BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

March 8, 1948.

CONFIDENTIAL

Honorable John W. Snyder,
Secretary of the Treasury,
Washington 25, D. C.

Dear John:

The Federal Open Market Committee, at meetings on February 27 and March 1, reviewed the general credit position and related problems of debt management in the light of changes in the economic situation which have taken place since its previous meeting. It was the opinion of the Committee that inflationary pressures are still strong in our economy, despite the sharp decline in commodity prices during February, and that there is as yet no convincing evidence that the need for restraint upon borrowers and lenders of credit has passed. In the light of this general finding, and for more specific reasons which are mentioned below, the Committee believes that we should continue the program of credit control and debt management we have been following for the past several months, and makes the following four point recommendation to the Treasury.

(1) In view of an expected substantial net drain on bank reserves in March, resulting from an excess of Treasury receipts over expenditures, no further calls on war loan accounts are recommended (during March) except as may become necessary for money market reasons in event withheld taxes are channeled through war loan accounts as suggested in paragraph (4) below.

(2) Federal Reserve holdings of maturing certificates on April 1 should be redeemed and the retirement of Treasury bills should be continued as long as funds are available. In order to make the weekly maturities of bills more nearly even in amount, it is suggested that 200 million dollars be retired on March 18, 300 million on April 1 and April 8, and 100 million in other weeks.

(3) An 11-month 1-1/8 per cent certificate issue should be offered in exchange for the 7/8 per cent issue maturing April 1, 1948. This would accomplish a desirable consolidation of the small April 1 issue with the outstanding March 1 maturities, and would pave the way

for an increase in the one year certificate rate to 1-1/4 per cent, as of June 1, if the credit situation and the situation in the Government securities market confirm present expectations that such action will be desirable when the June 1 financing terms are determined. On the other hand, if there should be a complete reversal of existing pressures in the intervening weeks, the Treasury would still be free to fix the terms of the June 1 financing in the light of these changed circumstances.

The Committee wishes to emphasize that in the absence of such a complete change in the existing situation its recommendation of an eleven months 1-1/8 per cent certificate to be issued as of April 1 is predicated upon the assumption that the one-year rate will move up to 1-1/4 per cent with the June 1 issue. Otherwise we might find ourselves in the untenable position of appearing to reduce rates and release pressure (by issuing a one-year 1-1/8 per cent certificate on June 1 following the eleven months 1-1/8 per cent certificate on April 1), at a time when credit policy and the condition of the Government security market counselled contrary action.

(4) As a means of providing better control of the impact of Treasury transactions on the money market, we are in accord with your proposal that the payment of withheld income taxes through bank depositaries should be channeled into war loan accounts rather than directly into the Federal Reserve Banks. Calls on war loan deposits would presumably be timed in the future, as they have been in the past, after consultation between the Treasury and the Federal Reserve, with a view to obtaining desirable money market effects. If the procedure for channeling withheld taxes through war loan accounts is not put into effect before the middle of March, no calls on those accounts will be needed before April. of March no call

We should be glad to discuss these recommendations with you, at your early convenience, and particularly our recommendation with respect to the April 1 financing, but perhaps it will be helpful to our discussion if we indicate here what underlies the latter recommendation. Briefly, we are of the opinion that from the standpoint of balance in the Government security market and the maintenance of an effective monetary policy, some further narrowing of the spread between short and long-term rates is necessary, and that the April 1 maturity offers an excellent opportunity to take the first step toward this objective, since there will be a period of two months (between the April 1 announcement and the June 1 announcement) within which to smooth the market effects of the transition to the higher rate. Our purpose in moving to a higher rate would be to increase the attractiveness of short securities, both in relation to the longer term obligations and to other outlets for bank funds.

It now appears likely that pressure on the banks' reserves will be greatly lessened after the first quarter of the year and that banks may actually acquire additional reserve funds (as a result of Treasury transactions, gold imports, and other factors). In these circumstances, it seems to us imperative that the commercial banks be encouraged to purchase short-term Government securities from the Federal Reserve Banks (in order to absorb their excess funds) rather than the System's holding of bonds, or to seek other outlets which would further increase the supply of credit at the disposal of the public. Otherwise we may again be faced with the problem of "playing the pattern of rates", with downward pressure on the long-term rate reasserting itself, or with a further unnecessary expansion of bank loans, or both. And, finally, our hands would be tied, at a most inappropriate time, with respect to a further increase in the discount rate of the Federal Reserve Banks, unless the certificate rate had also been advanced.

The executive committee of the Federal Open Market Committee will be meeting from time to time to canvass the situation further as it develops during the second quarter of the year.

Sincerely yours,

(Signed) Marriner

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

March 8, 1948

CONFIDENTIAL

Honorable A. L. M. Wiggins,
Under Secretary of the Treasury,
Washington, D. C.

Dear Lee:

There is enclosed for your information a copy of a letter which I am sending to John Snyder this afternoon.

Sincerely yours,

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

Enclosure

SRC/mg
cc: Chairman Eccles

March 8, 1948

CONFIDENTIAL

Mr. E. F. Bartelt,
Fiscal Assistant Secretary,
Treasury Department,
Washington, D. C.

Dear Ed:

There is enclosed for your information a copy of a letter which I am sending to John Snyder this afternoon.

Sincerely yours,

(SIGNED) MARRINER
M. S. Eccles, Chairman,
Federal Open Market Committee.

Enclosure

SRC/mg

cc: Chairman Eccles