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 on Wednesday, January 26, 1949, at 10:15 a.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. Thomas, Economist
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman, Board of Governors
Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Willis, Special Assistant, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee held on January 4, 1949, were approved.

Mr. Rouse read the principal portions of a review prepared at the Federal Reserve Bank of New York of the market for United States Government securities for the period January 4 through January 24, 1949, and presented a report of open market operations for the System account for the period January 5 to 24, inclusive, and a supplementary report covering transactions on January 25, 1949. Copies of the three reports have been placed in the files of the Federal Open Market Committee.

Mr. McCabe referred to the strength in the Government securities market during the recent period and asked Mr. Rouse to explain the basis upon which long-term securities were being sold from the System open market account.

Mr. Rouse responded that it was the purpose of the Federal Reserve Bank of New York to sell securities in the market to the extent that that could be done without completely satisfying the demand and thus stopping any tendency for the long-term market to move higher.

> There was a discussion of the extent to which further sales might be made and the factors contributing to the present strength of the market, at the conclusion of which, 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 January 4 to 25, 1949, inclusive, were approved, ratified, and confirmed.

Just before this meeting there were distributed to the members of the executive committee copies of a memorandum dated January 25, 1949, from Mr. Thomas discussing the outlook for bank reserves and Treasury financing during the coming months. Mr. Thomas commented on various portions of the statement stating that the situation had not greatly changed since the last meeting of the executive committee. He also referred to a preliminary survey made by the Division of Research and Statistics of the Board of Governors which indicated the possibility of some slackening in the demand for credit during the next few months.

There was a discussion of the areas in which such declines might occur, during which it was pointed out that the economic trend in the months ahead would probably depend on the policies of the Government with respect to spending for defense, foreign aid, etc.

Chairman McCabe referred to the action taken at the last meeting of the committee authorizing him and Mr. Sproul to present the views of the committee to Secretary of the Treasury Snyder in such manner as they thought best. He said that no letter had been written to the Secretary, but that he had talked to him informally on two or three occasions, that this morning he and Mr. Sproul met with Mr. Snyder, and that Mr. Sproul would summarize the discussion at that meeting.

Mr. Sproul made substantially the following statement:

> I stated that the case for a further increase in the short-term rate had never been more clear and in that connection made the following points:
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> Moving up the short-term rate from time to time had been a substantial and important factor in the ability of the Treasury steadily to increase the amount of short-term securities outstanding and to do the necessary refunding at short-term rates. The increased rate had maintained the interest of banks and other investors in the short-term market.
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> Movement in the short-term rate would be evidence of continued flexibility in that market and of an intention to avoid any return to a fixed pattern of rates which would encourage banks and others to "play the pattern of rates"; this tendency to play a fixed pattern of rates has recently re-emerged. Regardless of whether the System was faced with a period of inflation or deflation, "playing the pattern of rates" would almost certainly result in an increase in the money supply which would not be warranted at this time and which the System would not want to bring about.
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> Playing the pattern of rates could also have a harmful effect on the short-term market and, as long as it continued, it would not be possible adequately to appraise the real condition of the long-term market or to realize the hope that eventually the market would get to a point where it would not need support.

The System had always tried to take fully into account the cost of servicing the debt and it was felt that an increased short-term rate would make it possible to refund maturing securities in a manner that would not positively increase the cost of servicing the debt.

We talked about the problem of debt management and stated that the accumulation of maturities during the next two or three years made it desirable, if not necessary, to look at the open maturity dates in the period from 1954 to 1958, that it would be most undesirable to freeze the present pattern of rates if it were planned to issue obligations with maturities of from four to seven years to fit into those dates, and that issuance of such securities at present rates would result in either freezing the existing pattern or running the risk of the Treasury having some "sick" issues on its hand shortly after they were offered.

We emphasized the point that, if we were going to have to continue to support the market, the narrower the gap between the short- and the long-term rate, the more tenable the rate structure would be; that in a supported market in which all obligations might be regarded as demand obligations, a horizontal rate structure would theoretically be required, and that, while no one wanted or contemplated such a revision of rates, the existing spread in rates could not be defended and complicated the problem of market support.

Finally, we made the point that if the short-term rate were increased it would put the System and the Treasury in a position to reverse policy in a period of declining employment and production. It would be bad to come into a period when we wanted to increase the money supply to stem a deflationary trend if we now added further to a money supply which is already as great or greater than at the end of the war. If rates were increased now and later we wanted to decrease them again we would have room in which to move.

On all of these grounds we felt that the situation warranting an increase in the short-term rate was clearer than ever before, and we suggested that the increase should begin with the March 1 certificate maturity which could be refunded into a 1-3/8 per cent one-year certificate or into a 13-month 1-3/8 per cent note, thereby combining the March and April certificate maturities into a single issue.

Secretary Snyder said he was having a meeting with his staff on Friday of this week at which time consideration would be given to the problems which we had raised.

We told him that a meeting of the executive committee had been held on January 4, 1949, at which time the problems of credit policy and debt management had been discussed; that, in general, the views of the committee at that time were as we presented them to the Secretary; that, if anything, the changes that occurred since January 4, 1949, only served to strengthen those views; that the executive committee was meeting again today; and that if Mr. Snyder had any comments to make that would be helpful to the committee in its consideration of the matter the committee would be glad to have them. He had no comments other than to say that he had a meeting with his staff shortly and would go into the matter.

It was stated that Secretary Snyder had scheduled a meeting with representatives of the savings bank group tomorrow and with the Government Borrowing Committee of the American Bankers Association on Wednesday and Thursday of next week.

Chairman McCabe raised for discussion the question whether, in view of the meetings of the Secretary with the bankers' groups, the views of the executive committee should be put in a letter and sent to the Secretary so that he would have it before him when the meetings were held.

Mr. Sproul expressed the opinion that the Federal Open Market Committee should not be in a position of making preliminary recommendations which could be passed on to the banking groups, that the Treasury should meet with the bankers first, after which there should be another meeting of representatives of the Federal Open Market Committee with the Secretary for final discussion of problems concerning matters in which the Treasury and the System have responsibility.

Mr. Eccles suggested that it was important that the executive committee make a record of the recommendations to be made to the Treasury, with the understanding that, in accordance with the usual procedure, these recommendations would be transmitted to the Treasury, and that it might be well to send the committee's views to the Treasury before the Secretary's meetings with the Committee of the American Bankers Association, so that the thinking of the Treasury would not be crystallized to a point where it might be difficult to change.

There was a discussion of whether better results would be obtained if the views of the executive committee were transmitted to the Treasury before or after the meetings with the bankers and it was the view of the majority of the members that a memorandum or letter to the Secretary should be prepared and sent to him immediately after his meeting with the Committee on Government Borrowing of the American Bankers Association next week.

Chairman McCabe stated that he would be on the West Coast at that time but that Mr. Sproul could present the views of the committee and discuss them with Secretary Snyder.

At the conclusion of the discussion, it was agreed that Mr. Sproul would prepare a preliminary draft of a memorandum along the lines of the informal statement made to the Secretary of the Treasury this morning which would be sent to the members of the committee for approval and presentation by Mr. Sproul to Secretary Snyder after the meeting of the Secretary with the American Bankers Association Committee next week.

Mr. Sproul said that during the meeting with Secretary Snyder this morning it was stated that the Federal Open Market Committee was continuing the policy outlined in its letter of October 13, 1948, of permitting flexibility in the Treasury bill market up to the limit imposed by the support of the current certificate rate and that Secretary Snyder raised no objection to that procedure.

In connection with the procedure referred to earlier in this meeting of selling long-term securities from the System account to the extent that that could be done without entirely satisfying the demand and stopping a rise in prices, Mr. Eccles expressed the opinion that if the System was to be consistent in its support policy it should not sell long-term securities but should let the market reflect the demand for these issues. If it were possible, he said, to get a flexible short-term rate in which there could be rather wide variations, there would be little tendency for the long-term rate to change, but that as long as the short-term rate was also pegged, the long-term rate should be permitted to go up or down in response to market conditions thereby pointing up the need for flexibility in the short-term rate. He thought that in the absence of such a procedure, the Treasury and others might be entirely satisfied to continue the existing short-term rate.

Mr. Sproul stated that what the Federal Reserve Bank of New York had been doing was to allow the market price of long-term securities to rise and at the same time to sell securities to the extent it could be done without fully satisfying the demand and stopping the upward movement in prices. He felt that that was the desirable course to pursue in the interest of an orderly market and to withdraw funds from the market when it was possible to do so. Such sales, he said, would offset purchases that might have to be made later if the market were again under pressure and it became necessary to purchase securities to carry out the policy of supporting the market.

Mr. Eccles commented that the Committee should make every effort to get a flexible short-term rate, but that if the Treasury was not willing to accept that suggestion and the existing rate was continued indefinitely and the long-term market continued strong, he would let the long-term market rise and indicate thereby what the actual market situation was. The decision on that point, he said, should come after the decision was made on what the short-term rate should be.

Mr. Rouse suggested that before the meetings of the full Committee on February 28 to March 1, 1949, consideration should be given to what the policy would be in the event the long-term market should again come under pressure and prices of long-term bonds declined to the support level; that is, whether the prices at which the market would be supported would be the existing support levels of par and 8/32 on the longest term 2-1/2 per cent issues or whether it would be par or something below par.

> It was agreed that, in carrying out the instructions of the executive committee, the Federal Reserve Bank of New York would continue the current practice with respect to the sale of long-term bonds for the System account to the extent that could be done without completely filling the demand and stopping a further rise of prices of these issues. In reaching this agreement, it was understood that since the System's holdings of bank eligible 2-1/2's were small, it would be necessary if the market for these issues continued strong to allow prices to rise more rapidly than would be the case with other long-term issues.

Mr. Sproul raised the question whether, if the Treasury continued to oppose an increase in the issuing rate on one-year Treasury certificates, the Federal Open Market Committee should take action to increase the short-term rate in the market.

Mr. Eccles did not feel that the System could take such action under existing circumstances but that if a recession should develop accompanied by a resumption of the sale of short-term securities and purchase of long-terms with resulting pressure on the long-term rate and the Treasury continued to oppose an increase in the short-term rate, the responsibilities of the Federal Open Market Committee might be such that it would decide to allow the short-term rate to go up.

Mr. Rouse referred to earlier informal conversations during which it was suggested that, in order to reduce the work of handling the more than 18,000 securities held in the System account, arrangements be made with the Treasury to issue one certificate for each issue of bonds held (except that a sufficient number of bonds would be retained to enable the Bank to make delivery of any bonds sold). He said that following the informal discussions the matter was taken up with the Treasury Department and that Mr. Bartelt, Fiscal Assistant Secretary, had replied that the plan appeared to be entirely feasible, that the form of special certificate was being studied, and that it was hoped that a finished plan could be made ready by the end of January of this year. Mr. Rouse added that such an arrangement would not only save considerable time in handling the securities and maturing coupons but also, in the opinion of the auditor of the Bank, would be an added safety factor.

All the members were in agreement that the arrangement should be carried out.

Mr. Sproul stated that, unless there should be some change in the situation in the meantime, it should be understood that the System's holdings of March 1 and April 1 certificates would be redeemed without replacement. He said that this point had been mentioned in the conferences with Secretary Snyder, that Mr. Snyder expressed no objections thereto, and that the Treasury was receptive to keeping down its balances by retirement of Federal Reserve Bank held debt.

Mr. Rouse suggested, and the members of the committee concurred, that, in accordance with this policy, retirement of Treasury bills should continue to the extent that funds were available. It was pointed out that $600 million of Treasury bills could appropriately be redeemed during the second half of March and early April so as to reduce the total of each of the weekly offerings to no more than $900 million.

In a discussion of the policy with respect to calls on war loan accounts, Mr. Thomas stated the Treasury had cooperated fully in timing calls on these accounts to maintain pressure on member bank reserves.

Chairman McCabe inquired why the Treasury felt it was necessary to maintain such large balances and expressed the opinion that these balances with the accompanying interest cost were not in the public interest.

This point was discussed in the light of suggestions previously made that, if there were a flexible short-term market, the Treasury could borrow in that market any additional funds that might be needed, and that in the event of an emergency the System could purchase special short-term certificates of indebtedness from the Treasury under the authority of Section 14(b) of the Federal Reserve Act to provide the Treasury with needed funds. It was the consensus that, in these circumstances, the maintenance of such large balances by the Treasury was not necessary.

With respect to authority to be granted to the Federal Reserve Bank of New York to effect transactions in the System account pending another meeting of the committee, it was stated that of the $2 billion granted to the executive committee at the meeting of the Federal Open Market Committee on November 30, 1948, there remained authority to reduce the System account by $828 million, and that, therefore, the direction issued to the New York Bank might be changed to give to the Bank all of the remaining authority granted to the executive committee by the full Committee.

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 business on November 30, 1948, shall not be increased or decreased by more than $2,000,000,000 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 limitation contained in the direction included commitments for purchases and sales of securities for the System account.

It was stated that the next regular meeting of the executive committee would be just before the meeting of the full Committee on

February 28, 1949, and it was agreed that, in the absence of developments making an earlier meeting necessary, the next meeting should be held on that date.

Thereupon the meeting adjourned.

Chester Morrill

Secretary.

Approved:

Thomas B. McCabe

Chairman.