

C O P Y

Honorable John W. Snyder,  
Secretary of the Treasury,  
Washington, D. C.

CONFIDENTIAL

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Dear John:

The executive committee of the Federal Open Market Committee met on January 20 and considered the related questions of credit policy and debt management during the first quarter and the first half of 1948. It is the committee's opinion that Federal Reserve and Treasury debt management policies during the immediate future, and unless and until conditions change, should be determined with a view to placing continuing and persistent restraint upon the expansion of bank credit which is contributing to existing strong inflationary forces. It seems likely that there will be a heavy demand for bank loans from business, from consumers, and from real estate owners during the next few months. Further expansion of bank loans to meet these demands will help to finance the continuance of inflation.

The existence of a large Treasury surplus in the first quarter of the year is the main weapon available for combating inflation in this area. In the first instance, receipt of taxes by the Treasury in excess of current expenditures will reduce bank deposits and bank reserves. The use of this excess to retire debt held by the Federal Reserve Banks will keep these funds from returning to the commercial banks, as they would if the excess were used to retire securities held by such banks or other investors. Since it is the withdrawal of funds from the market by the Treasury which directly affects bank reserves, the timing of these withdrawals is an important factor in the control program. The timing of the retirement of securities held by the Federal Reserve Banks representing, as it does, largely a bookkeeping transaction with the Federal Reserve Banks, is not important from the standpoint of the money market.

As an aid in the consideration of problems of open market policy and debt management which this situation requires, estimates of the important elements relating to bank reserves, Treasury balances, and debt retirement by weeks for the first quarter of the year and by months for the half year, based on certain stated assumptions, were prepared by the staff of the Board of Governors, and are given in the attached memorandum.

On the basis of its consideration of these data the executive committee suggests that the Treasury retire all of the Federal Reserve holdings of certificates and bonds maturing in February, March, and April. In addition, it is suggested that the Treasury retire 100 million dollars of bills each week. On March 18, April 1, and April 8, when maturities are larger than in other weeks, retirements could be increased to 200 million or 300 million if funds are available.

The question of timing of Treasury withdrawals of funds from the market is complicated by the necessity of support of Government securities prices by the Federal Reserve Banks, which puts funds back into the market. In view of the indicated large withdrawals by the Treasury from bank reserves, it is expected that the banks will sell a considerable amount of Government securities between now and early April in order to maintain their reserves (and thus to maintain their loans and their other investments), and that the Federal Reserve Banks will be the principal if not the only buyers. The amount of securities that the banks will need to sell will be considerably less than the total drain by reason of Treasury transactions, of course, because of the expected inflow of gold and return flow of currency and possible other offsetting factors. The necessary sales by banks will be further reduced to the extent that nonbank holders of Government securities continue to sell part of their holdings and the securities are purchased by the Federal Reserve Banks, an operation which also provides commercial banks with reserve funds. The System's purchases of restricted bonds (sold by nonbank investors) have already exceeded a billion dollars since the beginning of the year. If they continue at this rate, the pressure on banks will be considerably reduced.

The committee was unanimous in its opinion that pressure on the reserve position of the banks should be exerted continually throughout this period, in order to restrain further expansion of bank loans, but was divided in its opinion as to whether the means available should practically all be used in the first quarter of the year, or whether some considerable part should be reserved for use in the second quarter. One view was that the maximum possible pressure on the reserve position of the banks should be maintained now; that unless the trend of expansion of bank credit is checked during the first quarter of the year the battle is likely to be lost. The other view was that a steady, persistent pressure would be just as effective as a more concentrated drain on bank reserves now, and that this would permit the retention of some ammunition for use in the second quarter of the year. Those who held the first view advocated much larger withdrawals of Treasury funds from war loan accounts, during the first quarter, than would be desirable if the second view prevailed. Both views took account of the fact that Treasury expenditures will exceed receipts during the second quarter of the year and that Treasury transactions

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will then be supplying funds to the market. In addition, the banks will no doubt gain reserves, during that period, through continuance of gold inflow. Unless the Federal Reserve System is to be granted additional powers by the Congress, therefore, or unless a substantial Treasury balance is to be left in war loan account (for withdrawal during the second quarter), the means of restraining a further expansion of bank credit will be temporarily exhausted by early April; it being assumed that maintenance of an orderly market in Government securities will continue to be part of our policy, and that substantial sales of Government securities by the Federal Reserve Banks will not be possible.

In consideration of both views expressed in the committee, and since decision as to the timing of calls on war loan deposit accounts need not be taken immediately, it was agreed that these accounts should be built up to at least a billion dollars and that recommendations as to calls could be made later in the light of developing conditions in the money market.

No matter which program is followed with respect to calls on war loan accounts, the drain on bank reserves from Treasury transactions and the possible use of powers still available to Federal Reserve authorities, during this period, may result in a further tendency for short-term money rates to rise. This would be especially true if bank loans continue to expand. It is the committee's view that any tendency for short-term rates to rise should not be opposed by System purchases of these securities at existing rates. On the contrary, in these circumstances the committee believes that it would be desirable for the Treasury to refund its March 1, March 15, and April 1 maturities with new issues maturing April 1, 1949, and bearing a coupon rate of 1-1/4 per cent.

We shall be glad to discuss this program at your convenience.

Sincerely yours,

(SIGNED) MARRINER

M. S. Eccles, Chairman,  
Federal Open Market Committee.

Enclosure

cc: Chairman Eccles