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B/D 6/7/51

1. By a succession of steps involving principally redemption of most of our maturing bills we took $647 million of reserve funds out of the market between April 26th and May 29th. Other factors affecting the banks reserve position caused a net decrease of $407 ~~$247~~ million in reserves, but required reserves declined $246 million. Member bank borrowings increased from $149 million to $538 million and excess reserves were reduced from $693 million to $279 million. With the shutting off of ready and profitable access to additional reserve funds (through sale of Government securities to the System) the money market for the first time in years became tight for an extended period and interest rates moved upward.

2. On May 28th, having waited until the latest possible date in accordance with Federal Open Market Committee recommendations, the Treasury announced the terms of refunding on its June 15th and July 1st maturities, including $1,627 million 2 3/4 per cent bonds maturing June 15th and $8,445 million notes maturing July 1st. The Treasury offered in exchange a 9 1/2 months 1 7/8 per cent certificate. The terms of this offering were generous in the light of the existing market and were tailored to meet the needs of banks and of many nonbank investors who held substantial amounts of the maturing issues. This also was in accordance with our ideas.

3. We were then faced with an obligation both in terms of orderly markets and our accord with the Treasury to do whatever we could to assure the success of the financing. That success would be measured in the light of market acceptance of the offering and the climate thus created for future refundings and possible new money borrowing, and in the light of the amount of the maturing obligations redeemed for cash - the so-called attrition. It is very difficult to meet these tests of success in a market which expects further near term increases in

interest rates, which would mean an immediate book loss to those who exchange their securities and which would mean that a higher yield could be obtained by waiting until after the refunding to purchase your investment requirements.

4. The Treasury's offering of 1 7/8 per cent for 9 1/2 months was above the then existing market which was around 1 3/4 per cent for that period. Either the "rights" would command a premium or the whole market would move up in terms of yield - down in terms of price - to the rate on the new issue. To help assure success as defined we took steps to see that the "rights" commanded a premium.

5. To do this and to absorb the selling of those who for one reason or another wanted to get cash and found it profitable to get cash by selling at a premium rather than redeeming, we have had to put some reserve funds into the market, at least temporarily. In addition, the banks gained reserve funds temporarily through the mechanics of the exchange of old series savings notes for the new series bearing higher yields which became available June 1st, and there was a substantial net gain of reserves to the banks due to an increase in float. Since May 29th, the banks have been able to reduce their borrowings by $432 million to $108 million, excess reserves have increased by $533 million to $833 million, and the money market has eased.

6. For the statement week ending yesterday System holdings of Government securities increased by $386 million from which can be subtracted a $25 million decline in our holdings under repurchase agreements, or a net increase of $361 million. This included purchases aggregating $885.5 million, mostly the maturing issues or "rights", sales aggregating $455.8 million, mostly bills and short notes, and a redemption of $44 million of bills.

7. This is a real testing period for our general credit controls as a part of an anti-inflation program. We have already had considerable success in damping down the expansion of credit, both commercial and mortgage, by the steps we have taken, but most recently these steps have been taken in the absence of the complicating factor of frequent and large Treasury financing. We now have the more difficult task of holding our gains in the face of the Treasury's requirements during the second half of the year. Fortunately, the Treasury is now working with us in terms of an integrated debt management-credit control program and, if the inherent difficulties of the situation are not too great, we can retain part of our gains and perhaps achieve a further measure of success.

8. For the whole two week period on which the directors should act today, changes in System account holdingsincluded purchases of $891,565,000, sales of $468,290,000, redemptions of $158,304,000 and exchanges of $102,212,000, a net increase of $264,971,000. Subtracting the decline of $25 million in our repurchase agreements gives a net increase of $239,971,000.