[redacted]ARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 28, 1957

To FOMC Files

From Mr. Sherman

Subject: Discussion, partly by telephone, with available members of FOMC

Mr. Riefler called me to his office shortly after 2:30 p.m. on Tuesday, August 27, 1957. Those present were Governors Balderston, Vardaman, and Robertson; Mr. Riefler, Mr. Sherman, Mr. Young, and Mr. Keir (first part of conference).

Mr. Riefler stated that this was not a meeting of the Open Market Committee but was a conference for the purpose of discussing certain matters that had been raised during a luncheon with Treasury officials this noon. The members of the Committee who were present felt that it would be desirable to obtain the views of the other members of the Federal Open Market Committee who were available in their offices, after which consideration would be given in the light of these discussions to the possibility of calling a meeting of the Committee later this week. It was understood that the first call would be placed to Mr. Treiber at New York, as alternate for Mr. Hayes, after which the other members of the Committee at Federal Reserve Banks would be called in alphabetical order and, in the event any such member was not available, his alternate would be called. Mr. Treiber was out of his office and the first member of the Committee to be reached was Mr. Allen at Chicago. Mr. Riefler then made a statement for Mr. Allen's benefit substantially as follows:

> This is not a meeting of the Open Market Committee. We are consulting individually with the members of the Committee who are available here in Washington and at the Federal Reserve Banks. Governors Balderston, Vardaman, and Robertson are here and we are talking with you individually with the loudspeaker hookup.
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> The Treasury people asked to come over for luncheon this noon instead of tomorrow. Secretary Anderson and Under Secretary Burgess, plus some of the staff came over. Their cash needs are getting very acute and they plan to borrow $3 billion of cash, with subscriptions on September 16 and payment September 21. They expect to offer $1 billion by reopening the two by fours and they wish to raise the other $2 billion with a June 1958 tax issue. The problem is how to offer that issue and how to price it. The last tax issue has not yet been digested and the yield is 4.16, quite a bit above the yield on surrounding issues. If the Treasury were to offer a coupon security it would have to be around 4-1/4 per cent, a new high rate with repercussions for them and, they think, for us. They do not wish to face an auction. They feel that the auction does not get as wide a distribution initially as a priced offering. They feel that there are still issues of the last two auctions that are not completely distributed by the banks that acquired them originally. Loading more securities onto the banks would mean an extremely high rate they fear. They grant that given a month arbitrage will bring the yields into line, but they wish to announce in two or three weeks. Therefore, the Treasury feels very strongly that since the

Federal Reserve is about to buy bills to meet the Labor Day demands for reserves and the autumn seasonal demands, we should purchase at least some in the new April securities in order to quicken the adjustment and to bring the yield on those securities down in line with the rest of the market. Inasmuch as the Federal Reserve's purchases to meet the Labor Day needs will be made tomorrow and Thursday and Friday of this week, the Treasury feels that a decision would be necessary immediately. That presented two questions (1) does the Manager of the Account have the authority now to buy the April securities; (2) if not, can the Open Market Committee operate fast enough to give him that authority in time?

Mr. Allen then commented substantially as follows:

My reaction is absolutely no, I would not do it. In the first place, I question whether the Treasury is correct about the distribution of those recent securities although they may know the situation better than I do. Here, those who bought the April bills have got them well distributed and in a couple of more weeks they will be even better distributed. I would not wish to get into the April maturities in our purchases and I would stick to bills. I would welcome the more seasoned judgment of those who have been following this and would like to think more about it, but that is how I feel at this time.

Mr. Riefler then commented that this request had been presented at the Treasury luncheon at which the new Secretary of the Treasury was present and that, while the Secretary had not formally requested that a meeting of the Federal Open Market Committee be called, there was no question but that he felt the matter was quite important.

Mr. Allen then stated that the question whether a meeting should be called would depend somewhat on the sentiments expressed by the members of the Committee in these telephone consultations: if sentiment appeared to be all one way there would seem to be no point in a meeting.

Mr. Riefler stated that some question had been raised as to whether the Manager of the System Account presently had the authority to buy April bills. He noted that the Committee's authorization now provided authority to operate in the short-term area, but there was a difference of opinion as to whether this authority contemplated purchases of the sort under discussion.

Mr. Allen responded that regardless of whether the Manager had authority for such purchases, if it appeared that they were to be made he would like to have an opportunity to record his views.

Mr. Riefler then stated that Governors Vardaman and Robertson were strongly of the same general view as that expressed by Mr. Allen, while Governor Balderston was inclined to think the Committee should include the April 1958 maturities in its purchases.

Additional calls were then completed with Mr. Treiber at New York, Mr. Williams at Philadelphia, Mr. Mangels at San Francisco (alternate for Mr. Leedy, who was on vacation), Governor Mills, who was at the San Francisco Bank, and Mr. Bryan at Atlanta. In each case Mr. Riefler outlined in terms similar to those used with Mr. Allen the problem presented by the Treasury, and after the Committee member had expressed his views, Mr. Riefler informed him of the views expressed previously by other members of the Committee. The following record gives substantially the views expressed, including views expressed by Governors Vardaman and Robertson. In all cases it was understood that this was not a meeting of the Committee, that no votes were being taken, and that the individuals were expressing their offhand reactions to the proposal that had been made by the Treasury. In each case, Mr. Riefler inquired whether the Committee members could attend a meeting on Thursday morning if one were called and he also inquired whether the members felt that the present authority would permit the Manager of the System Account to purchase the April 1958 maturities or whether it would be necessary to have specific authorization. On the question of a meeting, all of those with whom the matter was discussed excepting Governor Mills indicated that they could attend a Committee meeting on Thursday morning if one was called. On the question of whether the Manager presently had authority to make purchases of the securities in question, Messrs. Treiber, Mangels, and Mills felt he now had such authority. Messrs. Vardaman and Robertson felt he did not have such authority because, while he could purchase short-term securities to carry out Committee policy, the purpose of the proposed purchase of April 1958 maturities would be to influence the yield on a specific Treasury issue and this would be inconsistent with the policy that had been adopted in March 1953 that the Committee would not support any pattern of prices and yields in the Government securities market, that intervention in the Government securities market was to be solely to effectuate the objectives of monetary and credit policy, and that transactions for the System account in the open market shall be entered into solely for the purpose of providing or absorbing reserves. Other Committee members indicated that in any event they felt that if purchases of the April 1958 maturities were to be made, express authority for such purchases should be given by the Committee.

Comments of Individuals

Mr. Treiber: We have had some discussions here about this today. We talked with Mr. Burgess this morning. We bought some March tax anticipation bills and were discussing whether it would be desirable for us to buy some of the April bills. My own feeling is that it is desirable to buy some of them. How much is the question. It is clear that we have to put money into the market for reserve purposes at this time. We might just as appropriately serve two purposes so as to be helpful to the Treasury and to supply reserve funds by buying these bills. They are quite out of line as far as price is concerned, when you relate them to the certificates which mature April 15, 1958.

Looking forward to the maturity date, if we had a large holding of bills maturing April 15, 1958 and if the Treasury did not have the cash to pay us off and if it made an exchange offering, we might be in the position where it would be embarrassing to the Treasury if we decided not to exchange a large holding. If the holding were $100 million I think there would be no problem and $200 million would not make a problem. My own thinking is it would be quite appropriate for the System to acquire these bills as offered as we are putting money into the market during the next couple of weeks. We would not be trying to concentrate all of it on those bills but we should be buying some of them.

As to authority, I thought we had the authority to buy them. We have bought the March bills and I would have difficulty in seeing a difference in buying the April bills. If, however, there was a question from the general policy angle, that could be disposed of by a telephone hookup. However, I would have thought we had the authority to do it; since we have to put reserves in anyway we might properly be helpful to the Treasury in doing it. I could come to a meeting on Thursday.

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Mr. Vardaman: I want to say I do not think the Account Manager has the authority under our present instructions to buy anything other than the shortest bills available. I think we would make a grave mistake in the absence of a disorderly market or a real emergency in going away from a policy just to accommodate a temporary situation. The secondary distribution of the bills the banks hold should become effective within a couple of weeks. I think we would not have any propriety in purchasing an intermediate issue without a meeting of the Committee.

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Mr. Williams: My offhand reaction is that I would be reluctant to do this and I would think we ought to do it only if the total situation would lead to the conclusion that they were in a bad plight and that this was almost done in desperation.

It seems to me the authority that the Account Manager now has is to operate along the lines being followed at present. I would feel that if he was going to buy these bills we ought to make this a matter of specific action. I could come to a meeting on Thursday.

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Mr. Mangels: This comes out of a clear sky to me and I would like to have a little time to review it and call you back later. Governor Mills is with us at lunch this noon and I would like to discuss it with him.

(After further brief discussion, Governor Mills came to the telephone at the San Francisco Bank and after hearing Mr. Riefler's review of the situation made a statement substantially as follows:)

Mr. Mills: There is logic and reason for going into the market to buy bills or short-term securities in a volume that would approximate $200 million. We would not be giving a false sense to the market in making such purchases. My snap judgment on this proposal is that the Treasury is making a mistake. If we were to concentrate purchases in the April bills, that would be so obvious to any market observers that it would raise question and doubt rather than allay any misunderstanding. I have been of the feeling during the last few days that the whole list of Governments, particularly on the longer end, has strengthened. If we concentrate purchases in and drive down the rate on the April special bills, and if we later on have an adjustment in the Government list that would bring up the yield on the 3s, the 3-1/4s, and perhaps on the 2x4s, we would have altered completely the over-all yields in the market. I would think this would make a very muddy looking picture.

My offhand feeling would be that, while it would be desirable to go into the market, it could prove to be an error to overemphasize the April bills. What you do in that area could be canceled out within a week or ten days and in the process there could arise a great deal of thinking about System intentions of changing the yield structure. I doubt that we would be helping the Treasury in the way they want if we overemphasize that single issue.

Mr. Mangels: I feel somewhat as Governor Mills does. My own immediate reaction is that I would wait a little...... I would think that this was covered by our blanket authorization and Governor Mills indicates that he agrees...... I could come to a meeting on Thursday morning but Governor Mills would not be able to because he has a speaking engagement Wednesday night.

(Mr. Riefler then reviewed the views that had been expressed by the other members of the Committee.)

Mr. Mangels: I would be in the same position as Mr. Williams, that is, I feel it would be a mistake to purchase the April bills and would be reluctant to do so.

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Mr. Bryan: My reaction is that while a meeting would give more time for discussion I am not certain that we could not accomplish the same thing by telephone conference. Has the Treasury decided definitely that it will not use the auction method?

Mr. Riefler: No, they did not say so categorically but they very much do not want to.

Mr. Bryan: I would be willing to attend a meeting on Thursday but it would be inconvenient...... I hate to go beyond the nearest equivalent of money in our purchases. At the same time, without having heard any arguments on the other side, I do believe that there is a hook in the yield curve and that my first inclination, which I would reserve the right to change, is that I would vote to give the authority to the Manager to make the purchases of April bills. I think in the light of all the history that we ought to give a specific authorization. We have had considerable argument and debate about similar proposals before and I believe that by making it a specific authority it would be less likely to create a precedent. I would be interested in knowing how some of the others feel.

(Mr. Riefler then reviewed the comments that had been made by others, pointing out that Messrs. Balderston and Treiber were inclined to purchase the April 1958 bills, while Messrs. Vardaman, Robertson, Allen, Williams, Mangels, and Mills had indicated that they would oppose the purchase in varying degrees.)

Mr. Bryan: I made my statement that I would go along with the purchases with extreme reluctance, but I would like to hear the arguments that Governors Vardaman and Robertson have for not doing so.

Mr. Robertson: My reason against doing it would be, first, that this is not an attempt to provide or absorb reserves but would be solely for the purpose of changing the yield on a given security. I think that would be very much contrary to our purpose. Our purpose is not to do more than provide or absorb reserves. This would be a sad precedent. The Treasury will have to come to the market again and again and would wonder whether we would come in and make a rate at other times. Second, I think that the distribution on this one issue will take place, and probably before September 16, so that I doubt whether we would be accomplishing anything that would not be accomplished by performing our regular function. I hate to see us deviate from an accomplished principle for the sake of doing something that the market has not done itself. I also feel it is a very bad thing for the new Secretary of the Treasury, who is not experienced at this time in these things, to be put in the position of getting us to do something to put over a Treasury issue. I think that after a little experience he would not suggest such a thing. I personally think that he ought to use the procedure of auctioning the $2 billion of securities and I am confident myself that an auction will do the job. The Government has to get the money and we will have to provide the reserves that are needed. It is solely a matter of the price the Treasury has to pay.

Mr. Vardaman: Governor Robertson has covered my points pretty well except that I would like to talk in terms of the market, without impugning the motives of anybody. No matter what decision we make we are not denying the Treasury funds. It is the plan of the System to buy bills in quantity on Wednesday, Thursday, and Friday of this week. Their proposal in substance and in principle is that we rig the market in order to make a healthy or friendly atmosphere for a scheduled issue, something that is reprehensible in private markets and against the law. If we concentrate on purchasing the April bills, that can be expected to expose itself later on. I doubt if there is a member of this Committee who would favor giving the Treasury the right to borrow at a preferred rate of interest. I submit that in principle there is no difference between using the Open Market Account to rig the market to allow the Treasury to borrow at below the market rate and asking the Congress to pass a law giving the Treasury the right to borrow at less than the market rate...... Even if the market does not level out we should not put the powerful machinery of the Open Market Committee to use in this way. We are committed to a free market. The Treasury will not be denied funds but it will have to pay the going rate. If we were to do this we would be neutralizing the tight money policy that we have been following by artificially permitting this piece of financing at a favored rate. If we were denying the Treasury funds, I would step aside.

Mr. Bryan: There is no doubt that on principle the arguments are very powerfully against such purchases. On the point of the hump in the yield curve, it looked to me as though there was a sort of wart on the market in the April maturity...... In general, my preference would be not to make the purchases and I do not want to be interpreted in any sense as favoring them in principle. The principles that Governors Robertson and Vardaman have stated have my full and warmhearted support. As I understand it at this count you would have a majority against the purchases.

Mr. Riefler: That is their offhand reaction but what they would do on a final vote you can not tell. These, of course, are not votes.

Mr. Bryan: I am deeply sympathetic with the arguments of Messrs. Robertson and Vardaman and they meet my general philosophy. My saying that I would agree to do it, I suppose, was a sort of weakening in the face of what seemed to me to be a hard set of facts. If there is a majority that would be against it, I certainly would--I think we ought to be fairly unanimous--if there is a majority of the Committee opposed, I would take no exception and would vote with them. Since I have heard these arguments my inclination is more and more to say I think we ought to meet to discuss the question.

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(Later in the afternoon, Mr. Bryan telephoned Mr. Riefler to say that he had studied the matter further and had reached the definite conclusion that purchases of the April 1958 bills as suggested by the Treasury should be opposed.)

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Note: For further information, see Governor Balderston's memorandum to Chairman Martin dated 5:20 p.m.,August 27, 1957, and 9:30 a.m., August 28, 1957.