

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 Tuesday, January 4, 1949, at 10:10 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Szymczak
Mr. Williams
Mr. Evans (alternate for Mr. Eccles)

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager of the System
Open Market Account
Mr. Thurston, Assistant to the Board
of Governors
Mr. Riefler, Assistant to the Chairman,
Board of Governors
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

Upon motion duly made and seconded,
and by unanimous vote, the minutes of the
meeting of the executive committee held
on November 30, 1948, were approved.

Mr. Rouse submitted and commented on the principal portions of a review prepared at the Federal Reserve Bank of New York of the market for United States Government securities for the period November 30 through December 31, 1948. He also submitted a report of open market operations for the System account during the same period and a supplemental report of operations on Monday, January 3, 1949. Copies of the three reports have been placed in the files of the

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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 November 30, 1948, to January 3, 1949, inclusive, were approved, ratified, and confirmed.

Chairman McCabe asked whether the market was still thin for the issues of Government securities which were selling substantially above the support prices.

Mr. Rouse responded that the entire market was thin, that activity consisted largely of switching transactions with substantially no new buyers, and that it was not to be expected that there would be any substantial number of new buyers at existing rates, except to the extent that bank loans declined and banks undertook to replace maturing loans with Government securities. At the present time, he said, nonbank investors, on balance, were selling rather than buying securities.

Chairman McCabe then asked whether Messrs. Sproul and Rouse had any recommendations to make as to action at the present time with respect to a change in the prices at which securities were purchased for System account.

Mr. Rouse stated that he would not favor the action discussed at the last meeting of the executive committee and the full Committee of dropping the support prices to par, that if any action were to be taken it should be a more fundamental adjustment, and

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that in view of recent developments in the economy he would want to study the matter carefully before making a recommendation as to the adjustment that should be made.

Mr. Evans renewed the suggestion which he had made previously that the most efficient method for the Federal Reserve purchase of Government bonds would be to permit the holder of these bonds to go to any bank that is a member of the Federal Reserve System and receive cash and accrued interest for his United States Government bonds. The bank would be reimbursed by the Federal Reserve System for the service rendered. The Federal Reserve Bank would not sell the bonds to the public but would transfer them to the Open Market portfolio, where they would be handled as they are at the present time. This system would not apply to bills and certificates, which would continue to be handled as at present. This program would satisfy everyone about our support of the Government bond market and would prove to be of real value to member banks of the Federal Reserve System.

Mr. Sproul stated that he would prefer to continue to work toward a situation in which the market would not need support rather than merely to seek some improvement in the mechanics of the support policy, as such a course eventually would enable the System to exercise more fully its traditional function of credit regulation without being hampered by the necessity of continuously supporting the Government security market.

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Chairman McCabe stated that this morning he and Mr. Sproul had a very satisfactory conference with the Secretary of the Treasury, at the conclusion of which the Secretary stated that after the President's message on the State of the Union, the President's Economic Report, and the Budget Message had been delivered and it was possible to make some appraisal of the public reaction to the messages, another conference would be held for further discussion of the questions confronting the Federal Open Market Committee and the Treasury with respect to credit and debt management policies.

In response to a request from Chairman McCabe that Mr. Sproul review the discussion with Secretary Snyder, Mr. Sproul made substantially the following statement:

There seemed to be agreement that the program providing for calls on war loan accounts in such amounts and at such times as would maintain pressure on bank reserves had been working very satisfactorily and should be continued, particularly in order that the return flow of currency and gold imports during the early part of the new year would not materially ease the situation.

With respect to retirement of maturing Government debt, we talked with the Secretary in terms of using balances available over the next several weeks to retire maturing certificates held in the System account and some portion of maturing bills. On the question of retiring the entire issue of certificates maturing on February 1, the Secretary thought that, since only \$100 million of this issue was held by the Federal Reserve Banks, the retirement of the entire issue would put funds into the market which would be contrary to the policy of keeping pressure on the market, and that an arrangement for retiring System holdings of maturing certificates and some Treasury bills would be more in line with the general program.

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In connection with the terms of refunding the February 1 certificates, there was agreement that in view of the forthcoming State of the Union Message, the Economic Report, and the Budget Message, and the uncertainty of the public reaction to those messages, the Open Market Committee was not in a position to recommend, and the Treasury was not in a position to act on a recommendation, that the rate on the new issue be increased. The question of an increase in the certificate rate was discussed, however, not in terms of meeting an inflationary situation but of (1) the refunding problem that will confront the Treasury through 1952 and (2) changes to further reduce the wide spread between the short and long-term rates which had been inherited from the period of the depression and large excess reserves and which had interfered with the freedom of action of the Federal Reserve System in discharging its responsibilities in the credit field and the Treasury in its refunding program. It was pointed out that if the Treasury now should undertake to refund maturing issues through the issuance of securities with maturities of more than one year at existing rates it would freeze those rates and would call for continued support of both the long and the short-term rates, which was not compatible with the policy of trying to get the market to a point where it would not need support. That suggested that serious consideration should be given to increases in the certificate rate in connection with the March and April maturities in the interest of getting a more tenable rate structure.

We also suggested that the policy of the Treasury with respect to the refunding of the large volume of savings bonds that will mature over the next few years should be so designed as to encourage holders of maturing securities to reinvest in new savings bonds as well as to encourage new investments in such bonds, and that the Treasury should not be following a policy which forces the redemption of maturing savings bonds while it is urging sales of new bonds. To that end we stated that consideration might be given to some of the steps which the Open Market Committee had suggested in the past which would encourage reinvestment of funds from maturing savings bonds as well as the investment of new funds in savings bonds. The Secretary said that the Treasury was working on this problem and would have something on it at a later date.

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Mr. Thomas stated that the committee appointed to study the advisability of the Treasury refunding some of the long-term securities held by the System account with special short-term issues at a lower interest rate had not completed its study, that the problem depended to a considerable extent on what the policy would be with respect to the conversion of outstanding restricted bonds, and that there were some legal questions which would have to be considered.

Mr. Sproul stated that since sales of long-term bonds to the System account had subsided, and since the Treasury probably would not be willing under present conditions to enter into such a refunding arrangement, the matter was not a pressing one at this time.

It was agreed that the matter should be mentioned at the next meeting of the Federal Open Market Committee for the purpose of ascertaining whether the full Committee wished to have the study completed.

Just before this meeting there were distributed to the members of the committee copies of a memorandum prepared by Messrs. Thomas and Smith under date of January 3, 1949, on the subject of the immediate problems of Treasury refunding and Federal Reserve policies. Mr. Thomas elaborated on the comments contained in the memorandum on the following problems under consideration by the Federal Open Market Committee:

1. The Treasury cash position and debt retirement program with reference to the reserve position of banks during the next few months.
2. Rates and maturities of Treasury refunding

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issues with reference to Federal Reserve policies regarding short-term rates.

3. The longer term problem of bond market support.

The memorandum stated the objectives of policy as follows:

"It may be said that the broad long-time objective of postwar Federal Reserve policy with reference to the public debt has been to work toward attaining a structure of public debt maturities and rates and a market for Government securities which would make constant and vigorous Federal Reserve support unnecessary. It is only in such a situation that the Federal Reserve authorities would again be able to base their open market operations on the need of the economy for credit.

"In the immediate situation any subsidence of inflationary pressures would reduce the magnitude of the System's problem of supporting the Government securities market. But the problem will remain unless there should be substantial reduction in production and employment. In a situation of moderate prosperity even without price inflation, an unsound and unsustainable credit structure could easily be built up if money is too easy to obtain. The existence of a large public debt and continued support of money rates at a structure which was based on depression conditions would be conducive to the excessive use of credit. The System will need to continue its efforts to free itself from the box of supporting the rigid structure of interest rates."

With respect to the three problems listed above, the memorandum suggested:

1. That Federal Reserve holdings of certificates maturing February 1, March 1, and April 1 be retired for cash. System holdings are less than \$100 million each for the February and April issues but amount to about \$750 million of the March 1 issue. In addition to these retirements, about \$600 million of bills could be redeemed for cash in the period. Total retirements would amount to about 1.6 million which would leave the Treasury with a cash balance on April 6 of about 4.4 billion dollars which appears to be needed to meet all requirements for the following six months and should be adequate for that purpose.
2. It would seem advisable for the present to continue to refund maturing securities into new issues with

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maturities of approximately one year until a more manageable rate structure has been attained. In view of the present state of the market and uncertainty as to the business situation and credit demands, it appears that the February maturities should be exchanged for a 1-1/4 per cent one year certificate. If the situation next month justifies a slight further step toward a higher short-term rate consideration could be given to exchanging the March 1 maturity for a 13 month 1-3/8 per cent note and the April 1 maturity could be refunded with a 1-3/8 per cent certificate. These operations, together with the retirement of Federal Reserve holdings, would permit consolidation of these maturities with the April 1950 1-3/8 per cent already outstanding making a total outstanding on that date of about \$7.4 billion. This would be a further step toward the consolidation of outstanding certificates into a few issues.

3. Release of the System from its present boxed position with reference to the Government security market will probably require measures which will reduce the need for support of the long-term bond market. Proposals for types of issues that might be offered for the purpose of converting outstanding debt into obligations that will not require support have been presented in previous memoranda. This is a problem which will need further discussion by the System and the Treasury.

There ensued a discussion of the refunding program that might be followed by the Treasury over the next few years and it was agreed that it should be designed so as to remove as much as possible the need for market support by the Federal Reserve System. There was also a discussion of the terms of refunding the March and April certificate maturities and it was agreed that further consideration should be given to this problem at the next meeting of the executive committee.

Mr. Sproul raised the question whether a letter should be sent to Secretary Snyder giving the present views of the executive committee or whether those views should be communicated orally. It was his thought that the letter or statement would contain (1) a commendatory reference to the present program for handling calls on war loan

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accounts and the desirability of its continuance, (2) a statement to the effect that the System holdings of maturing February certificates should be redeemed for cash and that the committee would favor continued retirement of bills, (3) that, unless there was some change in the situation, the committee would look forward to redeeming the holdings in the System account of March and April certificates and would favor some increase in short-term rates in connection with the refunding of the March certificates, not as an anti-inflationary measure but as a means of moving toward a rate structure which would reduce the need for Federal Reserve support of the market. Mr. Sproul was inclined to the view that the better procedure at this time would be to inform the Secretary orally of the committee's views.

Upon motion duly made and seconded, it was agreed unanimously to authorize Messrs. McCabe and Sproul to present the views of the committee to the Secretary of the Treasury in such manner as they thought best, it being understood that the proposals as stated by Mr. Sproul might be varied in detail to meet changing conditions but that, if it appeared desirable to propose any fundamental change in the actions to be taken, the matter would be presented to the members of the executive committee or, if necessary, to the full Committee.

It was also understood that if the situation should call for the use of trust funds by the Treasury to purchase long-term securities held in the System open market account, that arrangement could be made with the approval of Messrs. McCabe and Sproul as coming within the understanding set forth above.

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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 \$1,000,000,000 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.

Following a discussion of the date of the next meeting of the executive committee, it was agreed unanimously that it should be set tentatively for January 26, 1949, at 10:00 a.m., with the understanding that if the further conferences of Messrs. McCabe and Sproul with the Treasury should make it desirable that a meeting be held before that date such a meeting would be called.

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Thereupon the meeting adjourned.

Chester Morrice
Secretary.

Approved:

Thomas B. Williams
Chairman.