A meeting of the executive committee of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Wednesday, August 11, 1948, at 2:10 p.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Szymczak
Mr. Williams

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman, Board of Governors
Mr. Young, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee held on June 23, 1948, were approved.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account, as reported to the members of the executive committee, for the period June 23 to August 10, 1948, inclusive, were approved, ratified, and confirmed.

Upon motion duly made and seconded, and by unanimous vote, the following letter sent to the Secretary of the Treasury under date of June 25, 1948, was approved and its transmission to the Secretary of the Treasury was ratified and confirmed:

"At a meeting on June 23, 1948, the executive committee of the Federal Open Market Committee reviewed the general credit situation and questions relating to debt management, including the short-term interest rate and further retirement of marketable debt which may be made possible by a favorable Treasury cash position. I will call you shortly to suggest a date for a conference with representatives of the Treasury on certain aspects of these questions. In the meantime, the Committee wishes to submit a recommendation for immediate action with respect to debt retirement.

"According to our estimates, it appears that during the next few months the Treasury may have sufficient cash to retire as much as 1.5 billion dollars of securities held by the Federal Reserve without reducing Treasury deposits (excluding gold) below 2 billion dollars at any time during the remainder of this calendar year. The System is exchanging all of its holdings of July certificates for the new issue, but the Committee recommends that at least 400 million of Treasury bills be retired during July. The timing and amount of further retirements will depend upon developments, including decisions made with respect to the September Treasury financing.

"The Committee also recommends that the Treasury continue for the time being its policy of timing calls on war loan deposits so that Treasury operations will not result in an increase in bank reserves."

Chairman McCabe stated that, in accordance with the understanding at the meeting of the executive committee on June 23, 1948, a draft of letter to the Secretary of the Treasury had been prepared as a basis for discussion with the Treasury and that the draft, which was in the following form, was handed informally to Mr. Snyder during a trip to Denver on July 16, 1948, with the comment that, if he had any changes to suggest in the letter before it was transmitted formally and became a part of the official record, the committee would be glad to have such suggestions. Mr. Snyder replied, Chairman McCabe said, that he was going to be away from

Washington for several days but that he would read the draft of letter as soon as he had an opportunity and forward to Chairman McCabe any comments that he might have:

"My letter of June 25 stated that the executive committee of the Federal Open Market Committee had been reviewing the general credit situation and questions relating to debt management and that I would call you shortly to suggest a date for a conference with you on certain aspects of these questions. This letter is for the purpose of presenting the general views of the committee on the situation that confronts us.

"The committee is deeply concerned about the statutory responsibility of the Federal Reserve System to carry out policies designed to restrain the expansion of bank credit in situations like the present. Its recommendations to the Treasury for refunding the April and June maturities of Government securities were made only after the most careful analysis of inflationary trends then apparent. In our considered view, the economic outlook for some time to come is even more clearly inflationary than was the case last spring. The aggregate rate of spending, public and private, promises to exceed income with resulting demand for bank credit expansion, leading to and supporting further price inflation and a rising cost of living.

"Consumer debt and mortgage debt is expanding and will continue to expand. This expansion undoubtedly will be financed to an important degree by the banking system. Prospective large outlays by business for expansion of inventories and plant, to the extent that they are not financed from internal funds or by borrowing current new savings, will cause further recourse to the banking system.

"Institutional investors, in particular the life insurance companies, are currently providing a large part of external business financing. They may continue to do so during the remainder of 1948, but it is not to be expected that they can meet the demands likely to be made upon them from current funds alone. It is estimated that these non-bank investors as a group may sell during the current half year more than $1.5 billion of marketable Government securities (including sales for the purpose of buying F and G bonds and corporate securities and making mortgage and other "loans). If the Federal Reserve finds it necessary to purchase these securities, as is likely in its policy of supporting the 2-1/2 per cent yield level on long-term Treasury bonds, a corresponding amount of additional reserves will be made available to commercial banks. These additional reserves, unless otherwise offset, could sustain a very large expansion of bank credit.

"This course of economic and monetary developments has been the source of increasing concern to the Federal Open Market Committee. The Committee is convinced that, so long as the present situation lasts, it is important to restrict further credit expansion and to promote a psychology of restraint on the part of both borrowers and lenders. To keep the reserve position of banks under pressure and discourage further inflationary credit expansion will require carefully coordinated operating measures on the part of both the Treasury and the Federal Reserve System. It is the judgment of the Open Market Committee that such coordination could best be effected along the following main lines:

"(1) The basic policy of the Federal Reserve System in the present situation should be three-pronged:

(a) to maintain constant pressure against further increase in bank reserves;

(b) to continue to promote orderly conditions in the market for short and intermediate term Treasury securities, but to modify existing practices sufficiently to carry out the general policy here proposed;

(c) to maintain a 2-1/2 per cent yield level for long-term Treasury securities.

"The objective of these policies should be to restrain support of further inflation through new bank credit creation; not to bring about a deflation by forcing a reduction in the large volume of bank credit already outstanding.

"(2) Federal Reserve policies in promoting orderly conditions in the market for short- and medium-term Government securities and in maintaining the 2-1/2 per cent rate on long-term bonds should be so managed as to counteract the creation of additional reserves. This means that to the extent that the System purchases additional amounts of long-term securities, corresponding reductions will be needed in the System's holdings of short-term securities.

"Should demands for bank credit expansion continue, as we expect, this policy of restriction of expansion in "bank reserves would result in a further rise of rates on bills and certificates. However, in that case it would be the policy of the Open Market Committee to provide support to the market so as to assure the refunding of the Treasury's September and October maturities on a basis not higher than a 1-1/4 per cent rate for 1-year maturities.

"The resulting higher short-term rates would encourage banks to invest new funds in shorter term Government securities and make it less attractive for them to sell such securities for the purpose of making loans or buying long-term bonds. In other words, the change in rates would help banks to maintain their earnings position without reaching out for new loans. More important, changes in rates will create uncertainty in the minds of lenders over the future price of money and will make them less eager to meet the increased demands for credit that are in prospect. Finally, such a step, though small, would signalize the purpose of those charged with responsibility for credit and monetary policy to restrain the inflationary forces that threaten the economy.

"(3) Consideration will be given at an early date by the Federal Reserve Banks and the Board to an increase in discount rates and use of the remaining power to increase reserve requirements by the final 2 per cent at New York City and Chicago.

"(4) Treasury operations would greatly assist in the objective set forth in paragraph (1) above if available funds were used to the fullest extent possible to retire securities held by the Federal Reserve. This would be in line with what the Treasury has been doing and should entail little or no difficulty or inconvenience to the Treasury in the period ahead.

"On the basis of current prospects for Treasury cash receipts and expenditures, including receipts from sales of additional nonmarketable securities and outlays for voluntary redemptions of securities, it appears that the Treasury may be able to withdraw somewhat more than a billion dollars of bank reserves from the market during the remainder of this calendar year. This could be done by using surplus cash to retire securities held by the Federal Reserve System. Such a program of Treasury debt retirement may not be sufficient to offset the effect on reserves of Federal Reserve purchases in support of the 2-1/2 per cent rate for long-term bonds. Further adjustments would be made so far as possible through the System's operations as proposed above, and the increase in "the short-term rate to 1-1/4 per cent would give greater assurance of our ability to make these adjustments.

"We want you to understand that we recognize the grave responsibility of the Treasury in the management of our huge public debt, and we believe that you appreciate our responsibility in the area of credit control during a period of inflation. Therefore, for the best interests of the country, we would welcome a full discussion of these important matters of such vital and mutual concern. We would appreciate it if you would set an early date."

Chairman McCabe also said that nothing more was heard on the matter until the receipt from Secretary Snyder under date of July 28, 1948, of a letter which stated he had no objections to any feature of the draft of letter except that he would suggest the substitution of the following paragraph for the eighth paragraph of the draft:

"Should demands for bank credit expansion continue, as we expect, a further rise of rates on bills and certificates would be necessary in order to carry out a policy of restricting the expansion of bank reserves. The Open Market Committee believes that an increase to 1-1/4 per cent in the rate on new Treasury certificates of indebtedness, together with a corresponding increase in bill rates, would be most helpful in implementing this policy."

Chairman McCabe added that the suggested substitute paragraph was of such significance that a response had not been made.

In reply to a request from Chairman McCabe for Mr. Riefler's comment on the objections to the suggested paragraph, the latter stated that it was his opinion that the formal letter from the Secretary on July 28 made the draft also a formal communication. He added that the draft stated that it would be the policy of the Open

Market Committee to provide support to assure the refunding of the September and October maturities on a basis not higher than 1-1/4 per cent for one-year maturities, whereas the proposed substitute paragraph, while concurring in the increase in the short-term rate, stated that it should be accomplished initially by an increase in the issuing rate on certificates rather than by Federal Reserve support policy in the market. The difference, Mr. Riefler said, is that the procedure outlined in the draft would recognize responsibility in the Federal Open Market Committee for conditions in the money market whereas the Treasury's substitute paragraph would leave that point unanswered. However, since a program had been agreed upon subsequent to Secretary Snyder's letter of July 28, Mr. Riefler saw no point in making an issue at this time of the question raised in the substitute paragraph.

There was discussion of what if any reply should be made to the letter of July 28 and of the question whether failure to reply would imply acquiescence in the suggestion that changes in rates should not be initiated by changes in the levels at which Government securities were supported in the market but rather by changes in the issuing rate on Treasury securities.

In this connection, Chairman McCabe stated that he and Mr. Rouse met with Secretary Snyder on July 30, 1948, and he and Mr. Sproul conferred with the Secretary again on August 2, at which time the Secretary said he would like to consider further the question of an increase in the short-term rate. On August 9, Chairman McCabe said, he met with Secretary Snyder again and as a result of that conference the Secretary addressed the following letter to him:

> "In accordance with our agreements and joint consultation, we have determined upon the following financing program for September and October:
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> (1) Announce that the three 1 percent issues, two certificates, and one note, maturing on October 1 (totaling $6.9 billion) will be refunded into a new 1-year, 1-1/4 percent certificate.
>
> (2) Announce that the $3.7 billion of 1-1/2 percent notes maturing on September 15 will be refunded into a new 1-year, 6-1/2 month, 1-3/8 percent note maturing on April 1, 1950.
>
> (3) Announce that the partially tax-exempt 2-1/2 percent bonds maturing on September 15, amounting to $451 million, will be paid in cash.
>
> (4) Permit the bill rate to rise to, perhaps, 1-1/8 percent; and permit short-term rates generally to adjust themselves to the new 1-1/4 percent interest rate.
>
> (5) Reaffirm directly or indirectly the policy of supporting the long-term 2-1/2 percent interest rate.
>
> (6) Increase the Federal Reserve rediscount rate from 1-1/4 percent to 1-1/2 percent.
>
> (7) Revise the terms of tax savings notes, effective September 1, so that they would yield 1.20 percent to maturity or to any prior redemption date.
>
> (8) Resurvey the situation after Labor Day; and, if it then seems desirable, increase reserve requirements."

Chairman McCabe went on to say that inasmuch as the letter contemplated that no action would be taken by the Board of Governors to increase reserve requirements of member banks until after Labor Day, the matter was discussed by the Board and at that time the suggestion was made that a reply to the letter of August 9 should be sent which would clarify possible implications contained in the Secretary's letter (1) that the bill rate would not be permitted to go above 1-1/8 per cent, and (2) that the Board of Governors would not take action on reserve requirements without the agreement of the Secretary of the Treasury.

A draft of reply, which had been prepared in accordance with this suggestion, was read and discussed and Chairman McCabe stated that he had told Secretary Snyder that the Treasury and the Federal Reserve System each had responsibility for action, that the System recognized the responsibility of the Treasury in the field of debt management, and that it was believed that the Treasury recognized the responsibility of the Federal Reserve System in the field of credit policy, but that it would be desirable if there could be consultations before either the Treasury or the Board took action on major questions of policy which would have effect in the field in which the other had responsibility. With that in mind, Chairman McCabe added, he would like to have the proposed reply to the letter of August 9 make it clear that, while the Board of Governors had responsibility for increases in reserve requirements, the Treasury would be informed of action proposed by the Board before it was actually taken.

Chairman McCabe also stated that in the discussion with the Secretary the opinion had been expressed that greater flexibility should be permitted in the bill rate to reflect the market, and that if that were done the rate might move above or below 1-1/8 per cent depending upon conditions, but that Mr. Snyder responded that he did not want to make too many changes in the existing situation at one time.

Mr. Riefler expressed the opinion that if the committee should allow the bill rate to go above 1-1/8 per cent Secretary Snyder would regard that as a breach of the agreement set forth in the letter of August 9.

It was the Chairman's view that this was a matter that might be discussed with the Secretary of the Treasury and that the proposed reply should so indicate.

It was also suggested that the reply might say that in view of the program outlined in the letter of August 9 there was no need for further discussion of the point raised in the letter from Secretary Snyder under date of July 28 in reply to the draft letter handed to him on July 16.

Mr. Szymczak inquired whether anything should be said in the proposed reply about the decision stated in paragraph three of Secretary Snyder's letter with respect to the redemption for cash of the $451 million of 2-1/2 per cent bonds maturing on September 15. It was the consensus that while this action will be inconsistent with a program of restraint on the market, since it has already been announced no comment on it should be made in the proposed reply.

At the conclusion of the discussion, upon motion duly made and seconded and by unanimous vote, the following letter to the Secretary of the Treasury was approved with the understanding that it would be submitted to the Board of Governors and that, if the first and last paragraphs were approved by the Board, the letter would be transmitted:

"I presented to the Board of Governors yesterday morning and to the executive committee of the Federal Open Market Committee this afternoon your letter of August 9, 1948, in which you summarized the understanding which we reached on the afternoon of that day with respect to the September and October financing and the other matters mentioned in the letter. The program outlined is generally in accord with our draft letter which I handed to you on July 16. In view of the program outlined in your letter of August 9 there is no need for further discussion of the point raised in your reply of July 28 to our draft letter. The Board and the Federal Open Market Committee appreciate the consideration that has been given to the problem by the Treasury and the cooperative conclusions that have been reached.

"As I mentioned to you on Monday we have felt that it would be desirable if there could be a greater degree of flexibility in the bill rate. At the meeting of the executive committee of the Federal Open Market Committee today that point was discussed again and it is our view that the bill rate should be allowed to fluctuate below the one-year certificate rate as conditions in the market might determine. If this becomes a matter of actual moment we shall be glad to discuss it with you further.

"At its first meeting after Labor Day the Board of Governors will take up the question of a further increase in member bank reserve requirements. At that time I will advise you informally as to any action contemplated by the Board."

Secretary's Note: The first and last paragraphs of the letter were approved by the Board of Governors on August 11, 1948, and the letter was transmitted to the Secretary of the Treasury under that date.

Mr. Sproul questioned whether the rate of 1.2 per cent on the new issue of tax savings notes as proposed in the paragraph numbered seven in Secretary Snyder's letter of August 9 was the right rate in relation to the 1-1/4 rate on certificates. This point was discussed and it was suggested that this was a technical matter which Mr. Rouse (who had been discussing the matter with Mr. Bartelt, Fiscal Assistant Secretary of the Treasury) and members of the staff should be asked to work out with representatives of the Treasury.

Upon motion duly made and seconded, and by unanimous vote, this suggestion was approved.

Mr. Szymczak inquired about the procedure to be followed in adjusting support prices of Government securities to the new 1-1/4 per cent rate on one-year certificates and Mr. Sproul stated that adjustments in support levels of maturities up to five years were already being made by the Federal Reserve Bank of New York to bring them into proper relationship to the higher certificate rate. In this connection Messrs. Sproul and Eccles referred to the recommendations contained in the letter sent to the Treasury on April 26, 1948, and suggested that it should be understood that the Federal Reserve Bank of New York, as agent for the System account, would be authorized, under the direction issued to it by the executive committee, to adjust support prices in the maturities up to approximately five years in line with the 1-1/4 per cent rate on one-year Treasury certificates. Mr. Sproul stated that the adjustments that would be required to carry out this suggestion would be from 1/32s to 8/32s depending on market prices and maturities of the respective issues.

Upon motion duly made and seconded, and by unanimous vote, the suggestion was approved.

Question was raised as to how rigid the support prices on various short and intermediate taxable issues should be and it was stated that the theory back of the support prices was that the New York Bank would try to get the market to determine prices on the various issues above the support prices, that it was not possible to say within a thirty-second what the support price on a particular issue should be, but that when offerings were made in the market in large volume at the support level it would not be possible to back away from the support price to any material extent and at the same time maintain a rate of 1-1/4 per cent on one-year Treasury certificates and 2-1/2 per cent on the longest term Treasury bonds. Mr. Sproul expressed the view that we should get away from support pegs but that the market had become habituated to supports and in periods of adjustment would feel around by making offers in the market to determine what the supports were. He also said that it had been the practice of the Federal Reserve Bank of New York to try to get dealers to sell offerings elsewhere in the market but that if, at the end of the day, the dealers said they had firm offers to sell which could not be disposed of at the support prices the Federal Reserve Bank of New York would buy the securities. If in situations like that, he said, the support price were temporarily dropped more than a thirty-second or so the market would begin to offer all maturities to try to ascertain whether there had been a change in the policy of support.

Chairman McCabe raised the question as to what the policy was with respect to the support price on Treasury bills and Mr. Sproul responded that when the policy was adopted by the Treasury of increasing the issuing rate on certificates the Federal Open Market Committee had adopted the policy of permitting the bill rate to go as close to the certificate rate as market conditions would determine and that the New York Bank tried to place bids for replacement of its weekly maturities at such levels as would enable the market to take as much of the offering as it wanted at a rate below the certificate rate. He added that under the present procedure with a 1-1/4 per cent issuing rate on certificates the bill rate probably would go to 1.08 or 1.10 per cent.

Chairman McCabe suggested that this arrangement in the recent period had resulted, in effect, in pegging the bill rate at approximately one per cent and that it would be desirable if there could be greater flexibility in the rate in response to market conditions. He also suggested that a statement be prepared of the existing procedure and of its effects on the bill market.

Mr. Eccles stated that he would have to leave the meeting to keep another appointment and suggested that the other matters on the agenda be disposed of, after which the discussion of Treasury bill policy could be resumed.

It was unanimously agreed that the next meeting of the executive committee would be held in Washington at 10:00 a.m. on Wednesday, September 15, 1948.

It was stated that as of the close of business yesterday all but $199 million of the $1.5 billion authority granted by the Federal Open Market Committee at its meeting on May 20, 1948, had been used and that, before the usual direction was issued to the Federal Reserve Bank of New York to effect transactions for the System account, it would be necessary to get additional authority from the full Committee.

Upon motion duly made and seconded, and by unanimous vote, it was agreed that inasmuch as the next meeting of the Federal Open Market Committee probably would not be held until after the first of October and in view of market conditions and the possibility of further increases in reserve requirements of member banks in the interim, the executive committee should recommend to the members of the full Committee that they approve an increase of $1.5 billion in the authority of the executive committee to effect transactions for the System account. It was also agreed that the direction issued at the last meeting of the executive committee to the Federal Reserve Bank of New York to effect transactions for the System account should be renewed with the understanding that the direction would not be sent to the Bank until the increased authority to the executive committee as recommended to the members of the full Committee had been granted.

Thereupon, upon motion duly made and seconded, the executive committee voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the executive committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities and allowing maturities to run off without replacement) for the System account, either in the open market or directly from, to, or with the Treasury, as may be necessary, in the light of the general credit situation of the country, for the practical administration of the account, for the maintenance of stable and orderly conditions in the Government security market, and for the purpose of relating the supply of funds in the market to the needs of commerce and business; provided that the total amount of securities in the account at the close of this date shall not be increased or decreased by more than $750,000,000 exclusive of special short-term certificates of indebtedness purchased for the temporary accommodation of the Treasury pursuant to paragraph (2) of this direction;

(2) To purchase direct from the Treasury for the System open market account such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held in the account at any one time shall not exceed $750,000,000.

In taking this action it was understood that the limitations contained in the direction included commitments for purchases and sales of securities for the System account.

Secretary's note: Following the meeting the members of the Federal Open Market Committee who were not members of the executive committee were informed of the recommendation of the executive committee and all of them (with the exception of Mr. Leedy who was on vacation and could not be reached as was Mr. Earhart, his alternate) approved an increase from $1.5 billion to $3 billion in the limitation contained in the first paragraph of the direction issued to the executive committee at the meeting of the full Committee on May 20, 1948. Following this approval by the members of the full Committee the direction set forth above was sent to the Federal Reserve Bank of New York by wire on August 12, 1948.

Mr. Eccles left the meeting at this point and the discussion of the Treasury bill rates continued.

Mr. Sproul stated that it would be possible to have greater flexibility in bill rates but that it should be borne in mind that as long as there was a policy of maintaining a 1-1/4 per cent issuing rate on Treasury certificates there could not be much freedom in the bill market.

Mr. Riefler suggested that, after the September and October financing was completed, consideration be given to placing no bids for bills and buying bills only in the market. That procedure, he said, would result in a beginning toward a return to a free market.

Mr. Sproul questioned whether that would be of any help to the committee or the market, and stated that rates on Treasury bills could not be divorced from rates on other short term obligations; if the rate for bills should rise to, say, 1-1/4 per cent or higher the market would sell us certificates and buy bills.

There was a discussion of the possible effects of leaving the bill market entirely free and the procedure that might be followed in returning to a free market in all Government securities eventually.

At the conclusion of the discussion, Chairman McCabe suggested that Mr. Rouse, in consultation with members of the staff, prepare a memorandum stating fully the present procedure and its effects, the steps that might be taken in the direction of greater freedom in the bill market, and the possible effects of such action, and submitting a recommendation as to what if any action should be taken.

Upon motion duly made and seconded, and by unanimous vote, this suggestion was approved, it being understood that until further action by the Committee following consideration of the memorandum referred to above the procedure, outlined by Mr. Sproul as having been followed during the period of rising certificate rates, under which a consistent, although not rigid, relationship between bill and certificate rates was maintained, would be continued.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

Thomas B. McCabe
Chairman.