BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

~~PERSONAL AND CONFIDENTIAL~~

December 9, 1950.

Dear Mr. President:

As you can imagine, your telephone call a few days ago and your subsequent letter of December 4 gave me great concern because I was distressed that you should have another problem added to the many critical ones before you.

The newspaper clipping to which you referred had not been previously called to my attention. I would not have considered it of special significance because it is such a distortion of the facts. We suspect that it was written by a man who we know makes a practice of baiting the Federal Reserve and creating an appearance of controversy. You can rest assured that we are fully conscious of the magnitude of the financial problems that face us, and that we will do all in our power to insure the successful financing of the Government's needs.

You will recall that I mailed you a copy of my letter of October 30 to John Snyder in which I outlined the policy to be pursued by the Open Market Committee in accordance with the assurance which I previously gave to you and John in your office on October 26.

We heartily subscribed to the Treasury's latest refunding announcement and I assured John Snyder that the Open Market Committee would do everything possible to make it a success. I told him that we might have to purchase between 2 billion and 4 billion dollars of the new issue before the refunding was completed, but that we were prepared to do it. I told him further that we would make every attempt to sell an equivalent amount of other securities in our portfolio in order to try to offset purchases. Excess of purchases over sales would tend to increase bank reserves. The creation of additional bank reserves in a period like this only adds more fuel to the fire of inflation. We have conducted our operations in strict accord with the policy which I outlined to you and John.

Actually we have purchased more than 2.5 billion dollars of the maturing issue in support of the Treasury refinancing. In addition, we have continued to buy long-term 2-1/2 per cent restricted bonds in the narrow range of from 23/32 to 26/32 above par. Since November 22 we have made a net increase in our portfolio of well over one billion dollars. We hope to sell enough Government securities in the coming weeks to offset the effects these purchases have had on bank reserves.

You can see from these figures that we have faithfully followed the policy as outlined to you.

It is our view that moderate fluctuations in price in response to market forces serve a useful purpose and help to maintain public confidence. Our feeling is that too rigidly pegged prices of securities encourage greater selling by investors. Our experiences over the past several months, in which we have had both rigid pegs for an extended period and slight fluctuations on the long-term restricted bonds, have convinced us that a moderate degree of flexibility is preferable. Since the end of November, covering the period when the subscription books to the new Treasury refunding issue were open, we have maintained a fixed buying price for the long-term restricted bonds.

I would prefer not to take up with the Open Market Committee the question of notifying the New York bankers of a fixed peg until I have had an opportunity fully to discuss with you the possible adverse consequences of such an action.

I expect to be in Birmingham, Alabama, and Chicago until December 15. I will be pleased to see you either on Friday, the 15th, or Monday, the 18th, if either of those dates is convenient to you. I can assure you that in the meantime our operations will be directed toward maintaining stability in the market.

Faithfully yours,

Tom

Thomas B. McCabe.

The President,
The White House.