4:30 p.m.,
February 24, 1951.
Cleared by Martin
but not by Bartelt
and Haas.

REPORT ON CONVERSATIONS AT THE TECHNICAL LEVEL OF TREASURY AND FEDERAL RESERVE SYSTEM REPRESENTATIVES

Participants:	Treasury -	Mr. Wm. McC. Martin, Jr. Dr. George C. Haas Mr. Edward F. Bartelt
	Federal Reserve -	Mr. Winfield W. Riefler Mr. Woodlief Thomas Mr. Robert Rouse (N.Y.Federal)
First Meeting -	Tuesday, February 20, 1951, 1:00 P.M., beginning at luncheon in Mr. McCabe's office. Adjourned at 2:45 P.M. to Federal Reserve Board Room and continued until 4:30 P.M.	
Reconvened -	Tuesday, February 20, 1951, 8:30 P.M., home of Mr. Riefler Adjourned at 11:30 P.M.	
Reconvened -	Wednesday, February 21, 1951, 2:30 P.M., Library of Federal Reserve Building Adjourned at 6:15 P.M.	
Reconvened -	Friday, February 23, 1951, 9:45 A.M., Library of Federal Reserve Building Adjourned at 12:15 P.M.	

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It was clearly understood by all that these were explorations at the technical level and not negotiations.

Lengthy discussion of the techniques of the Open Market Committee and the necessity for better liaison between the Federal Reserve and Treasury was a part of the early discussion, and it was clear that both of us could be better informed on the thinking of the other.

Inasmuch as the Federal Reserve group had a specific proposal, approved by the Open Market Committee, in the letter of February 7 of Chairman McCabe to the Secretary, most of the discussion attempted to clarify what was intended in that letter.

The Federal Reserve group continuously asserted the unhappiness of the Open Market Committee in continual monetization of the Federal Debt, particularly at premium prices and they made it clear that it was the judgment of the Committee that the price of the long-term bonds should be permitted to drop to par.

There was considerable discussion of the rigidities in the present market and the fact that a large amount of selling was probably because of commitments already made by insurance companies, savings banks, loan associations and the banking system, and the consequent replenishing of reserves through sales to the Federal Reserve in the open market of Government securities.

Under the policy proposed in the February 7 letter, the Federal would withdraw support from the short-term securities market and let it adjust itself around the 1-3/4% discount rate now prevailing. They believe that once these adjustments were made, a groundwork would be laid in the

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market which would act as a deterrent to lending and at the same time make it possible to undertake in a more orderly fashion, although at somewhat higher rates, the refinancings which the Treasury faces in the final six months of the Calendar Year 1951.

Much of their argument revolves around the traditional abhorence of the banks for borrowing from the Federal Reserve and their confidence in the restraining influence of borrowed reserves. Under these conditions short-term rates adjust to the discount rate.

Under considerable pressing by the Treasury group, the Federal Reserve group were willing to explore with the Committee the feasibility of a commitment to maintain the discount rate at 1-3/4% for a period of time running through December 1951 in order to facilitate Treasury planning of new money and refinancing at the new levels established as a result of these adjustments. It was pointed out, however, that any such advance commitment might present difficulties since it would involve all directors of all 12 Federal Reserve Banks as well as the Board of Governors.

There was long discussion, and much of it sympathetic, of a proposal advanced principally by Mr. Riefler that the Secretary announce a non-marketable 2-3/4% long-term, installment retirement, bond (29-1/2 years) which could be exchanged forthe existing 2-1/2's June and December of 1967-72, the desire being to lock these two issues up as much as possible and remove them as an important market factor. A feature of this issue might be an alternative of exchange for 1-1/2% five-year notes for those who desired to cash them or wanted a marketable issue.

At the concluding session it was suggested by the Treasury group

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that if the Secretary should offer no objection to the Federal Reserve proposal with respect to the adjustment of short-term rates and should decide to announce a 2-3/4% long-term nonmarketable issue, to be exchanged for the outstanding long-term restricted issues, the Federal Reserve might consider maintaining the current levels in the June and December issues until it was demonstrated whether they would continue to require support. In the event that continued support were necessary, the Treasury group suggested that the Federal Reserve and the Treasury could meet again to consider the problem.

This was put forward, not as a counter proposal, but on an exploratory basis and with an earnest plea on the part of Mr. Bartelt that we not attempt to prejudge the market. It was his hope that such an arrangement would release pressure from the market and permit us to get a start on the refinancing program without impairing further public confidence in the markets.

It was suggested by the Federal that if the Treasury desired to test the new exchange issue this way, they might consider an agreement that the cost of supporting the first two hundred million purchased be shared equally by the Treasury and the Federal Reserve, that the Treasury carry 75 per cent of the cost of the succeeding $400,000,000, and that the Treasury carry the whole amount of any purchased in excess of $600,000,000.

There was a lot of talk about secrecy and the difficulty if such an agreement leaked in any other way than through the published statements of the Federal and the Treasury, and the belief on Mr. Bartelt's part that knowledge that the Treasury and the Federal had gotten together would act as a tonic in restoring confidence to the market.

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There was general agreement throughout the discussions that the so-called feud between the Treasury and Federal was a most significant psychological factor in the current situation. Both groups attached great importance to the public's fear of further loss in the purchasing power of the dollar.

After extended discussion, it seemed to be generally agreed by all that the Federal Reserve approach was essentially a "package one" and is not susceptible, with any consistency, to very much compromise, unless there is a drastic change in the existing market situation, which on the basis of our talks appeared unlikely in the near future. It is the Federal view that their proposal would involve no serious disruption of the security market. They feel that the increased flexibility of the market would produce more confidence.

Their major point is an unwillingness on their part to continue monetization of debt. They concede that maintenance of orderly markets will entail some further monetization which they would hope to keep at a minimum.

There was general agreement that we were discussing degrees rather than absolutes, and that the Treasury was questioning the effectiveness of the operation, and also questioning the Federal evaluation that the repercussions in the market would not be serious.

Both sides agreed that monetization of debt must be stopped as far as possible. The Federal Reserve position was firm that this could not be done without repercussions in the money market while the Treasury view

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has been that it could be minimized through direct controls which were preferable to increasesin interest rates. This was the philosophy back of the Secretary's January 18 address. Upon exploration of the proposals in the light of that address, however, it was agreed that the proposals discussed did not run directly counter to that address. He did not discuss an exchange issue. Such an issue at 2-3/4%, if it were long-term and nonmarketable, would not be inconsistent with a 2-1/2% rate on the outstanding marketable issues.

At the end of the meetings it was made clear again that these were only exploratory talks. Accordingly, it was suggested that the matter now be referred to a higher level where negotiations or counter proposals might take place.

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