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 Friday, August 19, 1949, at 10:10 a.m.

PRESENT: Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Draper (Alternate for Mr. McCabe)
Mr. Clayton (Alternate for Mr. Vardaman)
Mr. Leach

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Thomas, Economist
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

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee held on August 5, 1949, were approved.

Mr. Sproul submitted a report prepared by the Federal Reserve Bank of New York of open market operations during the period August 5 to 18, 1949, inclusive, and summarized developments in the market since the meeting of the committee on August 5. In connection with the report, Mr. Sproul stated that conditions in the money market during the past two weeks had demonstrated that it was not possible to forecast on an arithmetical basis what the effect of the release of a stated amount of reserves and the reduction of securities in the System account by stated amounts would be. The reason for this, he said, was that some of the released reserves were retained by banks around the country which would carry them, for a time, as excess reserves rather than invest them immediately in Government securities, while the first impact of a sale or redemption of securities is usually felt in the New York market. He also said that during the period since the last meeting of the committee it had been indicated that the differential between bill and certificate yields, as determined by the market, is narrower than had been estimated and that there had been a clear market preference for certificates at times when we were making bills available through redemption of our holdings. It was his view that an arbitrary program of redemption without replacement of the System's holdings of maturing bills is not as satisfactory a way to absorb reserves as sales from day to day from the System account, since the latter method is much more flexible and tends to more stable conditions in the money market. During the recent period, he said, the market had been somewhat confused with recurring periods of ease followed by periods of considerable tightness at a time when it was thought that there would be continued ease while the market was adjusting to the reduction in reserve requirements recently approved by the Board of Governors.

During a discussion of the reasons for the conditions existing in the market during the last two weeks, the likely spread between yields on bills and certificates in the period immediately ahead, and the spread that should be maintained to further the objectives of current System credit policy, Mr. Eccles suggested that, having in mind the desirability of refunding the certificates maturing in October at a 1-1/8 rate, market yields on certificates should be maintained at a level which would pave the way for a refunding at that rate and that the rate on bills should be permitted to move rather freely in relation to the certificate rate. The other members of the committee were in general agreement with this view.

Thereupon, upon motion duly made and seconded and by unanimous vote, the transactions in the System account as reported to the members of the committee for the period August 5 to 18, 1949, inclusive, were approved, ratified, and confirmed.

Mr. Sproul then stated that it appeared to be possible for the immediate future to continue to operate within the ranges, agreed upon at the last meeting of the Federal Open Market Committee, within which bills and certificates would be purchased and sold for the System account, with the understanding that (1) in the currently weekly bill offering the Federal Reserve Bank of New York would put in a "backstop" bid of 1.06 in an amount equal to the first maturing bills (which might result in the System getting some of the new bills), and (2) there would be informal consultation between the members of the committee on the procedure to be followed with respect to bids to be placed in connection with future weekly offerings.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the procedure outlined by Mr. Sproul was approved with the further understanding that yields on certificates should be maintained at a level which would make possible the refunding of October certificates at 1-1/8 per cent.

There was unanimous agreement that the direction issued to the Federal Reserve Bank of New York at the last meeting of the committee should be renewed in the same form as the earlier direction.

> 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 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 changing economic conditions and the general credit situation of the country, for the practical administration of the account, for the maintenance of 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 $2,000,000,000 exclusive of special short-term certificates of indebtedness purchased for the temporary accomodation 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 $1,000,000,000.

In taking this action it was understood that the limitations contained in the direction include commitments for purchases and sales of securities for the System account.

Consideration was then given to the recommendations with respect to the September and October refunding to be made to the Secretary of the Treasury by Mr. Sproul on behalf of the executive committee when he met with the Secretary this afternoon. The matter was discussed in the light of Treasury cash requirements during the remainder of the current fiscal year and possible alternative forms which the refunding might take as set forth in a memorandum dated August 18, 1949, copies of which were handed to the members of the committee before this meeting.

Mr. Clayton questioned the desirability of refunding the $1.3 billion of September 15 bonds with a four- or five-year note unless additional money was to be raised by the Treasury at the same time, his feeling being that a note in such a small amount would make the issue so attractive that it would sell out of line with other issues in the market.

Mr. Eccles suggested that the September financing would be the first since the announcement of the Federal Open Market Committee on June 28, 1949, and the reductions in reserve requirements which are now becoming effective, that if the September maturities were refunded with a 1-1/8 per cent certificate it would be regarded as establishing a new pattern of refunding at that low rate, and that while maturing certificate issues should be refunded with new certificates rather than longer maturities, that course should not be followed in connection with maturing bonds. It was his view that the refunding of the September two per cent bonds into a four- or five-year note would be an indication that the banks might expect somewhat similar issues in connection with future bonds refundings, that this would tend to maintain market yields on bank eligible bonds, and that, while the step might be deferred until the December bond refundings, he felt it should be taken now as an indication that the Treasury refunding policies were in line with the recently announced policies of the System. This would not mean, he said, that all future bond refundings would be with four- or five-year obligations, but rather that the market might expect something more than a one-year certificate.

Mr. Leach raised the question whether it might be desirable to combine the September and October financing and offer the holders of maturing bonds and certificates the option of a 1-1/8 per cent certificate or a 1-3/8 per cent note. It was felt, however, that this alternative would be unacceptable to the Treasury as it would not be willing to refund certificates with a security carrying a higher rate.

In connection with a further discussion of the question raised by Mr. Clayton whether the Treasury should undertake to raise new money in connection with the September refunding, it was suggested that the new securities might involve a considerable amount of free riding and heavy oversubscriptions and that, while that might become necessary in the event of large Treasury deficits, it should be avoided as long as possible.

Mr. Sproul concurred in the views expressed by Mr. Eccles, stating that it was not necessary for the Treasury to raise any new money through intermediate financing at this time, that 1-3/8 per cent note would fit into the maturity schedule very well, would relieve pressure on the intermediate market which would result from the replacement of 2 per cent bonds with a 1-1/8 per cent certificate, and would be in harmony with the current System credit policies and sound debt management policies. He was not concerned about the small amount of the issue as it was enough, in his opinion, to provide the investment which a majority of the holders of the maturing issue would like to have. He did not think that the question of bank liquidity was an important point since the banks had adequate liquidity and would be just as anxious to meet the needs of their customers if they were given a 1-3/8 per cent note as they would be if the maturing bonds were refunded with a 1-1/8 per cent certificate.

There was a further discussion of whether, if the September refunding took the form of a four- or five-year note, there would be a commitment to refund future maturing bond issues with issues of not to exceed five years. It was agreed that that would not be the case, but rather that future bond maturities might be refunded with notes and bonds and not only with certificates.

> At the conclusion of the discussion, upon motion duly made and seconded, and by unanimous vote, it was understood that Mr. Sproul would recommend to the Treasury that the $1.3 billion of bonds maturing on September 15 be refunded into a four- or five-year note at about 1-3/8 per cent, and that the $6.5 billion of certificates maturing on October 1 be refunded with a 1-1/8 per cent certificate.

At the meeting of the Federal Open Market Committee on August 5, 1949, the executive committee was requested in discussions with the Treasury to recommend, for the reasons stated at the time, that the rates on savings notes be not changed for the time being. In a discussion of this matter, Mr. Sproul stated that, if existing rates on bills and certificates continued for some time, it might be necessary to consider a change in the rate on these notes.

> At the conclusion of the discussion, it was understood that in his conversation with the Secretary of the Treasury this afternoon, Mr. Sproul would make the recommendation requested by the Federal Open Market Committee.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

Allan Sproul
Vice Chairman.