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 Tuesday, March 13, 1951, at 9:15 a.m.

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

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman, Board of Governors
Mr. Youngdahl, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Leach, Economist, Division of Research and Statistics, Board of Governors

This meeting was called after long informal discussions yesterday by Messrs. McCabe, Riefler, Thomas, Youngdahl, and Leach with Messrs. Martin, Bartelt, and Haas of the Treasury (part of which were participated in by Messrs. Eccles and Szymczak), and telephone conversations with Mr. Sproul in New York and with Mr. Williams in Philadelphia. These discussions were carried on in the light of the weakness in the market for the long-term restricted 2-1/2 per cent Treasury bonds of 1967-72 for which the Secretary of the Treasury announced on March 4, 1951, an exchange offering of long-term nonmarketable Treasury bonds to bear interest at the rate of 2-3/4 per cent. The purpose of this meeting was to determine the instructions that should be issued by the executive committee to the

Federal Reserve Bank of New York covering operations of the System open market account from this point forward.

Chairman McCabe said there was complete unanimity on the part of the members of the executive committee and the representatives of the Treasury that the market should be stabilized at some point until the conversion operation was completed, and that the point at which the long restricted bonds would be held had been fully discussed. When the statement was made, Chairman McCabe said, that the matter would have to be considered by the executive committee of the Federal Open Market Committee, Mr. Martin said that he would like to hear the individual expressions of the members of the executive committee and he was invited to attend this meeting and would come over later in the morning.

Chairman McCabe also said that late yesterday afternoon in a telephone conversation with Mr. Sproul three possible alternative procedures were suggested: (a) maintain par on the restricted bonds of 1967-72 and possibly consider a minimum support price of around 97-3/4 for other restricted bonds, (b) maintain a support level of around 99-1/4 to 99-1/2 for all restricted bonds, (c) let the market for the long-term restricted bonds operate freely except that it would not be permitted to go below 98-1/4, which would put the conversion offering in line with existing shorter-term interest rates. Chairman McCabe went on to say that, after discussing the matter with his staff, Mr. Sproul called back and said that his thinking was that operations should be directed, for the time being, to maintain par on the 1967-72s, and that consideration should be given to a support price of 99-3/4 for the remaining restricted bonds, but that he would like to think the matter over before reaching a definite conclusion this morning as to what the procedure should be.

Chairman McCabe also said that Mr. Thomas, Economist, was in New York this morning, and that he would be able to give Mr. Sproul a full report of the discussions that took place in the Board's offices yesterday.

In response to a question from Chairman McCabe, Mr. Riefler stated that he had called Mr. Martin at the Treasury this morning to tell him that the executive committee planned to hold a separate meeting this morning and to suggest that Messrs. Martin, Bartelt, and Haas delay coming over until 9:30 a.m., and that during their conversation Mr. Martin commented that he had been talking with a number of his friends in New York since yesterday afternoon who had expressed the view that persons desiring a 3 per cent interest security were determined to break the present market for restricted issues, and that he (Mr. Martin) felt if the conversion offering was to be given a reasonable chance of success it would be necessary for the System open market account to enter the market at this time and stabilize it at whatever level the committee decided should be maintained throughout the period of the offering.

Mr. Williams stated that the entire market was familiar with the concern that had been felt by the Open Market Committee with respect to the long-term restricted bonds, that it was fully aware of the abortive attempt of the Committee to support the market at 22/32 above par last week, that if the committee were to set another point for support, whether it be par or near par, it would be regarded only as a change in the level that had been abandoned only last week. In these circumstances he felt it was important that the committee decide at what point below which the long-term restricted issues would not be permitted to decline and let the market go to that point if it chose to do so.

Mr. Szymczak stated that if the securities were permitted to decline below par there was a possibility that a great avalanche of selling would develop. For that reason, he said, he would have preferred to have held the price at par or slightly above, but that now it was a question of determining whether to hold at par or permit the price to go down but stand firmly at some price and take all bonds that might be sold at that price.

Mr. Eccles referred to the background of discussions leading up to the agreement with the Treasury on March 3, stating that there was now an opportunity to permit the prices of the longer-term restricted bonds to be established in the market directly in relation to a free market in which the short rate was acting very well. He suggested that the market for the long-term bonds be permitted to adjust as far as it would, that on the basis of present short-term interest rates this would be around 98-1/4 for the longest-term restricted bonds, and that if they declined to that price it would make them more attractive for persons who wished to purchase them for conversion into the 2-3/4 nonmarketable bonds as well as for persons who wished to hold a marketable security. Mr. Eccles also stated that it would be much better to have this decline take place at once rather than to maintain a price during the conversion period and permit it to decline afterwards, that the System had a responsibility for stabilizing the market during the conversion period, and that the quicker the restricted bonds were permitted to reach a level at which the market would support them the better.

At this point Chairman McCabe called Mr. Sproul on the telephone and following a conversation stated that Mr. Sproul said that he had revised his thinking over night and was now of the opinion that in view of the volume of securities that might have to be taken, he would recommend that the New York Bank place its buying orders for the restricted bonds at 99-1/2 since he felt that would be about the proper level in the market. He added, however, that this suggestion was made primarily for the purpose of maintaining an orderly market in accordance with the objectives of open market policy, and that he would wish to feel free to allow the market to decline further if developments indicated that to be desirable.

Messrs. Eccles and Szymczak also talked by telephone with Mr. Sproul expressing views similar to those previously expressed by them during this meeting. Chairman McCabe also reported that during the conversation Mr. Sproul stated that since the market was about to open he felt that he should put in orders to take securities on the same basis as was done yesterday pending a decision by the committee as to the procedure to be followed. After checking with the members of the committee in the room, Chairman McCabe told Mr. Sproul over the telephone that all of them agreed that pending further instructions from the executive committee later this morning, the New York Bank should put in orders for restricted issues on the same basis as yesterday, i.e., at par with limited amounts to be taken from any one customer.

Chairman McCabe then asked the members of the committee for comments on the proposal made by Mr. Sproul over the telephone, i.e., that the New York Bank try the market out on the basis of holding the restricted issues at 99-1/2 with the understanding, however, that consideration would be given to allowing these issues to go below that level should market developments warrant.

Mr. Szymczak reiterated the view that he did not like any quotation below par on the two restricted Treasury bonds convertible into the new offering of securities, but that he would go along with Mr. Sproul's suggestion if that meant firm support by the Open Market Committee.

Mr. Eccles stated that he had no objection to the figure of 99-1/2 for the time being, but that he felt the market should be permitted to get down, as quickly as possible, to whatever level it was going to go, and that for the conversion period the committee should assume the responsibility for taking any of the two restricted issues of securities that were offered at 98-1/4.

Mr. Williams expressed the view that the committee should fight a rear-guard action letting the market operate with the idea of a final support level of 98-1/4 for the two restricted issues until the conversion was completed.

Chairman McCabe stated that Mr. Sproul felt that to let the bonds go to 98-1/4 would be an extreme movement, to which Mr. Eccles responded that if it were reached in an orderly market there would be no objection to it.

Chairman McCabe suggested that Messrs. Martin, Bartelt, and Haas be invited to join the meeting at this point and that they be informed of Mr. Sproul's proposal.

At this point Messrs. Martin, Bartelt, and Haas entered the meeting at 10:14 a.m.

Chairman McCabe reviewed briefly the previous discussion, stating that Mr. Sproul had started the market this morning on the same basis as yesterday. He went on to say that Mr. Sproul recommended that the committee maintain an orderly market in restricted Treasury bonds down to a level of 99-1/2, that he had no idea what the market would do, but that he would let it operate in as orderly a manner as possible in the hope that it would stabilize before getting down to 99-1/2. If the market did not stabilize before reaching that point, the Chairman said, Mr. Sproul's suggestion contemplated that the System open market account would take the residual amounts of restricted bonds offered at that figure. Chairman

McCabe added that Mr. Sproul had expressed the hope that 99-1/2 would be the stopping point until the conversion offering was over, but he would not want to be definitely committed to that figure since it would depend on market developments.

Mr. Martin stated that his general reaction was that Mr. Sproul's suggestion was all right except that he thought the 99-1/2 figure or whatever figure the committee decided on would have to be an absolute stopping point during the conversion operation if the conversion offering was to be a success. He added that it was extremely difficult to judge the market but that in talking with various persons he had gained the general impression that they felt the market was already out of hand, that there was a great deal of criticism of the handling of it which would occur no matter who was operating it, but that he wanted to reiterate a statement that he had made yesterday, namely, that some point would be reached at which the committee would have to make a stand during the period of the Treasury's conversion offering. Mr. Martin went on to say that if the market were permitted to go down to 99-1/2 and held for a time at that point a subsequent decision to allow it to decline further would endanger the success of the conversion offering. He also said that he did not know at what point the market should be stabilized, that that was a decision that the committee should make, that it was apparent that the figure of par and 22/32 which was tried last week was not the right one, that the market was now getting to a new lower level, and that he was convinced that much of the uncertainty and weakness in the market was the result of a psychological reaction generated by various forces outside the market itself.

Mr. Szymczak then asked Mr. Martin whether, if it were decided that the market should be supported at 99-1/2, the Treasury would be in a position to use trust funds for that purpose (and support at 99-1/2 together with Federal Reserve funds), and whether it would consider advancing from March 26 the day for opening the books on the new 2-3/4 per cent issue so as to shorten the period in which the market would have to be supported. It was his expressed feeling that more bonds would be offered to the Federal Reserve at 99-1/2 than at 100.

Mr. Martin and Mr. Bartelt stated that it would not be practicable to advance the day for offering, and Mr. Martin did not think the Treasury would wish to put up funds for supporting the market. In a discussion of the first point it was agreed that the Treasury should not be asked to provide funds for support of the market, and that it was the responsibility of the Federal Open Market Committee to make the conversion offering a success.

Mr. Eccles stated that he did not agree that the market was out of hand, that he would rather see the conversion issue over-priced than under-priced, and that he would prefer to make any necessary adjustments in the prices of the restricted bonds now rather than after the conversion had been consummated as that would give the conversion operation the greatest chance of success.

Mr. Martin stated that he would agree completely with the analysis made by Mr. Eccles except perhaps for the unknown factor of public psychology growing out of the lack of confidence which had resulted from the various tangible and intangible factors which he mentioned. He added that some groups which had indicated a week ago that the conversion offering was an attractive one during the last few days had begun to question whether that was the case.

Mr. Williams stated that comments in the Third Federal Reserve District indicated that there would be a good demand for the conversion issue, that he agreed in general with the suggestions of Mr. Eccles, and that he felt that the market quickly would reach a point where those interested in securities would recognize that the market would be maintained.

At this point, Chairman McCabe called Messrs. Sproul and Rouse on the telephone, who stated that there was considerable shifting from the 1967-72 restricted bonds to other restricted issues and that, if the committee was going to give the New York Bank a direction along the lines discussed, it should do so as soon as possible.

Chairman McCabe then said that the question was whether an effort should be made to stabilize the market at levels down to 99-1/2 for the restricted issues with the understanding that the price might be lowered later after consultation with the Treasury, or whether a lower price should be determined which would be held during the conversion period.

Mr. Martin, in response to a question from the Chairman, stated that he felt the determination of the level at which the System would stand was the responsibility of the committee, but that he did feel that the downward price adjustment should be made as soon as possible. He went on to say that his thinking was not far from that of Mr. Eccles, that the important thing was to get the adjustment over with, that the offering of the nonmarketable 2-3/4 per cent issue generally had been considered an attractive offering, but that if uncertainty of the type that had existed for the past few days continued for long, it would seriously handicap the chances for success in the conversion.

Mr. Eccles commented that it would be preferable to make the adjustment over a couple of days, but that the important thing was to let the market know that the System was assuming responsibility for the offering and to give the necessary instructions to the New York Bank as to when it was to make a stand rather than to continue feeling the market out. Mr. Eccles also suggested that the New York Bank be given some leeway in moving the market down to whatever level was decided on so long as the adjustment was made within the next day or two.

Mr. Martin stated that he felt it was preferable to reach the final level today, that it would have been better if it had been reached yesterday, that if it were not reached until tomorrow or Thursday there would be speculation over the week-end as to whether there might be further probing of the market, and that if this went on for several days it would seriously interfere with the conversion offering.

Mr. Williams stated that he thought the figure of 98-1/4 would stop most of the speculative selling of securities, that technically the market would recognize 98-1/4 as a level related to the short-term interest rate, and that the instructions to the New York Bank should permit them to reach that level in such a way as to minimize the volume of funds put into the market.

Mr. Szymczak stated that he would have preferred a figure of 100 or 100-2/32, that 98-1/4 was technically the best figure, but that in all the practical and psychological circumstances he would prefer now to stand at 99-1/2 at which point the System account probably would have to take fewer securities than if the price were lowered to 98-1/4 -- but more than at 100 or 100-2/32.

Chairman McCabe again called Mr. Sproul on the telephone and stated that the view of the members of the committee at the meeting was that it was important to determine the final point at which a stand should be made for the period of the conversion, that it was the consensus that that figure should be reached today or tomorrow, and that the committee would like to have Mr. Sproul's latest views on the figure to be agreed upon in the light of the views expressed that a figure of 98-1/4 would be related to the short-term rate. Chairman McCabe reported from time to time during his conversation with Mr. Sproul, stating that the latter felt that a figure of 99--99-1/4 for all restricted bonds was one which the committee could stand on, that he would like to see operations carried on today with a view to finding out what would happen at a level of 99-1/2 or above, but that he would be prepared to let the market go quickly to 99 at which the restricted issues would be supported during the conversion.

Mr. Martin talked with Mr. Sproul by telephone, stating that he felt it important to avoid having any figure become just a peg in the market, that this should be a stabilizing operation, that there should be an aggressive interest that would mark the market up occasionally, and that he did not know what would be accomplished if the result was simply to establish another peg. In other words, he would not only hold the market at some level; he would also give some leadership to it.

In a further conversation between Messrs. McCabe and Sproul, there was a discussion of calling in the dealers and explaining to them in general the procedure contemplated and offering to take off their hands at present bid prices any taxable securities that they might hold having maturities of more than five years, including bank eligibles as well as restricted issues. It was agreed that this should be done and that the manner in which it was carried out should be left to the Federal Reserve Bank of New York as agent for the System account. Mr. Sproul was informed of this agreement.

Following further discussion, Mr. Eccles moved that, operating under the general direction issued by the executive committee to the Federal Reserve Bank of New York on March 8, 1951, and in the light of the discussion at this meeting, the New York Bank be instructed to follow a procedure, until otherwise instructed, under which the restricted issues would be permitted to decline immediately in an orderly market to 98-1/4 below which they would not be allowed to fall during the period of the conversion, it being understood that if necessary the market would be supported vigorously at that point and that if, as suggested by Mr. Rouse over the telephone, the New York Bank thought it desirable on the basis of market reactions to support the shorter restricted issues, at least temporarily, at a slightly higher price than the 67-72s, it would be at liberty to do so.

In connection with his motion, Mr. Eccles made the following statement:

During the period of conversion of the Treasury bonds of June and December 1967-72, the Federal Reserve will need to be prepared to prevent prices of long-term bonds from going below some selected level. At the same time, however, the Federal Reserve should hold to a minimum the creation of Federal Reserve credit through this operation. The price level on the restricted bonds which the Federal Reserve elects to defend, therefore, should be one that will require a minimum outlay of Federal Reserve credit.

Under the circumstances prevailing in the investment and money market and with the type of bond offered for the conversion, a price of between 98 and 98-1/4 for the longest two restricted bonds would be the strongest point of support and would be preferable to support points of par, of 99-3/4, or of 99 for the following reasons:

1. At a price of 98-1/4 on the 1967-72 restricted bonds there would tend to be an automatic market support based on the prevailing short-term market. The conversion bond of 1975-80 is exchangeable into a 5-year, 1-1/2 per cent marketable note, and thus the minimum value of the bond is anchored to the present value of the 5 year note. In the present market this is approximately 98 to 98-1/4. At this point dealers and others would buy the bond in large volume and hold it for appreciation and resale during the conversion period since they could protect themselves against loss by hedging in the 5-year maturity area. Federal Reserve support at this level might

not be needed at all or might only be needed in small volume. The large volume of funds seeking investment in the short-term market and easy money conditions expected over the next several weeks should prevent any undue pressure on the 5-year rate.

2. As an underwriter of the conversion operation, the Federal Reserve should set its support point at a level on the low side rather than on the high side of the point where the market might reasonably be expected to balance off. At the lower support point there would be less selling by present holders of the June and December 1967-72 bonds because of the loss involved. There would also be more buying by investors because the yield on the conversion bond would be more attractive.

Mr. Eccles' motion was put by the Chair and lost, Mr. Eccles voting "aye", and Messrs. McCabe, Szymczak, and Williams voting "no".

Mr. Williams then moved approval of the instruction to the Federal Reserve Bank of New York proposed by Mr. Eccles except that the price below which the restricted issues would not be permitted to decline be fixed at 99.

This motion was put by the Chair and carried unanimously, and Chairman McCabe advised Mr. Sproul by telephone accordingly.

In voting to approve Mr. Williams' motion, Mr. Szymczak made a statement substantially as follows:

The question before the Committee in accordance with the agreement with the Treasury is how to make the conversion a success and at the same time supply the least amount of reserve funds to the market. Within the past few days there has been great uncertainty in the market, part of which is psychological, and there has been an increasing tendency to sell securities in anticipation of the possibility of lower prices. From a purely technical standpoint, the figure of 98-1/4 for the longest restricted bonds is related to the present short-term rate, but a drop from 100 to 98-1/4 might increase the uncertainty to the point of causing disorderly conditions in the market, with the result that the System would have to buy large amounts of the bonds and thus add to reserve funds. I would have preferred that the longest restricted bonds be maintained at or slightly above par, because a decline to any support level below that, such as 99-3/4 or 99-1/2, might give the impression that support would be dropped further and thus cause a disorderly situation and result in very large sales of securities in the market, most of which would have to be bought by the System with the accompanying increase in bank reserves. It now appears that prices will go down somewhat, and having in mind the objective of the Committee's policy to avoid putting reserve funds into the market, I believe it would be more in line with this policy not to permit the longest restricted issues to decline below 99.

Thereupon the meeting adjourned.

Secretary