

1. Last meetings June 17-20, just after Treasury offering 3 1/2 billion 2 3/8 - 6 year bond which resulted in subscriptions between 11 and 12 billion and allotment of 4 1/4 billion. Happy days.
2. Decided current economic and credit situation was one of latent but not active inflation which suggested wisdom of keeping a close check rein on credit. In terms of open market operations this meant allowing market to adjust itself to changing money conditions with a minimum of interference by System, while at same time encouraging member banks to meet reserve needs at the discount window. Reaffirmation of policy of neutrality.
3. When the Executive Committee met on July 22nd, except for the steel strike, the economic outlook was much the same - precarious balance at high levels of production and employment, with inflationary pressures latent not active.  
  
Events in the banking position were already beginning to overtake us, however, and the so-called policy of neutrality was becoming a policy of at least mild restraint. Bank purchases of 2 3/8% bonds had put the banking system under pressure. Reserve funds were tied up which otherwise could have been used to support an expansion of loans and other investments. The Reserve System was not making funds readily available except through the discount window. The natural result was tightness in the money market and a rise in interest rates. We began to get the cumulative effect of continued and increasing high level borrowing from the Federal Reserve Banks.  
  
We then took stock of the probable seasonal needs for additional reserves and decided to provide some controlled relief through open market operations

while continuing to force banks to meet some of their needs at the discount window. No exact limits were fixed but it was thought this might mean purchases of, say, 1 billion of Government securities and another 500 million of borrowing.

4. The result of that meeting was a letter to the Secretary of the Treasury - July 23rd - in which we set forth our views on economic and credit conditions, stated what credit policy was going to be, and indicated only in a general way what we thought Treasury might have to do in refunding its August 15th and September 1st maturities (2% for one year or less). Important in that we consciously placed more emphasis on credit policy and less on detailed recommendations as to debt management. Treasury decided to refund 2.4 billion with a 2% one year certificate, and we decided to support it in a way which we hoped would best meet needs of credit policy, while making our contribution to the success of the financing. Because of the small size of the issues to be refunded and the Treasury's large cash balances, felt free to experiment. In order to avoid putting funds into market in amounts and at times which might not be consistent with credit policy, and in order to avoid buying securities (the "rights" to the new issue) whose term would not facilitate early disposal or run-off, we bought the maturing obligations at par (no premium) - as well as other shorter term obligations. The issue was deemed a failure by the Treasury - attrition of 391 million or 17% on the Treasury, and we were blamed for not giving adequate support. We bought 180 million of "rights" or 7.5% of the maturing issues, making the total attrition 24.5%.

5. It is significant to note, however, that so far as credit policy was concerned

we were having considerable success. For a period of two months the banks felt a continuous pressure on their reserve positions, became more reluctant and choosy lenders and investors, and total loans and investments were steady. At the same time there was no evidence of interference with the financing of necessary production and interest rates were only moderately higher. The central banking mechanism was working again.

6. There was considerable discussion in the Executive Committee of how to keep up the good work. At its meeting of August 29th several possible guides to action were considered, based on the estimated need of banks for reserves during the rest of the year, and the Treasury's financing needs.

- (a) Keep member bank borrowing at some specified level or permit some specified increase within a given period.
- (b) Set some specified ceiling on bill rates or permit some specified rise in rates during a given period.
- (c) Support Treasury financing with open market purchases and assume or hope that this would do the open market job, the rest to be done at the discount window.
- (d) On basis of normal credit and currency demands during rest of year and the calculated amount of reserves necessary to support those demands, decide how much and when reserve funds would be put into market through open market operations and discounts.

All of these were discussed, none was adopted. Difficulty of foreseeing economic developments which would be the final guide to credit policy, and the wayward and tremendous swings in other factors affecting reserves, highlighted the administrative difficulties of fixing a pattern or program by

Committee action. It was left that open market operations would be carried on,

in accordance with the general policy established and in the light of the Committee discussion of guides.

Here we have perhaps two influences. The legitimate desire of the Committee to go as far as possible in making policy - even to getting into the twilight zone where policy and execution become intermingled. And the natural desire of some members of the staff of the Committee, at least, to have more influence in execution of policy in the belief that they could do it better than the New York Bank and the Manager of the System Open Market Account.

7. At that time - August 29th - it was expected that the Treasury decision on refunding the October 1st certificates, would be made after the return of the Secretary and the Chairman of the Board of Governors from Mexico City on September 15th, and another meeting of the Executive Committee was arranged for that morning to discuss possible suggestions to the Treasury on the financing. As it turned out the Secretary made his announcement in absentia on September 12th, and on September 15th we could only hold a post mortem on that, and discuss methods of System support.

The Committee staff had evidently gone along on a 14 month  $2\frac{1}{8}$  although the Committee, or at least its Chairman and Vice Chairman, had strongly favored not going beyond a year maturity, feeling that the extra two months gained little or nothing and might freeze out some nonbank investors who don't want to go out beyond one year. The Committee staff also had recommendations on how the support of the new issue should be provided - a fixed ceiling on bills, no swaps, no purchases of outstanding issues of about same maturity as new issue, and purchase of "rights" at a premium of  $1/32$ . The idea seemed to be that

ineffective, that support now should be based on the pivot of the bill rate, and that since par for rights had been too low and a premium of 2/32 in previous years too high, we should settle on a premium of 1/32. The Committee decided to support the new issue by purchase of rights at a premium of 3/64. There was no need to dabble in the bill market because funds became so easy - Treasury manipulation of its balances - 257 below zero - float, and our purchases - that bills were in strong demand and bill rates went down substantially. The question of swaps and support of nearby issues did not present itself because with a premium being paid by us on rights, there was no interest in swaps or sale of nearby issues.

The result - transfer of Treasury attrition to us, but no greater success of financing and some breach of our credit policy.

At the beginning of the operation the System Account held 6.7 of the 10.8 of October 1st certificates. We were really dealing with 4 billion in hands of others. The attrition on the Treasury was about 346 million or 8.6% and we bought 714 or 17.8%. These figures approximately reverse the figures of the August-September refunding, we taking the major share of the attrition instead of the Treasury.

I think the lesson is that it hasn't been a question of finespun market techniques, the problem of Treasury financing in a period of credit restraint and prospective higher interest rates, is different from the problem of floating new issues on a sea of constantly rising reserve funds, as the Treasury had always contended without reading into that contention the right answer. We have to expect larger attrition in such circumstances and I think it would be better to have it come on the

Treasury than on us - to the detriment of our credit policy. The Treasury could

then make up its losses with increased issues of bills, which are the most popular because the shortest instruments in the market under such circumstances.

8. At the moment the reserve position continues relatively easy and bill rates are staying down, but there is no life in the rest of the market and the new issue is quoted par + to one + . It is expected that the Treasury will now build up its balance to 400 million again (the Special C. of I. paid off today) that float will decline substantially, and that the banks will lose a lot of their excess reserves and have to begin increasing their borrowing. We are letting 15 million of bills run off this week, but whether we should also sell some securities to prevent a temporary sloppy condition from lasting too long is a question for the Committee, in the light of the economic situation, the credit position, and the Treasury's need for new money. (Now estimated at about 5 billion to be sought in two chunks of 2 1/2 billion with Tax bills - the first chunk perhaps early in October. Bidding on October 3rd - dated October 8th.)