

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 12, 1947

To Chairman Eccles

Subject: Effect of Treasury operations

From Thomas Lee Smith

on reserves easing next week

T.L.S.

Since reporting to you Mr. Rouse's recommendation to Mr. Hefflefinger that 100 million dollars of Treasury bills be retired on November 20, I have discovered that the Treasury expects to receive 143 million dollars during the week ending November 19 from the sale of the "Big Inch", which will put additional pressure on the market.

We estimate the balance with Reserve Banks, the war loan balance, and the effect on reserves to be as follows:

(In billions of dollars)

	<u>Balance with reserve banks</u>	<u>War loan deposits</u>	<u>Decrease (-) or increase (+) of reserves</u>
Nov. 8	1.0	1.5	
Nov. 12	1.1	1.5	- .1
Nov. 19	1.5	1.5	- .4

If the proposed retirement of 100 million dollars of bills on November 20 is financed by a war loan call, equal in amount, for payment the same day, reserves will not be affected by the transaction, but if no call is made, reserves will be decreased another 100 million dollars.

Furthermore, an announcement of the Board's special reserve proposal probably would cause sales of intermediate securities, without an improvement in bank demand for short-term securities. The result would be downward pressure on the whole range of bond prices.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 12, 1947

To Chairman Eccles

Subject: Possible effect on bond market

From Woodlief Thomas

of the reserve proposal

Bob Rouse, with whom I talked in New York on Monday, feels that sponsorship by the President of the reserve proposal in a specific form might, in view of present conditions in the bond market, result in a rather substantial liquidation of bonds. Recent weakness in long-term bonds is showing some signs of spreading to the medium-term market and any announcement indicating further pressure on this market may cause considerable selling. This, in turn, would set forth a new wave of liquidation on the long-term market.

As you know, the principal effect of the new proposal will be to improve the market for bills and certificates and put a large part of the burden of reserve adjustments and of further debt monetization upon the short- and medium-term bond market. While this is a desired effect, there is danger, if Rouse's view is correct, of the impact being too strong, particularly if it comes at a time of general weakness in the market.

For these reasons Rouse feels that the System should be prepared to provide substantial support to the bond market next week. It will probably also be important in any statements issued by the System to indicate that imposition of any such proposals will be so graduated as to avoid putting undue pressure on the securities market at any one time.

W.T.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 12, 1947

To Chairman Eccles

Subject: Increased weakness in bond

From Thomas Smith

market.

T. S.

The Government bond market has deteriorated in the last hour and a half. The long-term Victory bond issue is down to 101 1/32 bid, and when 100, the next psychological point is broken, there may be an increase in selling which will force decision on the support level today or tomorrow. I am waiting for a call from Mr. Rouse

So far there has been no increase in supply, but sentiment has certainly taken a bearish turn. Buyers are sitting tight and potential sellers are constantly checking to see whether they can sell.

Weakness in the short-term market has also adversely affected sentiment. The System Account had to purchase a total of 153 million dollars up to about 2:30 P.M., consisting of 43 million dollars of bills, 32 million of certificates, and 78 million of notes.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 12, 1947

To Chairman Eccles

Subject: Telephone call from Mr. Rouse:

From Thomas Lee Smith

Retirement of Treasury bills

T.L.S.

Mr. Heffelfinger asked Mr. Rouse for his opinion concerning the retirement of Treasury bills next week. Mr. Rouse recommended that the Treasury retire another 100 million dollars of bills in line with the last exchange of views with the Treasury.

Mr. Rouse thinks it would be unwise to raise the retirement to 200 million dollars at this time.

Excess reserves on November 8 were 931 million dollars. About 200 million dollars of reserves would be cancelled by the following operations during November 8-20.

As of November 8, the Treasury balance with Reserve Banks was 1.0 billion dollars and war loan deposits were 1.5 billion. Retirement of 100 million dollars of bills and payment of 105 million on the last war loan call are to be made on November 13. If the proposed retirement of 100 million of bills and another call of the same amount are made on November 20, war loan deposits will be reduced to about 1.3 billion and the balance with Reserve Banks will remain unchanged at about 1.0 billion dollars.

BOARD OF GOVERNORS
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Office Correspondence

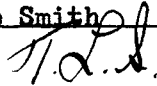
Date November 13, 1947

To Chairman Eccles

Subject: Support to be given long-term

From Thomas Lee Smith

bond price



Mr. Rouse informs me that the New York Reserve Bank has an increased order from the Treasury to buy 190 million dollars of bonds, the idea being to keep the market price of long-term bonds around 101 for the next few days. About 16 million dollars of the order has been committed at the time of Mr. Rouse's call.

I told Mr. Rouse that a price of 101 was in line with your thinking. On an earlier occasion, however, you had indicated that a drop to as low as 100 1/2 would not be too much. That, I gather, is largely the reason yesterday for keeping the initial purchases for the Treasury quiet. Mr. Rouse said that he and Mr. Sproul might talk with you today about the support price and the market, and I agreed he should.

Mr. Rouse feels that market situation has been on the verge of becoming serious and should be kept stable. He states also that Mr. Snyder is anxious to keep the market in a reasonably stable condition to give the country time to adjust to the President's message. The announcement tomorrow of the 1 1/8 per cent rate, the further increase in the bill rate on Monday, and the President's message will tend to disturb the market.

Bonds are expected to continue in supply for some time. The weakness in bond prices is based primarily ~~by~~ institutional shifting from Treasury bonds into high-grade industrial and utility obligations and mortgages. For example, a new offering of 40 million dollars of debentures of the Sun Ray/Oil Company will attract funds from the Government market.

Also, the short-term market is weak in the sense that not all of the selling is to obtain reserves. In addition to selling to obtain reserves, there has been some switching from longer-term securities, particularly the October certificates and notes, into bills both to obtain greater safety and because of the relatively high bill rate. With bills yielding .92 per cent and a 13-month 1 1/8 per cent note completely discounted by the market, the one-year market yield of .99 is too low. The Federal Reserve purchases in support of the 1 per cent rate are independent of need for reserves, and excess reserves are expected to increase somewhat for the week.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 13, 1947

To Chairman Eccles

Subject: Necessity to support entire

From Thomas Lee Smith

bond list to keep market steady.

Mr. Rouse reports that the market has gone "kind of sour" and that offers have become persistent without any takers. His object is now to maintain an orderly market as well as to support prices.

The weakness in bond prices has spread through the entire list to the point where the 2 per cent and the 2 1/2 per cent eligible bonds as well as restricted bonds will have to be supported. The 2 1/2 per cent September 1967-72 bank eligible issue is down 11 1/4/32 on the day to 11 1/4 10/32 bid which is 2 points lower than the high at about the end of August.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 14, 1947.

To Chairman Eccles

Subject: _____

From Ralph Young

Mr. Rouse called at six o'clock yesterday to report two items from a conversation with the Treasury, as follows:

- (1) The Treasury plans to go forward with retirement of 100 millions of Treasury bills next week.
- (2) The Treasury is hesitant about going forward with another call at this time. Rouse, however, recommended that they make such a call and suggested that the Treasury discuss the matter with the Board before making a final decision.

The market has turned fairly sour necessitating some transactions in bonds for purposes of maintaining orderly market conditions.



cc: Governor Szymczak
Mr. Thurston

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Mr. Eccles

Office Correspondence

Date November 14, 1947

To Chairman Eccles

Subject: Effect of Treasury operations

From Thomas Lee Smith

on reserves during next week

Since reporting to you Mr. Rouse's recommendation to Mr. Hefflefinger that 100 million dollars of Treasury bills be retired on November 20, I have discovered that the Treasury expects to receive 143 million dollars during the week ending November 19 from the sale of the "Big Inch", which will put additional pressure on the market.

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Furthermore, an announcement of the Board's special reserve proposal probably would cause sales of intermediate securities without an improvement in bank demand for short-term securities. The result would be downward pressure on the whole range of bond prices.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

12:50 PM

Office Correspondence

Date November 14, 1947

To Chairman Eccles

Subject: _____

From Woodlief Thomas

Rouse reports that the Treasury has decided to postpone the announcement as to the refunding of the December 1 certificates until Monday afternoon after the President's Message to Congress. There is a rumor that they may decide to offer an 11 to 12 month 1 per cent issue rather than a 1-1/8 per cent issue, but he has heard nothing from the Treasury to indicate that such a decision is likely. He intends to indicate his view, which is also that of Sproul and corresponds to yours, that the program should go forward as planned. The market expects the 1-1/8 per cent issue and has adjusted to such a rate. To offer something different at this time would be an indication of weakness. He agrees with you also that the situation in the long-term market is due primarily to other factors than the rise in the short-term rate and should not be a consideration in determining what rate should be placed on the new certificate issue.

The bond market, which was exceedingly shaky yesterday, is firmer today, but Rouse feels that the selling is by no means finished. He will follow a vigorous policy in supporting the bond market, particularly the long-term issues. The bank eligible 2-1/2's were permitted to decline sharply yesterday, which is not undesirable as these have been selling out of line.

Rouse believes that it will be necessary to give support to the medium-term bonds. The market is not capable of absorbing all the selling that may come in particular issues; therefore, it may be necessary to make some purchases in order to maintain an orderly market. The 2 per cent issues, in his opinion, are now selling on a basis that is reasonable for a 1-1/8 per cent one-year and a 2-1/2 per cent long-term rate.

It had been his intention, following announcement by the Treasury of a 1-1/8 per cent certificate rate, to raise the System's exchange bids on bills from an average of .92 to an average of .96 next week. If the Treasury does not announce the 1-1/8 per cent certificate rate, then he will not raise his bid rate on bills. I expressed the view that if the market is shaky perhaps it would be well to keep the bill rate unchanged for a week, even though it will be out of line with the 1-1/8 per cent certificate rate. He thought that such a policy might help to firm the market but did not indicate what he would do in case the new certificate was offered at 1-1/8 per cent.

Mr. Rouse expects to talk with Mr. Wiggins soon and will let me know in case he learns anything new about the certificate offer.

M. J.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 14, 1947

To Chairman Eccles

Subject: _____

From Woodlief Thomas

4:50 P. M.

STRICTLY CONFIDENTIAL

The Treasury decided to make an announcement today regarding the December 1 certificate offer in accordance with the Open Market Committee's proposal. This decision was reached after Mr. Rouse talked to Under Secretary Wiggins indicating the desirability of continuing along the lines contemplated.

With respect to handling of bills next week, Mr. Rouse and Mr. Sproul felt that the System also should continue a consistent policy and raise the bid rate on bills somewhat, in accordance with the higher certificate rate. He contemplates, however, raising it by only .02 points to .94 instead of to .96 as previously planned. He thought we could continue, however, to support the October 1 certificates at a slight premium.

With respect to the November 28 bill maturity, which amounts to \$1.3 billions (compared with \$1.2 billions for the past two weeks), Mr. Rouse is planning to suggest to the Treasury that retirements be raised to \$200 millions. Consideration will be given next week to the question of whether there should be another call on war loan deposits, which will be the factor affecting reserves.

W. J.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 18, 1947

To Chairman Eccles

Subject: System buying rate on

From Thomas Lee Smith

October certificates and notes.

Mr. Rouse talked yesterday morning with Mr. Wiggins at the initiative of Mr. Wiggins, who also talked independently with Mr. Sproul, about the state of the market. Rouse and Sproul had a chance to talk in between. Mr. Wiggins and Secretary Snyder were concerned less the market drop off again yesterday and also about the effect of raising the System bid on bills. Rouse and Sproul reassured them about the ability of the System to maintain an orderly market, and stuck to the decision to raise the System bid on new bills. The bid rate was increased by .02 per cent to .93 per cent.

Mr. Rouse also told Mr. Bartelt that the System intended to let the market rate on October certificates and notes rise a little. In the last few days, large System purchases to protect the prices of these issues have probably resulted in some increase of excess reserves, and the most recent increases in the bill and certificate rates will cause additional selling. The figures are as follows:

<u>Purchased</u>	<u>For Delivery</u>	<u>System purchases of Oct. certifi- cates and notes (In mil. of dollars)</u>	<u>Change in excess reserves</u>
Nov. 12	Nov. 13	154.2	+ 99
Nov. 13	Nov. 14	101.6	+ 121
Nov. 14	Nov. 17	83.8	
Nov. 17	Nov. 18	98.5	

Therefore, the System buying rate on October certificates and notes is being raised today to par, which is consistent with market bids of 1.01 per cent and offers of .99 per cent, and it is intended next week to raise the System buying rate gradually to 1.03 per cent.

Yesterday, the System purchased from institutions 10 million dollars of the 2 1/4 per cent September 1956-59 bonds, which were in supply, to permit institutional purchases of restricted bonds, thus indirectly supporting the price of the latter.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 19, 1947

To Chairman Eccles

Subject: Retirement of bills Nov. 27

From Thomas Lee Smith

and redemption of System holdings of
maturing certificates.

Mr. Rouse reports that, if the Treasury asks his opinion, he will suggest retirement of 200 million dollars of the 1,302 million dollars of Treasury bills maturing next week.

The manner of financing the retirement of the bills and the increase in System's bid rate for the new bills will have to be decided by Friday. If no call were made, the Treasury balance with reserve banks would be about 1.3 billion dollars after the 200 million dollar redemption on the 27th and war loan deposits would be about 1.5 billion dollars. Mr. Rouse tentatively favors a 10 per cent or 150 million dollar call if the Treasury redeems 200 million of bills, and an increase in the System bid rate of only .008 per cent instead of .02 per cent. The question is whether to jump the rate now and then taper the increases to a point in line with the increase in the certificate rate; or whether to reach the same point gradually over about four weeks to keep the market stirred up during the period.

Mr. Rouse also is planning to redeem the System's holdings of certificates maturing December 1 unless notified otherwise. As of the close on November 18, the System held 138.8 million dollars of these certificates.

The market quotation today on the new 1 1/8 per cent 13-month note on a when-issued basis is 1.10 per cent bid and 1.08 per cent asked.

The market opened fairly steady, although dealers dropped their quotes on the bank 2 1/2's about 5/32. Such a drop is consistent with an orderly market and a further approach to a yield differential, compared with restricted issues, at which the price of the bank 2 1/2's will take care of itself.

BOARD OF GOVERNORS
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Office Correspondence

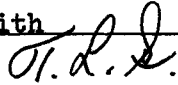
Date November 19, 1947

To Chairman Eccles

Subject: System support of bank

From Thomas Lee Smith

eligible bonds.



In a conversation with Mr. Rouse yesterday evening, he pointed out that the System is having to support almost the entire bank eligible bond market since it is impossible to give adequate support to particular sectors of the bond market if other sectors are ignored.

The key issue for support is the 2 1/4 per cent September 1956-59 issue. The System has bought about 20 million of this issue in the last two days, in part from savings banks who in turn have purchased the 2 1/4 per cent 1959-62 restricted issues. The size of the purchases has been partly a matter of cooperating with the Treasury in its expressed desire to let the price of the 1956-59 issue drop only slightly in order to bolster the price of the 1959-62 issues until the downward pressure on the latter issues abates.

The support of the longer partially tax-exempt and bank eligible 2 1/2 per cent issues is purely an orderly market operation. Mr. Rouse feels that the bank 2 1/2's will decrease in price from 6/32 to 20/32 more before they reach a level that can be maintained without support.

Mr. Rouse expressed no concern about the market other than the possibility that substantial selling of short-term tax-exempt issues might develop, which would require System action. Such selling has not developed so far.

The adjustment of the October certificate rate in the market to 1.01 per cent bid and .99 per cent offered was made smoothly, and coincided with a sharp decrease in offerings of this issue.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 21, 1947

To Chairman Eccles

Subject: Condition of Market

From Thomas Lee Smith

Mr. Rouse tells me that the market condition is potentially serious. There has been no buying at all and, while the selling has been light, there is a large volume of potential selling in the background. Bonds callable before 1951 are unchanged, but intermediate 2's are off as much as $6/32$ with the bank 2 $1/2$'s off $9/32$. Partially tax-exempt bonds are off as much as $4/32$. Quite a feeling of apprehension has been created in the market by the story in the Wall Street Journal that the Federal Reserve will ask for broad powers to regulate credit, which have also appeared on the ticker and all over the country.

When the market began to snowball, the System stopped it by showing substantial bids for a number of issues. It is now in hand. The System purchased around 20 million dollars of bonds, including 5 million of the June 1967-72 issue, 5 million of the 2 $1/4$ per cent 1956-59 issue, 1 $1/2$ million of the bank 2 $1/2$'s, and 5 million or so of various 2's.

When the price decline gathered momentum, there was not time to reach you. Mr. Rouse has put in a call to Mr. Thomas, but had not reached him by the time I talked to him.