Mr. Eccles

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 4, 1949.

CONFIDENTIAL

Dear Sir:

There is attached a copy of the letter prepared in accordance with the understanding at the meeting of the executive committee of the Federal Open Market Committee on January 26, 1949, and handed by Mr. Sproul to the Secretary of the Treasury at a meeting at the Treasury today.

Very truly yours,

S R Carpenter

S. R. Carpenter, Assistant Secretary,
Federal Open Market Committee.

Attachment

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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 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 can not 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 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,

(Signed) Allan Sproul

Allan Sproul, Vice Chairman,
Federal Open Market Committee.