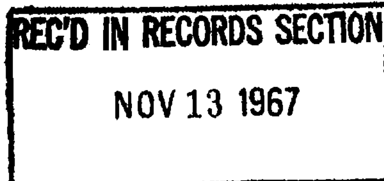
Authorized for public release by the FOMC Secretariat on 5/27/2020

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551



November 9, 1967.

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Holland

In preliminary response to the request at the last meeting of the Committee, there is attached a staff memorandum dated November 9, 1967 concerning "even keel" policy. This memorandum is supported by an attached set of three background papers authored by members of the staffs at the Board and the Federal Reserve Bank of New York, entitled respectively, "Interpretation of 'Even Keel' Policy," "The Behavior of Interest Rates, Bank Credit, and Marginal Reserve Measures During 'Even Keel': 1965 - Mid-1967," and "Brief History of System Direct Support of Treasury Financings."

Robert C. Holland, Secretary,
Federal Open Market Committee.

Attachments

Authorized for public release by the FOMC Secretariat on 5/27/2020

REC'D IN RECORDS SECTION
NOV 13 1967

November 9, 1967

CONFIDENTIAL (FR)

TO: Federal Open Market Committee SUBJECT: "Even Keel" Policy

FROM: The Staff

At the last meeting of the Federal Open Market Committee, President Bopp suggested that this would be an appropriate time for the Committee to take a new look at "even keel" policy. He urged that the Committee staff prepare a statement that would include the rationale of "even keel," the costs of moving from it, and possibilities of modifying it without jeopardizing the success of Treasury financing operations. It is clear that the assignment goes beyond the clarification of the rationale and objectives of "even keel" policy from the standpoint of System operations and the costs of moving from or modifying it. It also raises fundamental questions of the relationship between the Federal Reserve and the Treasury with respect to debt management--a relationship that has been subjected to extensive study within the System on past occasions--and about the relationships of both the Treasury and Federal Reserve with the market.

In response to President Bopp's suggestion, the Committee staff has undertaken a series of studies of the various aspects of "even keel" policy, and these will be made available to the Committee as they are completed. Three tentative and preliminary staff papers are being transmitted to the Committee at this time as background for a discussion of "even keel" policy.

Authorized for public release by the FOMC Secretariat on 5/27/2020

These include a brief memorandum on the interpretation of "even keel" policy; a paper describing the behavior of interest rates, bank credit and marginal reserve measures during "even keel" periods; and a very brief historical review of System policy with respect to direct support of Treasury financing operations.

1. The Interpretation of "Even Keel" Policy

Basically, as the attached memorandum notes, an "even keel" policy means that the System tries to avoid taking any action that would in itself tend to jeopardize a Treasury financing operation. It presupposes that, in its pricing and choice of maturities, the Treasury will meet the test of the market. It does not require that the Federal Reserve maintain any particular pattern of market rates or so manipulate the structure of rates that the Treasury financing is ensured of success, nor does the Federal Reserve have an obligation to support the new issues offered by the Treasury. The System, in effect, agrees to abstain from any overt policy move, and to conduct operations in the open market in such a way as to avoid any suggestion that policy has been changed. Should external forces cause a change in market expectations and rate levels, this change may be resisted by the System through a somewhat more liberal supply of reserves to the banking system, with an attendant reduction in the supply of Treasury bills in

Authorized for public release by the FOMC Secretariat on 5/27/2020

the market and/or more ready availability of financing, but nothing more. Resistance has not in recent years involved direct support of new Treasury issues by the System except in disorderly market conditions.

As the memorandum points out, the time span for "even keel" policy cannot be clearly delineated in advance, and is less important in the case of Treasury bill financings than in the case of refundings or cash offerings of coupon issues. Crucial time periods include the days before an issue must be priced, the period when the subscription books are open, and the period during which underwriters of the Treasury are distributing the securities they have taken on. "Even keel" thus requires a flexible approach, with both timing of the "even keel" period and the amount of leeway afforded the System dependent on the circumstances that accompany each individual Treasury financing operation.

2. The Behavior of Interest Rates, Bank Credit, and Marginal Reserve Measures during "Even Keel" Periods

The second attached memorandum on the behavior of various money market indicators during "even keel" periods should dispel any notion that "even keel" involves any pegging of either Treasury bill or longer term interest rates. The main thrust of operations to maintain "even keel" is reflected in a relative stability of the Federal funds rate, dealer lending rates, and marginal reserve measures--although the

Authorized for public release by the FOMC Secretariat on 5/27/2020

general market atmosphere may sometimes condition the form and magnitude of System operations to affect reserves. It must be remembered, however, that a major portion of the period covered by the memorandum was strongly affected by expectations of higher interest rates based on an exuberant economic outlook, disappointment over the lack of fiscal policy action, and a stringent monetary policy. Treasury financing, and the "even keel" policy associated with it, thus faced throughout most of 1966 an extremely difficult period. As the memorandum suggests, interest rates and other money market measures are *ex post* indicators, and as such they cannot convey a picture of the special operations that the Treasury occasionally had to undertake to support its offerings nor the numerous adaptations in operations that the Desk had to make in implementing an "even keel" policy.

3. Brief History of System Direct Support of Treasury Financings

The third memorandum reviews very briefly the history of direct System support of Treasury financing operations through the successive stages of the Treasury-Federal Reserve accord of 1951, the Ad-hoc Subcommittee report of 1952, the operating policies in effect from 1953 to 1960, and subsequent developments.

Despite the absence of any operating policies that specifically forbid operations in issues involved in Treasury financing operations, the Manager currently understands the intention of the Committee to be (1) to avoid creating artificial

Authorized for public release by the FOMC Secretariat on 5/27/2020

market conditions at times of new security offerings by the Treasury; (2) to avoid operations in issues involved in Treasury financing except in exceptional circumstances; (3) in the event that such operations should be required by exceptional circumstances, to avoid any suggestion of a pegging of Government securities prices. Through evolution, including the telephone meeting of November 4, 1965 referred to in the attached memorandum, the Manager understands that he has full authority to intervene in the market to deal with the emergence of disorderly markets (rather than to correct disorderly conditions after they have emerged). In practice he would bring plans for any such intervention before the Committee for discussion unless an emergency situation made it impossible to do so. In situations such as the present, when financial markets are greatly concerned if not demoralized by financing pressures from both the Government and private sectors in an inflationary environment, it is recognized that a difficult distinction has to be made between a disorderly market and a market that is adjusting rapidly to changing conditions and expectations.

4. Modification of "Even Keel" Policy

The restrictions imposed by conventional "even keel" considerations have on numerous occasions curtailed the freedom of the Federal Reserve to implement desired changes in monetary policy. On several occasions in recent years, when inflationary

Authorized for public release by the FOMC Secretariat on 5/27/2020

pressures were strong and the needs for tightened monetary policy seemed imperative, very modest shadings in the implementation of "even keel" have been introduced in order to achieve timelier monetary policy changes. Nonetheless, on the basis of its experience and study to date, the staff believes that any more significant deviation from the policy of "even keel" as it has evolved since the Treasury-Reserve accord risks the disruption of basic relationships with both the Treasury and the market that could jeopardize, rather than enhance, the possibilities of greater freedom for monetary policy.

There can be little doubt that any significant System policy move toward restraint in the midst of an "even keel" period would adversely affect the present mechanism for Treasury financing operations, given both the market's and the Treasury's understanding of "even keel" as it has been practiced.

In departing from "even keel," the practical problems that the System would face would depend, in part, on the phase of the "even keel" period in which the System policy move took place or became recognized by the market. If the move were made before the books closed, the System would most likely have to make up any shortfall in subscription by direct lending to the Treasury. If the move took place after the books had been closed and before distribution had proceeded far, the System would be faced with the problem of bailing out the underwriters and/or facing the charge that it had imposed losses on unsuspecting

Authorized for public release by the FOMC Secretariat on 5/27/2020

investors and underwriters. The longer run issues involve the danger of undue reliance of the Treasury on direct central bank credit, the forced takeover by the Federal Reserve of the market's function as underwriter of the Treasury, and a subsequent loss of control over the reserve base.

The foregoing considerations do not imply that the System is restricted by a rigid set of prohibitions or requirements at all times during Treasury financings. As the background memoranda indicate, the scope and requirements of "even keel" policy can vary quite widely depending on the circumstances that prevail at any given time. Nor does it mean that the urgency for a change in monetary policy may never override the considerable risks that a departure from "even keel" may entail. It does suggest, however, that any significant departure from traditional "even keel" policies should be made with the greatest caution and with full realization of the short- and long-run risks that are involved.

With this in mind the Committee staff will continue to investigate the possibilities and costs of modifications of "even keel" policy and will transmit its findings to the Committee. It will of course welcome any ideas or suggestions from any member of the Committee, from Presidents not currently serving on the Committee, or from their staffs.

Attachments

Authorized for public release by the FOMC Secretariat on 5/27/2020

FILED IN RECORDS SECTION
NOV 13 1967

November 9, 1967.

CONFIDENTIAL (FR)

TO: FOMC Staff

FROM: S. S. Marsh, Jr., Federal Reserve Bank of New York

SUBJECT: Interpretation of "Even Keel" Policy.

This memorandum is addressed to a description of the so-called "even keel" policy adopted by the Federal Open Market Committee in periods of Treasury financings, as that policy has been understood by the Manager of the System Open Market Account and applied at the Trading Desk.

Objectives

Basically the objective of an "even keel" policy is for the System to avoid any action which would tend to jeopardize the Treasury's financing operations. The time span of "even keel" is not necessarily constant, but in general it can be divided into different phases which may be adversely affected by market developments, which of course can be influenced by System activities. First there is the phase when the market expects the Treasury to come to market, the Treasury is canvassing the possibilities and finally announces the terms of the financing, type of issue, amount, rate, and maturity. During this period a significant change in market conditions complicates the Treasury's efforts to fix the terms of an offering which will fill its needs and suit the market. The second phase is between the announcement and the closing of the subscription books when the market is making up its mind about the offering and entering subscriptions. In an

Authorized for public release by the FOMC Secretariat on 5/27/2020

exchange refunding, the dealers will be buying "rights" from holders who do not want to exchange. Adverse market developments will influence dealers as to the amounts and prices of "rights" they are willing to take, and the holders of "rights" as to whether they will enter subscriptions. Similar decisions as to subscriptions are being made in the case of cash financings. This is the most vulnerable period for the Treasury, as the amount of subscriptions determines whether the offering will be a success and whether the amount of "attrition" on an exchange, or funds to be paid out by the Treasury in redemption of unexchanged rights, is excessive. The last phase, after the books close, is important to the general welfare of the market and to the success of future Treasury financings, as subscribers to a new issue, including dealers, will feel badly let down should market developments seriously undermine the value of their purchases too soon after they have made their commitments; they would be discouraged from future subscriptions and more inclined to sell out than to hold their new securities. Over the longer run "even keel" has thus been viewed as necessary to encourage the needed underwriting of the Treasury by banks and Government securities dealers.

General Principles

Depending on the circumstances, "even keel" policy may have relevance to virtually all aspects of open market operations, from overt changes in monetary policy all the way down to the

Authorized for public release by the FOMC Secretariat on 5/27/2020

actual carrying out of routine purchases or sales of securities in the market. It can cover periods from well before the actual offering of a new Treasury issue to well after the payment for and delivery of the new issue. Decisions as to what the System should or should not do throughout the wide range of choices must obviously depend on the particular circumstances prevailing at the time and, therefore, upon the judgment of those responsible for open market operations, the Federal Open Market Committee and the Manager of the System Account. Thus it has not been possible to set down a specific set of rules for the guidance of open market operations under an "even keel" policy. The following general principles, however, are ordinarily deemed to be applicable during such periods.

Under most circumstances "even keel" would mean no change in the discount rate and no change in reserve requirements, since these moves are ordinarily associated with policy shifts. With respect to open market operations the key principle is not to give the appearance of any change in System policy during Treasury financing operations. This means that the Federal Open Market Committee should not adopt either a more or less restrictive policy and that actual operations should not be conducted in such a way as to suggest to the market that there has been a change in policy. Any overt or semi-overt action of this kind would immediately raise questions as to the pricing and success of the new Treasury issue involved. If an

Authorized for public release by the FOMC Secretariat on 5/27/2020

offering has not been priced, the Treasury's job of pricing will be complicated; if the offering has already been priced its success at that price could be jeopardized by a shift to a more restrictive policy as the offering would be unattractive; conversely, a less restrictive posture could cause speculative excesses as the offering would appear underpriced.

Beyond these self-evident moves, the range of acceptable action becomes much more difficult to define and more dependent upon the market situation prevailing at the time. The time span over which "even keel" is to be maintained will also vary with market circumstances. It is fair to say, however, that the strictures of "even keel" will be much less demanding when the money and securities markets are not under the pressure of either very easy or very tight money conditions, which would tend to sharpen sensitivities to a prospective policy move in either direction. Likewise, if very strong expectations are affecting market attitudes, sensitivity to System moves will be especially strong. Present market conditions are an excellent case in point, as strong expectations have been generated that System policy will have to be tightened in the absence of prompt action to increase taxes, and the market is watching closely for any sign of such a shift.

The sensitivity of market expectations to any System action is also affected by likely future Treasury operations.

Authorized for public release by the FOMC Secretariat on 5/27/2020

For example, if the Treasury faces sizable demands for new cash beyond the current financing operation, the market will be much more sensitive to any System policy change suggesting a future reduction in credit availability to meet the Treasury's needs. When Treasury financing needs are less extreme and market attitudes are more neutral, sensitivity will be less and open market policy will have more leeway.

From an operational viewpoint, open market operations under an "even keel" policy are generally conducted so as to maintain a steady tone in the money market. The aim would be to keep reserve availability roughly the same, with free or net borrowed reserves and Federal funds rates fluctuating in a fairly narrow range, without extremes which could result from cumulative deviations in these measures. Whether a somewhat greater than normal supply of reserves may be required to keep the money market steady will depend largely upon the type of financing operation and the extent to which it involves underwriting or financing of dealer positions.

Other short-term rates, such as Treasury bill rates, should also not fluctuate unduly, but these rates often cannot be kept within a narrow range simply by maintaining a steady reserve base and Federal funds rate. Whether special efforts will be needed to constrain fluctuations in these other rates will depend on their possible impact on the Treasury's financing operation, which can only be judged at the time. If the Treasury's

Authorized for public release by the FOMC Secretariat on 5/27/2020

financing operation is confined to the intermediate or longer term area considerable fluctuation in bill rates may be tolerable, but if a short-term issue is being offered, some effort may be needed to keep bill rates from fluctuating too widely. Incidentally, the regular weekly and monthly offerings of Treasury bills do not normally call for an "even keel" posture, but tax bills may. Also, if the Treasury is substantially increasing the amounts of the regular offerings, "even keel" may be needed to help the market deal with the cumulative pressure of the successively larger offerings.

It must be emphasized, however, that the "even keel" policy has never been interpreted as requiring the maintenance of any particular level of rates in any of the securities markets, especially if changes in external forces -- apart from monetary policy -- are exerting strong pressures on interest rates. Thus, action to resist fluctuations in bill rates or other rates has been more in the nature of trying to temper the gyrations by adjusting the supply of reserves, rather than through buying at relatively fixed rates. To avoid any impression that the System has fixed ideas about rates, purchases of issues involved in a Treasury financing operation have been avoided as well as purchases of outstanding issues of similar maturities. Open market operations have from time to time included purchases of coupon issues solely to supply reserves. Such purchases are generally avoided when the Treasury is offering coupon issues,

Authorized for public release by the FOMC Secretariat on 5/27/2020

though they may be feasible if the financing is in the form of bills or if it is limited to a very short-term coupon issue.

The System can often facilitate exchange refundings by supplying needed reserves more through repurchase agreements against "rights" than through outright purchases of bills. Such procedure tends to facilitate dealer acquisition and carrying of "rights" in positions. This has generally been feasible without prejudice to the desired money market atmosphere. However, in cases where there has been no indicated need to supply reserves on balance, room for repurchase agreements against "rights" has, on occasion, been made by sales or redemptions of Treasury bills, as a demand for bills developed in connection with the refunding.

Timing

The periods over which the System has observed an "even keel" policy have varied considerably. As noted earlier, the policy has not generally applied to periods of regular Treasury bill financing, except that the System tries to avoid buying or selling sizable amounts of bills on the auction dates prior to the bidding. When offerings of Treasury Tax Anticipation Bills, bill strips, or any other bills appear likely to create market problems in an auction, the System may feel constrained to keep an "even keel" from several days before the auction through the payment date. With offerings of coupon issues the period can run from some time before the Treasury starts meetings with its advisory committees until after payment date. This period must be

Authorized for public release by the FOMC Secretariat on 5/27/2020

flexible to allow for the various conditions which may prevail prior to the financing and those which may develop as a result of and after the financing operation is completed, i.e., after payment for and delivery of the new issue. If a new issue is not reasonably firmly placed with investors by payment date, the System has been reluctant to undermine the position of the dealers and institutions underwriting the issue by changing policy immediately. There must also be allowance for a rapid succession of financings when the Treasury is under pressure to raise new cash, as has been the case this year. At such times the "even keel" period may have to be almost continuous from one operation to another.

The question often arises as to how long a time interval is needed between Treasury operations to allow a policy shift by the System. It has generally been felt that a period of at least three weeks between payment for one new issue and the start of the next "even keel" period was about the minimum necessary to afford the System time to make a policy change effective. A week or two is usually required for the market to become aware that policy has been changed, unless an announcement of some sort is made. An additional week may be desirable to allow the market to adjust to a new policy, since the Treasury could face considerable difficulty in designing its financing operation in a market not fully adjusted to a System policy shift.

Authorized for public release by the FOMC Secretariat on 5/27/2020

To summarize past "even keel" policy, the System has tried to maintain a neutral position, avoiding any policy decision or market action that would affect market expectations or interest rates. It might try to resist, but not offset, any changes in rates or expectations engendered by external forces. Both the duration of the "even keel" period and the flexibility accorded the System has tended to vary with the specific circumstances of each Treasury financing operation.

Authorized for public release by the FOMC Secretariat on 5/27/2020

REC'D IN RECORDS SECTION
NOV 13 1967

November 7, 1967.

TO: FOMC Staff

FROM: Stephen H. Axilrod and Joseph E. Burns

SUBJECT: The Behavior of Interest Rates, Bank Credit, and Marginal Reserve Measures During "Even Keel": 1965 - Mid-1967.

"Even keel" both in definition and in practice is, in the nature of the case, an elusive concept. The timing of "even keel", the behavior of interest rates and other monetary variables, and the extent of System open market operations depend in large part on the type of market and market psychology that develops in anticipation or in the wake of the Treasury financing involved. In general, most market participants have come to understand that "even keel" is basically a commitment to avoid actions that would signify a shift in monetary policy, particularly a move toward restraint, during periods of Treasury financings.

The purpose of the paper is to review--during the two and a half years from 1965 through mid-1967--the behavior of key market variables in an effort to determine how much variation or stability is shown by them during "even keel" periods in comparison with their behavior outside such periods. FOMC directives during "even keel" periods refer to Treasury financings as a factor to be taken into account in the conduct of open market operations. In the period under review, such directives generally specified no change in monetary policy, but occasionally policy, expressed in terms of money market conditions or reserve availability, was shaded toward restraint

Authorized for public release by the FOMC Secretariat on 5/27/2020

or ease to the extent consistent with the Treasury financing. Most "even keel" periods referred to coupon issue financings, but there were a few times when "even keel" was indicated for tax bill financings. There were also, of course, bill financings where no "even keel" constraint was noted.

This empirical approach is designed to shed some light on the variations in market rate and bank reserve movements that have been tolerated under the constraint of "even keel". But the results are necessarily limited by our inability to quantify market attitudes, changes in which will influence the tolerance with which the market views differing degrees of variations in interest rates and reserve measures.

Market attitudes are, of course, influenced by many elements outside the control of the System, but the timing and techniques of System day-to-day open market operations during "even keel" periods have at times been adjusted in an effort to stabilize these attitudes and to smooth out the Treasury financing operations. For instance, at times the System has run-off Treasury bills in an auction in order to have room, given net reserve targets, to make repurchase agreements to help dealers carry the new Treasury issue. Outright market transactions have also been timed so as to take the edge off of emerging market pressures, even if these pressures were apparently of a very short-run nature because of a reserve maldistribution, in order to avoid risking a deterioration in market psychology at critical times in the financing period, such as just before or after books are open.

Authorized for public release by the FOMC Secretariat on 5/27/2020

The interest rate and other monetary variables examined in this paper are partly influenced by the timing and techniques of open market operations during financing periods, but do not fully reveal the positive effects, at least in the short run, of such operations on market attitudes.

Time span of "even keel" and type of Treasury issue

The time span of, and money market stability during, "even keel" has varied in the past with the nature of the Treasury financing, with the market environment, and with the urgency behind the need for a monetary policy change. For purposes of statistical study, we have taken an "even keel" period lasting from a week before announcement to a week after payment or settlement date as a reasonable unit of analysis. In the few instances when the dates on which FOMC directives were issued were not consistent with such a unit of analysis, the "even keel" period was made to conform with the directive dates.

With respect to new Treasury coupon issues in a refunding or cash financing, the FOMC's directives of the past two and a half years are consistent with a time span for "even keel" that generally falls within the interval from a week before the announcement of terms to a week after the settlement date. The various relevant dates that bear on "even keel" are shown in Table 1. It is possible, of course, for "even keel" in practice to be longer or shorter than this period. It might extend somewhat beyond one week after settlement date if an especially large volume of new securities were left overhanging the

Authorized for public release by the FOMC Secretariat on 5/27/2020

TABLE I

TREASURY FINANCINGS DURING "EVEN KEEL" PERIODS

Dates Related to "Even Keel"				Description of Offering			
Directive date	Announcement date	Books opened	Settlement date	Type of offering	Size of offering (billions $)	Maturity of offering	Attrition or allotment ratio
			1 9 6 5				
12-15-64 1-12	12-30-64	1-4/1-8	1-19	Advance Refunding	22.1	5y 1m 9y 1m 27y 7m	$9.1 1/
2- 2	1-27	2-1	2-15	Cash	1.6	18m	.15(AL) 2/
4-13	4-28	5-3	5-15	Rights	4.1	15m 9m	.11(AT)
7-13 8-10	7-28	8-2	8-13	Rights	3.2	18m 3y 6m	.07(AT)
9-28	9-22	10-5	10-11	Tab	4.0	162 d 254 d	--
10-12	10-27	11-1	11-15	Cash	3.3	18m	.48(AL)
11-2	11-12	11-17	11-24	Tab	2.5	210 d	--
			1 9 6 6				
12-23-65 1-11	1-5	1-10	1-19	Cash	1.5	10m	.14 (AL)
1-11 2-8	1-26	1-31/2-2	2-15	Rights (incl. pre-refunding)	13.7	18m 4y 9m	7.4 1/ /.16 (AT)

Authorized for public release by the FOMC Secretariat on 5/27/2020

TABLE I (cont'd)

Dates Related to "Even Keel"				Description of Offering			
Directive date	Announcement date	Books opened	Settlement date	Type of offering	Size of offering (billions $)	Maturity of offering	Attrition or allotment ratio
4-12 5-10	4-28	5-2	5-15	Rights	2.5	18m	.46(AT)
7-26	7-27	8-1/8-3	8-15	Rights (incl. pre-refunding	8.1	1y 4y 9m	4.3 1/ .20 (AT)
10-4 11-1	10-5	10-11	10-18	Tab	[illegible] 5	185d 247d	--
11-1	10-27	11-1	11-15	Cash	3.2	1y 3m	.30(AL)
			1 9 6 7				
1-10	1-25	1-30	2-15	Cash	3.9	1y 3m 5y	.10(AL)
5-2	4-28	5-1	5-15	Rights (incl. pre-refunding)	9.1	1y 3m 5y	.19(AT)

1/ Amount exchanged in pre-refundings in billions of dollars.
2/ AL = Allotment ratio; AT = Attrition ratio.

Authorized for public release by the FOMC Secretariat on 5/27/2020

market. On the other hand, if the new offering was small or well distributed, "even keel" might be considered not to begin until two or three days before the announcement date and to end at settlement date, especially if dealer participation was commensurately moderate.

During the past two and a half years, there were three instances in which an "even keel" constraint was noted in the directive in relation to Treasury bill financings for new cash, out of eight such financings in the period (other than simply additions to the weekly bill auction). The financings that were "even keeled" varied between \$2.5 billion and \$4 billion in size and involved tax bills. The period of "even keel" in connection with a bill financing appears shorter than with a coupon issue, although in practice the period for a bill financing has at times merged with, or to a degree overlapped, an "even keel" constraint applicable to a coupon financing.

The "even keel" constraint has not been so regularly a feature of FOMC directives around bill financing periods as it is has been for coupon issues. It has been noted in directives--but not consistently--when issues have been large and/or when short-term markets have been likely to be under particular strain. There were five instances when bill financings for cash were not accompanied by mention of "even keel" in the directive during the 30 months ending mid-1967. One of these was a relatively large tax bill financing, but which took place at a time when policy was easing (March 1967). Another was a large tax bill financing that, by contrast, took place in a period of

Authorized for public release by the FOMC Secretariat on 5/27/2020

severe and growing monetary restraint (late August 1966). The remaining bill financings that were not accompanied by "even keel" were generally small--in the $1 - $2 billion range--and included tax bills and bill strips.

When "even keel" is applied to a bill financing, there are a number of reasons for the period being relatively short or for "even keel" to be less rigorously applied. First, the bill is auctioned, so that there is less need to hold markets stable between announcement date and auction date; in a coupon financing, on the other hand, the new issue is priced by the Treasury at announcement in the expectation that market attitudes will not shift significantly in the interval (typically 5 days in recent financings) until the books are open. Second, the risk of price fluctuation to holders of bills is smaller than to holders of intermediate-term or long-term coupon issues. And third, a purely technical point, the time span between auction and payment for bills is generally one week, while for coupon issues it is typically two weeks.

"Even keel" and interest rates

Interest rates have shown a relatively large amount of movement during "even keel" periods. Movements of interest rates are shown in Chart 1, with "even keel" time spans represented by the distance between the vertical lines that contain the arrows. It is not without interest that the "even keel" periods defined as noted above take up roughly 50 per cent of the 30 months plotted. Normal quarterly

Authorized for public release by the FOMC Secretariat on 5/27/2020

refundings would lead to "even keel" for about one-third of the year. But because of the large Federal deficits in the recent period, monetary policy has been affected at rather more frequent intervals.

Short- and long-term interest rates show different patterns of movements during "even keel" periods and also differ in relation to their behavior outside such periods. Day-to-day money rates, like the Federal funds and dealer loan rates, sometimes fluctuate rather sharply within an "even keel" period, just as they do in other periods. For instance, the Federal funds rate fluctuates in response to week-to-week shifts in the distribution of reserves between country and city banks. However, these rates generally do not show either an upward or downward trend in "even keel" periods. Trend movements in such rates generally occur in the periods between "even keel".

While an absence of trend movements in day-to-day money rates is a key characteristic of "even keel" periods, there have been a few exceptions during the 30 months under review. In "even keel" periods during the winter and spring of 1966, directives sought some reduction in reserve availability, while taking into account forthcoming or current Treasury financings. These directives covered the mid-February and mid-May refundings. Federal funds and dealer loan rates did not in the event show a rising trend in the first of these periods, but in the "even keel" period covering from about the third week in April to the third week in May, an upward trend in Federal funds and dealer loan rates was in practice permitted to develop.

Authorized for public release by the FOMC Secretariat on 5/27/2020

Because the April-May period illustrates a modest tightening of policy during "even keel", it is worthwhile to note the results of the financing and market factors bearing on it. The financing involved was a $2.5 billion rights exchange (in terms of public holdings) involving an offering of a single 18-month note. The attrition rate for this offering was a very large 46 per cent, the highest attrition rate by far in the period covered. Of course, April-May 1966 was a period of sharply rising loan demands in credit markets, so that the unfavorable reception might be partly attributed to cash needs of commercial banks and other holders of the maturing issue. In addition, the market was disappointed at that time by a fading in hopes for a program for fiscal restraint. Finally, the offering was priced to have a 10-12 basis point yield advantage over the outstanding market, which represents only a normal yield spread between new offerings and outstanding issues of a comparable maturity. All in all, there appear to be a variety of market factors accounting for the poor reception of the issue, but tightening of monetary policy before the books were open and expectations of further tightening certainly contributed.

The two directives in the "even keel" period from early October to late November 1966, which included both a tax bill and the mid-November refunding, noted that money market conditions should be "firm but orderly" and "generally steady", respectively; these directives also included proviso clauses related to liquidity pressures and bank credit. Over this period, dealer loan rates rose, but the Federal funds

Authorized for public release by the FOMC Secretariat on 5/27/2020

rate fluctuated widely, and began a downward trend after early November. The mid-November refunding was a straight cash exchange of $3.2 billion of maturing issues into a 15-month note. The allotment ratio was 30 per cent, as markets remained on the cautious side. The Federal funds rate was around its peak for the year in the period when books were open, but the market tensions of late summer and early fall were beginning to fade.

Bill rates. Treasury bill rates, as indicated by the yield on the 3-month bill, tend to display roughly the same kind of behavior--both in terms of fluctuation and trend--during an "even keel" period as is characteristic of the span of surrounding months. In 1965, bill rates--not to mention other rates--showed little movement in or outside "even keel" periods. In 1966 and 1967, however, bill rates moved relatively widely both in and outside "even keel" periods.

As examples of cyclical-trend movements in bill rates during the past two years, there were upward movements in the rate during the late July - late August 1966 "even keel" period and downward movements in the late January - late February 1967 period. In the former period, the directive specified unchanged money market conditions, but in the latter the directive called for an easing of such conditions.

The 3-month bill rate also declined very gradually in the early October - late November 1966 period. The bill rate had reached a peak for the year in late September, drifted down thereafter, and the decline accelerated following the "even keel" period as monetary policy moved overtly toward less restraint. Finally, it might be

Authorized for public release by the FOMC Secretariat on 5/27/2020

noted that the bill rate did not rise during the April-May 1966 period when day-to-day money rates rose. This behavior of the bill rate was consistent with its movement for a few weeks before and after the "even keel" period.

Longer-term rates. Longer-term rates, as typified by the yields on 3-5 year Government securities and on such securities maturing in over 10 years, show trend movement both in and outside "even keel" periods. They have both risen and fallen in "even keel" periods, the direction being generally consistent with the overall trend of times. Rate movements have generally been larger in magnitude outside "even keel" periods, but even this is not always the case. For instance, there was a very sharp rise in the yield on intermediate-term Governments in the mid-July - late August period. This was a relatively large refunding, including a pre-refunding, that zeroed in on the intermediate-term coupon area. Moreover, the financing took place in a period when financial market pressures were building to a peak; and certain monetary policy measures, apart from open market operations, were put into effect quite close to the refunding period.

With respect to open market operations, the FOMC directive on July 26 indicated an "even keel" stance and no change in money market conditions. The previous directive dated June 28 had also indicated

Authorized for public release by the FOMC Secretariat on 5/27/2020

no change in money market conditions, but dealer loan rates rose sharply nonetheless (although not the Federal funds rate). However, on July 15, the Board of Governors announced a lowering of the ceiling rates on time deposits with multiple maturities as of July 20, one week before the announcement date of the mid-August refunding. An increase in reserve requirements on time deposits in excess of $5 million had been earlier announced to be effective July 14 for city banks and July 21 for other member banks. On August 17, two days after settlement, the Board announced a further 1 percentage point increase in reserve requirements on time deposits in excess of $5 million.

The July reserve requirement and Regulation Q changes did not appear to have a particularly harmful effect on the refunding, partly because they were announced and their market impact could be assessed before pricing of the refunding. The refunding was priced normally against the outstanding market, and the attrition on the mid-August maturities was a moderate 20 per cent. However, the mid-August announcement of a rise in reserve requirement was followed by a sharp upward adjustment in interest rates, especially intermediate-term yields.

Marginal reserve measures

Free reserves and member bank borrowings shown in Chart 2, behave somewhat the same in "even keel" periods as does the cost of one day money--i.e., Federal funds and dealer loan rates. They show less cyclical movement than the 3-month bill rate and longer-term market rates, but they do fluctuate widely. And occasionally, they

Authorized for public release by the FOMC Secretariat on 5/27/2020

have shown moderate trend movements in one direction or another during an "even keel" period when the FOMC has directed the Manager to alter money market conditions while taking account of Treasury financings.

In early 1965, for instance, free reserves trended downward during an "even keel" period, and all member bank borrowing moved up slightly on balance. These were the main discernible effects of the FOMC's vote on February 2 to move toward slightly firmer money market conditions, while taking into account the Treasury financing.

Free reserves also showed downward movements in February and May 1966 periods when the FOMC was tightening in terms of reserve availability, while taking account of Treasury financing. On the other hand, free reserves rose, and member bank borrowings declined, in the "even keel" period of October-November 1966, beginning the trend movement in those variables that lasted until the spring of 1967.

The movement of free reserves in the October-November period was accompanied, as indicated earlier, by declines in bill and longer-term interest rates, by a tendency late in the period for the Federal funds rate to edge off, and by continued increases in dealer loan rates. The behavior of dealer loan rates was probably related to the severe pressures on large banks, who at the time were on the verge of realizing that the worst was over, but had not quite yet done so.

Bank credit

Bank credit flows show less special movement in "even keel" periods relative to other periods than do money market variables and perhaps even longer-term interest rates. The weekly behavior of the

Authorized for public release by the FOMC Secretariat on 5/27/2020

bank credit proxy is shown on Chart 3, and can be taken as generally representative of the flow of reserve funds made available to the banking system.

In 1965, the bank credit proxy showed a rather steady rising trend with very little variation in or out of "even keel" periods. There was an unusually sharp increase in connection with the $4 billion tax bill issued in October--a financing taken into account in the FOMC's directive. This was followed by a levelling off in bank credit, however, during the period of the mid-November refunding.

Similarly in 1966 outstanding bank credit rose rather consistently in and outside of "even keel" periods until summer. The subsequent decline in outstanding bank credit that lasted through November was not interrupted during "even keel" periods. And finally the sharp reversal to bank credit expansion that began in December 1966 showed no movement in "even keel" periods that could not be explained by the general overall trend.

Conclusions

(1) "Even keel" has been applied consistently to coupon issues financings. With respect to bill financings, "even keel" has been applied in large financings, but not consistently, and has been generally ignored in small financings since the beginning of 1965.

(2) To the extent "even keel" is intended to convince market participants that policy is not changing, there is evidence to indicate that the maintenance of such a market attitude is consistent with varying movements of bank credit and interest rates.

Authorized for public release by the FOMC Secretariat on 5/27/2020

(3) If any item were to be taken as an objective indicator of "even keel", at least as it has unfolded in recent experience, one would select the cost of one day money, and assign marginal reserves to a secondary, but important, role. These are the variables most in the minds of market participants, and also the ones that show the most stability in behavior during "even keel" periods (after allowing for normal day-to-day or week-to-week fluctuations).

(4) There is nothing in the material analyzed, however, to suggest that "even keel" is necessarily a fixed period or that it excludes some shading of policy toward restraint or ease. The fact policy was changed during a few "even keel" periods is on the face of it evidence that "even keel" does not imply any rigid attitude toward the market.

(5) There have been fairly wide fluctuations in money market variables during "even keel" periods, and there have also even been trend movements reflecting efforts by the FOMC to tighten or ease while taking account of Treasury financings. At times, this has been accomplished while not changing the attitudes of market participants because trend movements have been disguised for a few weeks by the large fluctuations that market participants are used to or because they have encompassed only a small portion of an "even keel" period as defined for purposes of this analysis.

(6) While the wide variations in behavior of the variables examined suggests that the "even keel" commitment is not only flexible

Authorized for public release by the FOMC Secretariat on 5/27/2020

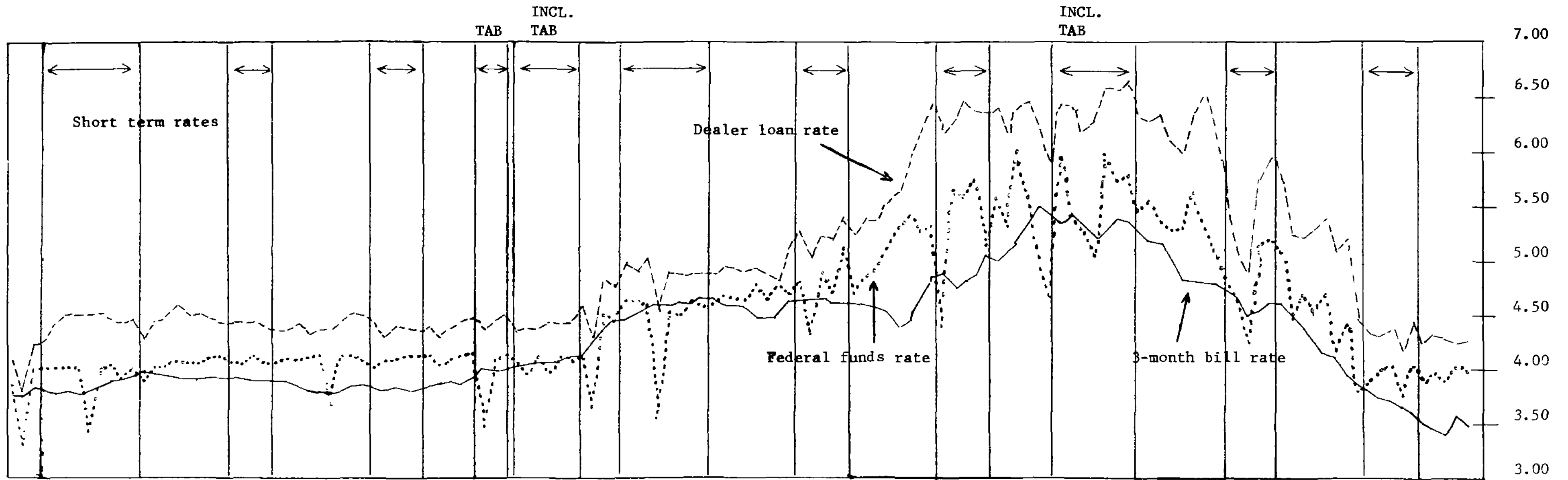
in terms of timing but also in terms of credit conditions, any sharp movements permitted in day-to-day money market conditions, or even under some circumstances in interest rates, is likely over the short-run to risk an unsuccessful Treasury refunding in the sense of a sizable attrition or high allotment ratio or in the sense of large offerings to official accounts from nervous holders.

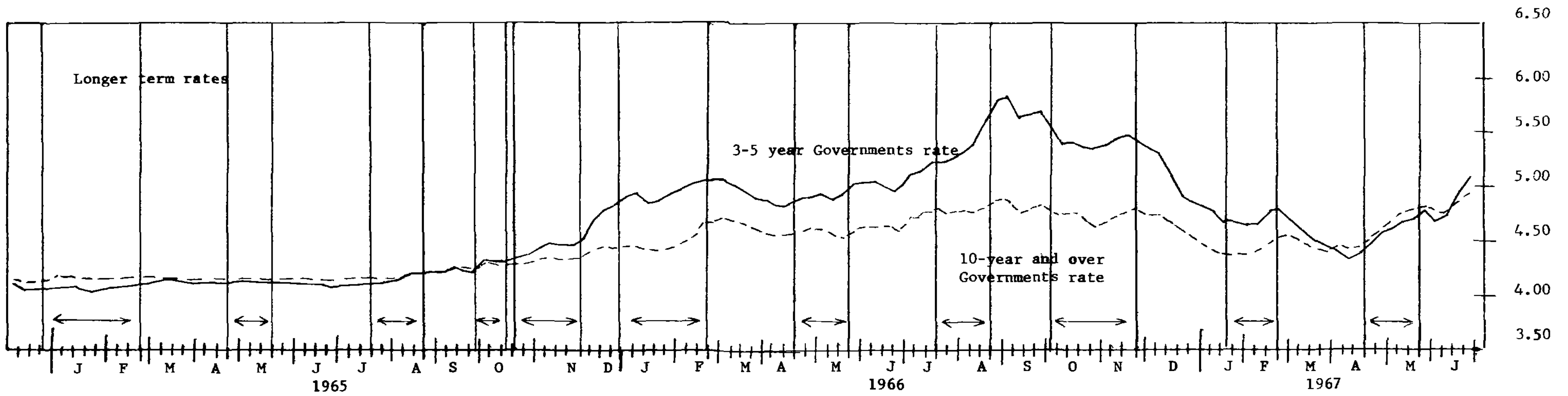
(7) Bill rates and intermediate- and long-term rates are influenced by changes in the supply of securities and by expectations as well as by monetary policy. On the other hand, actual marginal reserve measures and the cost of one day money are almost wholly the product of monetary policy as presently conducted. Thus, it is not surprising that bill rates and other yields show movements independent of "even keel". However, it almost goes without saying that their movements during financings would be more exaggerated without the "even keel" constraint. But whether the trend of interest rates over a relatively long period would be any different without "even keels" is quite another and an undecided matter.

Authorized for public release by the FOMC Secretariat on 5/27/2020

CHART 1

INTEREST RATES



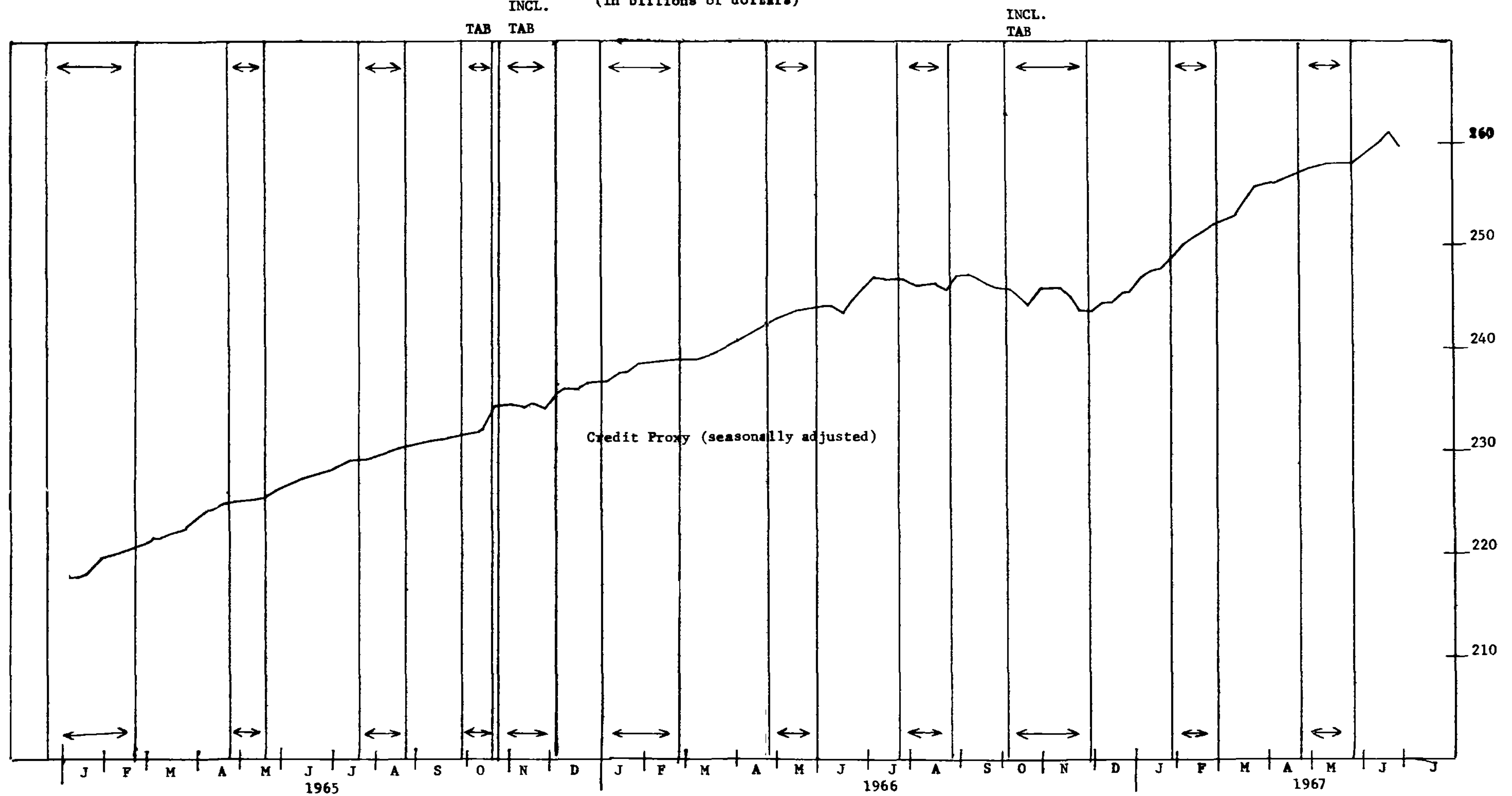


NOTE: "Even keel" periods are represented by the distances between the vertical lines as indicated by the arrows.

Authorized for public release by the FOMC Secretariat on 5/27/2020

CHART 3

BANK CREDIT
(In billions of dollars)

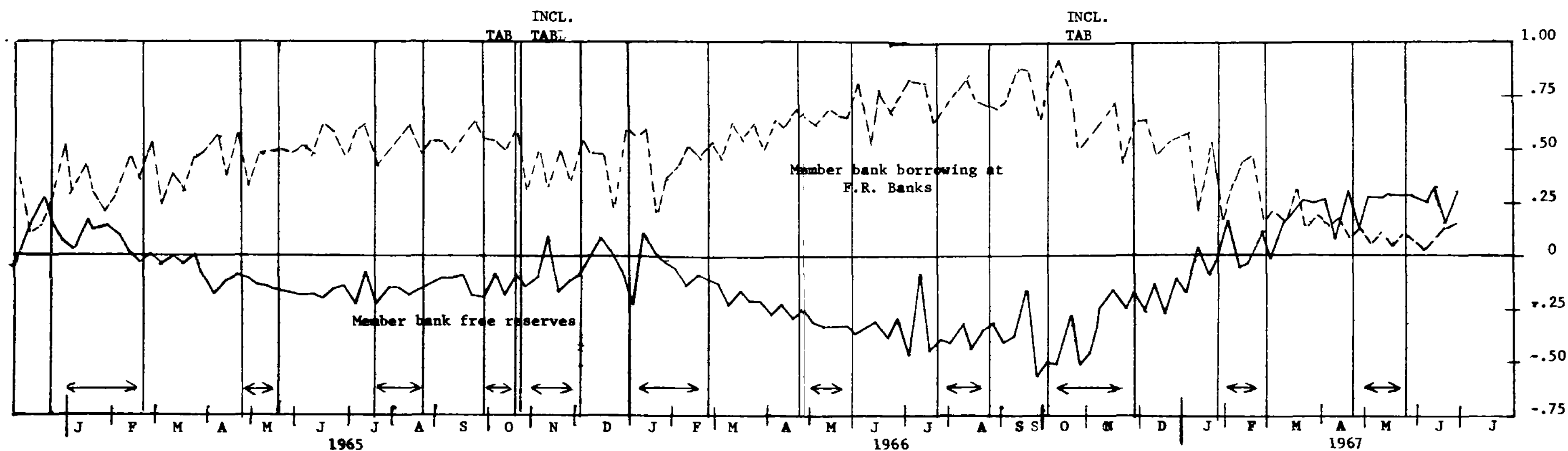


NOTE: "Even keel" periods are represented by the distances between the vertical lines as indicated by the arrows.

Authorized for public release by the FOMC Secretariat on 5/27/2020

CHART 2

MARGINAL RESERVE MEASURES
(In billions of dollars)



NOTE: "Even keel" periods are represented by the distances between the vertical lines as indicated by the arrows.

Authorized for public release by the FOMC Secretariat on 5/27/2020

REC'D IN RECORDS SECTION
NOV 13 1967

CONFIDENTIAL (FR)

November 9, 1967.

TO: FOMC Staff

FROM: R. L. Cooper,
Federal Reserve Bank of New York.

SUBJECT: Brief History of System Direct Support of Treasury Financings.

This paper briefly reviews the history and background of the Federal Open Market Committee's practice of avoiding transactions in rights, when-issueds, and comparable maturities during periods of Treasury financing.

During the war and immediate postwar years, the System operated in Government securities without any formal limitation as to timing or area of the market. Following the accord of March 1951, regular intervention in coupon issues was gradually withdrawn. However, the Desk continued to support Treasury financings by buying rights and when-issued securities (all refundings were then accomplished on an exchange basis). Beginning in December 1952, support of Treasury financings was discontinued as well. The decision to do so was an outgrowth of a study by an Ad Hoc Subcommittee of the Federal Open Market Committee, dated November 12, 1952. The purpose of the Subcommittee was to examine and report on the relevance and adequacy of the Federal Open Market Committee's own procedures and operations and to ascertain whether they tended to inhibit the development of real depth, breadth and resiliency in the market.

Authorized for public release by the FOMC Secretariat on 5/27/2020

The Subcommittee strongly recommended that support of Treasury financings be discontinued. The recommendation was based on the following rationale (see Exhibit A, excerpt from report, paragraph 73): "1. that the Federal Open Market Committee can promote the wellbeing of the market for Government securities by an assurance that henceforth it will avoid unnecessary intervention in the market, and will confine that intervention as much as possible to the very short-term maturities, preferably bills, 2. that the ability of the Federal Open Market Committee to give such an assurance is blocked by the present practice of purchasing rights and certain issues during periods of Treasury financing, and 3. that, in addition the portfolio of the open market account is becoming unduly weighted with the securities that have been acquired in these support operations." It was recognized, of course, that the avoidance of support operations was dependent upon the Treasury's assuming responsibility for pricing its offerings of securities realistically.

Based on the Ad Hoc Subcommittee's report, the Federal Open Market Committee adopted, in 1953, and published certain operating policies that voluntarily limited its intervention in the market until late 1960. The second of these policies was as follows: "Operations for the System Account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly

Authorized for public release by the FOMC Secretariat on 5/27/2020

markets), and during a period of Treasury financing there shall be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturities to those being offered for exchange." This policy was strictly adhered to except in 1955 and 1958, when rights and/or when-issued securities were purchased under emergency conditions that threatened the success of Treasury financing operations. Otherwise, System aid to Treasury financing was confined to the maintenance of an even keel in the money market and this was accomplished through operations in Treasury bills.

It is evident from the record that the adoption of this policy was prompted solely to promote the further development of a free, self-sustaining market for Government securities. Some thought was given by the Ad Hoc Subcommittee to the relations between the Treasury and the System and to their joint and several responsibilities in the management of the public debt (see paragraphs 64-69). But the question of keeping the System and Treasury at "arm's length" per se was apparently not an important consideration in either the Subcommittee's deliberations and report or in the adoption of the operating policies by the Federal Open Market Committee.

The development of a persistent deficit in the balance of payments in the late 1950's produced a need for greater

Authorized for public release by the FOMC Secretariat on 5/27/2020

flexibility in the conduct of open market operations. Therefore, in 1961, the Federal Open Market Committee first suspended and then abandoned its formal, published operating policies (see Exhibit B, excerpt from the policy record covering the meeting on December 19, 1961). The main purpose of discontinuing the policies was to relieve the Committee of its self-assumed obligation to confine its intervention in the market to the short-term area (preferably Treasury bills) and to permit System outright purchases of intermediate- and long-term issues and System swaps from the short-term into the intermediate- and long-term area. However, in discontinuing the formal, published operating policies, the Committee disavowed any intention of resuming the support of Treasury financing with the following statement:

> "The decision to discontinue the statements of operating policies related solely to the desirability of continuing to have such statements; it was not a decision to change the basic position of the System in relation to the Treasury or the market. The action was taken with the recognition that the bulk of open market operations would, in the nature of the case, continue to be in short-term securities; with the understanding that decisions about operations in securities of all maturities would continue to be made by the Committee in light of prevailing circumstances; and with the understanding that the Committee had no intention of pegging Government security prices, or of creating artificial market conditions at times of new security offerings by the Treasury."

Authorized for public release by the FOMC Secretariat on 5/27/2020

During the period since the operating policies were discontinued, the Desk has consistently avoided any operations in rights, when-issueds or comparable maturities during periods of Treasury financing. Although not formally instructed to do so, the Account Management has considered that such operations should not be undertaken without first securing the approval of the Committee. Meanwhile, market participants have understood that the old policy was being adhered to even though it was no longer formally and publicly acknowledged. In general terms, the prohibition has extended from one or two weeks before the announcement of a contemplated financing to the settlement date or beyond.

On one occasion, in November 1965, the Manager of the Account requested and received from the Committee agreement that when-issued securities might be purchased, if necessary, to head off the development of potential disorder in the market. The request was made to a telephone meeting of the Committee following the announcement of an unusually large allotment on a poorly received Treasury refunding offering. In dealing with this situation, it was considered desirable that the Manager should feel free to purchase when-issueds if they should become the focal point of market pressure rather than to dissipate the constructive influence of System buying in other areas of the market. The following statements by the Chairman, summarizing the discussion, are excerpted from the minutes of the meeting:

Authorized for public release by the FOMC Secretariat on 5/27/2020

". . . What the Committee was really doing was giving the Manager latitude to deal in when-issued securities if he thought it wise."

". . . The only thing this meeting was concerned with, he added, was the question of the Manager's dealing in when-issued securities within the framework of a potentially disorderly market."

". . . the Manager had full authority with respect to the maintenance of an orderly market."

In the event, no when-issued securities were actually purchased by the Desk. Substantial purchases of the new issue by the Treasury were sufficient to steady the market and System action was limited to purchases of Treasury bills and a small amount of repurchase agreements.

Authorized for public release by the FOMC Secretariat on 5/27/2020

...RDS SECTION
NOV 13 1967

EXHIBIT A

EXCERPT FROM FEDERAL OPEN MARKET COMMITTEE
REPORT OF AD HOC SUBCOMMITTEE ON THE GOVERNMENT SECURITIES MARKET, NOVEMBER 12, 1952

The problem of Treasury financing

(57) The Federal Open Market Committee now follows the practice of intervening in the market to support rights values on maturing Treasury securities. So long as this practice continues, it will be impossible to give the type of assurance discussed above. These interventions are recurrent. When sales to the Federal Reserve are appreciable, they result in the injection of reserve funds into the market in amounts that are embarrassingly large. They impose a pattern of yields on the market, and, consequently, are disturbing to its depth, breadth, and resiliency.

(58) The practice of supporting Treasury financings developed during the period of war finance, when the Treasury and the Federal Open Market Committee undertook jointly to see that lack of funds would not impede effective prosecution of the war. In the judgment of the subcommittee, it would be appropriate to sit down with the Treasury and review the practice in the light of current experience. If any change is to be made, there would be need for extensive consultation with the Treasury, since the Treasury's present debt management policies and its current practices in managing its cash balance would be directly affected.

(59) The subcommittee's views on this point have been considerably influenced by the judgment of its technical consultant Mr. Craft, and it urges that the Federal Open Market Committee give most serious consideration to the views expressed in the memorandum

Authorized for public release by the FOMC Secretariat on 5/27/2020

entitled "Ground Rules", attached as appendix C. The conclusion presented in this document is that for the open market operation to be successful there must be new ground rules, i.e., new methods of operation by the Committee, known in advance, that will permit the Committee to pursue vigorous credit and monetary policies without incurring the danger of disruption in the market for Government securities. The principal recommendations with respect to the most appropriate ground rules are three: (1) that the Committee (except in the case when it is dealing with a disorderly market) confine its operations to bills, (2) that, in the rare case of the emergence of a disorderly market, corrective actions be deferred until the need for them is clearly indicated and then be taken only after a poll of the executive committee rather than at the discretion of the management of the account, and (3) that the practice of supporting directly either new or refunding issues of Treasury securities be abandoned. The memorandum outlines in detail the considerations that have led to these conclusions, and the specific technical operations that would best carry them into effect.

(60) The memorandum outlines the serious operating problems that the Federal Open Market Committee will face necessarily, if it continues to acquire Treasury issues of new or refunding securities. The subcommittee is particularly impressed by the conclusion that the portfolio of the open market account may become, in fact if not in theoretical composition, frozen or semifrozen. As is pointed out, the securities which the open market account has acquired as rights in underwriting a refunding have subsequently been exchanged for the new

Authorized for public release by the FOMC Secretariat on 5/27/2020

issue and the Federal Open Market Committee has been hesitant to dispose of these new issues under normal conditions in the market -- a justifiable hesitation because sale of the securities in the market before they have been held quite near to their maturity might be disruptive.

(61) It is also pointed out that when these securities or, in fact any securities other than bills, however acquired, were sold into the market as they approached maturity, they have been purchased largely by corporations or other investors who had a specific need for cash at the maturity date. They have tended, consequently, to increase the natural and inevitable attrition connected with any maturing Treasury issue. Consequently, the securities have tended to be reacquired by the Committee in supporting the refunding.

(62) The persistent growth in the open market account of securities acquired directly or indirectly in support of Treasury refundings is disquieting.

(63) The present semifrozen position of the portfolio brings out in new form the desirability of a larger proportion of bills in the System's portfolio, and underscores the cogency of the recommendation that henceforth the Committee operate exclusively in bills except when it is intervening in the market to correct conditions of very serious disorder. Bills, in addition to their ready market ability and other qualities that make them preferred components of the portfolio, have the unique advantage, from the point of view of the Committee's operations, that they are marketed at auction for cash and are redeemed in cash at maturity. Neither at issue, nor at redemption, do they raise problems of support for the Committee, nor of attrition for the Treasury.

Authorized for public release by the FOMC Secretariat on 5/27/2020

(64) It is clear that the Federal Open Market Committee cannot consider the type of assurance that would contribute most to the development of depth, breadth, and resiliency in the market until it has come to a decision on the question of whether or not the Committee should continue to buy rights or any other securities other than bills during periods of Treasury financing. There are two opposing viewpoints on this basic and difficult problem.

(65) If it is believed that the System's responsibilities are strictly limited to the formulation and execution of credit and monetary policy, logic would preclude the Federal Open Market Committee from purchasing rights or other issues to support Treasury financing. Under this view, the Treasury, being responsible for debt management, would be responsible also for naming such terms and coupons on new securities that a natural-rights value in the market would be established automatically. There would be no occasion, therefore, for intervention or support by the Federal Open Market Committee. The Committee might, of course, engage simultaneously in open market operations to relieve an unexpected stringency in the money market, but it would not be expected to do so, and if it did it would operate only because of its responsibility for the general credit situation.

(66) This view rests on the doctrine that the governmental structure must provide that responsibility for public decision be clearly fixed and that public officials be held strictly accountable for their decisions. It, therefore, leaves little scope for purchases to support a new issue by the Federal Open Market Committee during the period of subscription. In this view, the

Authorized for public release by the FOMC Secretariat on 5/27/2020

Federal Open Market Committee would buy no rights on a maturing issue, with the result that all attrition would fall on the Treasury if the issue were not attractively priced.

(67) This would be expected under the logic of the doctrine of responsibility. Since decisions with regard to debt management are unquestionably a prerogative of the Treasury, the Treasury, under that doctrine, would expect to accept the consequences of an erroneous decision. If attrition were large, the Treasury would be expected to replenish its cash balance with a second offering on terms more in tune with the market.

(68) In contrast to this view is the position which holds that debt-management and reserve-banking decisions cannot be separated. While the Treasury is primarily responsible for debt-management decisions, that responsibility under this second view is shared in part by the Federal Reserve System, and while the Federal Reserve is primarily responsible for credit and monetary policy, that responsibility must also be shared by the Treasury. According to this position, the problems of debt management and monetary management are inextricably intermingled, partly in concept but inescapably so in execution. The two responsible agencies are thus considered to be like Siamese twins, each completely independent in arriving at its decisions, and each independent to a considerable degree in its actions, yet each at some point subject to a veto by the other if its actions depart too far from a goal that must be sought as a team. This view

Authorized for public release by the FOMC Secretariat on 5/27/2020

was perhaps unconsciously expressed by the two agencies in their announcement of the accord in March 1951. In that announcement they agreed mutually to try to cooperate in seeing that Treasury requirements were met and that monetization of debt was held to a minimum.

(69) In the view of the subcommittee, it would be wise to avoid pushing either of these positions to the full logical extreme. Neither position exactly fits the immediate situation facing the money market, the Treasury, or the Federal Open Market Committee.

(70) The Federal Open Market Committee has only recently abandoned its previous policy of continuous control of prices and yields throughout the list of Government securities. During periods of refunding, it is still purchasing rights, and on occasion interfering with market arbitrage by supporting issues whose maturity approximates the maturity of new Treasury issues. The object of these transactions is to shield the cash balance of the Treasury from the attrition that might otherwise occur when maturing issues are not presented for exchange.

(71) The Treasury, faced with enormous financing problems both for new money and refundings, has modified to a considerable degree the debt-management techniques developed during the war. Maturing certificates, however, are usually rolled over into a similar issue and when projections are made of needs of new money it is assumed that only moderate attrition will fall on the Treasury in connection with these refunding operations.

Authorized for public release by the FOMC Secretariat on 5/27/2020

(72) The market, too, is in a period of transition. It is confused with respect to the occasions when it should expect intervention from the Federal Open Market Committee, and it is uncertain with respect to the sectors in which this intervention might occur. It is hesitant, therefore, and lacks the depth, breadth, and resiliency that would be desirable. It is in the interest of the Treasury as well as of the Federal Open Market Committee that every effort be made to improve these characteristics of the market.

(73) It is in the context of this situation that the subcommittee is formulating its recommendations. It has found (1) that the Federal Open Market Committee can promote the well-being of the market for Government securities by an assurance that henceforth it will avoid unnecessary intervention in the market, and will confine that intervention as much as possible to the very short maturities, preferably bills, (2) that the ability of the Federal Open Market Committee to give such an assurance is blocked by the present practice of purchasing rights and certain issues during periods of Treasury financing, and (3) that, in addition the portfolio of the open market account is becoming unduly weighted with the securities that have been acquired in these support operations.

(74) The subcommittee recommends, therefore (1) that the Federal Open Market Committee ask the Treasury to work out promptly new procedures for financing, and (2) that, as soon as practicable, the Federal Open Market Committee abstain, during periods of Treasury financing, from purchasing (a) any maturing issues for

Authorized for public release by the FOMC Secretariat on 5/27/2020

which an exchange is being offered, (b) any when-issued securities, and (c) any outstanding issues of comparable maturity being offered for exchange.

(75) Should the Federal Open Market Committee adopt the recommendations of the subcommittee with respect (a) to the type of situation justifying intervention to correct disorderly market conditions, and (b) to the kinds of transactions appropriate during a period of Treasury financing, it would be in a position to give a public assurance to the market that henceforth, with two exceptions, the Committee will intervene in the market only to absorb or release reserve funds to effectuate its monetary policies, and that it will confine its intervention to the shortest sectors of the market, preferably bills.

(76) The two exceptions should be carefully explained to the market. They would occur (1) in a situation where genuine disorderly conditions had developed to a point where the executive committee felt selling was feeding on itself and might produce panic, and (2) during periods of Treasury financing. In the first case, the Federal Open Market Committee would be expected to enter more decisively in the long-term or intermediate sectors of the market. In the second case, intervention, if any, would be confined to the very short maturities, principally bills. The subcommittee recommends most strongly that the Federal Open Market Committee adopt the necessary measures and give this assurance.

Authorized for public release by the FOMC Secretariat on 5/27/2020

EXHIBIT B

EXCERPT FROM POLICY RECORD OF
FEDERAL OPEN MARKET COMMITTEE
DECEMBER 19, 1961

3. Statements of continuing operating policies and authority to effect transactions in intermediate- and longer-term securities.

The Federal Open Market Committee discontinued the three statements of operating policies that had been in effect since 1953 and were last reaffirmed by the Committee on March 22, 1960. This action was taken with the understanding that it would make unnecessary the special authorization permitting transactions in longer-term securities, adopted in February 1961 and renewed at each subsequent meeting, and this authorization was therefore not again renewed. The three discontinued operating policy statements read as follows:

> a. It is not now the policy of the Committee to support any pattern of prices and yields in the Government securities market, and intervention in the Government securities market is solely to effectuate the objectives of monetary and credit policy (including correction of disorderly markets).
>
> b. Operations for the System Account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly markets), and during a period of Treasury financing there shall be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturities to those being offered for exchange; these policies to be followed until such time as they may be superseded or modified by further action of the Federal Open Market Committee.
>
> c. Transactions for the System Account in the open market shall be entered into solely for the purpose of providing or absorbing reserves (except in the correction of disorderly markets), and shall not include offsetting purchases and sales of securities for the purpose

Authorized for public release by the FOMC Secretariat on 5/27/2020

of altering the maturity pattern of the System's portfolio; such policy to be followed until such time as it may be superseded or modified by further action of the Federal Open Market Committee.

Votes for this action: Messrs. Martin, Hayes, Balderston, Irons, Mitchell, Shepardson, Swan and Fulton. Votes against this action: Messrs. King, Mills, Robertson, and Wayne.

The operating policy statements had been reviewed at the meeting of March 7, 1961, in accordance with the customary practice of reviewing all continuing authorities and statements of policy at the first meeting each year following the election of new members from the Federal Reserve Banks. At that time, pursuant to the recommendation of a Subcommittee, the Committee tabled consideration of possible changes pending a more comprehensive review of the appropriate form for such statements under present circumstances, including those associated with the operations recently begun in intermediate- and longer-term securities. Subsequently, Committee members gave extended consideration to alternative possible formulations of the statements and to the advantages and disadvantages of continuing them in some form. Further deliberations at this meeting culminated in the decision to discontinue the statements.

The language of the statements had reflected the Committee's expectation that departures from various of the individual policies described would be needed from time to time, and the Committee had in fact made such departures on several occasions. The most recent was the special authorization for transactions in longer-term Government securities first made in February 1961 and renewed at each

Authorized for public release by the FOMC Secretariat on 5/27/2020

subsequent meeting until December 19, 1961. In voting to discontinue the three statements of operating policies, it was the belief of the majority of the Committee that in the future greater latitude might be needed for adapting System operating techniques to changing circumstances than had been required over most of the period since 1953, especially in view of the change in this country's international payments position.

The decision also reflected the belief of a Committee majority that some of the advantages seen earlier in having statements of operating policies were now considerably reduced in importance. The main purpose of the statements, when they were originally adopted in 1953 and reaffirmed in subsequent years, was to clarify the role of the Federal Reserve with respect to the Government securities market. During World War II and the postwar period up to the Treasury-Federal Reserve accord of March 1951, the System maintained the prices and yields of outstanding Government securities on a relatively fixed schedule, and in the 18 months following the accord the System continued actively to support Treasury financings. A majority of the Committee had believed the statements of operating policies served a major role in defining more clearly the System's operations in the Government securities market and in facilitating the transition from a supported to an unsupported market. But the transition had long since been successfully accomplished and a majority now felt that this purpose no longer provided a compelling reason for continuing formal statements of operating policies.

Authorized for public release by the FOMC Secretariat on 5/27/2020

Another of the original purposes of the statements was to provide guidelines for open market operations undertaken on the Committee's behalf. At the time the statements were adopted in 1953 the Federal Open Market Committee met relatively infrequently--a minimum of four times a year, with occasional additional meetings--and in the relatively long intervals between meetings responsibility for effectuating policy lay with the executive committee. Along with other types of instructions, the operating policy statements were considered to serve a useful function in providing guides for the executive committee and the Account Management. Since mid-1955, however, when the executive committee was discontinued, the full Committee had been meeting regularly at short intervals--usually every 3 weeks--and it had been able to maintain close direction over the conduct of operations. In these circumstances the majority felt that the importance of the operating policy statements as guides for operations was also considerably reduced.

The decision to discontinue the statements of operating policies related solely to the desirability of continuing to have such statements; it was not a decision to change the basic position of the System in relation to the Treasury or the market. The action was taken with the recognition that the bulk of open market operations would, in the nature of the case, continue to be in short-term securities; with the understanding that decisions about operations in securities of all maturities would continue to be made by the