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MEMORANDUM TO THE PRESIDENT

Last Friday afternoon I announced to the market that the \$13-1/2 billion of Treasury bonds and certificates of indebtedness, maturing or called for redemption on September 15 and October 1, would be refunded into 13-month, 1-1/4 percent Treasury notes, which issues have to be approved by you under the provisions of the Second Liberty Bond Act, as amended. In essence and reality, therefore, the offering of Treasury notes is an action undertaken by the President of the United States.

When the market opened on Monday morning, the Open Market Committee of the Federal Reserve System, through its open market operations, established and maintained a pattern of prices on various short-term issues of Government securities which would justify a 1-3/8 percent rather than a 1-1/4 percent rate on Treasury notes of the type offered in connection with the refunding. Their operations, if continued along the lines followed up to now, are untenable because they will force a market failure of the refunding of the \$13-1/2 billion of maturing issues which you approved on Friday.

This matter is one of most serious import because it aims directly at the matter of maintaining confidence in the financial strength of the United States Government. As you know, confidence in our financial strength and stability, both at home and abroad, is of prime importance. I developed this matter fully with the Federal Reserve immediately after the outbreak of the Korean crisis and in my letter of July 17, a copy of which is attached. Years have been spent in building up confidence in this strength and the action of the Federal Reserve at a time when the debt is \$257 billion, and when its successful management is no simple matter, may have serious results in our successful prosecution of the war effort. It is of paramount importance that no uneasiness about the management of the public debt should occur, yet such uneasiness could become wide-spread easily if a loss of confidence should result in the action of the Federal Reserve, and wholesale liquidations of Government securities, particularly savings bonds, could be touched off among non-bank investors.

I mention these matters not to be an alarmist, but with the view of approaching the situation objectively so that I may convey to you the seriousness and possible ultimate effect on our war effort itself, which might result from a financial disturbance of importance.

RECOMMENDATION

It is my recommendation that you advise the Federal Reserve Board that you approved the Treasury refunding announced last Friday, as required by law and that you advise the Federal Reserve that you intend that all agencies of the Government, with public powers and responsibilities, are to do everything necessary to make this operation a success; and that you are fully aware that there need be no difficulty toward making the present operation a success if it is the Board's intention to do so and the Board takes appropriate action along the lines with which it is completely familiar.

Attachment

THE SECRETARY OF THE TREASURY

Washington

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July 17, 1950

Dear Tom:

Thank you very much for your letter of July 12, expressing your thoughts and those of the Executive Committee of the Federal Open Market Committee with respect to new financing and the current situation in the Government bond market.

As I asked Mr. Bartelt to transmit to the Open Market Committee on June 26, I feel that everything possible should be done to maintain a basically strong position in the Government bond market during the present period of international disturbance. The firmness with which the market has withstood the impact of the events of the past three weeks is certainly a testimonial to good management. It is also the best possible evidence of the confidence which has been built up in our ability and determination to maintain a stable market for Federal securities.

I know you will agree with me that it is of the utmost importance at the present time to maintain that confidence and, in addition, to do everything possible to strengthen it. This involves, first of all, avoiding any course which would give rise to a belief that significant changes in the pattern of rates were under consideration. The operations of the Open Market Committee since the beginning of the crisis have been well adapted to this end.

As I have studied the situation, I have become convinced that present circumstances call for one further precaution which is, perhaps, of even greater importance than maintaining a good balance in current market operations. In my view, we must take extreme care to avoid introducing any factor which would run the risk of producing unsettlement in the broad market for Federal securities represented by investors throughout the Nation. It is my belief, in particular, that no new financing program should be undertaken at the present time without maximum assurance that it will be well received and can be carried through to a successful conclusion.

Our future tasks, whatever they may be, would be made very much more difficult by anything less than 100 percent success in a program for raising new money. In my judgment, we can not attain the maximum assurance of success until the outlook with respect to both the international and the domestic situations has become considerably more clarified.

At present, the defense needs which may have to be financed in the near future are not known. Our expectations as to revenues are also subject to considerable change as the situation develops. For these reasons, as you know, I recommended that the Congress postpone action on the tax bill now under consideration in the Senate Finance Committee. The same basic considerations lead to my strong belief that no new financing program whose reception is to any considerable extent unpredictable should be introduced into the market at the present time.

There are, of course, occasions which call for quick and bold action. These occasions have occurred with respect to the Federal security market and they may occur again. But every appraisal of the present situation indicates that the maintenance of stability should take priority over all other market considerations. A stable and confident situation in the market for Federal securities is our first line of defense on the financial front, no matter what may be ahead of us.

As you know, developments in the Government bond market have repercussions which fan out through the entire economy. Both the size and the wide distribution of the Federal debt are unprecedented in comparison with the situations which faced us at the start of other periods of crisis. Under these circumstances, we have an obligation of the highest order not only to maintain the finances of the Government in the soundest possible condition, but also to fulfill our responsibilities to the millions of Federal security holders throughout the Nation.

There is one further consideration which confirms my view that the present situation calls in the highest degree for caution and prudence. During the present stage of the emergency, it is vital to make use of every opportunity for assuring our citizens that those at the head of their Government have a strong and steady hand on the helm. The response of the Nation to the President's courageous action in the Korean crisis was one of the greatest demonstrations of unity that we have ever had in this country. The Nation is now waiting to learn what domestic programs may be needed in order to utilize our full strength in the interests of national defense. When these

programs are brought forward, it will take time for the public to assimilate them. In view of these facts, it is of the utmost importance that no action be taken at the present time which could be construed in any sense as anticipating proposals for defense which may later be outlined by the President.

In short, every circumstance at the present time calls for steadiness and manifest strength in the Federal security market as a primary measure of economic preparedness. That is the net of the situation as I see it. And, as you will note, I am sending my thoughts on to you just as they have occurred to me, in order to let you know the course of my thinking as events unfold.

Sincerely yours,

(signed) JOHN W. SNYDER

Secretary of the Treasury

Honorable Thomas B. McCabe
Chairman, Board of Governors of
the Federal Reserve System
Washington 25, D. C.