

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 Friday, January 6, 1950, at 10:10 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Leach
Mr. Vardaman
Mr. Draper (Alternate for Mr. Eccles)
Mr. Gidney (Alternate for Mr. Sproul)

Mr. Szymczak, Member of the Federal
Open Market Committee

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. Young, Director, Division of Research
and Statistics, Board of Governors
Mr. Youngdahl, Chief, Government Finance
Section, Division of Research and
Statistics, Board of Governors
Mr. Arthur 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 December 13, 1949, were approved.

Mr. Rouse submitted and commented upon a review of the market for United States Government securities for the period December 13, 1949, to January 4, 1950, inclusive, which had been prepared at the Federal Reserve Bank of New York. He also submitted a report of

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open market operations for the System account for the same period and a supplemental report covering operations on January 5, 1950.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account for the period December 13, 1949, to January 5, 1950, inclusive, were approved, ratified, and confirmed.

Chairman McCabe stated that there had been no further discussions with the Secretary of the Treasury since the meeting of the Federal Open Market Committee on December 13, 1949, and that there were no developments of importance to bring to the attention of members of the Committee other than the situation in the market which had been covered by Mr. Rouse's report.

Consideration was then given to the recommendations to be made to the Treasury with respect to Treasury financing. In that connection, there had been distributed to the members of the executive committee before this meeting copies of (1) a memorandum from Messrs. Riefler, Thomas, Young, and Youngdahl under date of January 5, 1950, submitting a suggested program for debt management in 1950, and (2) a memorandum sent to the executive committee by Mr. Sproul under date of January 4, 1950, when it was ascertained that he would not be able to attend this meeting.

The first memorandum outlined the reasons why it was desirable to keep short-term rates from declining and stated that, since the situation might preclude action at this time by the System to set the

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market for a 1-1/4 per cent one-year rate, it would be helpful if the Treasury would lay the groundwork for such a rate in its handling of the February refunding, and that as part of a program for flexibility in short-term rates it would be desirable to work toward further concentration of certificate maturities. After stating the reasons for such concentration, the memorandum outlined a suggested refunding program for 1950 which contemplated the refunding of (1) February and March notes with 14 and 13 month 1-1/4 notes, respectively, (2) the March bond and all April, June, September, and December maturities with 4-5 year 1-1/2 per cent notes, and (3) the July, October, and January certificates with new one-year certificates. The memorandum pointed out that this program would provide for only a slight increase in short-term rates and would permit the System to operate in the bill market within a more adequate range, but would not call for determination of a one-year coupon rate until July. It also stated that, while the issuance of 1-1/4 per cent notes in connection with the February and March refunding would be interpreted by the market as a move to a 1-1/4 per cent one-year rate, it would not be a definite commitment, and that, if the situation justified, a 1-1/8 per cent one-year rate could be offered in connection with the July refunding.

Mr. Sproul's memorandum, after reviewing System open market policies since the June 28, 1949, statement, said that the three principal determinants of policy during the near future were the

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state of business, the financing needs of the Treasury, and the availability of funds to the open market, that the outlook for the next three or four months was for continued active business and the injection, by the payment of approximately \$2.8 billion of veterans' insurance money, of what might be a real though temporary inflationary force in the economy, and that a policy of credit neutrality which would permit or encourage some rise in rates from the low levels of last summer would seem to be in order. The memorandum also stated that if the Government securities maturing through April 1 were handled separately credit policy would be hemmed in by the frequency with which the Treasury would have to price securities for the market during a period when the money market in the ordinary course would be predominantly easy. This situation, the memorandum said, would seem to call for resistance to "natural" ease in the money market during early January, for the sale of Government securities (including bills and certificates on the present rate-scale rather than at declining rates and restricted bonds when the market permitted) to whatever extent was necessary to offset reserves becoming available to the market, and for permitting a slight firming of rates in response to market forces late in January and perhaps some intervention to maintain these rates in February. The memorandum added that it was becoming increasingly clear that the greater the frequency of the Treasury's need to price issues for the market, the more difficult it was to have a flexible and quickly responsive credit policy,

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and that this consideration suggested a strong reaffirmation of the view, earlier pressed with the Treasury, that the certificate offerings be reduced in number. Therefore, the memorandum suggested some such handling of the February, March, and April maturities as the following: The February and March certificate maturities and the March 15 maturity of 2 per cent bonds in a total amount of \$6.9 billion be refunded with 1-1/4 per cent notes and certificates maturing on March 15, 1951, and that the April 1 maturities of notes and certificates in a total amount of \$4.5 billion be refunded with a bond priced on the market in the five- to ten-year area, this issue to include new money offering if cash were needed to finance the Treasury deficit. The memorandum concluded that the suggested program would not attempt to prejudge the possible emergence of either a deflationary or an inflationary situation but would form the basis for a policy which could be accommodated to either development.

In a discussion there was agreement among the members of the committee that the approaches of the two memoranda were essentially the same, the differences being in detail, that current and prospective economic developments over the next three or four months called for a slight increase in short-term rates, and that the program of the Treasury and the Federal Open Market Committee should be shaped accordingly.

Chairman McCabe raised the question whether the committee should make any recommendations to the Treasury at this time other

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than to urge strongly that maturity dates of certificates be arranged on a quarterly rather than a monthly basis, that the February refunding be determined with that proposal in view, and that the refunding be accomplished through the medium of a 14-month 1-1/4 per cent note.

At the conclusion of the discussion, upon motion duly made and seconded, it was voted unanimously that a letter to the Secretary of the Treasury be prepared, and sent when in a form satisfactory to the Chairman, which would recommend (1) the concentration of certificate maturities on not more than four dates in the calendar year for the purpose of facilitating orderly debt management and at the same time making possible more flexible monetary policies in response to changing economic conditions, and (2) the refunding of the February certificate maturity with a 14-month 1-1/4 per cent note.

Secretary's note: The letter delivered by the Chairman to the Secretary of the Treasury on January 10, 1950, pursuant to this action was as follows:

"The executive committee of the Federal Open Market Committee met in Washington on January 6, 1950, and at that time gave consideration to the recommendations which it might make to the Treasury with respect to the refunding of the certificates maturing on February 1, 1950. This problem was considered not only in the light of current and prospective economic developments but also from the point of view of more general debt management considerations. The Open Market Committee, as you know, has long been impressed with the desirability of concentrating certificate maturities on not more than four dates in the calendar year with the view that such a change would facilitate orderly debt management and at the same time make possible more flexible monetary policies in response to changing economic conditions. The executive committee believes that the forthcoming refunding operation presents an opportunity to make a further step in this direction.

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"Accordingly, the committee recommends that the approximately \$2 billion of certificates maturing on February 1 be refunded into a 14-month note maturing on April 1, 1951. On the basis of existing and prospective conditions in the money market, the committee believes that a coupon rate of 1 1/4 per cent would be appropriate for such a note. The market undoubtedly would interpret such an issue as a move toward a 1 1/4 per cent 1-year rate but whether that or a different rate should be applied to subsequent issues would depend upon conditions prevailing at the time. Therefore, it should be understood that a 1 1/4 per cent rate on a 14-month note would not constitute a commitment as to the coupon rate on any 12-month security that might be issued in the future.

"Mr. Sproul and I would like to meet with you for the purpose of giving you the full background for the committee's views and to discuss further with you the problem of refunding the February maturity. I will call your office in the next day or two so that a date can be arranged."

Reference was made to whether the recommendations to the Treasury should include any comments with respect to changes in rates and terms on Treasury savings notes or to deficit financing. It was the unanimous view that if the recommendations of the committee with respect to the February financing were adopted there would be no occasion for recommendations as to savings notes and that since it appeared that no new market financing would be done until after the end of March nothing need be said by the committee on that point at this time.

There was a review of the current understanding of the executive committee with respect to the replacement of maturing Treasury bills in the System account and the ranges of rates at which the Federal Reserve Bank of New York purchases and sells bills

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and certificates for the account (1.04-1.12 for bills and 1.08-1.12 for certificates), and it was unanimously agreed that no changes in the understanding or in the ranges of rates were called for at this time.

Chairman McCabe raised the question whether, particularly during the period immediately ahead when the System would be selling securities to absorb reserves coming into the market, there should be larger sales of the System's holdings of restricted bonds. Mr. Gidney felt that with the longest term restricted issue selling to yield approximately 2.23 per cent it would be desirable if there could be more vigorous sales from the System account than had been the case in more recent months.

During the course of the ensuing discussion Mr. Rouse stated that it was the desire of the Federal Reserve Bank of New York to sell these issues whenever possible, that bonds had been made freely available whenever a bona fide investment offer came into the market, but that there was a professional speculative influence in the market, which it was not possible to isolate, which tended to move the market up, and that although the System's offerings in the market had brought prices down temporarily they tended to work up again because of the speculative element. He pointed out that the existing understanding with respect to sales of restricted issues from the System account did not contemplate that bonds would be sold

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in excess of demand or to an extent which would force prices down, and while such a course could be taken he questioned the desirability of any action to peg the market or of a step which would be interpreted as undertaking to force prices down at the risk of an adverse effect on market confidence.

Consideration was given to the possible effects of making restricted bonds of the System's holdings more freely available and in this connection the members of the committee expressed the view that prices should not be permitted to go higher but that if anything they should tend in the other direction if that could be brought about without disturbing the market.

Mr. Rouse emphasized that since September there had been little market demand for these issues and that there had been little opportunity to sell without pushing the market down. In response to a question, he also said that, if the recommendations of the committee with respect to February refunding were adopted by the Treasury, quotations on long-term issues would decline somewhat.

Mr. Young said that if all of the mortgages which would come into the market over the next few months were absorbed it probably would be necessary for some insurance companies and other institutional investors to sell from their holdings of long-term Governments, which would also tend to bring current prices down. The further statement was made that even under the present understanding with respect to

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sales of long-terms there probably would be a greater opportunity to dispose of these issues during the next two or three months of easier money conditions than had been the case in recent months.

In a discussion of what the objective of larger sales from the System account would be, Chairman McCabe stated that in his mind such sales during the period immediately ahead would (1) absorb bank reserves coming into the market in an inflationary situation, (2) follow a desirable policy for a central bank of reducing its holdings of long-term issues whenever opportunity afforded so that it would be in a better position to meet any pressure on the long-term market that might arise in the future, and (3) tend to exert an upward influence on short-term rates which would be desirable at this time.

Consideration was given to what form an understanding of the committee with respect to the sale of long-term issues might take. Mr. Rouse suggested that it might provide that the Federal Reserve Bank of New York would sell restricted bonds in the market at existing or slightly higher yields when the opportunity was presented.

In a discussion of what might be termed slightly higher yields, Mr. Rouse stated that he would interpret it to mean within the range between the present yield of 2.23 on the longest term issue and a yield of 2.27 (a yield of 2.27 would mean a decline from present prices of about $\frac{3}{8}$ of a point).

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Question was raised whether if such an understanding were agreed upon it should include a specific reference to sales within this range. During a discussion of this point, Mr. Rouse suggested that it be the understanding of the committee that the Federal Reserve Bank of New York would sell restricted issues from the System account, whenever an opportunity was presented, for the primary purpose of absorbing excess reserves, that moderate price declines in these issues would not deter further sales for this purpose, but that if substantial declines should occur the executive committee should consider the matter further.

Chairman McCabe stated that, as he understood the situation, there was no disposition on the part of the executive committee that the Federal Reserve Bank should go into the market and press the sale of restricted issues, but rather that the volume of sales should be increased somewhat over sales in recent months for the purpose of absorbing reserves.

The other members of the committee concurred with Chairman McCabe's statement, whereupon Mr. Rouse suggested that it be understood that the Federal Reserve Bank of New York would sell restricted bonds from the System account, whenever an opportunity was presented, for the primary purpose of absorbing reserves. This suggestion was approved unanimously by the members of the committee.

There was agreement that no change need be made in the general direction to the Federal Reserve Bank of New York to effect transactions

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for the System account and that the direction issued at the meeting of the committee on December 13, 1949, should be renewed.

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 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 changing economic conditions and the general credit situation of the country, for the practical administration of the account, for the maintenance of 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 \$1 billion 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 \$500 million.

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

It was tentatively agreed that the next meeting of the committee would be held on February 3 or 6, 1950, whichever date was more acceptable to Mr. Sproul.

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Thereupon the meeting adjourned.

Chester Morris
Secretary.

Approved:

Thomas B. Williams
Chairman.