February 4, 1949

CONFIDENTIAL

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

Dear Mr. Secretary:

In the absence of Chairman McCabe I have undertaken to summarize below the views of the executive committee of the Federal Open Market Committee with respect to the problems of credit policy and debt management as discussed with you on January 26 and at a subsequent meeting of the committee on that day:

1. The Treasury program of calls on war loan accounts to offset the seasonal return flow of currency, gold imports and other factors and to maintain some pressure on bank reserves has worked satisfactorily and should be continued.

2. Available Treasury balances should be used to retire System holdings of March and April certificates and to redeem $600 million of Treasury bills during the latter part of March and early April.

3. The present System policy with respect to bids for bills and purchases and sales of bills has proved satisfactory and should be continued.

4. With the lifting of pressure from the long-term market, the most pressing consideration to be taken into account in setting the rate for the March and April certificate refundings is the desirability of holding investment interest in a steadily growing volume of short-term debt. The market will be called upon to absorb a very heavy volume of refundings in the near future. Certificates will mature in the amount of $30 billion in the coming year. In addition $1 billion of bonds will mature in June, $1.3 billion in September, and $4.4 billion in December. The proportion of the public debt falling into the shorter maturities is already

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large and will increase substantially. Short-term rates should be set at a level which will attract investment in these issues and avoid or minimize the inducement to "play the pattern of rates".

a. During recent weeks there has been growing evidence of a tendency on the part of the banks to resume this practice. The System has been called upon to purchase bills in large volume while banks were increasing their purchases of eligible long-term bonds. The System's portfolio of eligible bonds callable after 4 years now amounts to only a little over $300 million. If the practice of "playing the pattern of rates" continues or spreads significantly, it will be impossible for the System to prevent a disorderly rate structure and to keep long-term bonds, particularly bank eligibles, from developing erratic premiums.

b. Once the System is unable to sell long-term eligible bonds to offset its acquisitions of short-term securities, excess reserves will again be created in large volume leaving the undesirable alternative, which the System would like to avoid, of imposing higher reserve requirements on member banks.

c. While in the opinion of the committee it will shortly become desirable to refund some of the maturing debt into intermediate term securities this cannot be accomplished within the present structure of rates without accentuating the problem of market support and debt management.

d. A short rate that will hold market interest will permit the continued refunding of maturing long-term bonds into shorter issues without increasing the aggregate cost of servicing the market-held debt. It will also tend to avoid undue concentration of short-term debt in the portfolios of the Federal Reserve Banks.

e. Since there is to be continued support of the 2-1/2 per cent long-term rate, it is essential that there be permitted a greater degree of flexibility in short-term

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rates. It is not possible to exercise a flexible monetary policy with two pegs--one at the short end and one at the long end--as far apart as at present.

5. All these considerations point toward the desirability of refunding the certificates maturing on March 1 into a 1-3/8 per cent 1-year certificate or a 13-month 1-3/8 per cent note. The latter would make possible the combination of the March and April maturities into a single issue.

The committee's views are based on the conviction that preparation should be initiated now for the successful placement outside the Federal Reserve Banks of the large amount of financing necessary to refund issues maturing or callable through 1952. We hope you will find yourself in agreement with these views.

Sincerely yours,

Allan Sproul, Vice Chairman,
Federal Open Market Committee.

SRC/mg

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February 9, 1949

Dear Allan:

Reference is made to your letter of February 4, 1949, summarizing the views of the Executive Committee of the Federal Open Market Committee with respect to the problems of credit policy and debt management developed during discussions of the Committee on January 26, 1949.

I have given careful consideration to the views of the Committee suggesting the desirability of refunding the certificates maturing March 1 into a 1-3/8% one-year certificate or a 13-month 1-3/8% note. In the light of conditions existing at this time I find myself unable to agree that the certificate maturing on March 1 should be refunded into a 1-3/8% security, and I feel that it is too early to decide what should be done in the refinancing of the certificate maturing April 1.

It is noted that the Committee suggests that the present System policy with respect to bids for bills and purchases and sales of bills be continued. As you know, I have had some apprehension concerning the gradual rise in the bill rate, but understand that it will be the policy of the Federal Reserve to exercise a high degree of caution so as to enable the Treasury to continue the refinancing of the floating debt at the current one-year rate of 1-1/4% until such time as a different rate can be mutually agreed upon.

With respect to a program for the redemption of maturing Treasury bills during the latter part of March and early April, I am in general agreement that Treasury bills be redeemed as the Treasury balance and market conditions permit, but I would prefer to continue the present policy of considering Treasury bills on a week-to-week basis and making our decisions accordingly.

It seems to me we should permit more development in the present factors affecting debt management before making any substantial changes in our refunding operations or to move to higher levels for the one-year rate. The April 1 maturity of certificates

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amounts to only $1 billion, or thereabouts, and there is no further maturity until June 1. In a few months we can better judge the course of events with particular reference to the legislative program which might be enacted, including the action which the Congress may take in connection with the President's recommendation for increased taxes. We will then have a much better base upon which to plan our operations covering the period from June through the balance of the year.

In line with these views, I am reluctant at the present time to use the cash balance to retire any of the System's holdings of certificates maturing on March 1, and would prefer to have the System exchange its holdings of this maturity.

Sincerely yours,

(Signed) JOHN W. SNYDER

Secretary of the Treasury

Mr. Allan Sproul,
Vice Chairman,
Federal Open Market Committee,
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Washington 25, D. C.

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