds in order to maintain liquidity, and some banks would feel restrained in making credit extensions while others might stretch their loans and investments to increase earnings. He also felt that securities would be sold by banks and others because of a fear that support prices would be lowered, and he went on to say that the amount of the contemplated increase was, in his opinion, too big a jump at one time because it would churn up the market unnecessarily when a smaller increase would create the desired restraining effect and still leave more authority to be used later.

Mr. McLarin felt the increase would not do much good in restraining credit expansion since the banks in his district already had prepared for it or would sell Government securities and call in balances from New York in order to meet it.

Mr. Rouse said that the proposed increase, coming at a time when reserves would be reduced by income tax payments, would cause more activity in the money market than if the effective date were delayed until October 1. In this connection, there was a discussion of the authority to be given at this meeting to the Federal Reserve Bank of New York to effect transactions in the System account and Mr. Rouse suggested that it be for $1,500,000,000, or double the amount of the direction given at the meeting on August 11, 1948.

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 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 $1,500,000,000 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.

Turning again to a discussion of the effect of an increase in reserve requirements on open market operations, Chairman McCabe stated that he felt consideration should be given to lowering the support levels at which the Federal Reserve Bank of New York was buying Treasury securities for the System account, since, knowing there would be large amounts of bonds sold in the market immediately following the announcement of increased reserve requirements, he could not understand why the Open Market Committee should set support prices so that insurance companies could sell bonds at a premium for the purpose of making commercial loans. He suggested that the support prices should be set to maintain the 2-1/2 per cent long-term restricted Treasury bonds at par, without the premiums now being paid.

Mr. Sproul said that while it was possible that a mistake may have been made in setting the support level on the long 2-1/2 per cent bonds to include as much as 8/32 premium, he felt a change at this time would increase apprehension as to whether the entire support program was going to be continued, and that any possible saving to the System by making a minor adjustment within the 8/32 premium would be far more than offset by the need for purchasing large amounts of additional securities which would immediately be sold by both bank and nonbank investors who would interpret a change as meaning that the market would not be supported, or might be permitted to decline substantially further.

Chairman McCabe then asked if a support level of 100 plus 8/32 might be set for all restricted bonds.

Mr. Sproul responded that the question was whether the System was to support rates or to support prices of the securities. He said that a policy could be adopted for supporting all Government securities at par but that the present support program which was based on rates and yields was adopted with the thought of having the market largely take care of itself, that it had been felt under the program adopted that the Federal Reserve would find it necessary to purchase smaller quantities of securities than if it operated on a policy of supporting securities at par, and that as it had worked out most of the securities sold had been taken in the market rather than by the System. Mr. Sproul also said that the support program was based primarily upon yield rather than on a par-price support and that if the concept of supporting yields rather than prices was abandoned the whole program of supporting the market might be brought into question with the result that selling might develop on a scale which would result in the System having to purchase a greatly increased volume of securities.

Chairman McCabe suggested that a change in support levels might be accompanied by a bold, courageous announcement of support at the new levels, and Mr. Sproul stated that he felt no further announcements should be made with respect to support prices, that the action taken last December in dropping the market, combined with an announcement of support, had worked reasonably well, that if support prices were changed and an announcement made a second time there would be less widespread acceptance of the program, and that there was a question whether such an announcement, coming at this time, either with or without a change in support prices, might not increase liquidation of securities in the market and add to the amounts the System would have to buy. He added that he would like to get rid of announcements already made as a means of getting rid of commitments to support the market, and that he felt, for the present, the best procedure would be to give aggressive support at established levels without any announcement.

Mr. Williams stated that insurance company officials with whom he talked had the feeling that abandonment of the 2-1/2 per cent support level on long-term bonds was inevitable in any event, and Mr. Sproul said that such feeling was developing, but that he felt the System should not accept that feeling and change its policy because of it. He reiterated that no more effect in restraining sales of securities or in carrying out the restrictive credit program could be obtained by having a support price of 100.00 in place of 100.08, and that if no gain could be made, it would be a mistake to risk the possibility of an avalanche of selling because of increased apprehension regarding the support program.

Mr. Rouse stated that the support prices established last December had their origin during the war period when it was decided to support an issuing rate of 2-1/2 per cent on Treasury bonds having a maturity of from 22 to 27 years, that other support prices were established in line with that rate on the basis of an investment return increasing as maturities increased, and that a drop in the support prices now would mean that the yield of 2-1/2 per cent was to be based on securities having a maturity of, say, 14-19 years. Such a change, Mr. Rouse added, would mean the longer term rate on corporate and other non-Government securities would tend to rise further and, so long as the longest term Governments were supported at a 2-1/2 per cent yield, make it more attractive for insurance companies and other investors to sell long-term Governments for the purpose of placing the funds elsewhere.

During a further discussion Mr. Sproul stated that he felt the committee should review the support prices and put them as low as possible in terms of an intelligent guess of what the market judgment would be on the basis of yields and maturities.

There was also a discussion of the holdings by the System account of partially exempt Treasury bonds and it was the view of the committee that the New York Bank should endeavor to dispose of such securities whenever the market afforded the opportunity.

Chairman McCabe then brought up the subject of the buying rate for Treasury bills, asking what would happen if the market were permitted to find its own level.

Mr. Sproul said that he understood the proposal was to let the bill market find its own level, which would involve a gradual lowering of the prices bid for bills each week until the yield reached a point at which the market would take all the bills offered. The reasons advanced for the proposal, he said, were first, it would begin the long process of freeing the System from support of the Government security market which interferes with maintaining appropriate credit policies; second, it would provide a register of money market forces in that the yield on bills would fluctuate with the state of the money market; and third, it would facilitate further advances in short-term rates as an aid in the program of restraining credit expansion. Mr. Sproul felt these reasons had some merit, if true, but that it was doubtful if they could be accepted while continuing to support the market for one-year certificates of indebtedness at a fixed rate and the market for longer term securities at proportionately higher rates. He felt no useful purpose would be accomplished if the bill rate were freed when the policy was to maintain support of the one-year certificate rate which, in order to maintain orderly market conditions, required that all of these issues be kept in some sort of proper relationship. The whole truth, he said, was that the bill rate at about 1.08 was too low to attract full absorption by the market in relation to a pegged certificate rate and supported prices for other Government securities. He also felt that the argument for freeing bills in order to have a register of money market forces was not important since there were two or three other registers such as the Federal funds market, discounts by the Reserve Banks, and dealings in bankers acceptances.

This matter was discussed at some length during which discussion Mr. Rouse stated that, as requested at the meeting on August 11, 1943, he was preparing a memorandum with respect to the bill rate and hoped to have it ready for distribution to members of the Committee next week. Mr. Rouse stated that he felt the policies which had been followed with respect to bill rates should be continued at least until the current Treasury refunding was completed and that in the meantime a copy of his report could be mailed to all members of the Federal Open Market Committee for consideration at the meeting to be held in October.

Chairman McCabe commented that in view of the strong feelings expressed by Messrs. Sproul and Rouse with respect to the rate at which bills were being bought it would seem inadvisable to make any change at this time in the policy adopted at the meeting of the executive committee of August 11, 1948, pending a further consideration of the matter in the light of the proposed staff report.

It was the consensus that this procedure should be followed.

Question was then raised as to what recommendations should be made to the Treasury with respect to forthcoming financing. Mr. Sproul suggested that plans should be laid to refund rather than retire the $571 million issue of bonds which had been called for December 15 and that any surplus funds which the Treasury received should be used to retire Federal Reserve held debt. The question whether a suggestion should be made with respect to the possibility of a further increase in the certificate rate was also discussed and it was agreed that this matter should not be included in a letter at this time but should be the subject of discussion with the Secretary of the Treasury some time during October when Chairman McCabe and Mr. Sproul could meet with him.

It was agreed unanimously that a letter to Secretary of the Treasury Snyder should be drafted along the lines of Mr. Sproul's suggestions.

Secretary's note: The following letter addressed to Secretary Snyder over Chairman McCabe's signature was approved by Messrs. McCabe and Sproul and mailed under date of September 13, 1948:

"Last week we had a meeting of the Executive Committee of the Federal Open Market Committee to consider open market operations in the light of the then contemplated action by the Board of Governors with respect to reserve requirements. In discussing both of these areas of credit control, of course, we took into account the position of the Treasury during the remainder of the year, and the probable "effect of its operations on the supply of funds available to the banking system.

"I think we are all pretty much in agreement that Treasury operations during the remainder of the year will probably be a neutral factor; that there is no likelihood of the maintenance of that substantial and steady pressure on the market which has been exerted by fiscal and debt management policy during the earlier months of the year. To continue the latter policy in principle, however, and to correlate Treasury policy with the steps which the System is taking in the credit field, would still seem to be essential to attainment of our mutual objective. In the opinion of the committee this suggests at least two things as part of present planning. First, it suggests that the Treasury seek to maintain its balances with the Federal Reserve Banks at about the level expected at the end of the month, i.e., $1,750 million, drawing on its war loan balances, as far as practicable, to meet its continuing need for funds. Second, it suggests that plans be laid now to refund rather than to retire the $571 million issue of bonds which has been called for December 15th. Both of these suggestions have in mind, of course, the importance of avoiding any unnecessary payment of funds into the market at a time when we are trying to keep the reserve position of the banks under pressure and to restrain further expansion of bank credit. If during the remainder of the year, and particularly during the month of October, funds do become available to the Treasury which can be used for the retirement of debt, we strongly urge that these funds be used to retire Treasury bills held by the Federal Reserve Banks.

"The committee wished me to bring these views to your attention and to emphasize its concern with them. Sometime in the near future Mr. Sproul and I, in behalf of the committee, would like to discuss these and other matters with you."

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

Thomas B. McCabe
Chairman.